CHIEF INVESTMENT OFFICE

Capital Market Outlook

April 5, 2021

All data, projections and opinions are as of the date of this report and subject to change.

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- Macro Strategy—This month we analyze our Market Balance Sheet, which is tilted towards a supportive backdrop favoring global equities. Managing long-term portfolios is as much about understanding the upside as it is about acknowledging the downside, all the while remaining true to the overall financial plan. Given that forecasting economic variables is an imprecise exercise, in our view a clear-eyed understanding of the bull and the bear cases may aid key portfolio decisions.
- Global Market View—The precise causes of last month's six-day blockage of the Suez Canal by an ultra-large container ship are still to be determined. But the container ship Ever Given episode raised a number of broader questions for the globalized system of trade and commerce in which manufacturers, service providers and investors function today.
- Thought of the Week—A significant growth gap has emerged between the U.S. and Europe, which could adversely affect U.S. corporate earnings, as well as real U.S. gross domestic product (GDP) growth, and turn the consensus on the weak U.S. dollar trade on its head.
- Portfolio Considerations—We adjusted our sector views in March by raising Energy, which was balanced by a move lower in Technology and a downgrade to Consumer Staples. We reaffirm our positive view on equities relative to fixed income and expect participation to broaden across sectors, regions and styles.

MACRO STRATEGY

Nick Giorgi, CFA®
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GLOBAL MARKET VIEW

Ehiwario Efeyini
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THOUGHT OF THE WEEK

Joseph P. Quinlan
Managing Director and Head of CIO Market Strategy

Data as of 4/5/2021, and subject to change

MACRO STRATEGY

The CIO Market Balance Sheet

Nick Giorgi, CFA®, Director and Investment Strategist

Kirsten Cabacungan, Assistant Vice President and Investment Strategist

Managing long-term portfolios is as much about understanding the upside as it is about acknowledging the downside, all the while remaining true to the overall financial plan. Given that forecasting economic variables is an imprecise exercise, in our view a clear-eyed understanding of the bull and the bear cases may aid key portfolio decisions such as how much risk to carry and where to allocate it at a given point in the cycle, within the context of baseline return expectations and time horizons.

Here we attempt to understand the investment outlook from a schematic Balance Sheet construct of Assets, Liabilities and in-between or "Transitory" items. We view the CIO Market Balance Sheet as tilting toward a supportive backdrop favoring global Equities

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versus Fixed Income, based upon improving economic activity and corporate earnings, low but rising inflation and interest rates, and an accommodative policy backdrop. We are cognizant of key risks such as signs of bullish sentiment and positioning, deteriorating government balance sheets, and the still-to-be conquered coronavirus.

Exhibit 1: The CIO Market Balance Sheet.

	Assets (+) (7)	Balanced/Transitioning (-->) (3)	Liabilities (-) (4)
Macro	Economic Growth (+) Corporate Earnings (+) Secular Trends (+)	Inflation (-->)	Debt Burden (-)
Policy & Geopolitics	Monetary Policy (+) Fiscal Policy (+)	Government Policy (-->) Geopolitical Backdrop	Health Crisis (-)
Capital Markets	U.S. Dollar (+) Commodities (+)		Valuation (-) Technicals & Sentiment (-)

Note: (+) indicates potential upside and (-) indicates potential downside. Transitioning arrows indicate the direction the factor may be moving toward. Source: Chief Investment Office. March 31, 2021.

Market Balance Sheet "Assets"

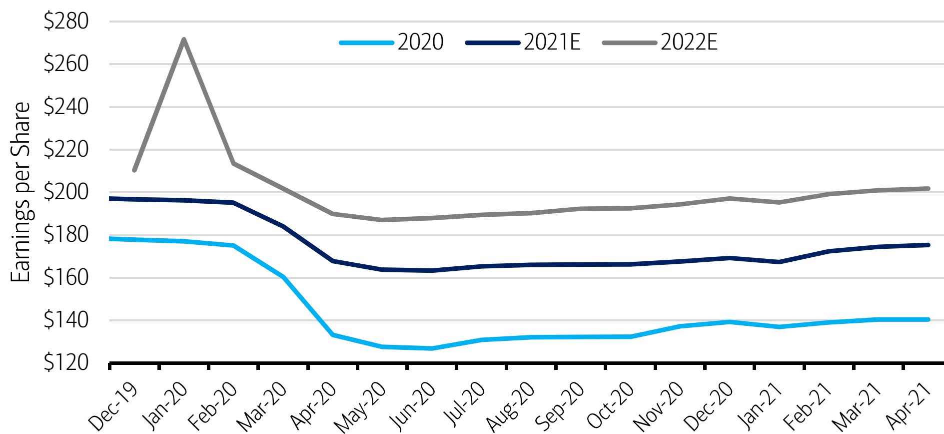
Massive monetary and fiscal stimulus in conjunction with broader coronavirus vaccine distribution and the acceleration of secular trends and the digitalization of the economy all point to a strong economic outlook and supportive backdrop for equities going forward, in our view. Many economists continue to revise their economic growth forecasts higher as the path for economic activity, corporate earnings, policy and market dynamics remain pillars of strength for the recovery.

Large savings cushions and resilient financial health help make the consumer a bright spot for economic growth. The personal savings rate, currently at 13.6%, well above the 20-year average of 6.6% and the pre-coronavirus level of 8%,[1] will likely be a source of funds for consumption as the economy reopens and consumers tap into pent-up demand. Household net worth grew to a record high in the fourth quarter of 2020 at $130 trillion and will likely support consumer confidence to spend. Continued signs of job creation and a pickup in business investment are also catalysts that could potentially help propel the post-pandemic economy higher.

Corporate earnings should benefit from faster economic growth, especially in certain portions of the service economy that may regain their footing after the pandemic subsides. The pandemic initially spurred analysts to slash their expectations, but some of their worst doubts proved too dour, as actual earnings outpaced consensus estimates (Exhibit 2). The S&P 500 earnings per share (EPS) growth for 2020 declined roughly 13%, a less depressed rate of growth than is typical in a recession. Analysts have been in the process of adjusting their projections higher, with global earnings revision ratios showing upgrades outpacing downgrades by 25%.

[1] Bureau of Economic Analysis, Bloomberg. Data as of March 29, 2021.

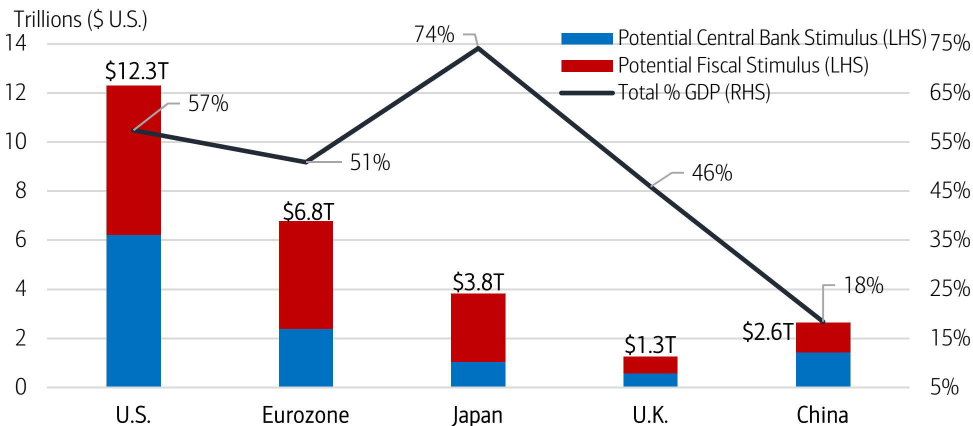
Exhibit 2: S&P 500 Earnings Expectations Have Risen From Early Pandemic Lows.



E=Estimate. Sources: Chief Investment Office, FactSet. Data as of March 29, 2021. Performance would differ if a different time period was displayed. Short term performance shown to illustrate more recent trend. Past performance is no guarantee of future results.

Accommodative monetary and fiscal policy is likely to continue despite already totaling 29% and 28% of gross domestic product, respectively (Exhibit 3). A highly supportive Federal Reserve (Fed) is likely to be status quo until inflation substantially and sustainably picks up given its updated policy framework. Recent central bank messaging remains clear that a reversal in its policy is unlikely to happen any time soon despite a recent pickup in interest rate volatility. On the fiscal side, following multiple rounds of relief aid packages, risks of inadequate stimulus have subsided. The potential for additional stimulus later this year continues to increase as policymakers turn their focus toward infrastructure and jobs programs.

Exhibit 3: Global Monetary and Fiscal Stimulus February 2020–March 2021.



Source: Cornerstone Macro Research. Data as of March 31, 2021. Past performance is no guarantee of future results.

The overall dollar weakness since the start of the pandemic and rebound in commodity prices could also be an accelerant for global economic activity and corporate profits. As the world's reserve currency, cheaper dollars lessen the relative cost of international funding and transactions while also making U.S. exports more competitive. This should allow not only for global commerce to gather momentum but also for U.S. businesses, in particular, to prosper. Commodity prices have recovered from their depths and suggest increased expectations for manufacturing activity, construction and pricing pressures.

Market Balance Sheet "Transition" items

Given ultra-accommodative monetary and fiscal policy, inflation concerns have crept in, driving 10-year Treasury yields from 0.9% at the start of the year to 1.7%. For now, our view on inflation remains balanced. The question is whether the current inflationary forces can overtake the disinflationary pressures most economies are experiencing as they

continue to operate below potential with slack in the labor market and idle excess capacity weighing on consumer prices. The U.S. labor force participation rate has fallen to 61.4%, a full 2 percentage points lower than a year ago and significantly lower than the 66% level in 2008. As more people rejoin the labor force, wage growth may remain restrained, and business investment could increase productivity, which also helps neutralize pricing pressures. Risk of higher and accelerating inflation, however, in 2023 and beyond persists given the sharp rise in money supply growth.

From a government policy perspective, additional stimulus packages, immigration reform, lower trade barriers and potentially renewed alliances with traditional partners like Europe and Japan could be supportive of global equities. On the flip side, the unified Democrat-controlled government does increase the potential for greater regulation, higher labor costs and potential tax hikes. The geopolitical environment remains favorable amid less heightened trade tensions, but the lack of global models for trade policy, cybersecurity, foreign policy and climate change point to complex challenges ahead.

Market Balance Sheet "Liabilities"

The short-term outlook on the health crisis remains mixed as new strains of the coronavirus have emerged. If the spread is not contained, resulting in the reinstatement of regional shutdowns, the economic outlook would become murkier. In addition, while positive news on vaccine effectiveness and distribution helps overshadow periods of rising case counts, emerging markets that will likely receive vaccines down the road could still pose a risk to broad economic reopenings.

A sizeable debt burden may weigh on the longer-term outlook for the economy and investor sentiment. The amount of national U.S. debt held by the public now exceeds the annual output of the economy and is only expected to grow as policymakers continue to spend to support the economy and advance priorities of the administration across education, healthcare, infrastructure and renewable energy. For now, the Fed's accommodative stance has helped to keep the government's spending on debt service low despite the high levels of debt, but continued growth in debt remains a risk down the line as interest rates steadily rise.

Valuations and the technical and sentiment backdrop have shifted to liabilities within the Chief Investment Office framework, but remain on our watch list as earnings improve and cash from the sidelines rotates into equity markets. The S&P 500 is currently roughly at the 100th percentile for both price-to-earnings (P/E) and price-to-book (P/B) over the past 20 years. The relative approach to cross-asset valuation depicts a slightly different story, especially considering future growth expectations, lower margin volatility, and rock-bottom discount rates. The equity risk premium (ERP), or the spread between the earnings yield of the S&P 500 and the 10-year Treasury yield, is 2.9% which is the 55th percentile dating back to 1991. On balance, we believe that valuation is slightly elevated but should reach more appropriate levels as fundamentals like earnings improve.

Technical factors are currently favoring more cyclical assets. Market breadth has improved, with 93% of S&P 500 stocks closing above their 200-day moving average. However, sentiment has turned bullish after a period of peak negativity. According to BofA Global Research, fund manager cash levels are at eight-year lows, allocation to commodities is at an all-time high, the spread between equity and bond overweight allocations is close to the highest level ever, and bullish survey expectations are historically elevated. However, it is important to recall that sentiment had been significantly depressed for quite some time, and global fund flows have been decidedly "risk-off" for years, perhaps allowing for sentiment to run elevated for longer.

Outlook

The current economic cycle is in a reflationary zone, which is favorable for risk assets such as global equities and commodity-related areas. The accompanying secular bull market may undoubtedly experience cyclical and sentiment-driven pullbacks as weaker hands are

shaken out on intermittent worries about the trajectory of the aforementioned fundamentals. To help navigate this environment, investors should continue to monitor the broader factors and maintain a disciplined investment process that provides an optimal mix of diversified assets.

GLOBAL MARKET VIEW

After the Suez Saga: Implications for a Globalized Economic System

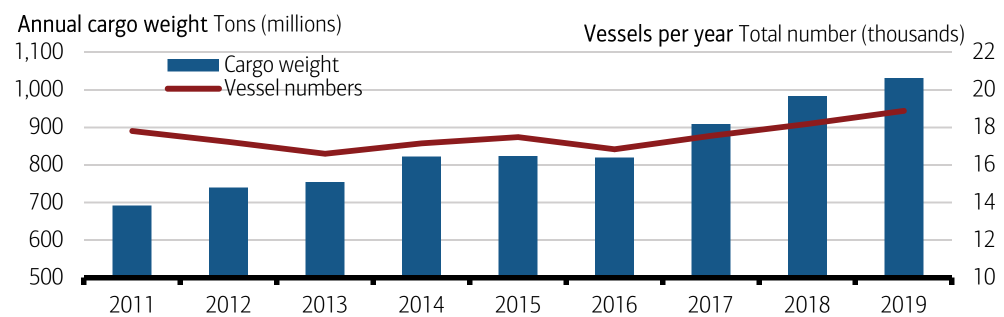
Ehiwario Efeyini, Director and Senior Market Strategy Analyst

The precise causes of last month's six-day blockage of the Suez Canal by a 1,300 foot, 220,000 ton container ship are still to be determined. But the container ship Ever Given episode raises a number of broader questions for the globalized system of trade and commerce in which manufacturers, service providers and investors function today. The Ever Given—Japanese owned, registered in Panama, operated under a Taiwanese charter and transporting cargo from China to the Netherlands—is itself a product of globalization. And the backlog of more than 300 vessels left stranded in its wake across the northern and southern entrances to the channel were carrying a wide range of goods for delivery into global markets—from oil and gas to chemicals, grains, livestock, manufactured components and consumer products.

Around 20,000 ships cross the Suez each year. And the volume of activity passing though the canal accounts for close to 10% of global seaborne oil trade (including the majority going from the Persian gulf to Europe), around 12% of global goods trade and roughly 30% of global container traffic worth $9.6 billion per day according to shipping journal *Lloyd's List*. The March closure was its longest in over 45 years. But with global trade as a share of GDP close to two-thirds higher today than it was in 1975, the potential implications of such an episode are far more significant under current conditions. This relatively short shutdown caused a 7% jump in crude oil prices, led to fuel rationing in Syria due to delayed supply from Iran, and is expected to create a flood of insurance claims on overdue cargo stretching into the hundreds of millions.

The Suez Canal was expanded in 2015 in order to increase daily shipping volumes and cut waiting times. But over the past decade, tonnage crossing the canal has increased substantially without a commensurate increase in the number of vessels (Exhibit 4), meaning larger cargoes for each ship. This potentially increases the risk of similar incidents taking place in the future, with both short-term and longer-term implications for a globalized economic system that includes many potential chokepoints beyond this waterway alone.

Exhibit 4: Growing Cargo Weight Through The Suez Canal With Limited Increase In Vessel Numbers.



Source: Suez Canal Authority. Data as of 2019.

Indeed this latest Suez crisis has not been the only major disruption to global supply chains in recent months. Earlier in March, fire damage at the plant of a major semiconductor manufacturer in northern Japan caused further production shortages in the chip industry,

affecting global output of light vehicles and electronic devices. The company accounts for close to 30% of the global market in microcontrollers used in cars, and around two-thirds of the chips produced at the facility supply the auto industry. This episode came only shortly after three other large semiconductor companies from Korea, Germany and the Netherlands were also forced to shut down production at their Texas factories following the winter storm that hit the state in February. In one case, approximately one month of output was estimated to have been lost with an estimated affect of roughly $100 million in revenue.

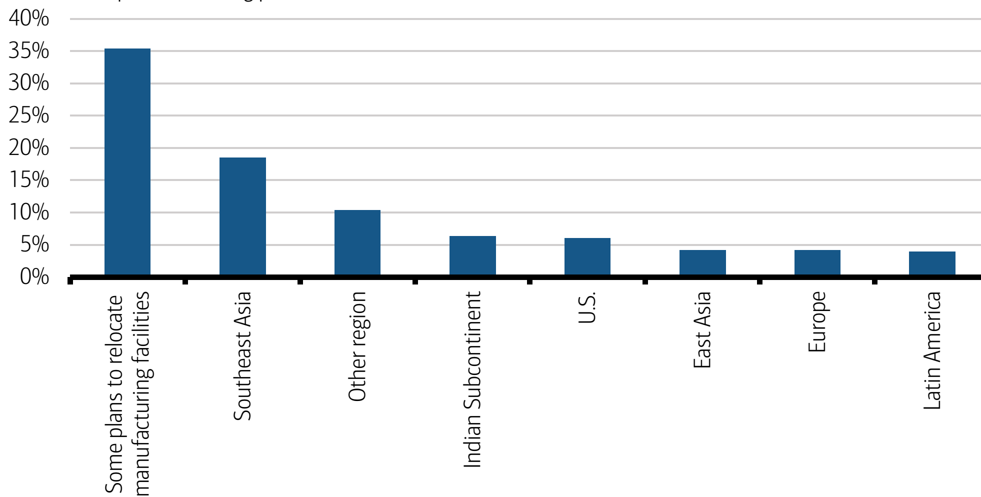
In the case of the Suez shutdown, the near-term implications will likely include weeks of delivery delays after several stranded vessels were forced to reroute around southern Africa, adding over 3,000 miles and up to 15 days to their journey times. Reductions in measured imports into Europe and Asia are also likely to be recorded for March and April as the arrival of goods into local ports is pushed back. And price increases from higher freight rates and higher oil prices may do little to ease investor inflation expectations, which have risen over recent months on the back of substantial monetary and fiscal stimulus from global policymakers and the gradual reversal of coronavirus restrictions in a number of major economies around the world. The local blockage may now have been cleared, but its global ripple effects could therefore still be felt for weeks and months to come.

Over the longer term, the Suez saga could also add impetus to the development of alternative shipping lanes, especially as potential future supply bottlenecks are set against structural growth in online retail demand. Thawing Arctic sea ice, for example, makes northern routes above Russia and Canada more viable for commercial shipping between North America, Europe and Asia. In light of the recent crisis, the Russian leadership has reiterated the importance of the Arctic as a potential substitute for the longer, existing routes between Europe and Asia that go through the Middle East or around the Cape of Good Hope. And similarly over the past 10 years, China has developed several alternative transit routes to the contested Strait of Malacca between the Indian Ocean and the South China Sea for the shipment of oil and natural gas. These include the 2013 takeover of operations at Pakistan's Gwadar port to receive oil imports from the Middle East and Africa for land transportation across Asia, the buildout of oil and gas pipelines across Myanmar and the establishment of the Khorgos Gateway on its border with Kazakhstan for goods transportation by rail. And similar to the Suez waterway, China has also proposed the construction of a 60-mile-long canal through southern Thailand, plans for which remain pending.

The fragility of global supply chains has also been a major factor in the recent tensions between the U.S. and China. And here too there are parallels to be drawn with recent events in the Suez. Rising wages and tightening environmental standards had already undercut China's labor cost advantage over the preceding years. But price increases from the tariffs imposed in 2018 and 2019 and, most recently, disruptions to medical supplies and other products from the coronavirus shutdowns have only served to underscore the cost of over-dependence on Chinese manufacturing hubs. According to a 2018 survey of 432 member companies by the American Chamber of Commerce, around 35% of manufacturers operating in China had some plans to move their operations to alternative territories based on risks to future U.S.-China relations (Exhibit 5).

Less than three months into the new Biden administration, the U.S. is already reviewing its supply chain concentrations in semiconductors, batteries, pharmaceuticals and key minerals used in electronics. And this could not only lead to a reconfiguration of production locations over the coming years, but may also increase business investment in new processes such as 3D printing and industrial automation.

Exhibit 5: U.S. Companies Considering Shift In Manufacturing Operations Away From China.



Sources: American Chamber of Commerce; Chief Investment Office. Adapted from American Chamber of Commerce. Data as of 2018.

A decade on from Japan's Fukushima disaster, three years after the onset of the current U.S.-China trade frictions and one year on from the outbreak of the coronavirus, last month's crisis in the Suez Canal once again highlights the vulnerability of a globalized economic system to single points of failure. And though the immediate fallout from the incident should remain limited, the broader questions it raises could have much longer-term implications.

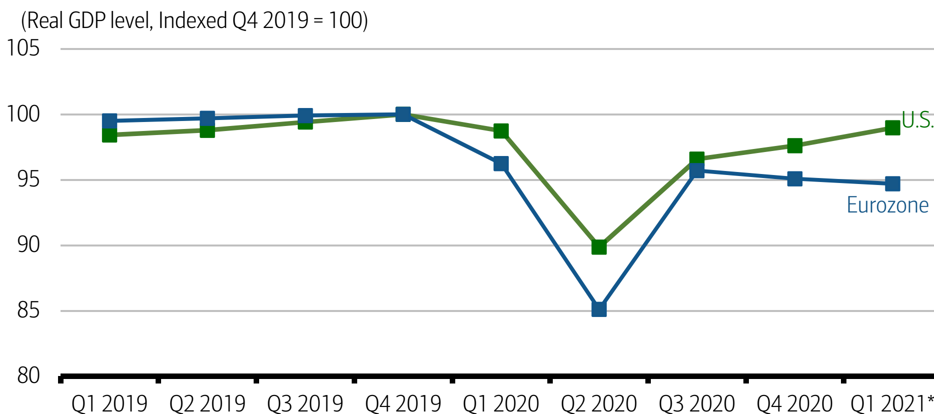
THOUGHT OF THE WEEK

What a Drag: What Divergent Transatlantic Growth Means for U.S. Investors

Joseph P. Quinlan, Managing Director and Head of CIO Market Strategy

A year ago, the U.S. and the European Union (EU)—the world's two largest economies—were navigating the same economic storm wrought by the coronavirus. A year on, however, Europe's recovery has been driven off course, while America sails on to calmer waters. As depicted in Exhibit 6, a significant growth gap has emerged between the U.S. and Europe early in 2021.

Exhibit 6: U.S.-Europe Growth Divergence.



*Q1 Forecasts are from Atlanta Fed and European Central Bank.
Sources: U.S. Bureau of Economic Analysis; Eurostat. Data as of March 2021.

America's economic trajectory is upward owing to the double-barreled policy response from Washington and coronavirus vaccines rollout that is now running at over 2 million jabs per day. In Europe, meanwhile, the vaccine rollout has come late and has been afflicted with miscues. The result: Just 14 doses have been administered per hundred across the EU, versus 41 in the U.S. Rather than reopening, many parts of Europe are shutting down—again. The tourist-dependent Mediterranean economies will likely face another lost summer; meanwhile, not one euro from Europe's much-vaunted Recovery and Resilience fund announced last summer has yet to be spent. The upshot: The eurozone area started the year in recession, while the U.S. powered ahead.

Europe's drag on the transatlantic economy could potentially manifest itself in the following ways:

- Weaker-than-expected global earnings for U.S. multinationals considering that the EU accounts for roughly 55% of U.S. foreign affiliate income, a proxy for global earnings;
- A wider-than-expected U.S. merchandise trade deficit with Europe; the latter tallied a near-record $175 billion last year and is poised to expand again this year; and
- Unexpected U.S. dollar strength, with U.S.-EU growth differential and spreads on U.S. 10-year bond yields versus German bunds clearly in favor of a stronger greenback.

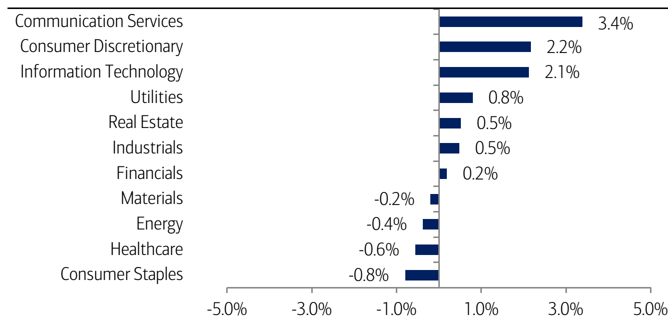
In addition to all of the above, a weakened and divided EU isn't much help in bolstering a common transatlantic front when it comes to dealing with China, North Korea, Middle East tensions and Russia. The heavy lifting—not for the first time—will likely fall to the U.S. In the end, Europe's a drag, with clear implications for the U.S. capital markets.

MARKETS IN REVIEW

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	33,153.21	0.3	0.5	8.9
NASDAQ	13,480.11	2.6	1.8	4.8
S&P 500	4,019.87	1.2	1.2	7.4
S&P 400 Mid Cap	2,647.71	0.9	1.5	15.1
Russell 2000	2,253.90	1.5	1.5	14.4
MSCI World	2,841.89	1.0	1.1	6.1
MSCI EAFE	2,223.56	0.5	0.7	4.2
MSCI Emerging Markets	1,338.23	2.4	1.7	4.0

S&P 500 Sector Returns



Fixed Income†

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	1.55	0.05	0.17	-4.12
Agencies	0.84	-0.22	-0.03	-1.62
Municipals	1.17	0.09	0.08	-0.27
U.S. Investment Grade Credit	1.63	0.00	0.10	-3.28
International	2.27	0.52	0.35	-4.32
High Yield	4.15	0.45	0.18	1.03

	Current	Prior Week End	Prior Month End	2020 Year End
90 Day Yield	0.01	0.02	0.02	0.06
2 Year Yield	0.19	0.14	0.16	0.12
10 Year Yield	1.72	1.68	1.74	0.91
30 Year Yield	2.36	2.38	2.41	1.64

Commodities & Currencies

	Total Return in USD (%)			
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	178.99	-0.4	0.5	7.4
WTI Crude $/Barrel††	61.45	0.8	3.9	26.6
Gold Spot $/Ounce††	1728.87	-0.2	1.2	-8.9

Currencies	Current	Prior Week End	Prior Month End	2020 Year End
EUR/USD	1.18	1.18	1.17	1.22
USD/JPY	110.69	109.64	110.72	103.25
USD/CNH	6.58	6.55	6.56	6.50

Sources: Bloomberg, Factset. Total Returns from the period of 3/29/2021 to 4/2/2021. †Bloomberg Barclays Indices. ††Spot price returns. All data as of the 4/2/2021 close.
Past performance is no guarantee of future results.

Asset Class Weightings (as of 3/2/2021)

	Under-Weight		Neutral	Over-Weight	
Global Equities				●	
U.S. Large Cap Growth				●	
U.S. Large Cap Value				●	
U.S. Small Cap Growth				●	
U.S. Small Cap Value				●	
International Developed			●		
Emerging Markets			●		
Global Fixed Income		●			
U.S. Governments		●			
U.S. Mortgages			●		
U.S. Corporates				●	
High Yield		●			
U.S. Investment Grade Tax Exempt			●		
U.S. High Yield Tax Exempt		●			
International Fixed Income	●				
Alternative Investments*					
Hedge Funds					
Private Equity					
Real Assets					
Cash					

*Many products that pursue Alternative Investment strategies, specifically Private Equity and Hedge Funds, are available only to qualified investors.
CIO asset class views are relative to the CIO Strategic Asset Allocation (SAA) of a multi-asset portfolio.

Economic & Market Forecasts (as of 4/2/2021)

	Q2 2020A	Q3 2020A	Q4 2020A	2020A	Q1 2021E	Q2 2021E	2021E
Real global GDP (% y/y annualized)	-	-	-	-3.2	-		5.8
Real U.S. GDP (% q/q annualized)	-31.4	33.4	4.1	-3.5	7.0*	10.0	7.0
CPI inflation (% y/y)	0.4	1.3	1.2	1.2	1.8*	3.6	2.9
Core CPI inflation (% y/y)	1.3	1.7	1.6	1.7	1.4*	2.1	1.9
Unemployment rate (%)	13.0	8.8	6.7	8.1	6.2*	5.3	5.2
Fed funds rate, end period (%)	0.08	0.09	0.09	0.09	0.06	0.13	0.13
10-year Treasury, end period (%)	0.66	0.68	0.91	0.91	1.74	1.85	2.15
S&P 500 end period	3100	3363	3756	3756	3973	-	3800
S&P earnings ($/share)	28	39	42	140	36*	40	165
Euro/U.S. dollar, end period	1.12	1.17	1.22	1.22	1.17	1.18	1.15
U.S. dollar/Japanese yen, end period	108	105	103	103	111	104	106
Oil ($/barrel, avg. of period, WTI**)	29	40	44	40	59	64	60

The forecasts in the table above are the base line view from BofA Global Research. The Global Wealth & Investment Management (GWIM) Investment Strategy Committee (ISC) may make adjustments to this view over the course of the year and can express upside/downside to these forecasts. Historical data is sourced from Bloomberg, FactSet, and Haver Analytics.

Past performance is no guarantee of future results. There can be no assurance that the forecasts will be achieved. Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment performance.

A = Actual. E/* = Estimate. S&P 500 represents the year-end target for 2021. **West Texas Intermediate.
Sources: BofA Global Research; GWIM ISC as of April 2, 2021.

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Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Indexes are all based in dollars.

S&P 500 Index is a stock market index that measures the stock performance of 500 large companies listed on stock exchanges in the United States. It is one of the most commonly followed equity indices.

U.S. Treasury 10-Year Index is a one-security index comprising the most recently issued 10-year U.S. Treasury note or bond.

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