CHIEF INVESTMENT OFFICE

Capital Market Outlook

May 10, 2021

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

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- Macro Strategy—Structural deflation in the Technology sector has lulled many investors into complacency about the outlook for inflation. In our view, rapidly rising money supply is about to show that higher inflation is attainable in a deflationary digital world as the relative value of the material world increases, driving further rotation toward shorter-duration value and cyclical stocks and away from long-duration growth stocks.
- Global Market View—Concerns over the next leg for equity markets have become more acute amid concerns of rising yields, inflation, higher taxes and potential Federal Reserve (Fed) tapering. History would dictate some consolidation in the near term, higher volatility and moderating returns, adding to the growth of the secular bull market.
- Thought of the Week—A Fed survey suggests the pandemic resulted in the permanent closure of 200,000 excess businesses compared to recent years. At the same time, a less expected dynamic developed—and that's the spike in applications to start new businesses.
- Portfolio Considerations—When it comes to assessing the market environment, we prefer to choose "half full." In terms of the broader economic environment, we believe we are closer to mid-cycle than late cycle and that growth is currently flashing bright green and surprising more than expected. We will remain vigilant for rebalancing opportunities in our asset allocation models as we expect rates and Equities to drift higher.

MACRO STRATEGY
Chief Investment Office Macro Strategy Team

GLOBAL MARKET VIEW
Niladri Mukherjee
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THOUGHT OF THE WEEK
Lauren J. Sanfilippo
Vice President and Investment Strategist

Data as of 5/10/2021, and subject to change

MACRO STRATEGY

Inflation in the Material World

Chief Investment Office, Macro Strategy Team

During the decade following the Great Financial Crisis, the Fed persistently fell short of its 2% inflation target. Markets adopted a defensive tone as worries about an underlying deflation risk refused to go away. In a world where growth, inflation and interest rates were all historically low, investors paid a premium for growth stocks and income. Today, the Fed has shifted course, trying to overshoot its inflation objective, changing the investment environment.

The narrative that developed to rationalize low inflation and the Fed's apparent inability to stoke higher prices focused on the deflationary nature of the digital transformation of the world economy. Moore's law keeps the price of computing power on a sharp downward spiral, making the costs of digital goods and services persistently decline. At the same time, Metcalfe's law keeps the market for digital goods and services growing exponentially, driving unit overhead costs ever closer to zero. In addition to these deflationary forces from technological progress, globalization and population aging were also frequently cited in support of the low-inflation narrative that dominated the past decade, leaving the Fed supposedly impotent to reflate the economy.

There is, however, a simpler narrative that explains the shortfall of inflation over the past decade. Money-supply growth was not strong enough to create a 2% inflation rate. From this perspective, policy has been too tight, keeping inflation below stated targets. Even in Japan, where the problem goes back to the 1990s, conventional wisdom believes policy has been easy with interest rates near zero for decades. However, money growth has not been adequate to support nominal growth or inflation. Where it's fallen short, money-supply growth has been below historical averages. In other places, the opposite is true. Countries like Venezuela and Zimbabwe have experienced hyperinflation. The distinguishing difference is explosive money growth in the hyperinflation economies. In short, inflation is always and everywhere a monetary phenomenon regardless of technology, demographics and globalization, and a look at U.S. history also proves the point (Exhibit 1).

Exhibit 1: Strong Increase In Money Growth Associated With Very High Inflation.

Highest inflation and money-supply growth episodes since 1900 (four-year annual average % growth)

	M2* money supply	Consumer Price Index (CPI)
1917-1920	13.5	16.3
1945-1948	17.6	8.1
1978-1981	10.7	10.7

*M2 is a calculation of the money supply that includes all elements of M1 as well as "near money." Sources: Haver Analytics; Chief Investment Office. Data as of May 5, 2021.

Indeed, the biggest inflation outbreaks over the past 120 years were during World War I (WWI), WWII and the 1970s. In all three cases, the outbreaks were associated with sharp accelerations in money-supply growth, two or three standard deviations beyond historical averages. Money growth (M2) has exploded by 24% during the 12 months from March 2020. This surpasses the prior record during WWII. Fiscal deficits are also rivaling the records set during the World Wars. This stimulus caused nominal gross domestic product (GDP) growth to set an all-time high in the first quarter of 2021. Nominal growth surged over 10% at an annual growth rate during the winter, well above economists' estimates. While real growth was about as expected at 6.4%, the surprise was in higher inflation, with GDP inflation just above 4% and consumer prices up by 3.5%, which topped the consensus by a percentage point.

If past experience with this magnitude of monetary and fiscal stimulus is any indication, double-digit nominal growth is likely to continue through 2022. However, as the economy reaches full employment and the Fed continues to increase the money supply at a double-digit pace even with a full tapering of quantitative easing over 2023, double-digit growth in nominal GDP over the course of next year would inevitably shift toward more inflation and less real growth as capacity constraints bite harder and harder. Inflation, which is already running in the 3% to 4% range, is likely to move higher in 2022.

The 10%-plus growth rate in first quarter U.S. consumer demand exceeded domestic production by a wide margin, causing a surge in imports and a big draw-down in inventories. This excess of demand over supply is typical of inflation outbreaks like we saw in the 1970s. This helps explain the surge in mentions of inflation in first quarter earnings reports. Supply chains are stretched thin, with some surveys showing delivery delays not seen since the double-digit inflation days of 1974. Shortages are evident in a wide array of commodity prices. According to Evercore ISI Research, the Bloomberg commodity index, which recently hit a 10-year high, is "consistent with fiscal and monetary policy that is interested in pushing the supply side by supporting demand and accepting an inflation overshoot. An index of commodities futures created by Bloomberg, which includes metals, agriculture and oil is now showing the steepest backwardation in 14 years. That typically happens when supply is believed too tight." As a result, stocks of commodity producers are among the best performing so far in 2021. The price for copper, for example, which is used three or four times more

in electric vehicles than in combustion engine vehicles, has more than doubled off its lows from a year ago, making its producers' stocks one of the best performing sectors in the market.

Input price pressures do not necessarily spill over into inflation if companies cannot pass them on. That depends on whether consumers can afford to pay higher prices, which in turn depends on whether wage gains are sufficient to absorb higher prices. If not, consumers have to make a hard choice and buy less when prices rise. That reduces demand and prevents high input prices from causing generalized inflation. Currently, wage gains are moderate, but they did not slow much in the pandemic recession despite the record surge in the unemployment rate. They moderated for a couple of quarters and have picked up over the past six months, according to the employment cost index (ECI) data for the first quarter, which surprised to the upside.

In the 2007-2008 recession, the ECI fell by 200 basis points (bps) in a two-and-a-half-year period. In this past year, the ECI fell by a mere 40 bps before recovering that much over the past two quarters. In short, unlike most recessions, the pandemic recession left workers with more income rather than less and failed to cool wage pressures. The reason is simple: Government transfer payments have more than made up for wage losses and reduced interest in labor-force participation. As a result, businesses are reporting that finding workers is their number-one problem. Household wealth and savings surged to record levels during the past year, leaving consumers with the wherewithal to pay higher prices as businesses pass through surging input costs. Thus, it's not surprising that Warren Buffet declared at his annual shareholder meeting that his companies are having no problem passing through higher costs as inflation proliferates.

Without rapid money growth, wages are constrained, preventing input-price inflation from becoming generalized output-cost inflation. The rapid income growth financed by Fed money printing to provide unprecedented fiscal transfers removes the constraint on output prices as consumers can buy more of everything even at higher prices. Wait times for many products are extending for consumers just as they are for businesses as shortages become more common, adding to price pressures.

The explosion of monetary and fiscal stimulus has put the U.S. and world economies on a much faster growth track than that prevailing before the pandemic. This means the near-term rise in nominal GDP, corporate revenues and household incomes is much bigger. This stronger near-term rise in growth is evident in the rotation away from long-duration growth stocks toward short-duration cyclical and value stocks that benefit more from the big boost to the outlook for the next few years. Higher inflation and interest rates reduce the present value of growth realized in the distant future, especially in the technology world, where deflation erodes the nominal value of future revenues even more in an inflationary environment.

In short, while inflation is heating up in the material world of commodities and goods output, as well as in the labor market for near-term services, technology deflation is likely to continue. In a higher inflation, faster near-term growth environment, structural deflation in the Technology sector diminishes the relative value of long-duration Growth stocks, helping explain the rotation toward cyclical and Value stocks after a decade of underperformance in the old slow-growth, low-inflation regime.

Equities up 90%. Now What?

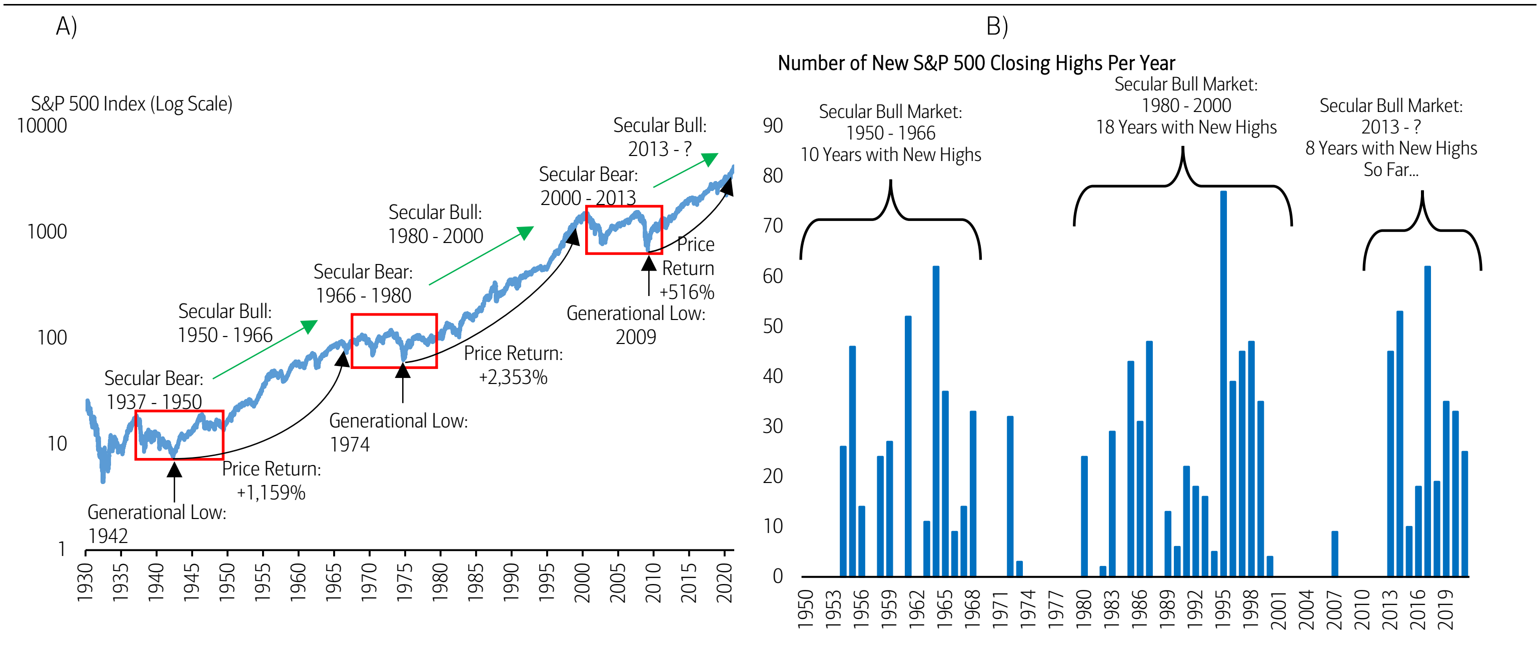
Niladri Mukherjee, Managing Director and Head of CIO Portfolio Strategy

Kirsten Cabacungan, Assistant Vice President and Investment Strategist

Since the market bottom, the S&P 500 has gained 90% on a total return basis, reaching new all-time highs, propelled by accommodative monetary policy, giant fiscal stimulus and prospects for economic reopenings. Concerns, however, over the next leg for equity markets have become more acute, with investors asking how much more upside could possibly exist from here given the threat of rising yields, inflation, the potential for higher taxes and the next major decision to likely come from the Fed: the timeline for tapering of asset purchases. As we highlight here, history would dictate some consolidation in the near term, higher volatility and moderating returns, adding to the growth of the secular bull market.

Zooming out and placing the equity rally in the context of the broader secular bull market, it may be prudent to point out that this cycle appears to be just another chapter and likely not the event that ultimately derails the secular one. Remember that secular bull markets, and secular bear markets for that matter, comprise both cyclical bull and bear markets as well as economic expansions and contractions. Relative to previous secular bulls (1950-1966 and 1980-2000), this one has performed relatively modestly at best. The S&P 500 price return since the generational low in 2009 to today comes in at only +516%, a sign that perhaps there is more room to rise. The last two secular bull equity advances from the generational low to secular peak were +1,159% and +2,353% (Exhibit 2A). Similarly, looking at the number of years that the S&P 500 closed at market highs in the context of a secular bull, the current one again pales in comparison and could mean several years of new all-time highs to come (Exhibit 2B). According to BofA Global Research, the upside breakouts for the S&P 500 in 1950, 1980 and 2013, which marked the start of secular bull markets, each experienced "the seven-year itch," or an interruption from a cyclical bear market in the seventh year. The cyclical lows in both 1957 and 1987 tellingly marked the start of the second half of the secular bull market, not the end.

Exhibits 2A and 2b: The Coronavirus Shock Did Not Likely Derail the Secular Bull Market.

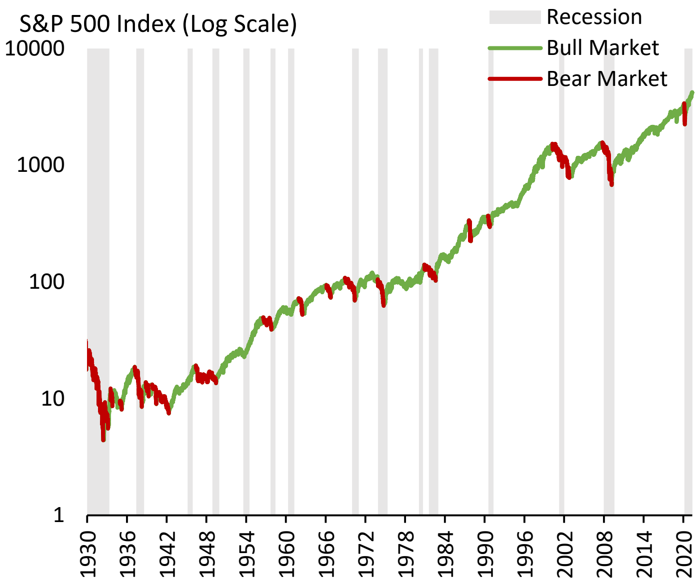


Sources: (Left) Chief Investment Office; BofA Global Research; Bloomberg. (Right) Chief Investment Office; Strategas Research Partners; Bloomberg. Data as of May 5, 2021. Past performance is no guarantee of future results.

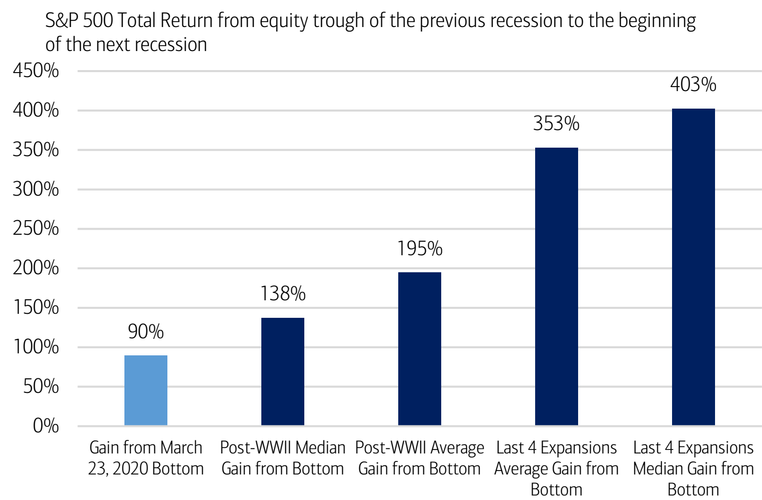
From a cyclical bull market perspective, the equity market advance in this cycle still trails previous trends. Looking at the last four expansions, the median total return of the S&P 500 from the equity trough of the previous recession to the start of the next is roughly 403%, a far cry from where the market gain stands today (Exhibit 3B). And as history has shown, equity markets tend to recover from a bear market as fundamentals improve and grind higher for many years ahead during an economic expansion, which tend to last five to 10 years (Exhibit 3A). In fact, the coronavirus shock ended the longest economic expansion in U.S. history that ran from June 2009 to February 2020, or 128 months, which broke the previous record from March 1991 to March 2001, or 120 months.

Exhibits 3A and 3B: The Cyclical Bull Market May Still Have Ample Upside Potential.

A)



B)



Recession periods are defined by the National Bureau of Economic Research (Left): Note: Bear markets describe conditions when the S&P 500 fell by 20% or more from a recent high. Bull markets describe the upward trending condition following a bear market contraction. Source: Bloomberg. Data as of May 5, 2021. (Right): Note: The Post-WWII periods are defined using the equity trough of the previous recession as the starting date and the first day of the month of the beginning of the next recession as the end date. Sources: Bloomberg; Chief Investment Office; Goldman Sachs. Data as of May 5, 2021. Past performance is no guarantee of future results.

Rounding back to today, there could be a valid argument that, while the secular and cyclical bull market ends may not be imminent, the advance from this point on may not mirror the stellar performance of the last year. Strategas Research Partners have found that the average first-year performance of a bull market is roughly 42% off the bear market lows, going back to October 1957. The second year, on the other hand, tends to see positive gains slow down, with average performance of roughly 13%, while also experiencing an average correction of roughly 10%. Now into the second year of this recovery, history would suggest a slower and more volatile pace of gains from current levels.

Some investors have pointed to peak economic data as a potential signal for more subdued stock market returns or potential corrections ahead. The economy has seen an explosion of growth since the start of the year with first quarter annualized real GDP coming in at 6.4%. BofA Global Research is penciling in 7.0% growth in U.S. real GDP for 2021, with the likelihood of further upward revisions given strong economic data and more fiscal spending. In years when the economy saw similar blockbuster growth, equity markets typically kept moving higher but saw corrections of roughly 10%—such as 14% and 10% corrections in 1950 and 1951 as well as declines of 11% and 14% in 1955 and 1984, respectively. The manufacturing purchasing managers' index (PMI) recently hit a new pandemic high in the 10th decile at 64.7, a stark contrast to the low-40 PMI report at the start of the pandemic a year ago. Historically, top decile PMI readings have been consistent with below-average forward six-month S&P 500 returns.[1] Whereas previous periods of peak economic data typically brought Fed rate hikes back into the discussion, which may have been a contributing factor to the below-average stock market performance, in the current environment, the Fed's new policy framework likely leaves any rate hikes off the table for some time to come.

Other areas that may point to some consolidation ahead include market breadth, sentiment and input cost pressures for companies. Ninety-three percent of S&P 500 stocks are now above their 200-day moving average.[2] This broad participation is rare, and in the past such levels have fed into a lengthy pause. However, more names breaking out from their long-term ranges generally bodes well from the perspective of a multiyear advance. Sentiment indicators are pushing toward bullish levels, raising questions on whether or not investors may be fully invested. Still, cash on the sidelines remains

elevated, with money market fund assets at roughly $4.5 trillion, or roughly $900 billion higher than the start of 2020. Cash levels have actually increased since the start of this year, likely as a result of additional stimulus and hesitant investors, and could help mitigate the extent of any near-term correction. With earnings producing positive surprises, some investors are worried that rising input costs could crimp margins if companies struggle to pass off price pressures to consumers. For now, signs of near-term inflation appear more transitory, and the strength of the consumer due to the improving labor market and net worth continues to reinforce expectations of pent-up demand leading to strong consumption and therefore strong earnings.

Our preference for Equities over Fixed Income is rooted in our view of rapidly rising corporate earnings, interest rates drifting higher and attractive relative valuation. The equity risk premium (ERP), expressed as the difference between the earnings yield of the S&P 500 and the 10-year Treasury yield, at 3.1% and in the 57th percentile, shows that stocks remain more attractively valued to bonds. Rising earnings should be a major support for the ERP, especially as earnings revision ratios continue to turn higher. While not our base case, another rapid and sharp move higher in interest rates would be a headwind.

Still, this cycle, for many reasons, can be characterized as "unusual," and thus any historical precedence could potentially turn out to be less of a guide. For one thing, the exogenous shock derived from a pandemic led to a widespread global economic shutdown that canceled mobility, and in-person consumption and resulted in widespread unemployment for workers, especially for employees who could not easily shift their work to a remote environment. Equally historical has been the experimental giant fiscal and monetary support. For now, despite the unusual circumstances, there is plenty of fuel left to push the economy forward from the lagging effects of stimulus to healthier household balance sheets relative to previous recessions and signs of material progress on the health front. All of these together should support equity markets, which is likely to consolidate its gains in the near term while building the foundation for the continuation of the secular bull, as earnings catch up and sentiment moderates.

THOUGHT OF THE WEEK

The Pandemic Startup Surge

Lauren J. Sanfilippo, Vice President and Investment Strategist

A recent Fed survey suggests that the pandemic resulted in the permanent closure of 200,000 excess businesses compared to recent years (on average 600,000 establishments permanently close annually, at an 8.5% closure rate).[3] This means, more "closed" signs were hung on storefronts during the first year of the coronavirus outbreak, for obvious

[1] Strategas Research Partners. April 2021.

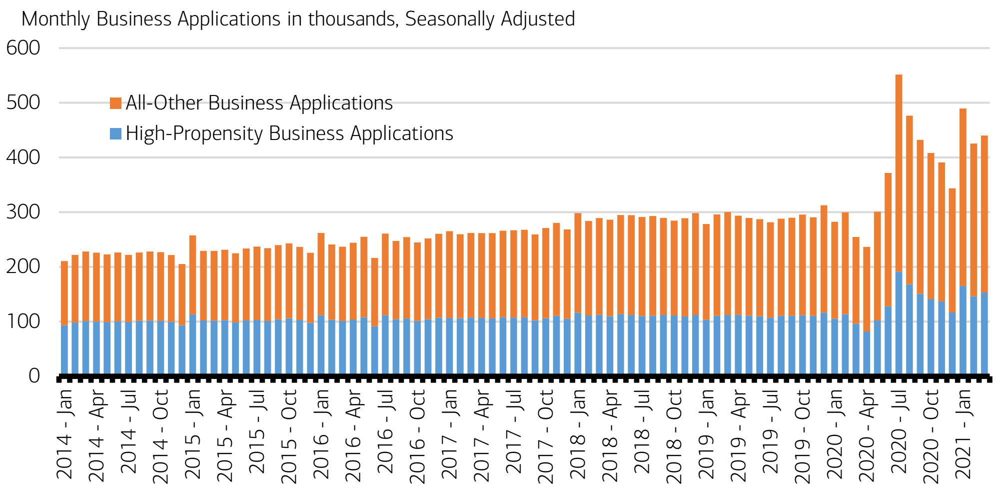
[2] Bloomberg. Data as of May 5, 2021.

[3] Federal Reserve, "Business Exit During the COVID-19 Pandemic: Non Traditional Measures in Historical Context," Finance and Economics Discussion Series, April 2021.

reasons. At the same time, a less expected dynamic developed—and that's the spike in applications to start new businesses.

Applications for employer identification numbers that entrepreneurs need in order to start a business numbered 4.3 million during 2020, an excess of 845,000 business formations compared to the prior year and 50% higher than an average spanning 2010-2019. What's more, over the first quarter of this year, applications jumped by 62% from a year ago. Exhibit 4 shows how in July of last year, business applications spiked, reaching a monthly high of 551,000, only to spike again in January of this year, remaining at an elevated rate of 400,000-plus. The 440,000 applications filed in March were up 47% from February 2020, the last month before the pandemic. All of the above reflects American ingenuity during its darkest hour.

Exhibit 4: Entrepreneurial Euphoria: A Surge in Startups.



The projected business formations provide an estimate of the number of new business startups that will likely form within 4 quarters of application. High-propensity business applications are determined by the Census Bureau as applications with a strong likelihood of turning into businesses with employees on payroll. Source: U.S. Census Bureau. Data as of March 2021.

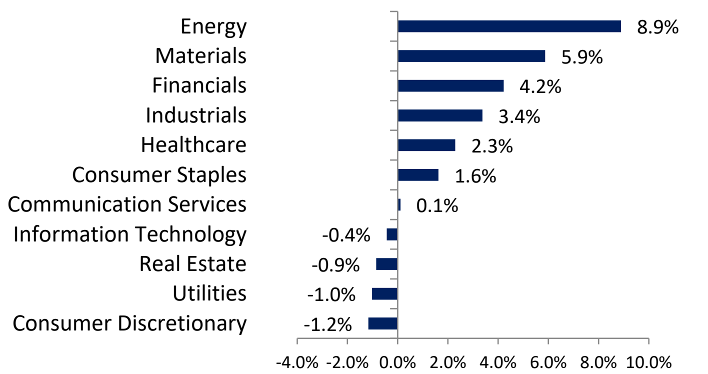
The key takeaway: A critical engine of job creation is small businesses with fewer than 500 employees, accounting for nearly half of private-sector employment, according to the Census Bureau. The good news is that the onslaught of business formations is promising for future employment growth. The not-so-good news: As reported in the National Federation of Independent Business survey of small businesses, 42% of owners reported "job openings that could not be filled," a record-high reading. Hence, while the reflation trade is on, and the recovery is gaining momentum broadly with both the U.S. economy and corporate earnings cycle turning up, a key potential inhibitor to our market outlook is the labor market. An unexpectedly soft April jobs report and a revised down March report suggests slowing momentum in the labor market. Rising concerns around wage pressures/inflation and labor supply could become more prominent and prevalent in the months ahead and therefore demand the close attention of investors.

MARKETS IN REVIEW

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	34,777.76	2.7	2.7	14.3
NASDAQ	13,752.24	-1.5	-1.5	6.9
S&P 500	4,232.60	1.3	1.3	13.3
S&P 400 Mid Cap	2,770.27	1.7	1.7	20.6
Russell 2000	2,271.63	0.3	0.3	15.4
MSCI World	2,979.41	1.4	1.4	11.4
MSCI EAFE	2,324.42	2.6	2.6	9.4
MSCI Emerging Markets	1,348.57	0.1	0.1	4.9

S&P 500 Sector Returns



Fixed Income†

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	1.42	0.38	0.38	-3.07
Agencies	0.71	0.22	0.22	-0.97
Municipals	1.02	0.19	0.19	0.68
U.S. Investment Grade Credit	1.49	0.28	0.28	-2.34
International	2.13	0.51	0.51	-3.10
High Yield	3.91	0.29	0.29	2.24

	Current	WTD	MTD	YTD
90 Day Yield	0.01	0.00	0.00	0.06
2 Year Yield	0.14	0.16	0.16	0.12
10 Year Yield	1.58	1.63	1.63	0.91
30 Year Yield	2.28	2.30	2.30	1.64

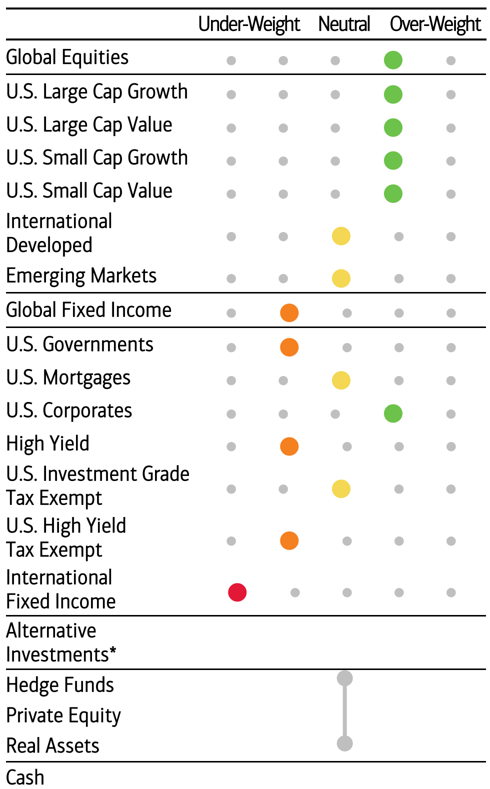
Commodities & Currencies

	Total Return in USD (%)			
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	200.14	3.7	3.7	20.1
WTI Crude $/Barrel††	64.90	2.1	2.1	33.8
Gold Spot $/Ounce††	1831.24	3.5	3.5	-3.5

Currencies	Current	Prior Week End	Prior Month End	2020 Year End
EUR/USD	1.22	1.20	1.20	1.22
USD/JPY	108.60	109.31	109.31	103.25
USD/CNH	6.42	6.47	6.47	6.50

Sources: Bloomberg, Factset. Total Returns from the period of 5/3/2021 to 5/7/2021. †Bloomberg Barclays Indices. ††Spot price returns. All data as of the 5/7/2021 close. **Past performance is no guarantee of future results.**

Asset Class Weightings (as of 5/4//2021)



*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 5/7/2021)

	Q4 2020A	2020A	Q1 2021A	Q2 2021E	Q3 2021E	Q4 2021E	2021E
Real global GDP (% y/y annualized)	-	-3.2	-	-	-	-	5.9
Real U.S. GDP (% q/q annualized)	4.3	-3.5	6.4	10.0	9.0	5.1	7.0
CPI inflation (% y/y)	1.2	1.2	1.9	3.7	3.1	2.9	2.9
Core CPI inflation (% y/y)	1.6	1.7	1.4	2.5	2.1	2.3	2.1
Unemployment rate (%)	6.7	8.1	6.2	5.6	4.6	4.2	5.1
Fed funds rate, end period (%)	0.09	0.09	0.06	0.13	0.13	0.13	0.13
10-year Treasury, end period (%)	0.91	0.91	1.74	1.85	2.00	2.15	2.15
S&P 500 end period	3756	3756	3973	-	-	-	3800
S&P earnings ($/share)	42	140	42*	46	48	49	185
Euro/U.S. dollar, end period	1.22	1.22	1.17	1.18	1.16	1.15	1.15
U.S. dollar/Japanese yen, end period	103	103	111	107	110	113	113
Oil ($/barrel, avg. of period, WTI)**	44	40	58	64	60	58	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 May 7, 2021.

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Index Definitions

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 U.S. 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.

Bloomberg Commodity Price Index is a family of financial benchmarks designed to provide liquid and diversified exposure to physical commodities via futures contracts.

Commodity Research Bureau Metals Price Index measures the aggregated price direction of various commodity sectors.

ISM Manufacturing Index or purchasing managers' index (PMI) is considered a key indicator of the state of the U.S. economy.

Consumer Price Index (CPI) an index of the variation in prices paid by typical consumers for retail goods and other items.

Employment Cost Index (ECI) is a quarterly economic series detailing the changes in the costs of labor for businesses in the United States economy.

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