

CHIEF INVESTMENT OFFICE

Capital Market Outlook

June 27, 2022

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

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Macro Strategy—*About Bears and Recessions*: The same rules that apply to bear sightings may also apply to recessions: Don't run, don't panic, and stand your ground.

For investors that means holding true to investment goals and philosophy. Through the turmoil, the reset of asset prices through recessionary periods tend to be favorable entry points for long-term investors.

Market View—*The Changing Paradigm for Corporate Earnings*: Any forward-looking view of the equity markets has to take into account the path of interest rates, current valuations and corporate earnings.

Since the start of the year, investors have seen a spike in interest rates and significant valuation compression. Investor attention is now turning to earnings as the third leg of the fundamental stool for Equities as they attempt to gauge the key support levels. Here we outline some of the main earnings dynamics unfolding ahead.

Thought of the Week—*Bear Market History as a Guide*: This being the 12th bear market since World War II, on average Equities have declined 34% peak-to-trough over 13 months' time.

As we work through the market bottoming process, our highest conviction is to stay both disciplined and diversified.

MACRO STRATEGY ►

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MARKET VIEW ►

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THOUGHT OF THE WEEK ►

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MARKETS IN REVIEW ►

Data as of 6/27/2022,
and subject to change

Portfolio Considerations

As this period of uncertainty matures, markets, in our view, will be searching for signs of stability to finally bottom out and create a new base. While risks remain, global Equities still have the support of higher nominal growth levels, healthy corporate profits, a strong consumer, and an improvement in the service sectors in the near term. We still expect high-quality Fixed Income to be a diversifier, and this diversification effect has proven true when rate volatility decreases. For investors, there is a growing list of reasons to shore up and maintain strategic exposure to commodity prices.

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About Bears and Recessions

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

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Whether a lover of wildlife or an investor, the cardinal rule on being in the presence of a bear is the following: Don't run, don't panic, and stand your ground. The principles hold true whether you're on a deserted road in Yellowstone National Park or standing on the floor of the New York Stock Exchange.

For the investing class, don't run means don't sell out of the market. While every bear market is different in terms of duration, declines and recoveries (see Thought of the Week), the point is that every major market downturn in the past has been followed by a recovery—and then some.

Calling a bottom in a bear market is a fool's game. However, investors would do well to remember two things: Being out of the market during days of outsized market gains can reduce total returns over the long-term, and as a stable and predictable wealth-generating machine, the S&P 500 Index has generated chunky 11% returns on a compounded annual return basis since 1945. Don't run from a bear, in other words.

Don't panic means maintain your investment composure and avoid being caught up in the moment of high anxiety and fear. Bears—real or financial—are frightening, with the financial media looking to elevate the mood of negativity. We believe now is not the time to panic. Why? Because a great deal of bad news has already been priced in asset prices; yes, as the Federal Reserve (Fed) fights inflation, China battles with the virus, and the crisis in Ukraine continues, there is a high probability of more market downside. But we believe the biggest declines are most likely behind us. And as Exhibit 1 highlights, market losses had quickly recouped 12 months after reaching a bear market bottom.

Exhibit 1: Recession + Bear Markets = Outsized S&P 500 Index 12-Month Returns.

Recession	Market trough	12-Month Returns
Nov 48 - Oct 49	6/13/1949	42.1%
Jul 53 - May 54	9/14/1953	37.7%
Aug 57 - Apr 58	10/22/1957	31.0%
Apr 60 - Feb 61	10/25/1960	30.7%
Dec 69 - Nov 70	5/26/1970	43.7%
Nov 73 - Mar 75	10/3/1974	38.0%
Jan 80 - Jul 80	3/27/1980	37.1%
Jul 81 - Nov 82	8/12/1982	58.3%
Jul 90 - Mar 91	10/11/1990	29.1%
Mar 01 - Nov 01	10/9/2002	33.7%
Jan 08 - Jun 09	3/9/2009	68.6%
Feb 20 - Apr 20	3/23/2020	74.8%
		Average = 43.7%

Source: Bloomberg. Data as of June 23, 2022. **Past performance is no guarantee of future results. It is not possible to invest directly in an index.**

Finally, stand your ground means sticking to your underlying investment philosophy, being opportunistic, and taking the long view. The current stance of the Chief Investment Office is high quality and defensive, with a preference for Energy, Utilities, Financials and Healthcare, as well as dividends. Over the next few quarters, however, we see three entry points for investors, running from this June/July as the bear market matures, in Q3/Q4 as 2023 earnings are reset, and early next year when the Fed tightening cycle winds down.

As for the long-term perspective, Exhibit 2 depicts the Dow Jones Industrial Index over the better part of a century. The upshot: Despite periodic exogenous shocks and challenges, the bias of U.S. Equities has been upwards over the longer term.

Not surprisingly, large market corrections—including bear markets—are often accompanied by rising fears of an economic recession. Indeed, the odds of a recession have increased this year and in 2023, but below we offer some brief perspectives on what an economic recession entails.

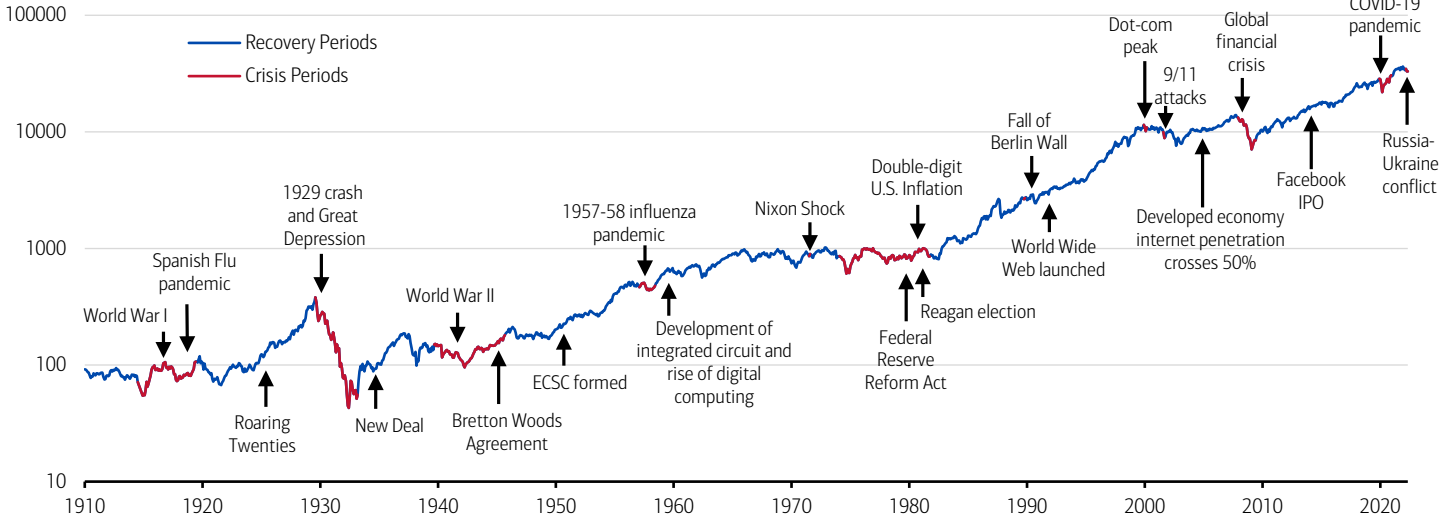
Investment Implications

Every major market downturn in the past has been followed by a recovery—and then some. To best weather the market volatility, we would emphasize allocations to high-quality assets and total return opportunities.

Exhibit 2: Equity Market and Historical Periods of Crisis and Recovery.

Equity Market And Historical Periods Of Crisis And Recovery

Dow Jones Industrial Index
Level (log scale)



Sources: Chief Investment Office; Bloomberg. Data as of June 23, 2022. **Past performance is no guarantee of future results. It is not possible to invest directly in an index.**

About the “R” Word

Although an economic recession is not our base case—BofA Global Research expects real growth of 2.3% this year and 1.4% next year—the incessant debate about the odds of a U.S. recession misses a number of critical points.

First, recessions are like bear attacks; they are rare. There have been 12 recessions since 1945, equating to 10.3 years in total. Looked at another way, economic growth has prevailed in the U.S., about 87% of the time over the post-war era.

Second, recessions can be painful and costly in the near term, but the after effects of an economic downturn are typically salutary. Downturns rid the economy of its excesses; reallocate capital to more productive parts of the economy; and create and destroy, leaving firms stronger and more competitive—and Equities poised for more upside.

Third, recessions typically augur structural changes that boost the long-term potential of the economy. To wit, the recessions of the mid-1970s and early 1980s broke the back of double-digit inflation, allowing the economy to grow on a more sustainable basis in the new environment of price stability. The 2001 recession brought market multiples back down to more rational levels after the overinflated valuations of the late 1990s and sparked a game-changing technology-led boom in growth. And finally, the 2008-2009 recession led to a strengthening of the banking system through more stringent capital and liquidity requirements and higher lending standards.

Finally, and above all else, by resetting asset prices, recessions are favorable entry points, in our view, for long-term investors. The same rules for bears apply to recessions: Don't run, don't panic, and stand your ground by holding to investment goals and philosophy.

The Changing Paradigm for Corporate Earnings

Niladri Mukherjee, Managing Director and Head of CIO Portfolio Strategy

Kirsten Cabacungan, Assistant Vice President and Investment Strategist

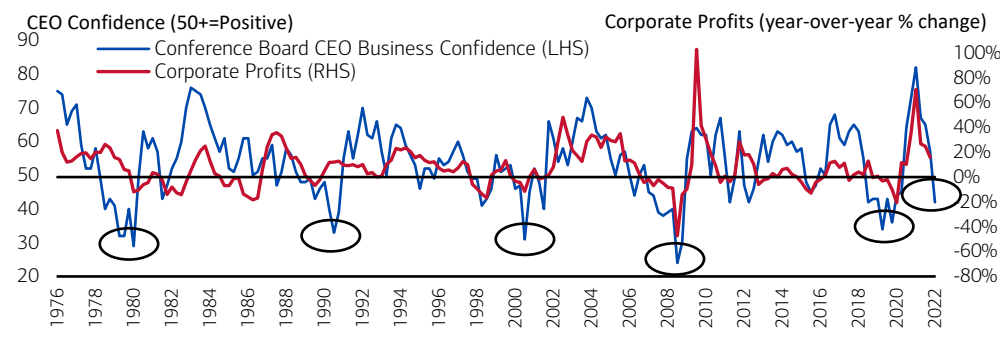
Any forward-looking view of the equity markets has to take into account the path of interest rates, current valuations and corporate earnings. One can argue that we have already seen a significant repricing in the bond markets given the spike in interest rates across the curve, with the short end pricing in most of the Fed's hiking cycle and the long end reflecting elevated inflation. Although, a further rise in rates can be argued given the delay in "peak inflation," Equity valuations on the other hand are cheaper today, especially for long-term investors willing to look past the ongoing volatility. The third leg of the fundamental stool for Equities, i.e., corporate earnings, is where investor attention is now turning to as they attempt to gauge the key support levels for Equities.

Throughout the previous decade, U.S. corporate earnings rose at a high average annual growth rate of 10.7%,¹ driven by a long but slow expansion, weaker wage growth pressures, lower commodity and, especially, energy prices, and a steady rise in globalization. Then, after the initial shock of the pandemic recession, a strong recovery in nominal growth, operating leverage and margin expansion helped 2021 earnings per share for the S&P 500 Index move up 28% above pre-pandemic 2019 level highs. Given changing macrodynamics, however, the risk of a potential moderation in corporate earnings is growing.

Signs of decelerating economic growth are becoming more evident, especially after real U.S. gross domestic product (GDP) declined 1.5% at an annualized pace in Q1 following a 6.9% increase in the prior one. In fact, forecasters surveyed by the Fed Bank of Philadelphia lowered their expectations for real GDP growth for 2022 are now forecasting an annual rate of 2.5%, which is down from their previous forecast of 3.7% at the start of the year.

While economic output slumped in Q1, consumer spending growth remained robust, with personal consumption expenditures up 4.1% (percent change in seasonally adjusted personal consumption expenditures from end of period Q4 2021 to Q1 2022). Consumer sentiment, however, is now waning. The University of Michigan's Consumer Sentiment Index dropped to its lowest level on record in June. The percentage of consumers surveyed who believe it is a good time to buy household goods or cars declined to all-time lows. Weakening consumer confidence could contribute to a slowdown in consumer spending in the second half of the year. The fall in month-over-month retail sales in June, the first decline of this year, offers an initial glimpse of fading consumer momentum. And not to mention, consumers could face reduced spending power as higher prices continue to draw down on savings, with the savings rate now at its lowest level since September 2008.

Exhibit 3: Pessimistic CEO Confidence Has Coincided With Periods Of Weaker Profit Growth.



Note: Corporate profits reflects after-tax values without inventory valuation and capital consumption adjustments. Sources: The Conference Board; Bureau of Economic Analysis; Haver Analytics. Data as of June 22, 2022. **Past performance is no guarantee of future results.**

If demand slows, companies' ability to pass high costs off to consumers may diminish. Reduced pricing power amid a historically tight labor market and rising input cost environment would depress profit margins. Margins have already been pressured by strong wage gains, costs

Portfolio Implications

The broader macro environment remains one of slowing growth and corporate profits, elevated inflation and tightening financial conditions. Investors should emphasize high quality, stable earnings, Value and Real assets like Commodities in portfolios.

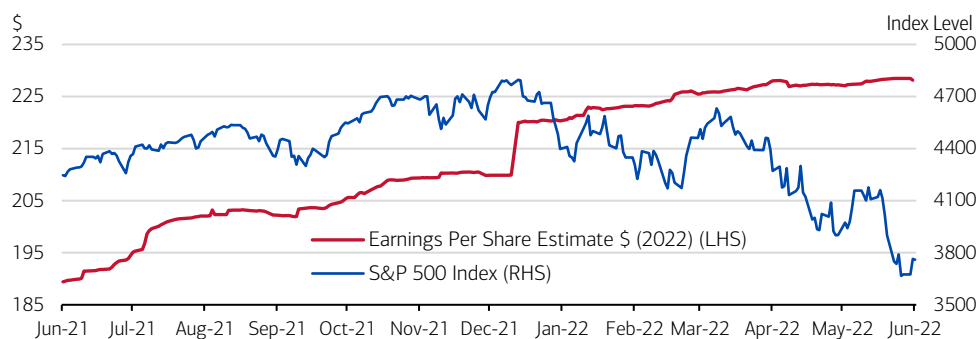
¹ Data reflects the average of annual earnings per share growth rates from 2010 to 2019. Source: FactSet.

associated with supply chain issues and rising commodity prices. Unit labor costs² accelerated 8.2% in Q1 from a year ago, the largest four-quarter increase since 1982. The sharp drop in CEO Confidence for Q2 into negative territory³ and the lowest level since the start of the pandemic could be a further warning sign for challenged corporate profits growth ahead (Exhibit 3).

The strength in the U.S. dollar could also pressure earnings growth. Amid a confluence of factors from a hawkish Fed and rising bond yields to concerns over a recession and geopolitical tensions, the U.S. dollar has broken to a new 20-year high. Dollar strength may pose headwinds to profits growth for U.S. multinational companies whose international sales are now worth less in dollar terms. Already we have seen some high-profile companies with significant global businesses lower their earnings expectations due to foreign exchange headwinds.

Amid the many risk factors, consensus earnings estimates are still suggesting an uninterrupted rise in profits in the coming years (Exhibit 4). Balancing these factors could be elevated cash levels on corporate balance sheets that would enable companies to engineer earnings per share growth through buybacks and relatively lower interest costs given refinancing in recent years. Buybacks broke record levels in 2021, with S&P 500 companies buying back \$882 billion in stock for the full year.⁴ Strong buybacks continued into Q1 of this year, eclipsing another record high. Still, the question of whether companies may be able to continue this strong trend in buybacks remains. As economic concerns rise, investors could see business executives pivot back to building cash reserves and fortifying their balance sheets. The latest BofA Global Research Fund Manager Survey reported 44% of investors want companies to strengthen balance sheets over increasing spending on capital expenditures or returning cash to shareholders via buybacks, the highest level since January 2021. Yet, looking at a longer-term horizon, earnings could be propped up by the accelerated shift toward digitalization. In recent years, robotic installations have surged, which should act as a tailwind for productivity growth in the years ahead and ultimately help keep unit labor costs in check.

Exhibit 4: Earnings Estimates Have Remained Firm While The S&P 500 Has Dropped.



Sources: Chief Investment Office; Bloomberg. Data as of June 22, 2022. **Past performance is no guarantee of future results. It is not possible to invest directly in an index.**

Still, earnings estimates could continue to shift lower in the near term. Of the 103 companies that have issued guidance for Q2 so far, 72 companies, or 70% of the total, issued negative guidance, which is the highest number of S&P 500 companies since Q4 of 2019 and well above the five-year average percentage of companies with negative guidance of 60%, according to FactSet. From a sector perspective, consensus earnings estimates have been trimmed for the majority of sectors, but upward revisions continue to lead for the Energy and Materials sectors, which are benefiting from elevated commodity prices.

Conclusion

Overall, corporate earnings growth is likely to be in the mid-single digits in the near term, but a further rise in 2023 is being threatened by a slowing economy and margin pressures. BofA Global Research is forecasting earnings growth of 6% for 2022 and 4% for 2023. These weakening earnings dynamics should add to the volatile and uncertain environment for risk assets like Equities and corporate bonds. Defensive sectors that exhibit relative earnings strength in such an environment, such as Healthcare and Utilities, are likely to outperform at the expense of Consumer Discretionary and Communication Services, while “recessionary concerns” provide a tailwind for companies with high-quality balance sheets, pricing power and sustainably growing dividends.

² Unit labor costs is how much a business pays its workers to produce one unit of output.

³ CEO Confidence is measured by the Conference Board, Inc. A reading below 50 points reflects more negative than positive responses.

⁴ Haver Analytics. Data as of June 2022.

Bear Market History as a Guide

Lauren J. Sanfilippo, Director and Senior Investment Strategy Analyst
























Already securing the superlative of the worst start to a year since 1970, the S&P 500 moved into bear market territory by declining 23.5% peak-to-trough.⁵ Using history as a guide, bear markets of varying lengths, declines, duration and time to a new high are shown in Exhibit 5. So how does this bear, or the period from the January 3 high through Friday's close, stack up to bears before it? While this is the 12th decline of 20% or more since World War II, bear markets have historically been worse off than a 23.5% decline—on average, Equities have declined -34% peak-to-trough over 13 months' time. Worse, during the dot-com bust of the early 2000's., the S&P 500 fell 49% over 2 1/2 years. Comparatively, and on the other end of the bear market spectrum, the pandemic-induced 2020 bear market's turnaround was in record time, hitting bottom in 33 calendar days and going on to set a new high in 148 days.

While some bear markets are isolated to financial markets, a bear market could portend a recession, as recessions have accompanied nine of the last 17 bear markets on record. Doubting the Fed's ability to achieve a soft landing, recession odds over the next 12 months continue to rise each week. As we work through the market bottoming process, our highest conviction is to stay disciplined and diversified. Within Equities that means through sector exposures—whether on guard in defensively oriented sectors or exposed to growth areas of Energy and parts of Technology that offer dividend yields. Either through indexes or individual companies, focus on high-quality factors such as strong balance sheets, high free cash flows and positive forward earnings revisions. While markets rapidly shift, investors should consider rebalancing into their strategic long-term allocations.

Portfolio Considerations

Through this market bottoming process we would consider using market volatility to become even more balanced at the sector level in Equities and diversified at the asset allocation level according to an investor's risk profile.

Exhibit 5: Bear Market History As A Guide.

The duration of the 12 bear markets since the World War II era...				...and how long it took to recover from them.			
Peak	Trough	Decline, %	Duration, in days	New record high	Days from trough to new record high		
June 15, 1948	June 13, 1949	-20.6		363	Sept. 22, 1954		1,927
July 15, 1957	Oct. 22, 1957	-20.7		99	Sept. 24, 1958		337
Dec. 12, 1961	June 26, 1962	-28.0		196	Sept. 3, 1963		434
Feb. 9, 1966	Oct. 7, 1966	-22.2		240	May 4, 1967		209
Nov. 29, 1968	May 26, 1970	-36.1		543	March 6, 1972		650
Jan. 11, 1973	Oct. 3, 1974	-48.2		630	July 17, 1980		2,114
Nov. 28, 1980	Aug. 12, 1982	-27.1		622	Nov. 3, 1982		83
Aug. 25, 1987	Dec. 4, 1987	-33.5		101	July 26, 1989		600
March 24, 2000	Oct. 9, 2002	-49.1		929	May 30, 2007		1,694
Oct. 9, 2007	March 9, 2009	-56.8		517	March 28, 2013		1,480
Feb. 19, 2020	March 23, 2020	-33.9		33	Aug. 18, 2020		148
Jan. 3, 2022	June 16, 2022*	-23.5*		164			

*Trough so far. Data as of June 24, 2022. Notes: Durations are measured in calendar days. For bear markets before 1948, the S&P 500 did not pass its record from the depression era before the next downturn began. Sources: Yardeni Research; Refinitiv; New York Times analysis of S&P 500 data. **Past performance is no guarantee of future results.**

⁵ S&P 500 peak-to-trough decline 01/03/2022 to 06/16/2022.

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	31,500.68	5.4	-4.4	-12.4
NASDAQ	11,607.62	7.5	-3.9	-25.5
S&P 500	3,911.74	6.5	-5.2	-17.3
S&P 400 Mid Cap	2,334.40	5.1	-7.1	-17.3
Russell 2000	1,765.74	6.0	-5.2	-20.9
MSCI World	2,619.48	5.4	-6.1	-18.2
MSCI EAFE	1,874.19	2.8	-7.9	-18.4
MSCI Emerging Markets	1,011.18	0.8	-5.9	-17.0

Fixed Income†

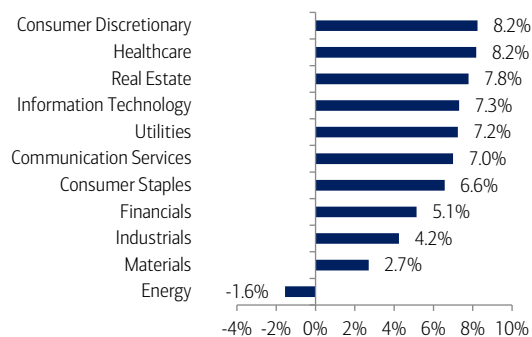
	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	3.77	0.49	-2.12	-11.54
Agencies	3.31	0.52	-1.14	-6.39
Municipals	3.25	0.83	-1.99	-9.31
U.S. Investment Grade Credit	3.81	0.61	-2.21	-10.94
International	4.73	0.34	-3.03	-14.59
High Yield	8.42	0.57	-5.01	-12.61
90 Day Yield	1.63	1.56	1.04	0.03
2 Year Yield	3.06	3.18	2.56	0.73
10 Year Yield	3.13	3.23	2.84	1.51
30 Year Yield	3.26	3.28	3.05	1.90

Commodities & Currencies

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Commodities				
Bloomberg Commodity	259.92	-4.3	-7.6	22.7
WTI Crude \$/Barrel**	107.62	-1.8	-6.1	43.1
Gold Spot \$/Ounce**	1826.88	-0.7	-0.6	-0.1

	Total Return in USD (%)			
	Current	Prior Week End	Prior Month End	2020 Year End
Currencies				
EUR/USD	1.06	1.05	1.07	1.14
USD/JPY	135.23	135.02	128.67	115.08
USD/CNH	6.68	6.71	6.68	6.36

S&P Sector Returns



Sources: Bloomberg, Factset. Total Returns from the period of 6/20/2022 to 6/24/2022 †Bloomberg Barclays Indices. **Spot price returns. All data as of the 6/24/2022 close. Data 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.**

Economic Forecasts (as of 6/24/2022)

	2021A	Q1 2022A	Q2 2022E	Q3 2022E	Q4 2022E	2022E
Real global GDP (% y/y annualized)	6.1	-	-	-	-	3.2
Real U.S. GDP (% q/q annualized)	5.7	-1.5	1.5	2.5	1.8	2.3
CPI inflation (% y/y)	4.7	8.0	8.4	8.2	7.0	7.9
Core CPI inflation (% y/y)	3.6	6.3	5.9	5.9	5.7	6.0
Unemployment rate (%)	5.4	3.8	3.6	3.5	3.5	3.6
Fed funds rate, end period (%)	0.07	0.33	1.63	2.88	3.38	-

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.

Sources: BofA Global Research; GWIM ISC as of June 24, 2022. BofA Global Research is research produced by BofA Securities, Inc. ("BofAS") and/or one or more of its affiliates. BofAS is a registered broker-dealer, Member SIPC, and wholly owned subsidiary of Bank of America Corporation.

Asset Class Weightings (as of 6/7/2022)

Asset Class	CIO View		
	Underweight	Neutral	Overweight
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			

CIO Equity Sector Views

Sector	CIO View		
	Underweight	Neutral	Overweight
Energy	●	●	●
Financials	●	●	●
Real Estate	●	●	●
Materials	●	●	●
Healthcare	●	●	●
Utilities	●	●	●
Information Technology	●	●	●
Industrials	●	●	●
Consumer Discretionary	●	●	●
Consumer Staples	●	●	●
Communication Services	●	●	●

*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. Source: Chief Investment Office as of June 7, 2022. All sector and asset allocation recommendations must be considered in the context of an individual investor's goals, time horizon, liquidity needs and risk tolerance. Not all recommendations will be in the best interest of all investors.

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 Equity 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.

Dow Jones Industrial Index is a stock market index of 30 prominent companies listed on stock exchanges in the United States.

University of Michigan Consumer Sentiment Index is a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in the first quarter of 1966.

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