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CHIEF INVESTMENT OFFICE

Capital Market Outlook

July 6, 2021

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

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Thought of the Week—Over a rewarding first half of the year, the S&P 500 ended 14.4% higher riding a fifth consecutive monthly gain. Even given the U.S. equity market's torrid pace over the first half, seasonality suggests the benchmark just entered its strongest month of the year—July.

Portfolio Considerations—We are monitoring the possibility of higher yields and higher levels of inflation, although we generally would expect an increase in price levels to favor equities over fixed income. Consider rebalancing through the summer months if risk assets drift materially higher over and above target allocation levels.

MACRO STRATEGY

Niladri Mukherjee
Managing Director and Head of CIO Portfolio Strategy

Emily Avioli
Assistance Vice President and Investment Strategist

GLOBAL MARKET VIEW

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

THOUGHT OF THE WEEK

Lauren J. Sanfilippo
Vice President and Investment Strategist

Data as of 7/6/2021, and subject to change

MACRO STRATEGY

Macro Moderations and Market Transitions

Niladri Mukherjee, Managing Director and Head of CIO Portfolio Strategy

Emily Avioli, Assistant Vice President and Investment Strategist

The U.S. has been on a strong uptrend this year so far, as highly accommodative fiscal and monetary stimulus and economic reopenings have combined to lift the economy from the pandemic lows. Real gross domestic product (GDP) expanded at an annualized 6.4% in Q1, and Bloomberg consensus estimates another 9% rise in Q2. The strong rebound has been reflected in asset prices, with the S&P 500 Index up roughly 14% year to date, with reflation and reopening beneficiaries enjoying robust gains. In our view, going forward, growth levels in economic activity and corporate profits should remain at historically high levels. However, as we move past crisis-era stimulus aimed toward direct household support and central bank liquidity keeping financial conditions artificially ultra-accommodative for an extended time frame, incoming data should moderate (Exhibit 1). As such, the market's drivers are likely to

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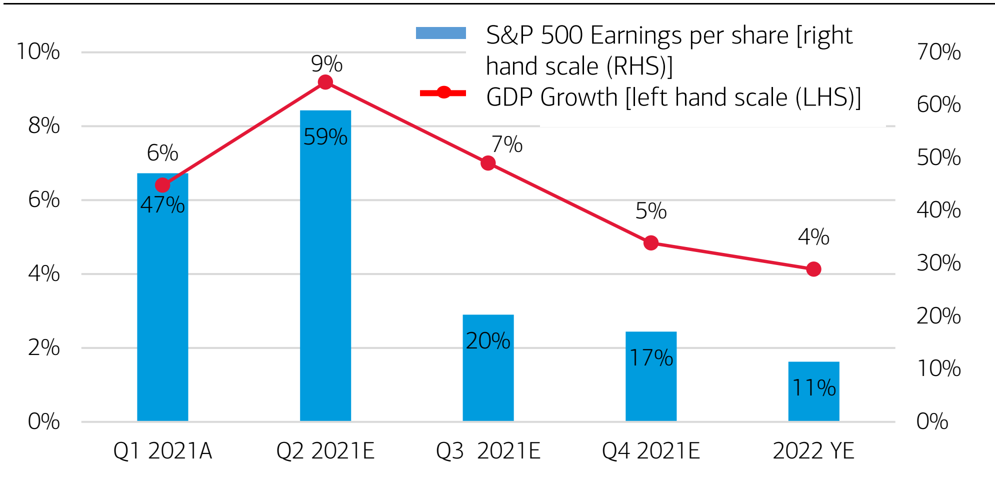
transition toward business spending, productivity and shifting consumer spending toward services.

Exhibit 1: GDP and Profit Growth Levels Are Likely To Moderate As The Economy Transitions To A Mid-Cycle Phase.



EPS growth refers to consensus-expected EPS growth for the S&P 500 Index. GDP growth refers to consensus-expected GDP growth for the U.S. A = Actual, E = Estimate. Sources: Factset; Bloomberg. Data as of June 28, 2021. Projections are hypothetical and subject to change. Past performance is no guarantee of future results.

A Natural Moderation

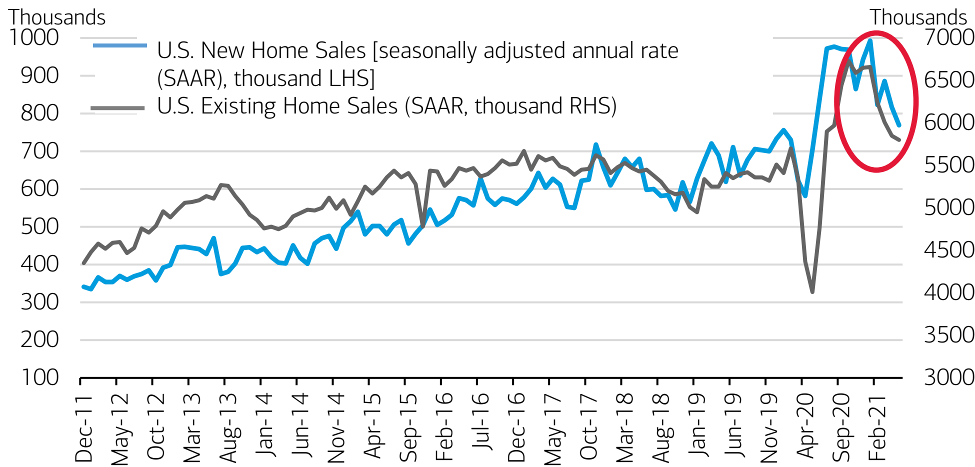
Rising vaccination rates were a key driver of reopening in the first half of this year, but as more willing participants are inoculated, that effect may begin to fade. Meanwhile, increasing cases in states with lower rates of vaccinations being attributed to a new, more infectious variant creates the risk that some of the reopening momentum could stall. Financial conditions and liquidity are still loose, but they are likely to incrementally tighten from here as interest rates rise and growth in Federal Reserve (Fed) liquidity reaches its apex. Money supply growth, which was running at a 20%-plus level since May of last year, has since decelerated to a 14% level last month, which is still historically high.

Additionally, after strong gains fueled by record-low mortgage rates and a scramble to leave urban centers, the housing market has cooled recently, as higher prices and lower inventory has weakened demand and transactions—existing home sales peaked at 6.8 million units and have since declined by 14%; new home sales lower by 23% (Exhibit 2). Overseas, China, which has been a major driver of global growth, has seen its growth moderate as fiscal and monetary policy has been tightened with the intended goal of reigning in financial excesses. This could mean lower demand for imported goods by the Chinese and some near-term headwind for commodity prices.

Corporate profits have driven much of this year's rally in equities, and we expect nominal growth and margin strength to remain supportive anchors. This is reflected in the earnings revisions ratios, which remain elevated, with analyst upgrades outnumbering analyst downgrades by a ratio of 1.71.[1] However, profit growth should see a natural deceleration in the second half and into 2022 (Exhibit 2), as financial conditions tighten, and the base effects from last year abate. Consensus estimates for earnings growth for the S&P 500 are roughly 36% for 2021 and 11% for 2022, with the biggest risks to the earning's uptrend being rising input costs for businesses, particularly wage inflation and a potential hike in corporate taxes.

[1] FactSet, June 2021. Ratio refers to the three-month average upgrade/downgrade.

Exhibit 2: A Current Red Hot Housing Market Is Cooling.

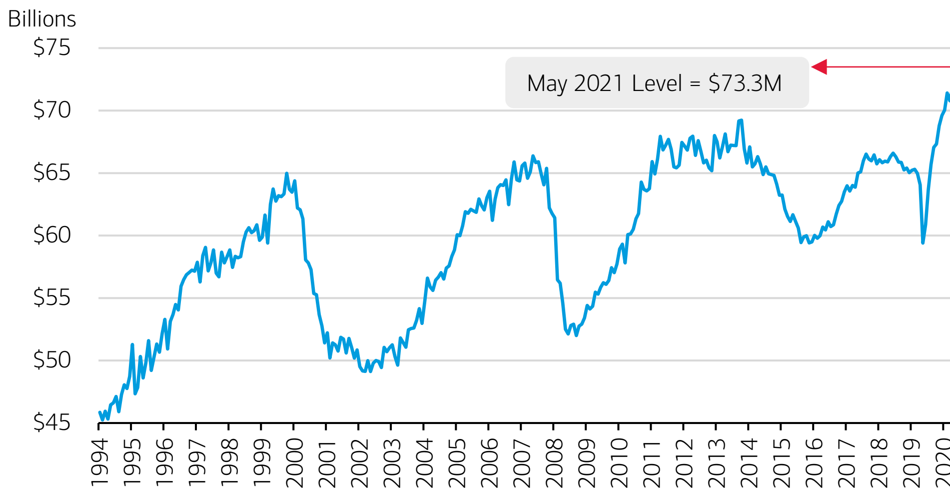


Source: Bloomberg. Data as of 6/29/2021.

Shifting To Organic Growth Drivers

Years of underinvestment, stimulus-fueled skyrocketing consumer demand, rising profits and easy credit conditions have paved the way for a powerful new capital expenditure (capex) cycle, underway since last year (Exhibit 3). Leading indicators like orders for new capital goods and the Conference Board Measure of CEO Confidence signal more strength ahead—the recent Conference Board survey showed executive confidence levels at a 45-year high.

Exhibit 3: U.S. Non-defense Capital Goods Shipments ex-Aircraft.



Source: Cornerstone Macro Research. Graph reflects U.S. Nondefense Capital Goods Shipments excluding Aircrafts as of May 31, 2021.

Strength in capex has positive spillover effects on the rest of the economy, resulting in increased manufacturing activity, job creation and wage growth providing another boost to consumer spending and, eventually, faster productivity growth. Cornerstone Macro Research estimates that private capex spending alone could boost GDP by almost 2% in 2021 and 1% in 2022. In addition, the recently proposed $1 trillion infrastructure plan, if it were to pass Congress, could finally begin to address major supply-side bottlenecks plaguing the U.S. economy, improving the longer-term growth and inflation outlook.

Accelerating innovation should be a key driver of growth through this cycle. Most U.S. companies were forced to digitize in some capacity during the pandemic, ushering in a new wave of innovation that is showing no signs of slowing. McKinsey & Company recently

estimated that this increased technological investment has the potential to accelerate annual productivity growth by 1% through 2024, more than double the pre-pandemic rate.

Asset Allocation Considerations

All things considered, we reiterate that we believe the outlook for U.S. growth is strong and that the recovery is far from over. There remains a high level of consumer pent-up demand still to be released, more benefits to be gained from economic reopening, and slack in the labor market to be picked up. Manufacturing activity is expected to remain elevated and innovation should support productivity, while the outlook for capex is encouraging. Still, as we transition into the mid cycle of this recovery, some moderation is to be expected for growth, consumer spending, liquidity and corporate profits. In our view, investors should consider the following big picture asset allocation implications:

- Inflation will likely be higher in this cycle than in the previous decade. The Fed is appropriately acknowledging the recent pricing pressures in the data but is committed to remaining accommodative and to achieving its average inflation target of 2% in addition to maximum employment in a more inclusive fashion. This hasn't changed despite their recent perceived hawkish turn. Fed officials have indicated that they may start tapering soon and could begin hiking policy rates in 2023.
- Interest rates are biased higher, and the 10-year Treasury yield could drift toward the 2% levels over the next few quarters. This means that Fixed Income broadly remains unattractive for now, on a tactical basis, but as yields likely rise, a portfolio rebalance opportunity could present itself from Equities into bonds.
- Despite the likely rise in yields, and the Fed turning relatively more hawkish, investors should consider remaining invested in U.S. Equities. The continuing uptrend in corporate profits and economic activity remain a powerful support for Equities. The beginning of Fed tightening does not mean the end of a business cycle is near. For the past seven hiking cycles, the average return for the S&P 500 has been 11% after 12 months since the Fed started to tighten.[2]
- We favor Developed over Emerging Markets for now. The uncertainty created by the more infectious variant, combined with weaker health infrastructure and the commencement of central bank hiking cycle in some Emerging Markets in response to inflationary pressures, presents scope for more volatility there.
- We suggest keeping a balance of Value and Growth in portfolios. The back and forth on the inflation debate and a choppy rates environment mean that leadership can flip between the two, as we have witnessed recently. But over a 12-month time frame, Value is likely to outperform because it is trading at a relative discount, corporate earnings are on a strong uptrend, and interest rates are likely to be higher. We have kept that balance of Growth and Value in our asset allocation and in our sector selections where we have a preference for Value-based sectors like Financial and Energy and to Growth-based ones like Technology.
- Financial and liquidity conditions are very loose, but they are likely to incrementally tighten from here. As a result, volatility could rise in the rates and currency markets, with potential spillover into Equities. Equities may consolidate as a result, but any meaningful pullbacks should be an opportunity to put cash to work, given that credit conditions are supportive and that the Fed may have potentially lengthened the cycle by reigning in inflation expectations.

[2] Chief Investment Office, Capital Market Outlook "What Fed Tapering Could Mean for Equity Markets," June 1, 2021.

- Finally, as financial conditions tighten and profit growth decelerates, active management* could add value during the selection process as investors pay more attention to fundamentals rather than broad macro factors like liquidity. In addition, High-quality, such as those areas of the market with better balance sheets, ability to maintain and grow margins, and more sustainable businesses with less earnings volatility, could be in favor.

GLOBAL MARKET VIEW

Ten Reasons to Stay Long the United States

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

With many major U.S. indexes at or near all-time highs, some investors, not unexpectedly, are eying the exits, contemplating scaling back their U.S. equity exposure. Below, however, we briefly outline 10 reasons to stay long U.S. equities.

First, no economy in the world is as large, diverse and dynamic as the U.S. economy. Think of the U.S. as a hydra-headed superpower, leading the world in such diverse activities as aerospace, agriculture, finance, energy, technology, healthcare, education and numerous other activities. With just 4.2% of the global population, the U.S. accounts for over 16% of global GDP on a Purchasing Power Parity basis. In nominal dollars, the U.S. economy is over $6 trillion larger than China's. Never have so few people produced so much output, creating so much wealth. And speaking of wealth, while China's economic ascent has been stunning, keep in mind that China remains relatively poor versus the U.S. The latter's per capita income was $63,416 in 2020, six times larger than China's ($10,484) according to figures from the International Monetary Fund (IMF). ***Investment implications: Broad-based exposure to the S&P 500 should be at the core of any investor's portfolio.***

Second, contrary to popular lore, the U.S. remains a global manufacturing superpower. According to recent data from the United Nation's (U.N.) Development Organization, of the 22 manufacturing categories outlined by the U.N., the U.S. ranked first in terms of global share of output in 12 categories. The top ranking of the U.S. runs the gamut from paper products to motor vehicles to aircraft. And that's not all: The U.S. tallied second in six other categories. Combined, America ranked first and/or second in 18 out of the 22 sectors, underscoring the manufacturing breadth and competitiveness of American manufacturing. ***Investment implications: Gain or maintain long-term exposure to America's manufacturing champions.***

Third, the U.S. remains among the largest exporters of goods and services in the world. Currently, U.S. monthly goods and services exports are clipping along at $205 billion (April 2020), a monthly tally only China comes close to. What the U.S. exports in a month is greater than what most countries export in a year. Whether it's soybeans or spacecraft, propane or plastics, accounting services or automobiles, the breadth of U.S. exports is virtually unparalleled. So too is Corporate America's global footprint via foreign direct investment and sales of U.S. foreign affiliates. The latter was in excess of $6 trillion in 2019, according to figures from the Bureau of Economic Analysis. ***Investment implications: Consider staying long Technology and Healthcare, two U.S. sectors the most globally exposed and positioned for global growth/demand.***

Fourth, the U.S. remains a magnet for foreign capital. Indeed, no country attracts as much overseas cash as the U.S. thanks to myriad attributes, including a vast and wealthy consumer market, a large skilled labor pool, a transparent rule of law, and, more recently,

*Active management seeks to outperform benchmarks through active investment decisions such as asset allocation and investment selection.

cheap energy costs and low corporate taxes. The upshot, the U.S. remains a magnet for other peoples' money. Foreign holdings of U.S. securities (U.S. Treasurys, corporate bonds, government agencies and equities) totaled $24 trillion in the first quarter of 2021, up over 75% from the start of 2009. Meanwhile, over the 2011–2020 period, the U.S. attracted 17.2% of total global foreign direct investment, light years ahead of second place China (8.5%), according to the U.S. Federal Reserve and U.N. ***Investment implications: Strong capital inflows are supportive of the U.S. dollar over the long term. Don't believe the narrative that the U.S. dollar is doomed; consider staying long U.S.-dollar denominated assets.***

Fifth, America remains the home to the world's top global brands. Despite intense global competition, America's global brand presence has become stronger over the past few years. Of the top 10 global brands in 2020, eight of 10 were American according to a report by BrandZ, which ranks the top 100 most valuable global brands. ***Investment implications: The strength and attractiveness of U.S. global brand leaders lies with their intangible value; innovation leaders should be at the core of portfolio construction.***

Sixth, while U.S. brands are emblematic of America's "soft power", America's unsurpassed military supremacy speaks to "hard power" or the fact that the U.S. spends more on defense than the next 10 countries combined.[3] The ascent of China, the ongoing security threat from Russia, and the explosion in cybersecurity breaches—all of these factors have made global defense a growth industry, with the U.S. among the largest spenders. ***Investment implications: Consider staying long U.S. defense/aerospace/cybersecurity leaders.***

Seventh, while China has made significant technological strides over the past decade, the U.S. remains the world's technology leader owing to the nation's risk-taking, not-afraid-to-fail entrepreneurial culture that underpins America's leadership in both technology and innovation. America is the largest market in the world for information technology (IT) spending on hardware, software and services, accounting for 33% of global IT spending in 2020, according to International Data Corporation. That's equivalent to the combined spending of Europe and China. ***Investment implications: Buy and hold U.S. innovation leaders; consider staying invested in the NASDAQ.***

Eighth, the top-ranked universities in the world are in the U.S.; indeed, 32% of the universities in the Quacquarelli Symonds World Rankings' top 100 universities for 2020 were located in America; five out of the top 10, and 9 out of the top 20, were American universities. ***Investment Implications: America remains a global leader in producing skilled/productive human capital, which represents a competitive advantage likely to help U.S. equities outperform global peers over the long run.***

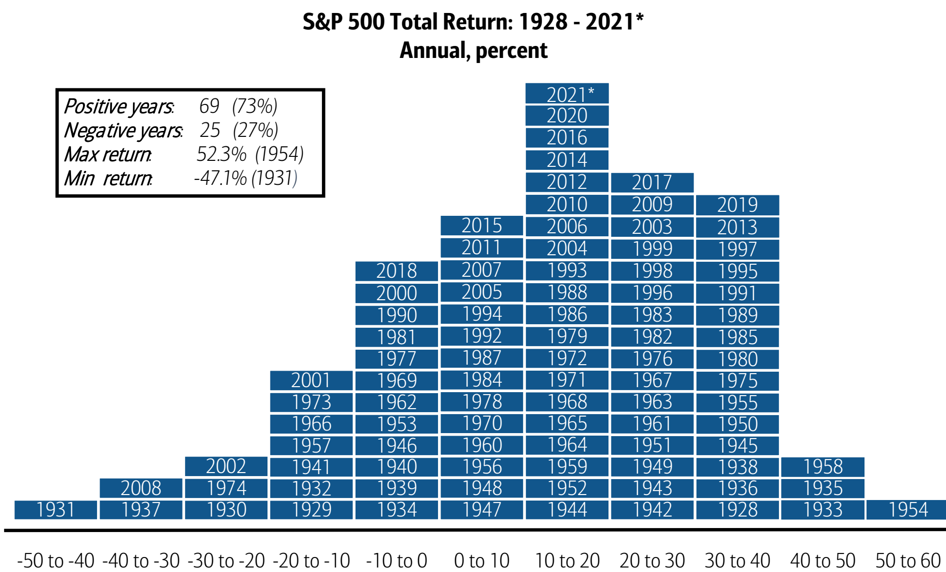
Ninth, while the "Made in America" financial crisis was touted by many as the death knell of the U.S. dollar, nothing of the sort has occurred over the past few years. The greenback remains king for now—the world's unchallenged world reserve currency, accounting for 61.8% of global central bank reserves as of the third quarter of 2019, according to the International Monetary Fund. For second-place euro, the currency's share of central bank holdings declined from 28.0% in mid-2009 to 20% in Q3 2019. ***Investment implications: The global economy still pivots around the greenback, an "exorbitant privilege" for the United States and U.S. investors.***

Finally, the U.S. still ranks as one of the most competitive economies in the world. According to the IMD World Competitiveness Rankings of 2021, the U.S. ranked tenth overall, trailing smaller economies like Switzerland, Sweden and Denmark. Meanwhile, the U.S. ranked second in the latest competitiveness survey from the World Economic Forum. Only Singapore ranked higher. ***Investment Implications: Competitiveness matters—and the U.S. is positioned to remain among the world's most competitive economies. Hence, our overall asset allocation preferences remain U.S.-centric.***

[3] See "U.S. Defense Spending Compared to other countries," Peter G. Peterson Foundation, May 13, 2020.

Exhibit 4 visually captures and reflects all of the above. While America is hardly perfect and confronts a number of challenges in the decade ahead, U.S. equities are currently out front when it comes to the potential to generating 'long-term' returns for investors. Consider staying long U.S. equities.

Exhibit 4: Distribution of S&P 500 returns since 1928.



*Data for first half of 2021. Source: Bloomberg. Data as of June 30, 2021. **Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index.** Past performance is no guarantee of future results.

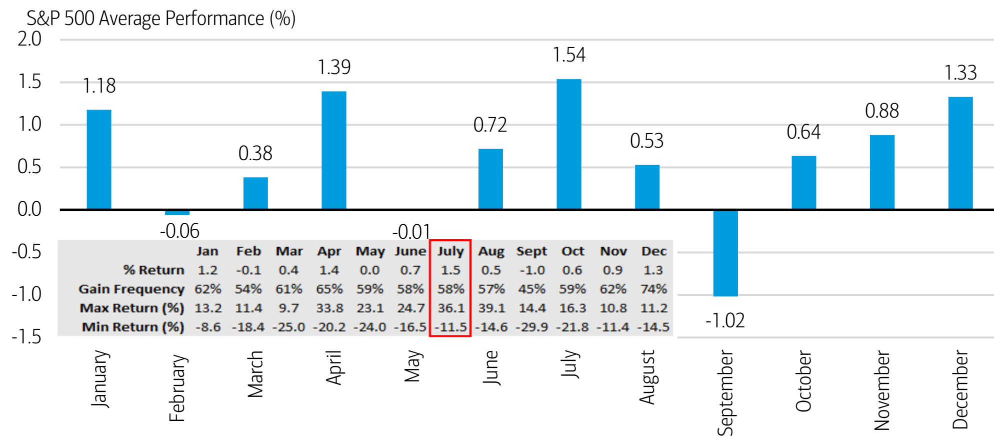
THOUGHT OF THE WEEK

'Tis the Season(ality)

Lauren J. Sanfilippo, Vice President and Investment Strategist

Over a rewarding first half of the year, the S&P 500 ended 14.4% higher riding a fifth consecutive monthly gain. Even given the U.S. equity market's torrid pace over the first half, seasonality suggests the benchmark just entered its strongest month of the year—July. Exhibit 5 shows the seasonality of how the S&P 500 has historically traded, compiling data back to 1930. June typically ushers in a strong bullish seasonality, persisting into and through the month of July, before petering out by fall. The S&P 500 has been positive in July 58% of the time, with an average gain of 1.5%, beating the average of 0.6% return on all months historically.

Exhibit 5: Monthly S&P 500 Seasonality Trend 1930-2021*.



	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
% Return	1.2	-0.1	0.4	1.4	0.0	0.7	1.5	0.5	-1.0	0.6	0.9	1.3
Gain Frequency	62%	54%	61%	65%	59%	58%	58%	57%	45%	59%	62%	74%
Max Return (%)	13.2	11.4	9.7	33.8	23.1	24.7	36.1	39.1	14.4	16.3	10.8	11.2
Min Return (%)	-8.6	-18.4	-25.0	-20.2	-24.0	-16.5	-11.5	-14.6	-29.9	-21.8	-11.4	-14.5

*Data through June 30, 2021. Source: Bloomberg. Data as of June 30, 2021. Past performance is no guarantee of future results.

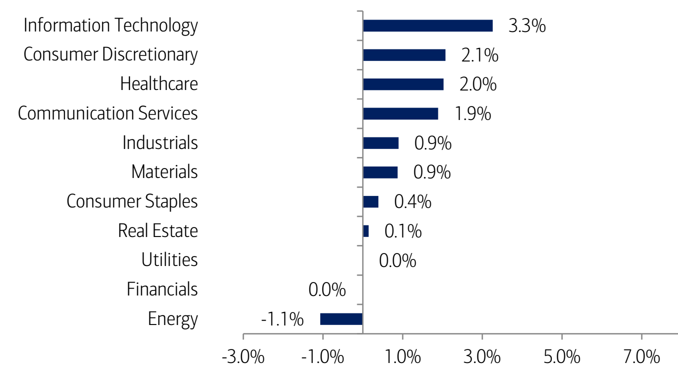
Another simple average to consider: The S&P, on average, experiences three 5% pullbacks a year, and yet the last pullback of at least 5% (-7.5%) was October 2020. Still, this market and economic cycle, charting the biggest drop, shortest recession, and sharpest rebound was certainly "nuanced," making any historical context for the economy or markets less of a guide. Aside from historical tendencies and simple averages, our core investment thesis centers on fundamentals in the market and the broader economic picture, which we believe remains supportive for equity markets. Second-quarter earnings season comes into focus later in July, with consensus estimates for full-year S&P 500 earnings growth of 35% and 12% revenue growth according to FactSet. While risks such as a Fed policy error, persistent inflation and coronavirus variants loom, we continue to believe the portfolio strategy of the first half will continue to play out over the balance of the year. We consider the economically sensitive areas and value segment of the market, but also growth factors to benefit from the cyclical and secular forces at play. We expect the major U.S. indexes to grind higher over the near term based on several tenants of the first-half run: stronger-than-expected real GDP growth, red-hot consumer spending, above-consensus earnings growth and a measured global immunization rollout. We remain constructive toward Financial, Industrial and Energy segments, and remain long-term bullish on Technology and Healthcare. On broad equity market weakness and depending on cash position and target equity levels, we'd look to leg into our favored areas.

MARKETS IN REVIEW

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	34,786.35	1.1	0.9	14.8
NASDAQ	14,639.33	2.0	6.5	14.0
S&P 500	4,352.34	1.7	3.7	16.7
S&P 400 Mid Cap	2,709.57	-0.6	-0.5	18.2
Russell 2000	2,305.76	-1.2	1.7	17.3
MSCI World	3,046.09	0.7	2.5	14.1
MSCI EAFE	2,315.50	-1.1	-0.7	9.3
MSCI Emerging Markets	1,355.38	-1.7	-1.2	6.0

S&P 500 Sector Returns



Fixed Income†

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	1.39	0.67	1.17	-1.81
Agencies	0.77	0.28	0.20	-0.71
Municipals	1.01	0.21	0.36	1.14
U.S. Investment Grade Credit	1.49	0.54	0.83	-1.48
International	2.04	0.81	1.79	-1.11
High Yield	3.69	0.46	1.54	3.82

	Current	WTD	MTD	YTD
90 Day Yield	0.04	0.04	0.00	0.06
2 Year Yield	0.23	0.27	0.14	0.12
10 Year Yield	1.42	1.52	1.59	0.91
30 Year Yield	2.04	2.15	2.28	1.64

Commodities & Currencies

	Total Return in USD (%)			
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	202.79	2.7	2.3	21.7
WTI Crude $/Barrel††	75.16	1.5	13.3	54.9
Gold Spot $/Ounce††	1787.3	0.3	-6.3	-5.8

Currencies	Current	Prior Week End	Prior Month End	2020 Year End
EUR/USD	1.19	1.19	1.22	1.22
USD/JPY	111.05	110.75	109.58	103.25
USD/CNH	6.47	6.46	6.37	6.50

Sources: Bloomberg, Factset. Total Returns from the period of 6/28/2021 to 7/2/2021. †Bloomberg Barclays Indices. ††Spot price returns. All data as of the 7/2/2021 close. **Past performance is no guarantee of future results.**

Asset Class Weightings (as of 6/1/2021)

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					

*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 7/2/2021)

	Q4 2020A	2020A	Q1 2021A	Q2 2021E	Q3 2021E	Q4 2021E	2021E
Real global GDP (% y/y annualized)	-	-3.2	-	-	-	-	6.1
Real U.S. GDP (% q/q annualized)	4.3	-3.5	6.4	10.0*	9.0	5.0	7.0
CPI inflation (% y/y)	1.2	1.2	1.9	4.7*	4.7	4.6	4.0
Core CPI inflation (% y/y)	1.6	1.7	1.4	3.6*	3.9	3.9	3.2
Unemployment rate (%)	6.7	8.1	6.2	5.9	5.4	4.6	5.5
Fed funds rate, end period (%)	0.09	0.09	0.06	0.08	0.13	0.13	0.13

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 July 2, 2021.

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S&P 500 Total Return 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.

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All 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.

Asset allocation, diversification and rebalancing do not ensure a profit or protect against loss in declining markets.

Investments have varying degrees of risk. Some of the risks involved with equity securities include the possibility that the value of the stocks may fluctuate in response to events specific to the companies or markets, as well as economic, political or social events in the U.S. or abroad. Treasury bills are less volatile than longer-term fixed income securities and are guaranteed as to timely payment of principal and interest by the U.S. government. Investments in foreign securities involve special risks, including foreign currency risk and the possibility of substantial volatility due to adverse political, economic or other developments. These risks are magnified for investments made in emerging markets. Investments in a certain industry or sector may pose additional risk due to lack of diversification and sector concentration. There are special risks associated with an investment in commodities, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and the impact of adverse political or financial factors. Investing in fixed-income securities may involve certain risks, including the credit quality of individual issuers, possible prepayments, market or economic developments and yields and share price fluctuations due to changes in interest rates.

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