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CHIEF INVESTMENT OFFICE

Capital Market Outlook

August 10, 2020

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

IN THIS ISSUE

- **Macro Strategy**—While a synchronized global expansion has begun, fueled by the end of economic shutdowns and aggressive policy stimulus around the world, the degree of recovery in different regions varies quite a bit. Europe has lagged behind in this process but now appears to be in position to catch up. This is supporting European equities.
- **Global Market View**—Social distancing-cum-limited human contact as the new COVID-19 normal means increased demand for, and the acceleration of, the adoption of robots and automation. All of which are part of the coming boom in service robots in particular, and the beginning of a long cycle for the likes of Flippy, Sally, Neo and others.
- **Thought of the Week**—The U.S. dollar has reversed course since peaking in March, reflecting improved prospects for global economic growth and potentially an investor pivot toward cyclicality. U.S. dollar weakness will likely not put the global reserve currency status in jeopardy, given its prominent role in the global financial order. Downward pressure on the greenback could provide tailwinds for corporate earnings.
- **Portfolio Considerations**—We believe we are in the early stages of another long-term bull market (one with higher-than-average valuation, slightly elevated volatility and lower rates for longer) and remain highly favorable on equities relative to fixed income and cash.

MACRO STRATEGY

Chief Investment Office Macro Strategy Team

GLOBAL MARKET VIEW

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Managing Director and
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THOUGHT OF THE WEEK

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Data as of 8/10/2020, and subject to change.

MACRO STRATEGY

Europe Poised to Catch Up

Chief Investment Office Macro Strategy Team

The performance of economies around the world in 2020 has been heavily influenced by the course of the pandemic and the national policy responses to it. Countries have tried different approaches to controlling their coronavirus outbreaks and different amounts of monetary and fiscal support to stimulate their economies.

Despite these differences, the broad patterns of recovery that have emerged around the world share some common features. First, a severe shutdown to contain the initial outbreak and learn how to better control its effects was tried in most places, with Sweden a notable exception. China was the first affected country, experiencing the shutdown about three months ahead of the U.S. and Europe. Its first-quarter gross domestic product (GDP) growth plunged at about a 30% rate before growth resumed in the second quarter when the economy reopened, making it about three months ahead of the rest of the world in this new expansion. Europe and the U.S. experienced their

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big hits to GDP in the second quarter, during the initial shutdown phase. U.S. GDP, like China's, plunged about 30%, while Europe's dropped about 40% at an annual rate.

The relatively worse second-quarter performance in the Eurozone reflects the more widespread and severe initial outbreak as well as the generally stricter shutdown response and, importantly, a less aggressive monetary and fiscal response. In contrast, the U.S. outbreak was initially concentrated in a narrower region of the country, predominantly from New York City to Boston on the East Coast, which experienced fatality rates several times worse than those in the rest of the country and about double those in Europe's worst hit countries like Belgium, Spain and Italy. Sweden, which avoided a shutdown, has had a lower fatality rate than all of these countries and states (Exhibit 1).

Once cases subsided in the hard-hit U.S. states, reopening began in May and the second-wave outbreak began in the Southern states, which initially were much less affected by the virus. Still, these states benefited from the lessons learned during the shutdown phase and have continued the reopening process with focused dial-backs to contain regional flare-ups. The key point here, as Federal Reserve (Fed) Chair Jerome Powell noted in his recent post-Federal Open Market Committee (FOMC) meeting press conference on July 29, is that "social distancing measures and fast reopening of the economy actually go together. They're not in competition with one another…"

Exhibit 1: Despite Continued Case Growth Fatality Data Improved Relative To March/May Outbreaks (fatalities per million people).

States		
Mainly First Wave March–May	NJ	1792
	NY	1685
	MA	1252
	CT	1243
	RI	951
Mainly Second Wave June–Aug 2	FL	330
	CA	237
	AZ	517
	TX	251

Countries		
Mainly First Wave March–May	Belgium	849
	UK	680
	Spain	608
	Italy	581
	Sweden	568
	U.S.*	477
	France	464
	Germany	110

* U.S. more mixed first- and second-wave cases. Fatalities mainly in first Wave (75%).
Source: Worldometer.info. Data as of August 2, 2020.

While reopening is proceeding everywhere, it has been slowed down recently by the FCAT (Florida, California, Arizona and Texas) outbreaks, as evident, for example, in the recent backup in unemployment filings. Importantly, however, the second wave of coronavirus cases in the FCAT states appears to be leveling off, just as the first wave did after rising to a peak in about six weeks, and fatalities seem to be following with about a two-week lag. Although the case count has been much higher in this second wave, the fatality rates in the FCAT states remain about 20% of those during the first-wave outbreak concentrated in the tri-state region around New York City (Exhibit 1). Still, the first-wave regions are less hampered in the reopening process, while FCAT states have had to slow their reopenings to address their delayed case surge.

Most of Europe experienced the outbreak coincident with the first wave in the U.S. and therefore has avoided the big case surges seen recently in the FCAT states. With a more widespread and intense infection wave than in the FCAT region initially but much more muted in the reopening phase, presumably because the first-wave regions are closer to herd immunity than regions that were spared in the first wave, Europe has gone from being slower to reopen to relatively faster recently.

The more intense first-wave impact in Europe compared to the U.S. arguably explains part of its bigger second-quarter GDP decline. Perhaps just as significant is the different policy response in the U.S. compared to the European Union (EU). Both fiscal and monetary policy have been much more timely and aggressive in the U.S. than in the Eurozone, which has been hamstrung by the absence of a unified fiscal authority. Individual European countries had to do what they could given the bloc's constraints on national budgets. This "every country for itself" approach helped fill some of the void created by the shutdowns, but it was much more limited than the U.S. fiscal surge, which managed to replace lost wages in real time to such a complete extent that this was the first recession in history with rising disposable personal income.

The bigger U.S. income-replacement policy has supported consumer spending and is a major reason why the loss of consumer confidence has been more muted in this recession compared to the 2008/2009 Great Financial Crisis, when the income losses were severe and unemployment was seen as more lasting. The fiscal response in that episode was passed in dribs and drabs over years. This time, unprecedented income replacement happened in real time to such an extent that a University of Chicago study estimates that almost 70% of unemployed workers were receiving more while unemployed than they were making while working before the pandemic.

This massive front-loaded U.S. fiscal thrust stands in sharp contrast to the more delayed EU fiscal response. Recognizing the shortcomings of their fiscal effort, EU leaders finally agreed to create an EU-wide borrowing facility, something that Germany and other Northern European countries had resisted for decades. The large, newly approved fiscal support will be released over the next few years. As a result, despite a harder initial pandemic experience and weaker policy response to date, the EU is looking at a future with more widespread fiscal support and less restraints from the pandemic, at least as it appears now.

These positive developments have caused a major technical breakout of the Euro from about 1.08 dollars per euro before the pandemic to just shy of 1.20 recently. Indeed, before this new fiscal authority, there was a widespread view that the Euro could not last as a viable currency given the high risk that long-suffering southern members might decide that the cost of being a Eurozone member outweighed the benefits. As hard-hit southern member states will benefit disproportionately from the new EU fiscal stimulus, that risk has considerably diminished. The reduced risk of a Euro breakup is a powerful force for a stronger currency and a stronger European and global economy.

Perhaps equally important as the Euro's newfound strength is the more general weakening of the dollar against most other currencies. The strong dollar of the past decade was the direct result of relatively stronger U.S. growth and higher U.S. interest rates. The Fed had more scope to cut rates in response to the global shutdown recession, and policymakers have made it clear that they plan to "err on the side of ease" for the indefinite future. This abundant liquidity is typical in the early stage of a new business recovery.

In short, both recent U.S. and European developments favor a stronger Euro and relatively better Eurozone growth. While the U.S. equity market has generally outperformed over the past decade, we may be witnessing a major shift with EU equities now able to hold their own.

GLOBAL MARKET VIEW

Long Flippy, Sally, Neo and Others Like Them

Joseph Quinlan, Managing Director and Head of CIO Market Strategy

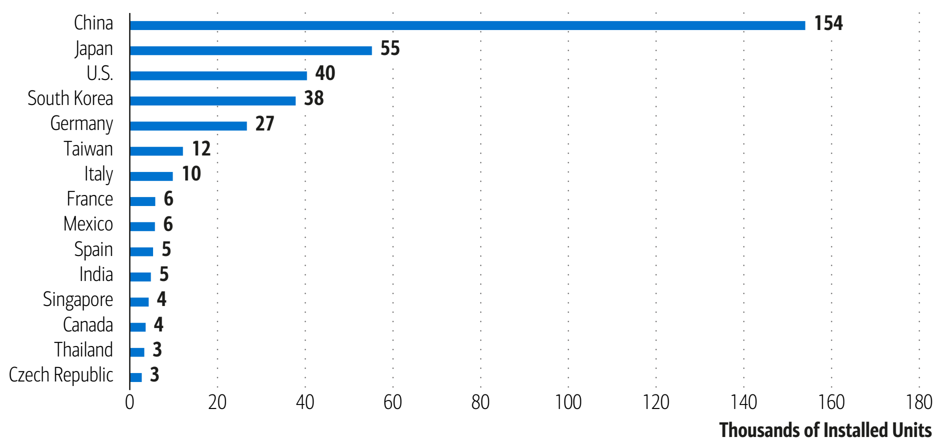
"As COVID-19 impacts every aspect of our work and life, we have seen two years' worth of digital transformation in two months." —Satya Nadella, CEO of Microsoft Corp, (April 29, 2020)

Well into the pandemic of 2020, it is increasingly clear that coronavirus will accelerate the adoption of robots and robotics automation. The new normal—social distancing-cum-limited human contact—means increased demand for the services of Flippy, Sally and Neo and others like them. Flippy—go figure—flips hamburgers and cooks French fries; Sally makes customized salads, and Neo spends days scrubbing and disinfecting hospital floors. They are all part of the coming boom in service robots in particular and the secular march of machines in general.

While the global recession and attendant decline in capital spending weakened global robot shipments in the second quarter, long-term growth dynamics remain promising.

Even the most mature part of the robotics market—industrial robots—is positioned for an upturn in growth owing to de-globalization and the ensuing reconfiguration of global supply chains. A more fragmented world means more duplication of supply chains and more "reshoring" of production, which translates to more demand for capital spending, including robots. Another tailwind to robotic growth: the greater dispersion of global demand. To this point, in 2018, just five nations (China, the United States, Japan, Germany and South Korea) accounted for 74% of global robot installations (see Exhibit 2). This concentration of demand, however is expected to decline as more companies in other parts of the world embrace robots in the face of declining labor force participation rates, rising wages and restrictive immigration policies.

Exhibit 2: Annual Installations of Industrial Robots: 15 Largest Markets.

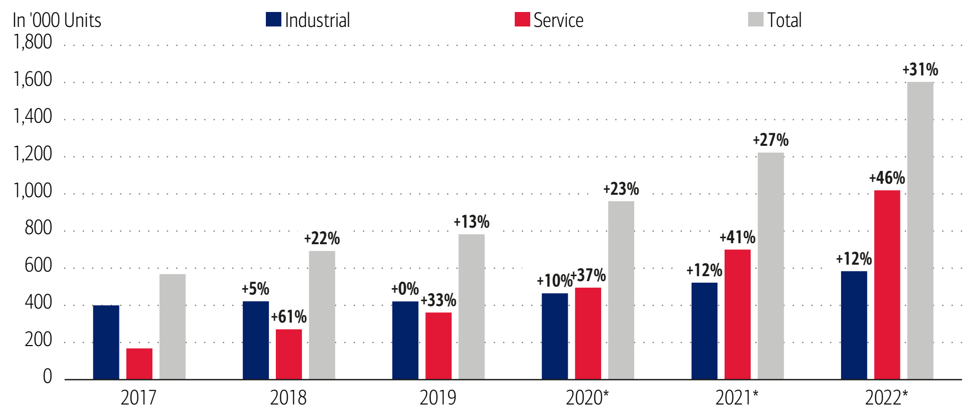


Source: International Federation of Robotics. Data as of September 2019.

In addition, the largest users of industrial robots are the automotive and electrical/electronic sectors, which combined, accounted for 60% of all global demand for industrial robots in 2018. Yet as other manufacturers (e.g., the meat packing industry, plastics and chemicals, food and beverages) adjust their factory floors/configurations in the post-pandemic world, demand for industrial robots is expected to expand beyond traditional users.

Demand for robots like Sally and Neo will be even stronger. Albeit from a low base, sales of professional service robots have soared over the past few years, rising 124% in 2017, 61% in 2018 and by an estimated 33% last year according to estimates from the International Federation of Robotics (Exhibit 3). The estimated pre-pandemic growth of 37% for service robots in 2020 is likely to be a conservative estimate given the coronavirus premium on social distancing and less human-to-human contact, and hence the soaring demand for service robots.

Exhibit 3: Annual and Projected Global Robot Unit Sales for Enterprise Use (2016–2022*).



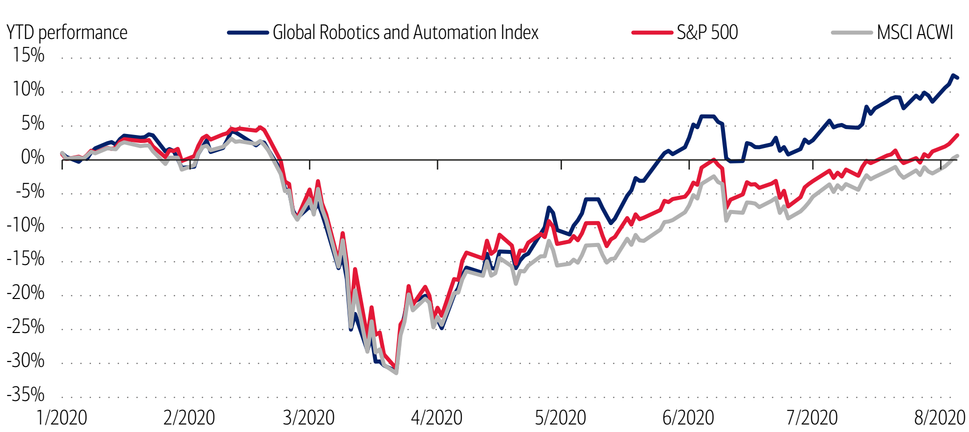
*Estimates. Note: Does not include consumer service robots. Percentages above columns denote annual growth rates. Source: International Federation of Robotics. Data as of September 2019.

Recent demand for robots has been particularly strong in healthcare and retail, or two sectors where person-to-person contact has been significantly altered and constrained by the pandemic. Robots are being used to disinfect entire hospitals, handle biohazardous medical waste, sort and distribute lab results, and deliver food and medical supplies to those in need. Many of these functions are considered high-risk activities to humans, notably during a pandemic. But the more service robots are deployed, the safer and healthier the workforce, and the lesser the risks of spreading coronavirus.

Service robots are also stocking shelves for retailers, in addition to tracking inventories, package orders and delivering shipments. Both food processing and fast-food enterprises are turning to service robots as contact-free alternatives, driving increased sales of service robots. Ditto for the recycling industry: Increasingly overwhelmed with more plastic from face masks/shields and medical waste, companies have embraced robots as a safer alternative to humans when it comes to recycling.

In the end, we are just at the beginning of a long cycle for service robots. The pandemic has accelerated demand for professional robots and cobots, and pulled forward many key trends that were already in place. Anticipating future demand, the Global Robotics & Automation Index has benefited from the increased adoption and varied applications of both robotics and artificial intelligence and has risen 11.6% year-to-date (YTD) against a flat MSCI World benchmark or the S&P 500 3.7% gain YTD (Exhibit 4).

Exhibit 4: Bots are Beating S&P 500 and MSCI ACWI.



Source: Bloomberg. Data as of August 7, 2020. **Past performance is no guarantee of future results.** Short-term performance shown to illustrate more recent trend.

Despite Weakness, the U.S. Dollar Remains Solid

Kirsten Cabacungan, Investment Analyst

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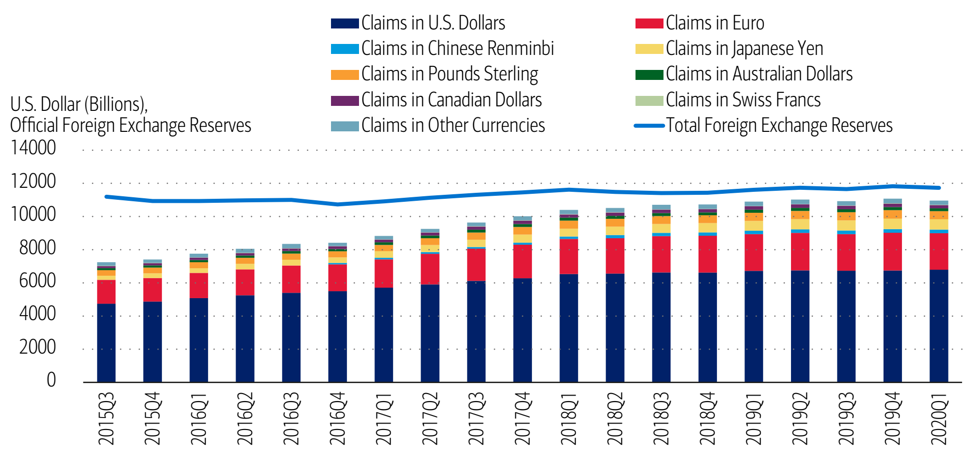
During the throes of market chaos in March, the dollar strengthened as investors sought out less risk. The U.S. dollar has since reversed course, falling roughly 10% and moving to a two-year low in July, as a global recovery is underway, while the U.S. still lags in coronavirus curve suppression. Europe, for example, has reduced their case count more successfully, while a landmark pandemic stimulus response has improved sentiment toward the bloc with investment flows following. The Euro has appreciated from 1.07 this March versus the dollar to a current exchange rate of 1.18, reflecting a flow of capital to a region gaining in relative attractiveness. This is also beginning to reflect in equity performance, as European equities are beginning to perform more in line with the U.S. after lagging considerably over the past decade.

Dollar weakness often raises concern regarding the viability of the U.S. dollar as the global reserve currency, especially within the context of China's rise. However, despite China's efforts to establish the Renminbi (RMB) on the global stage, the dollar continues to dominate, representing roughly 62% of official foreign exchange reserves. For context, the Euro commands 20%, and the RMB represents only 2% (Exhibit 5). In fact, the reliance of the dollar has been shown to actually increase during periods of chaos as seen during the recent pandemic when the Fed offered currency lines to foreign central banks to satisfy demand for the greenback. To overturn the dollar's dominance would require a massive reconfiguration of the financial order, a viable competitor, and would likely take several years to complete.[1]

In our view, the recent trajectory of the dollar reflects lower real yields in the U.S. and signals improved prospects for global growth, leading to geographical diversification of investment capital toward more cyclical markets. Longer term, the prominence of the dollar does not appear suspect. From a tactical perspective, weakness in the U.S. dollar could provide tailwinds for corporate earnings growth, boosting international sales to foreign markets.

Exhibit 5: The U.S. Dollar Has Maintained Its Market Share of Foreign Exchange Reserves.



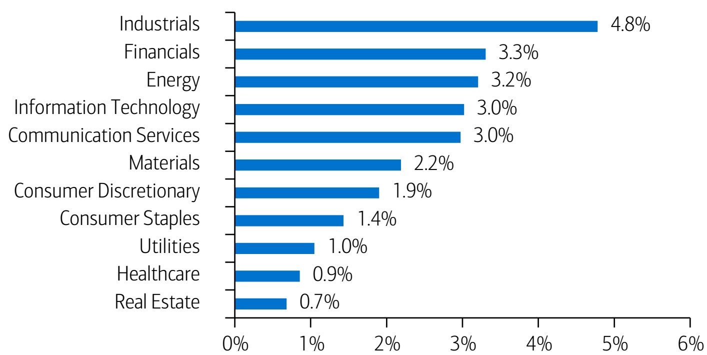
Source: International Monetary Fund. Data as of August 2020.

[1] Absolute Strategy Research, "Can the RMB depose the USD as reserve currency?" January 2018.

Equities

		Total Return in USD (%)		
	Current	WTD	MTD	YTD
DJIA	27,433.48	3.9	3.9	-2.5
NASDAQ	11,010.98	2.5	2.5	23.4
S&P 500	3,351.28	2.5	2.5	4.9
S&P 400 Mid Cap	1,938.53	4.0	4.0	-5.1
Russell 2000	1,569.19	6.0	6.0	-5.2
MSCI World	2,355.97	2.2	2.2	1.0
MSCI EAFE	1,855.12	2.0	2.0	-7.5
MSCI Emerging Markets	1,089.32	1.0	1.0	-0.7

S&P 500 Sector Returns



Fixed Income[1]

		Total Return in USD (%)		
	Current	WTD	MTD	YTD
Corporate & Government	1.04	0.1	0.1	9.5
Agencies	0.51	-0.1	-0.1	5.5
Municipals	1.13	0.5	0.5	4.3
U.S. Investment Grade Credit	1.03	0.1	0.1	7.8
International	1.82	0.4	0.4	8.9
High Yield	5.31	0.6	0.6	1.3

	Current	Prior Week End	Prior Month End	2019 Year End
90 Day Yield	0.09	0.08	0.08	1.54
2 Year Yield	0.13	0.11	0.11	1.57
10 Year Yield	0.56	0.53	0.53	1.92
30 Year Yield	1.23	1.19	1.19	2.39

Commodities & Currencies

		Total Return in USD (%)		
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	150.34	2.6	2.6	-12.6
WTI Crude $/Barrel[2]	41.22	2.4	2.4	-32.5
Gold Spot $/Ounce[2]	2,035.55	3.0	3.0	34.2

Currencies	Current	Prior Week End	Prior Month End	2019 Year End
EUR/USD	1.18	1.18	1.18	1.12
USD/JPY	105.92	105.83	105.83	108.61
USD/CNH	6.97	6.99	6.99	6.96

Source: Bloomberg, Factset.Total Returns from the period of 08/03/20 to 08/07/20. Bloomberg Barclays Indices.[1] Spot price returns.[2] All data as of the 08/07/20 close.
Past performance is no guarantee of future results.

Asset Class Weightings (as of 8/4/2020)

	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*	see CIO Asset Class Views				
Hedge Funds					
Private Equity					
Real Assets					
Cash					

* Many products that pursue Alternative Investment strategies, specifically Private Equity and Hedge Funds, are available only to pre-qualified clients.

Economic and Market Forecasts (as of 08/07/20)

	Q3 2019A	Q4 2019A	2019A	Q1 2020A	Q2 2020A	2020E
Real global GDP (% y/y annualized)	–	–	2.9	–	–	-4.2
Real U.S. GDP (% q/q annualized)	2.1	2.1	2.3	-5.0	-32.9	-5.6
CPI inflation (% y/y)	1.8	2.0	1.8	2.1	0.4	1.0
Core CPI inflation (% y/y)	2.3	2.3	2.2	2.2	1.3	1.4
Unemployment rate (%)	3.6	3.5	3.7	3.8	13.0	9.0
Fed funds rate, end period (%)	1.90	1.55	1.55	0.08	0.08	0.13
10-year Treasury, end period (%)	1.66	1.92	1.92	0.67	0.66	1.00
S&P 500 end period	2977	3231	3231	2585	3100	2900
S&P earnings ($/share)	42	42	163	33	25*	115
Euro/U.S. dollar, end period	1.09	1.12	1.12	1.10	1.12	1.08
U.S. dollar/Japanese yen, end period	108	109	109	108	108	103
Oil ($/barrel, avg. of period, WTI**)	56	57	57	46	29	40

The forecasts in the table above are the base line view from BofA Global Research team. 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.

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 2020. **West Texas Intermediate.
Sources: BofA Global Research; GWIM ISC as of August 7, 2020.

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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 dollars.

S&P 500 is a stock market index that tracks the stocks of 500 large-cap U.S. companies. It represents the stock market's performance by reporting the risks and returns of the biggest companies.

Global Robotics & Automation Index is an equity benchmark designed to track the performance of companies that are focused on developing and productizing hardware and software products related to robotics and automation.

MSCI ACWI is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world.

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