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CHIEF INVESTMENT OFFICE

Equity Spotlight

The State of International Equities and Equity Markets Signaling the "Shifting Plates"

April 2022

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

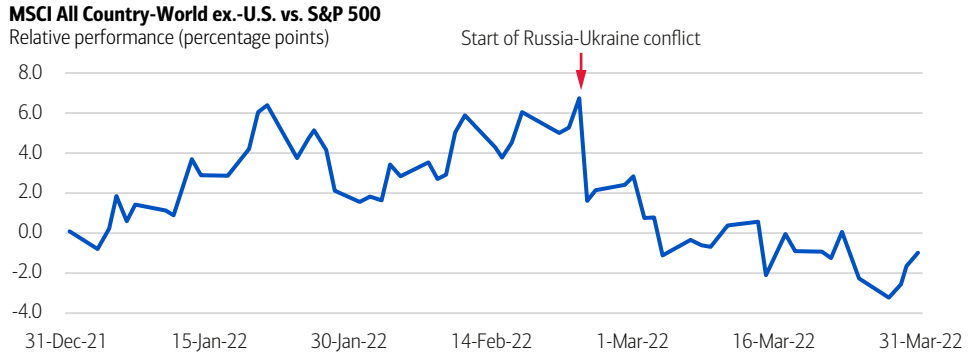
IN BRIEF

- **The State of International Equities:** We still see a range of near-term hurdles that keep us tactically neutral in both International Developed and Emerging Markets, and we retain our preference for U.S. Equities in the current environment.
- **Equity Markets Signaling the "Shifting Plates":** Equities are currently supported by positive macroeconomic fundamentals and remain one of the most attractive asset classes for investors on a relative basis, but as we move into the late-cycle environment, volatility will remain elevated, and shifting fundamentals may require some asset allocation changes.

THE STATE OF INTERNATIONAL EQUITIES

International Equities led U.S. markets for much of a volatile first quarter of 2022. Rising interest rate risk dragged Equity markets lower on a global basis in January and February, but non-U.S. Equities were relatively insulated from the repricing due to their lower weightings in the most richly valued Growth sectors such as Information Technology and Communication Services. The MSCI All-Country World ex-U.S. Index had established a return advantage of seven percentage points over the S&P 500 by late February, but international market outperformance has since reversed in the wake of the Ukraine/Russia conflict (Exhibit 1).

Exhibit 1: Non-U.S. Equity Markets Have Underperformed Since the Start of the Ukraine/Russia Conflict.



Source: Bloomberg. Data as of March 31, 2022. Performance results are extremely short term and do not provide an adequate basis for evaluating performance potential over varying market conditions or economic cycles. **Past performance is no guarantee of future results. See Index Definitions at the end of this report.**

CIO ASSET CLASS VIEWS

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	•	•	●	•	•

Source: Chief Investment Office as of April 5, 2022. CIO asset class views are relative to the CIO Strategic Asset Allocation (SAA) of a multi-asset portfolio.

CIO EQUITY SECTOR VIEWS

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

Source: Chief Investment Office as of April 5, 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.

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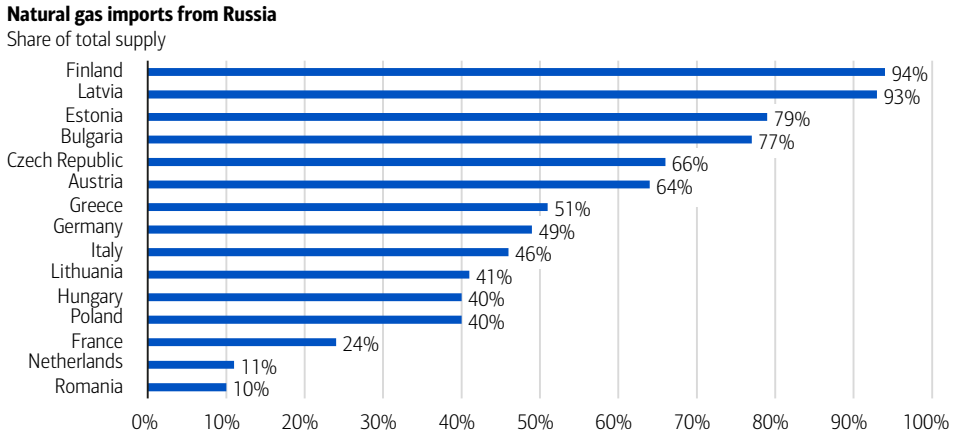
Asset freezes, export controls, limited access to dollar funding, restrictions on international payments, and other financial and trade sanctions are likely to leave the Russian economy isolated from the international system for a prolonged period. And in the new environment, we expect most non-U.S. markets to remain relative underperformers. The main consequence for investors is likely to be the effect of the conflict on natural resource prices given the significant role played by both Russia and Ukraine in the global supply of oil and natural gas, as well as metals like nickel and palladium, and agricultural commodities such as wheat and corn.

Markets closest to the crisis epicenter—especially those that import a significant share of their energy consumption from Russia—are likely to remain more vulnerable than markets in the rest of the world. As a result, we remain particularly cautious on European Equities in the current environment. At just under $300 billion in 2021, European Union trade exposure to Russia stands at around 12 times that of the U.S. economy. And within the European market, the Consumer Discretionary and Financial sectors have been hard hit by rising energy prices and bank exposure to Russian assets, particularly in Central and Eastern European markets such as Poland and Hungary. Looking forward, the Baltic states, as well as large natural gas importers in Western Europe such as Germany and Italy, are also likely to face major challenges to corporate profitability and real household incomes given their high exposure to Russian gas (Exhibit 2).

Exhibit 2: European Economies Highly Exposed to Russian Natural Gas Imports.



Sources: European Union Agency for the Cooperation of Energy Regulators; Statista. Data as of March 2022.

By contrast, Latin American Equities along with other commodity producers in Africa and the Middle East, have been significant outperformers relative to global markets in 2022. Though they account for a relatively small share of the non-U.S. Equity universe, markets like Chile and Peru have close to 40% weightings in the Materials sector. Colombia and South Africa have around 30% weightings in Energy and Mining, respectively. And while Gulf States like Saudi Arabia and Qatar have less direct market exposure to natural resources, their underlying economies should continue to benefit from improved terms of trade in oil and natural gas. A renewed focus on energy security in Europe and elsewhere is also likely to accelerate longer-term plans to increase capacity in alternative energy for power and transportation. And the resource-intensive nature of this required buildout in clean energy infrastructure should further support regions most exposed to base and precious metals.

Alongside European markets, Asia has also been an underperformer this year. The few commodity exporters in the region, such as Indonesia and Malaysia, have been outliers. But large resource-importers such as China, Korea and Taiwan have been set back by the rise in energy, food and metals prices, in addition to their significant market exposure to Technology-oriented sectors. Governments across the region are also being forced

PORTFOLIO CONSIDERATIONS

Our overall portfolio strategy continues to be on guard, but we remain overweight Equities relative to Fixed Income. We continue to prefer sectors that are most likely to benefit from Real Asset growth and increasing free cash flow, such as Energy, Materials and Mining. Given the geopolitical realities of our times, we also favor exposure to defense and cybersecurity on a thematic basis, and continue to favor U.S. Equities relative to the rest of the world.

to divert public spending away from investment and toward food and energy subsidies, further undermining public budgets that are yet to fully recover from the pandemic.

Outside the spillovers from the conflict, emerging Asia has also been driven by extreme volatility in the heavyweight Chinese market, which still accounts for an outsized 40% of regional market capitalization, according to Statista. A resurgent coronavirus, weakness in the real estate market and ongoing regulatory pressures have been major headwinds for China and are likely to remain an intermittent challenge as we move deeper into the year. New coronavirus cases in China have reached their highest levels since initial outbreak, rising to more than 20,000 per day in early April and causing local authorities to impose either partial or full shutdowns in at least 70 cities. Policy tightening measures targeted at the Real Estate sector over recent years have put constraints on leverage for both developers and homebuyers. And while the government appears committed to limiting the economic downside for the sector, slower activity in construction and related services will continue to weigh on local growth. Despite calls from the Chinese vice-premier for the government to "actively introduce policies that benefit markets," we also expect periodic state intervention in selected Chinese industries to continue in the pursuit of social stability.

A further risk to watch internationally will be capital outflows as the Federal Reserve (Fed) continues to raise policy rates. In past cycles, Fed interest rate hikes have been a major hurdle for Emerging Market assets in particular. But while individual countries with the weakest balance of payments positions will be most at risk, Emerging Markets as a whole should be relatively well insulated in aggregate given that around 75% of their market capitalization today is in economies with a current account surplus.

On the valuation front, price-to-earnings (P/E) multiples remain well below their long-term averages for Europe, Japan and Emerging Markets, particularly relative to U.S. Equities. This should help to enhance prospective returns for international markets over time. But we still see a range of nearer-term hurdles for non-U.S. markets, particularly from natural resource price pressures, weakened fiscal positions, domestic headwinds in China and tightening Fed policy. These vulnerabilities keep us tactically neutral in both International Developed and Emerging Markets, and we retain our preference for U.S. Equities in the current environment.

EQUITY MARKETS SIGNALING THE "SHIFTING PLATES"

Equity market messaging has been mixed this year. The S&P 500 proved resilient in Q1, ending the quarter up nearly 10% since its max drawdown in mid-March, according to Bloomberg, but dispersion below the index level has widened and leadership has continuously shifted. In our view, Equities are currently supported by positive macroeconomic fundamentals and remain one of the most attractive asset classes for investors on a relative basis, but as we move into the late-cycle environment, volatility is expected to remain elevated and shifting fundamentals may require some asset allocation changes.

The Equity market pullback in Q1 was largely driven by a contraction in P/E multiples, as annual earnings expectations for the S&P 500 gradually rose throughout the quarter. Value-oriented inflation beneficiaries with exposure to Real Assets and Commodities fared best during this time. Energy ended Q1 up around 40%, and related industries like Oil & Gas and Metals & Mining logged double-digit returns. Growth-oriented Equities generally underperformed Value amid higher rates with Information Technology ending the quarter down -9%, according to Bloomberg. These moves were largely influenced by tightening financial conditions, mounting inflation concerns, and a continuation of the cyclical/Value-driven uptrend that gathered steam in 2021.

DID YOU KNOW?

- Equity ETFs saw inflows of +$154B in Q1, marking the second-best start to a calendar year.[1]
- German yields surged the most in Q1 since 1994.[2]
- While upward earnings revisions have cooled, Energy, Real Estate and Technology all recorded an increase in their bottom-up earnings per share estimate for Q1 2022.[3]

[1] Strategas. 4/5/2022.

[2] Bloomberg. 3/31/2022.

[3] Factset. 4/1/2022.

But some of the most beaten-down areas of the market clawed back losses in a late-quarter rally. Small-caps bounced on heightened geopolitical turmoil, leading Small-cap Value to outpace Large-cap Core for the quarter. Meanwhile, defensive sentiment slowly gathered steam—Utilities and Consumer Staples are now leading sectors on a year-to-date basis. Cyclical sectors have started to waver, with bank stocks lower by -10% for the year, even as rates have increased. In our view, these dynamics are indicative of the beginning stages of a late-cycle, where investor behavior is typically unsure between bottom fishing for recent laggards or seeking capital perseveration of the most defensive sectors.

The recent moves higher in certain areas of the market were likely in part driven by individual investors and dip-buyers. Retail investors were net purchasers of stocks for all but one week in Q1, and dip-buyers emerged throughout the quarter when stocks were trading at a perceived discount to help cap losses—data shows that their buying of the Q1 dip was more aggressive than all other 10% pullbacks post financial crisis.[4] We see a number of reasons for the individual investor's pervasive enthusiasm for Equities. Valuations became less extended in Q1, creating a more attractive entry point, and projections for corporate profit growth remained strong. Investors may have also been encouraged by a number of contrarian short-term trading "buy" signals that were reached during the quarter—American Association of Individual Investors bearish sentiment exceeded its historical average, the Chicago Board Options Exchange (CBOE) Volatility Index (VIX) spiked above 30, and the BofA Bull & Bear Indicator fell to 2.0.

Meanwhile, a variety of macroeconomic data reinforced the view that Equities remain well supported by a strong domestic economy, though the pace of growth is starting to moderate. Consumers have largely been able to shrug off multidecade-high inflation. U.S. manufacturing growth remains in expansionary territory, with the Institute for Supply Management Purchasing Managers' Index at 57.1 in March. The unemployment rate has fallen to 3.8%, and initial jobless claims have dipped below pre-pandemic levels, indicating that the labor-market recovery is strong while also raising concerns about overheating. Company margins have generally held up in the face of higher input costs, but worries about the pace of wage growth have started to mount.

Even as the tides begin to shift, Equities remain one of the most attractive options for investors on a relative basis, as bond market volatility has recently increased, and certain parts of the yield curve have either flattened aggressively or even briefly inverted. This development should be watched closely but does not deter from our Equity overweight for a number of reasons—the 3-month/10-year yield curve is still steep, recession tends to follow inversions with a long and variable lag, and Equities generally move higher after inversion. On average, the S&P 500 rises 11% in 12 months and 16% in 24 months following the inversion of the 2-year/10-year yield curve.[5]

From an investment perspective, investors should continue to monitor spreads, the yield curve, earnings revisions and other indicators to assess the broad economic climate. In the near term, we are likely to remain in a range-bound market with rising bond yields pressuring valuation multiples and an uptrend in corporate earnings supporting Equities.

[4] BofA Securities Equity Client Flow Trends, March 2022.

[5] Chief Investment Office, Bloomberg. March 2022.

Data as of 4/11/2022 for full table					Valuations**									Consensus Earnings Estimates***					
	Performance				P/E (FWD)			P/B			P/S			2021A		2022E		2023E	
Index	1 Month	3 Months	6 Months	1 Year	As of 4/11/2022	20 year Average	Percentile (%)*	As of 4/11/2022	20 year Average	Percentile (%)	As of 4/11/2022	20 year Average	Percentile (%)	Value	% Year-over-Year	Value	% Year-over-Year	Value	% Year-over-Year
S&P 500 Index	5.7%	-5.5%	2.5%	9.3%	18.7	15.7	89	4.3	2.8	96	2.8	1.7	94	208	48%	229	10%	251	10%
NASDAQ 100 Index	5.6%	-11.2%	-4.2%	2.6%	23.3	20.2	72	7.5	4.5	92	4.6	3.1	92	502	38%	537	7%	614	14%
Russell 1000 Total Return (TR)	5.6%	-5.9%	0.6%	6.9%	18.9	16.0	89	4.2	2.7	95	2.7	1.7	94	219	49%	241	10%	265	10%
Russell 1000 Growth TR	5.5%	-10.0%	-4.0%	4.4%	24.9	18.3	91	11.8	5.5	94	4.5	2.3	93	60	33%	67	12%	76	14%
Russell 1000 Value TR	5.6%	-1.7%	5.7%	9.7%	15.3	14.1	74	2.6	1.9	95	1.9	1.3	94	59	59%	65	9%	70	8%
Russell 2000 TR	0.8%	-8.9%	-9.8%	-10.0%	21.5	23.3	40	2.5	2.1	92	1.3	1.1	88	186	166%	234	26%	290	24%
Russell 2000 Growth TR	1.7%	-12.3%	-16.3%	-18.5%	36.2	32.0	84	4.4	3.7	88	1.7	1.5	86	130	299%	180	38%	278	55%
Russell 2000 Value TR	0.0%	-5.6%	-3.1%	-0.9%	15.7	17.9	19	1.8	1.5	86	1.1	0.8	91	477	156%	586	22%	668	14%
MSCI Daily TR Net World Ex USA USD	4.9%	-5.9%	-3.7%	-1.3%	13.0	13.5	33	1.7	1.7	47	1.4	1.4	92	149	52%	161	8%	169	5%
MSCI Europe	7.4%	-3.3%	2.7%	9.4%	12.9	13.0	48	1.9	1.9	58	1.4	1.1	94	135	60%	142	5%	149	5%
MSCI Japan****	7.2%	-3.9%	-3.3%	-0.4%	12.2	15.1	12	1.3	1.4	36	1.0	0.8	87	77	51%	89	16%	94	5%
MSCI Daily TR Net EM USD	4.1%	-8.9%	-10.2%	-13.4%	10.9	11.3	41	1.6	1.7	43	1.3	1.3	59	92	46%	93	1%	101	10%

*Percentile refers to the percentile rank of the current P/E (FWD). **Monitors commonly used valuation ratios (P/E (FWD) = Forward Price/Earnings, P/B = Price/Book, P/S = Price/Sales). Source: Bloomberg. ***Yearly Earnings Per Share (EPS) estimates for indices referenced. A= Actual. E = Estimate. Source: Factset. **** MSCI Japan earnings expressed in Yen. For illustrative purposes only. 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, unless indicated otherwise. Performance during periods of exceptional market conditions should not be expected to be repeated in a normal market environment. Performance results are extremely short term and do not provide an adequate basis for evaluating performance potential over varying market conditions or economic cycles. **Past performance is no guarantee of future results. See Index Definitions at the end of this report.**

The table below provides a rough indication of where the S&P 500 Index's central tendency could be, given various scenarios for EPS in 2023 and price-to-earnings (P/E) ratio multiples. These scenarios are not official price targets and are not meant to signal levels where portfolio actions may always be needed. However, during times of market volatility, it's useful to keep this basic framework in mind when considering whether to incrementally add to or trim risk from portfolios while staying invested in one's strategic asset allocation framework.

S&P 500 SCENARIOS BASED ON FORWARD P/E AND 2023 EPS

Forward P/E (Next 12 months)

2023 EPS	Forward P/E (Next 12 months)				
	18.0x	19.0x	20.0x	21.0x	22.0x
$275	4,950	5,225	5,500	5,775	6,050
$265	4,770	5,035	5,300	5,565	5,830
$255	4,590	4,845	5,100	5,355	5,610
$245	4,410	4,655	4,900	5,145	5,390
$235	4,230	4,465	4,700	4,935	5,170
$225	4,050	4,275	4,500	4,725	4,950
$215	3,870	4,085	4,300	4,515	4,730

For illustrative purposes only. Forecasts are subject to change. Source: Chief Investment Office as of April 5, 2022.

Glossary of Terms

Price-to-earnings (P/E) Forward is a version of the ratio of price-to-earnings that uses forecasted earnings for the P/E calculation.

Earnings per share (EPS) is calculated as a company's profit divided by the outstanding shares of its common stock.

Price Return is what is earned on an investment after accounting for taxes and inflation.

Asset Class Proxies and 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.

Equities/S&P 500 widely regarded as the best single gauge of the U.S. equities market, includes a representative sample of 500 leading companies in leading industries of the U.S. economy.

Chicago Board Options Exchange (CBOE) Volatility Index (VIX) is a calculation designed to produce a measure of constant, 30-day expected volatility of the U.S. stock market, derived from real-time, mid-quote prices of S&P 500® Index (SPX℠) call and put options.

NASDAQ 100/Nasdaq Composite Index is a modified capitalization-weighted index of the 100 largest and most active non-financial domestic and international issues listed on the NASDAQ.

Russell 1000 Total Return (TR) consists of the largest 1000 companies in the Russell 3000 Index. This index represents the universe of large capitalization stocks from which most active money managers typically select.

Russell 1000 Growth TR measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value TR measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values.

Russell 2000 TR measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

Growth/Russell 2000 Growth TR measures the performance of the broad growth segment of the U.S. equity universe. It includes those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values.

Value/Russell 2000 Value TR measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 2000 companies with lower price-to-book ratios and lower expected growth values.

Institute for Supply Management Purchasing Managers' Index is a monthly indicator of U.S. economic activity based on a survey of purchasing managers at more than 300 manufacturing firms.

MSCI All Country World Index (ACWI) is a stock index designed to track broad global equity-market performance.

MSCI All-Country World ex-U.S. Index is a float-adjusted market capitalization index that is designed to measure the combined equity market performance of large- and mid-cap securities in developed and emerging market countries excluding the United States.

MSCI China Index measures large and mid-cap representation across China securities listed on the Shanghai and Shenzhen exchanges

MSCI Daily TR Net World Ex USA USD captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries – excluding the United States. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI Emerging Markets Index is used to measure the financial performance of companies in fast-growing economies around the world.

MSCI Europe is a free-float weighted equity index measuring the performance of Europe Developed Markets.

MSCI Japan Index is a free-float weighted equity JPY Index.

MSCI Daily TR Net EM USD captures large and mid cap representation across 23 Emerging Markets countries and targets coverage of approximately 85% of the free float adjusted market capitalization in each country.

MSCI U.S. Index is designed to measure the performance of the large and mid cap segments of the US market.

S&P 500 Growth Index is a stock index that represents the fastest-growing companies in the S&P 500.

S&P Value Index uses what it calls a "style-attractiveness-weighting scheme" and only consists of stocks within the S&P 500 Index that exhibit strong value characteristics.

S&P 500 Sector and Industry Indices measure segments of the U.S. stock market as defined by GICS® – Information Technology, Health Care, Financials, Consumer Discretionary, Communication Services, Industrials, Consumer Staples, Energy, Utilities, Real Estate, and Materials.

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