MERRILL
A BANK OF AMERICA COMPANY

CHIEF INVESTMENT OFFICE

Viewpoint

The Grinding Recovery

August 2020

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

IN BRIEF

- Global growth continues to grind higher, laying the foundation for a synchronized advance and a new long-term bull market supported by a reflationary triangle of a weaker dollar, lower real yields, and a steeper yield curve.
- This month, we are upgrading International Developed equities, specifically Europe, to neutral as macro conditions have solidified, and structural progress toward a fiscal union is viewed as positive. We continue to emphasize U.S. Large-cap equities, but reduce the magnitude of the overweight. As the recovery advances, we expect both cyclicals and Growth to participate as more diversified performance leadership should begin to develop.
- In addition, we are taking this opportunity to actively rebalance portfolios back to tactical targets given substantial drift over recent months. With the potential for higher volatility accompanying the U.S. presidential election, we view a diversified approach to portfolio strategy as prudent and our move to add global equity exposure and to rebalance to our target weights reflect this.
- Within Fixed Income, we recommend short-duration relative to a stated benchmark, as interest rates are extremely low and may be limited in how much further they can drop. In the taxable space, we continue to prefer Investment-grade corporate bonds.

We continue to move further into five-phases — Liquidity, Bridge or Economic Buffer, Economic Recovery, Pent-Up Demand Cycle and the New Frontier — outlined by our Chief Investment Office in the May 2020 Investment Insights report, *The Great Separation*. We are now in the second part of Phase Three: Economic Recovery. This part of the phase will be a bumpy recovery as state and local economies grapple with new coronavirus outbreaks and pull back on some components of the reopening. This is the phase in which we transition from a sharp V-shaped rebound to a more "grind it out" recovery. We expect this environment to last into year-end before we shift to Phase Four: The Pent-Up Demand Cycle in 2021. At this juncture, we believe more cyclical areas of the capital markets should begin to gain momentum with the triple tailwinds (weaker dollar, steeper yield curve, negative real interest rates) of reflation further filtered through into the broader economy. We believe the housing and auto sectors should provide important clues as to the strength of the overall recovery in this regard.

CIO ASSET CLASS VIEWS

This month the Global Wealth & Investment Management Investment Strategy Committee upgraded International Developed equities to neutral, while reaffirming our positive view on Equities relative to Fixed Income, with an emphasis on U.S. Large-cap. We also actively rebalanced portfolios to target tactical weightings after substantial drift, diversifying back to appropriate levels across portfolios.

View the CIO Asset Allocation Guidelines

Listen to the audio cast

Asset Class	CIO View				
	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.
CIO asset class views are relative to the CIO Strategic Asset Allocation (SAA) of a multi-asset portfolio.

We expect the large growth segments of the market to continue to lead the broader indices in the intermediate and long terms. However, as the recovery gains momentum in the next six months, a more diversified performance leadership should begin to develop. Cyclicals and Growth should begin to perform better together, in our view. This line of thinking begets a more diversified approach to portfolio positioning within Equities, in our opinion. It is not Growth or Value, cyclicals or defensive, disruptors and innovators versus higher-quality slower-growing global brands, it is a mixture across all of the segments. In this new frontier in which innovation is accelerating, the world's supply chains are shifting, and the global to local mindset across regional economic zones is building, weaker balance sheets and asset heavy areas are having a more difficult time pivoting and making the necessary adjustments to thrive. In this new frontier and post-pandemic environment, an acceleration of business model adjustments should continue, which allows for an increase in operating leverage. This is one of the base case catalysts for the potential for positive surprises in earnings from the corporate sector in the next two years. We expect this to occur even in the face of an initial increase in costs as supply chains shift from global to local.

In addition, with the upcoming November presidential election in the U.S. fast approaching, there are a wide range of outcomes building given the differences in policy proposals being discussed; and, a big gap between the "tails" of proposals to likely lead to a resumption in volatility in the markets. Potential higher volatility supports our view of a more diversified approach to portfolio strategy in the coming months and also the need to hedge some U.S. market outperformance risk.

Therefore we are adjusting our portfolio strategy as outlined below:

Portfolio rebalancing and corresponding tactical changes:

- This month we are upgrading International Developed equities, specifically our outlook for Europe from underweight to neutral.
- We remain overweight U.S. Large-cap equities relative to our strategic targets, but reduce the magnitude of the overweight to U.S. Large-cap Growth where appropriate. Within U.S. equities, we have a balanced allocation to Growth and Value.
- Along with this tactical adjustment, we view this as an opportunity to rebalance portfolios after an extended drift higher in Equities relative to our tactical weightings.
- These changes add more cyclicality and global diversification to portfolios, reflecting our view that a new global economic expansion is underway, sustained by aggressive monetary and fiscal policy. We retain our preference for U.S. Large-caps versus international but acknowledge that macro conditions for International Developed equities have improved.

Key trends leading us to examine our tactical views and portfolios:

- U.S. equities have recovered nearly 50% from the March bottom and are positive for the year. Secular growth-oriented industries have dominated, propelling Large-cap Growth to significant outperformance over Value.
- The U.S. dollar has weakened since March, making non-U.S. equities more attractive, as opposed to a stronger dollar which pulls capital from the rest of the world into U.S. investments.
- Inflation expectations, which declined in February - April have since rebounded as the 10-year inflation breakeven is almost 1%, higher than during the lows of March.
- Policymakers in the U.S., Europe and Japan have surprised to the upside with stimulative measures. The landmark €750 billion European Union (EU) pandemic response package may mark a step towards debt mutualization and fiscal union, long seen as necessary steps for greater clarity on Europe's long-term prospects. In total, Europe stimulus commitment is roughly 44% of gross domestic product (GDP) and Japan's is 60%.

- Global growth is grinding higher. Manufacturing, housing, and autos are early leaders.
- Corporate earnings estimate revisions have improved as the trough in economic data may have passed. Valuation for International Developed equities is attractive. On a price-to-book ratio basis, Europe is trading at 1.7x and Japan at 1.3x, both below their respective historical averages.
- The path of the global economy is dependent on the coronavirus. While there has been uneven progress in some regards, advancement in testing, treatment, and vaccine developments are encouraging. The Eurozone has been relatively more successful in flattening their coronavirus case curve and the high-stakes presidential election in the U.S. augers for greater regional diversification.

In summary, we believe we are in a new long-term synchronized advance with a new long-term bull market already developing. With the bumpy recovery phase upon us and the potential for higher volatility up ahead of the U.S. presidential election (not to mention rising tensions between the U.S. and China and worries over potential new outbreaks as the weather turns colder in the U.S.) we have a strong preference for a more diversified portfolio approach. We maintain our Equity overweight relative to Fixed Income and believe weaker periods in the markets are buying opportunities for longer-term investors given the unprecedented policy stimulus available and the low investor positioning overall.

CIO INVESTMENT DASHBOARD

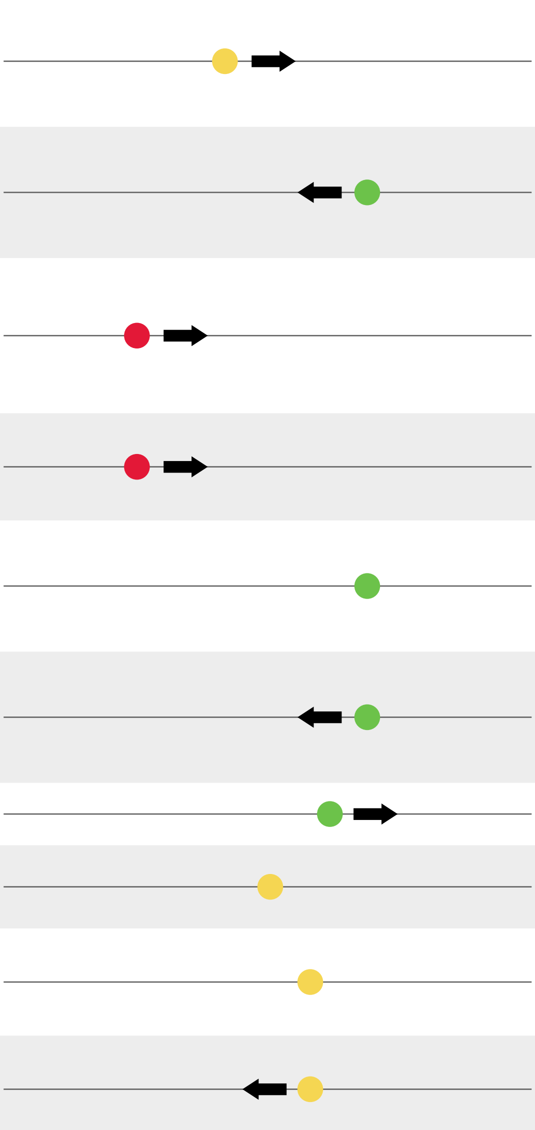
Global equities have rebounded in many parts of the world as global growth continues to trend higher, albeit in bumpy fashion, and markets begin to look toward progress as it relates to containing the coronavirus and an improvement in corporate earnings into 2021 and beyond. In the near term, we expect the success of economic reopening plans and scientific developments to be among the key drivers of financial markets.

Corporate earnings are likely to remain depressed in the near term; however, improving economic data and company earnings calls have noted optimism at an increasing pace. Earnings revision ratios have begun to pick up, especially as the U.S. monetary and fiscal policy continue to provide an accommodative backdrop for equities, with stimulus measures so far totaling 44% of GDP in the U.S. and approaching 30% globally, according to Cornerstone Macro Research. Corporate credit conditions have generally improved as a result of measures taken by the Federal Reserve (Fed), with credit spreads tighter across Investment-grade and high yield (HY), while valuations continue to favor Equities over Fixed Income on a relative basis.

Investor sentiment is shifting slightly from bearish, and positioning is closer to neutral, while market volatility, including the Chicago Board Options Exchange (CBOE) Volatility Index (VIX) has settled into a lower range. We are mindful of potential downside to equities over the near term if recovery and reopening efforts stumble, and emphasize Quality, Yield and Growth in multi-asset portfolios.

CIO INVESTMENT DASHBOARD

Current readings on the key drivers of equities for investors to consider, with arrows representing the recent trend.



Factor	Implication for Equities (Negative / Neutral / Positive)	CIO View
1. Earnings		Consensus expects quarterly year-over-year S&P 500 earnings growth to trough in Q2 and a pickup to begin thereafter. Many companies have suspended guidance amid uncertainty from the coronavirus, but Q2 earnings results are currently tracking above analyst expectations. One-month earnings revision ratios also improved globally across all regions and for all styles.
2. Valuations		U.S. equity valuations remain attractive compared to fixed income, with the equity risk premium, which is especially relevant given particularly low yields, at 4.0% versus the historical average of 3.3%, and in the 80th percentile. Low but positive interest rates should support higher valuations for equities by maintaining easier financial conditions while keeping deflationary fears at bay.
3. U.S. Macro		U.S. economic activity is bumpy but improving. The Institute for Supply Management (ISM) Purchasing Managers Index (PMI) entered expansionary territory in June, housing activity has been robust with the national 30-year fixed rate on mortgages at historic lows, and the U.S. Citi Economic Surprise Index is at a record high, indicating that recent data releases have been much stronger than expected. BofA Global Research expects Q3 GDP growth of 15% on an annualized quarterly basis after a record 32.9% contraction in Q2.
4. Global Growth		The coronavirus pandemic represents an unprecedented shock to global economic activity. We expect global GDP to contract by -4.2% in 2020 but rebound at 6.0% in 2021. The duration and shape of recovery depends on the trends in health data and advancements of testing and treatments.
5. Federal Reserve/ Inflation		The Fed has maintained its ultra-accommodative stance in combating the economic and financial impact of the coronavirus outbreak. After their latest meeting, the Federal Open Market Committee (FOMC) reiterated its dovish stance, emphasizing the commitment to using its full range of tools to support economic growth given the tremendous hardship from this pandemic.
6. Trade/ Fiscal Policy		Policymakers in Washington have already passed over 15% of U.S. GDP in fiscal stimulus, including checks for individuals, support for small businesses, and aid to state and local governments according to Cornerstone Macro Research, but recent rhetoric indicates that additional stimulus may be forthcoming heading into fall. Tensions between the U.S. and China have increased.
7. Corporate Credit		Corporate credit conditions have broadly improved as a result of measures taken by the Fed, with credit spreads continuing to tighten across Investment-grade and HY.
8. Yield Curve		Accommodative policy by the Fed is reflected in the shape of the yield curve, with the spread between the Fed funds rate and 10-year Treasury yield currently about +45 basis points (bps) versus about -55 bps in early March.
9. Technical Indicators		Volatility has settled into a lower range, with the VIX hovering around 25 and The MOVE Index stabilizing at low levels. Just 35% of New York Stock Exchange (NYSE) stocks are currently above their 200-day moving average, compared to the 2020 peak of 67% in early January, which remains low but has gradually moved higher off of recent bottoms.
10. Investor Sentiment		Investor sentiment is slightly bearish as institutional cash levels have receded, but aggregate positioning is moving closer to neutral. The last six weeks saw record inflows into Gold funds. The BofA Bull & Bear Indicator is at 3.4, a neutral signal and off of its recent lows. The American Association of Individual Investors notes that investors remain bearish.

Source: Chief Investment Office. Data as of July 31, 2020.

EQUITIES

- **We expect equities to outperform fixed income**: Global equities have rallied from their recent bottom in March as investor optimism builds on economic recovery and coronavirus medical advances. Historic levels of global monetary and fiscal policy support should help to shore up those portions of the economy and markets most acutely affected by the coronavirus, while equities remain reasonably valued relative to other asset classes from a cash-flow and yield perspective. Looking forward, there remains uncertainty given varying case trends, heightened U.S.-China tensions, and the upcoming U.S. presidential election. We believe investors should continue to emphasize Quality, Yield and Growth in their equity allocations. We continue to favor U.S. Large-caps but have moved to a neutral outlook toward International Developed equities and remain underweight Emerging Markets (EMs).

- **We are overweight U.S. equities:** The U.S. remains our preferred equity region relative to the rest of the world, with stronger balance sheets on aggregate, greater exposure to secular growth industries, and a weaker dollar, which may support earnings. U.S. Large-caps offer an appropriate balance of aforementioned Quality, Yield and Growth factors. We expect earnings per share (EPS) for the S&P 500 to drop to $115 for 2020, a year-over-year decline of 29%. However, the trough for earnings growth may be in Q2, and the trend of analyst upgrades has improved with one-month revisions reflecting more upgrades than downgrades. In addition, purchasing managers surveys indicate that manufacturing activity is now expanding, which also bolsters the case for an earnings recovery. An improvement in growth and profits earlier than expected would support equities. Technology, Communication Services and Healthcare are our favored sectors in the long term due to the secular rise in spending on innovation, productivity and health infrastructure, while we believe Consumer Discretionary should benefit from a pickup in global consumption.

  The current equity risk premium, or the difference between the earnings yield of the S&P 500 and the 10-year U.S. Treasury, is currently 4.0% and in the 80th percentile of its historical range, which supports the attractiveness of equities over Fixed Income. The rising exposure of the S&P 500 toward secular growth industries, lower level of global interest rates, and stable profit margins supports higher multiples longer term, but in the near term, performance will be influenced by coronavirus developments. We recommend higher-quality exposures such as large- over small-caps and the U.S. over international allocations.

  This year, the divergence between Growth and Value has reached levels not seen since 1999. The extended investor positioning in growth and technology-oriented names has the potential to create broad volatility if investors take profits. Timing these sentiment-based shifts is difficult, and, therefore, we believe portfolios should have a balance of both Growth and Value factors that can simultaneously gain from cyclical and secular forces gaining traction. Growth should continue to benefit from accelerated secular investments in 5G, artificial intelligence, cloud computing, robotics and health infrastructure globally. Value has a higher exposure to cyclicals like Financials and Industrials, and should benefit from an improved pace of earnings growth and economic normalization as we make progress toward a vaccine. Higher levels of nominal growth in 2021 and beyond would give investors greater confidence to step into Value and cyclicals, which should finally see better demand, pricing power and cash flows. Relative to our strategic targets, we still have preference for growth, but in a full portfolio context we take a balanced approach.

- **We are underweight EM equities**: Given the effects of the ongoing coronavirus outbreak, the potential for accelerated shifts in global supply chains, and increased U.S. and China tensions, we remain underweight EM equities. In the near term, EM ex-China will likely face headwinds from regional flare-ups of the coronavirus and depressed global economic growth, but there have been early indications of an economic recovery with the JP Morgan Global Manufacturing PMI improving back toward February levels. Activity in China has improved, and total economic activity may be back to pre-pandemic levels sooner. However, weaker demand from abroad could remain as the reopening and economic recovery in many global regions may be choppy. EM equities could face headwinds from less fiscal and monetary policy flexibility, a secular shift toward "localization" of supply chains, and rising tensions between the U.S. and China. However, the continued rise in EM consumer spending remains a big reason why investors should maintain a strategic allocation to EM equities. The developing world now constitutes about 41% of global personal consumption expenditures (PCE) according to the United Nations. This should support GDP growth and corporate earnings in emerging economies, as broad equity indexes such as the MSCI EM Index shift toward more consumer-oriented sectors (especially in China). We favor active management* when investing in EMs, as fundamentals differ across countries

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

based on key vulnerabilities to commodity prices, borrowing costs, external financing conditions, sharp declines in economic output and other factors.

- **We are upgrading International Developed market equities to neutral this month:** International equities, particularly those in Europe and Japan, have strong sensitivities to global manufacturing and trade activity, which has begun to expand on economic reopenings. The Markit Eurozone Composite PMI surged to 54.8 in July after having been in contraction since February, with both manufacturing and services components expanding. This should help to support corporate earnings. The pace of estimate revisions in Europe has begun to improve, although Japan lags on a relative basis. Monetary and fiscal stimulus should continue to be tailwinds, with Japan having committed nearly 60% of GDP to stimulus and the Eurozone adding approximately 44%, according to Cornerstone Macro Research. Promoted by Germany and France, the new shared fiscal relief plan that will potentially provide grants to hard-hit countries like Italy and Spain, has boosted investor confidence in the sustainability of the Euro. Risks remain for the new plan not being approved by individual members, Brexit uncertainties and a weak banking system. This increased level of fiscal policy coordination may help promote a cyclical economic expansion and support sectors that are heavily represented in International Developed equity markets.

EQUITY WATCH LIST

- Regional economic reopenings, coronavirus case trends, medical advances
- Economic data around production, labor, consumer expectations, and credit and liquidity conditions
- Acceleration of earnings estimate upgrades
- Further central bank support and fiscal stimulus packages
- Reorganization of global supply chains and U.S.-China relationship
- U.S presidential election and policy concerns

FIXED INCOME

- **We are slightly underweight fixed income**: We recommend short duration relative to a stated benchmark, as rates are extremely low, but the Fed is not expected to move rates into negative territory, therefore limiting how much further rates can reasonably drop. Markets have continued to improve month-on-month. Investment-grade spreads are more than halfway from recessionary levels (~200 bps) to pre-coronavirus levels at +133 bps, their tightest since the crisis. HY spreads are also tighter and at their post-crisis lows at approximately +491 bps. Consistent with that theme, Municipal (Munis) are also at historic lows, with AAA 10-year rates currently around 0.67%.

  Despite record-low yields—10-year Treasurys are now 0.55%—longer-dated Treasurys still provide diversification in a risk-off environment. This recent crisis again highlights the fact that Treasurys are one of the few asset classes that has the potential to provide a meaningful, short-term hedge against market value declines in risky assets and, as such, should generally be a component of most investors' diversified portfolios, in our view. While other fixed income assets saw large price declines due to changing economic conditions and stressed liquidity, we still expect overall fixed income to be a diversifier over longer periods of time as coupon income becomes more of a determining factor to total returns. However, with yields so low and inflation expectations in the market extremely low, investors may wish to consider replacing some nominal Treasury exposure with Treasury Inflation-Indexed Securities (TIPS) exposure. TIPS provide direct exposure to the Consumer Price Index (CPI) and may perform relatively—not absolutely—better than nominal Treasurys if inflation rises or rates rise or both. Investment-grade corporates still have direct support, with the Fed recently purchasing individual corporate bonds and exchange-traded funds (ETFs), while HY corporates have limited support via the Fed potentially purchasing "fallen angels." Credit losses in Investment-grade are manageable and not a huge component of spreads, but the same cannot be said in HY, where significant credit losses are extremely likely and may meaningfully reduce total returns from yield income. The yields now available in HY (approximately 5.4%) only provide meager compensation for investors with a long-term time frame. We are still more constructive on Investment-grade corporates. For HY allocations, we recommend an equal weighting between HY unsecured bonds and secured leveraged loans, and caution that near term, strong performance may not be sustainable.

In July, the muni yield curve declined and flattened, while muni-to-Treasury yield ratios generally declined, particularly at the front end of the curve. Investor demand remains strong, based, in part, on confidence that policymakers in Washington will provide more stimulus to state and local governments. Technicals should remain strong over the summer, with seasonally high levels of bond maturities and calls, which will need to be reinvested. Headline and credit risks remain, as most states have closed significant budget gaps with expected federal government aid, as well as additional borrowing and expense cuts. We believe investors should favor general obligation bonds issued by high-quality state and local governments with structurally balanced budgets and strong balance sheets, as well as essential service revenue bonds (e.g., water/sewer and public power) that have adequate coverage and reserves. We believe investors should be cautious of issuers that are overly reliant on revenues from oil/natural gas, travel and tourism, or capital gains taxes, or that have very large unfunded pension liabilities. We would also be cautious of certain muni sectors such as senior living, private colleges, transportation/transit and bonds backed by narrow revenue streams, such as hotel occupancy taxes or convention center revenues.

We remain slightly negative on the Mortgage-Backed Securities (MBS) sector. Spreads have settled at the wider end of the pre-crisis five-year range. Fed purchases that now total close to $0.8 trillion have stabilized at $40 billion/month, which removes demand uncertainties for mortgage investors. At the same time, the path of prepayments remains a major question with record-low mortgage rates and volatility in the market, higher dollar prices of the mortgage bonds, and the still very much unclear economic and housing picture that could result in heightened risk of rising default rates from unemployment. While MBS now look attractive versus Treasury rates, we feel that uncertainties around pre-payments and extension remain a headwind for sector performance. We continue to suggest conservative positioning in securities with less extension and price risk. Therefore, while we counsel that investors still maintain a significant weight to the sector as it is a large component of the high-quality bond market and a direct beneficiary of Fed intervention, the opportunity set is currently greater in the Investment-grade corporate sector.

FIXED INCOME WATCH LIST

- Any signs of risk aversion in terms of spreads, yields or new issue activity
- Default and recovery statistics in corporate HY and leveraged loan markets
- Increased utilization of the Fed's liquidity and credit programs
- Significant inflation—significantly unlikely, very contrarian and would catch the market offside, hence why it is a risk
- Better-than-expected outcomes could pressure yields significantly higher
- Details of Congress's fiscal stimulus package, expected to be finalized in August

ALTERNATIVE INVESTMENTS

Given the differences in liquidity characteristics between alternative investments (AI) and traditional investments, the AI portfolio positioning and CIO asset class views have been neutral rated versus our strategic allocations. These types of investments, in our opinion, should not be viewed at the asset class level on a tactical basis, but rather the tactical positioning should be expressed at the subasset class level.

We will continue to provide strategy-level guidance for qualified AI investors. We believe allocations to AI can introduce differentiated returns that can help complement existing traditional holdings by potentially enhancing returns, reducing risk and capitalizing on opportunities not available through traditional investments.

- **We favor a strategic approach when allocating to hedge funds**: As stated previously, we are advocates of diversification when investing in this heterogeneous asset class. That said, we currently see a favorable opportunity set for select hedge fund strategies given the impact of the coronavirus and the resulting economic fallout on a wide range of assets. Sustained market volatility, continued uncertainty on the macro front, and widening dispersion between earnings estimates will likely contribute to a larger gap between top—and bottom—quartile performance in equities, and, as such, skilled stock pickers stand to benefit. Accordingly, we recommend incremental allocations to equity long/short and equity market-neutral strategies. Additionally, global macro managers are currently benefiting from opportunities not seen in years, and we recommend these strategies for investors seeking to diversify equity risk in light of the continued uncertainty around the impact of massive fiscal and monetary policy responses, resurgent trade tensions, and the upcoming U.S. presidential election.

- **We favor a strategic approach when allocating to private equity** and view these strategies as long-term potential portfolio return enhancers with unique access to specialized deals unavailable to traditional investors. Given the recent drawdown and resulting valuation compression, we expect that savvy managers will deploy dry powder opportunistically to buyout and distressed areas of the market, via direct and through secondary investments. As per usual, and even more important in markets like these, we recommend that investors plan a disciplined, multiyear commitment strategy that builds portfolio diversity among different managers, styles, geographies and vintages. Within the broad private equity universe, we continue to favor special-situation strategies that could benefit from pockets of dislocation resulting from the coronavirus pandemic, lingering trade disputes, and secular shifts across sectors due to disruptive technologies.

- **We favor a strategic approach when allocating to private real estate**: The coronavirus has had a swift and profound impact on the commercial real estate market. Deal activity has ground to a halt, and the securitized market has experienced dislocation and liquidity issues. In the near term, we think conditions will be closely tied to the duration and severity of the coronavirus pandemic and could weigh on pricing, volume and cash flows in certain parts of the core real estate market (hospitality, retail, office). It is worth noting that prior to this "pause," economic conditions were on solid footing for commercial real estate. Generally speaking, the supply and demand for rentable space were relatively balanced across the country, with a few property types and market exceptions, such as regional malls and power centers in the retail category, and in some multifamily and central business district (CBD) office markets. For prospective investors, we would place emphasis on direct investments in well-located properties in strong regions of the country that will exhibit attractive rent-roll and cash-flow characteristics and have the potential to bridge into the next cycle, providing a long-term hedge against inflation.

- **We remain neutral on commodities and the dollar:** The European Commission's fiscal stimulus has bolstered the Euro, helping to push the trade-weighted dollar lower and raising prospects for global growth. Further dollar softness would help the global economy and the reflation effort. Commodity prices (for example, copper) have rebounded sharply the last few weeks as the dollar has weakened and reflation gains traction. Gold continues to benefit from low real interest rates. With the Fed in a reflationary mode, rising geopolitical tensions and high economic uncertainty, we believe some exposure to Gold remains appropriate.

- **Tangible assets**: Over the long term, especially given the unprecedented stimulus and monetary reflation now in place, tangible assets—such as real estate, timber, and farm and ranch land—may benefit portfolios through increasing diversification, helping to provide a hedge against potential future inflation, generating cash flows, and providing possible favorable social impact opportunities.

MACRO STRATEGY

- Economic reopening slowed as the coronavirus case count picked up, but overall global growth continues to gain momentum. Lower inflation allows more accommodative monetary policy around the world. Massive fiscal stimulus continues to support a positive, self-reinforcing growth dynamic, boosting profits and jumpstarting growth. We believe this is a positive backdrop for equities.
- Private-sector interest rates are reaching all-time lows in the U.S., fueling V-shaped economic recoveries in interest-rate sensitive sectors like housing and manufacturing. The Fed indicated Quantitative Easing (QE) and zero rates are likely until inflation sustainably averages around 2% for an extended period.
- Market volatility continues to trend lower as the shock dissipates and Fed liquidity floods the system. We believe there is potential for more episodic volatility in 2020 around long-term U.S. and China relations and the U.S. presidential election cycle.

Economic and Market Forecasts (as of 07/31/20)

	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	1.1
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 baseline 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 July 31, 2020.

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When assessing your portfolio in light of our current guidance, consider the tactical positioning around asset allocation in reference to your own individual risk tolerance, time horizon, objectives and liquidity needs. Certain investments may not be appropriate, given your specific circumstances and investment plan. Certain security types, like hedged strategies and private equity investments, are subject to eligibility and suitability criteria. Your advisor can help you customize your portfolio in light of your specific circumstances.

CIO ASSET CLASS VIEWS

Asset Class	CIO View					Comments
	Under-weight		Neutral		Over-weight	
Global Equities	•	•	•	●	•	We retain our positive view on equities based upon favorable relative valuations and improving global growth. Corporate earnings are likely to remain under pressure in the near term, but the trough may be in Q2 as revision trends have improved, policy remains supportive, and global growth grinds higher in a bumpy fashion. We favor Growth, Quality and Yield. We remain overweight the U.S., underweight in EMs, and this month move to neutral International Developed.
U.S. Large Cap Growth	•	•	•	●	•	Given our expectation for episodic volatility, we recommend higher-quality exposure, which leads us to favor large- over small-cap equities. Growth should continue to benefit from accelerated secular trends but Value, which has higher exposure to cyclical sectors, should benefit from an improved pace of earnings growth and economic normalization. We believe a balance of both is appropriate. At the sector level, consider being selective, with a preference for Technology and Communication Services for long-term investors
U.S. Large Cap Value	•	•	•	●	•	
U.S. Small Cap Growth	•	•	•	●	•	Small-caps have more leverage in this cycle and weaker earnings trends. Large-caps should be preferred for higher quality as economic uncertainty remains high.
U.S. Small Cap Value	•	•	●	•	•	
International Developed	•	▶	●	•	•	We are moving to neutral International Developed markets this month. Recent data suggests a global economic recovery is underway, which may benefit more cyclically oriented International Developed markets. A substantial monetary and fiscal policy thrust in Europe and Japan, paired with relatively attractive valuations, could support equities, while Brexit uncertainty and stalling on the stimulus front are headwinds..
Emerging Markets	●	•	•	•	•	We are underweight EM equities as they face near-term headwinds of uncertainty and weaker growth due to the coronavirus, in addition to the potential for structural reorganization of global economic systems and U.S.-China tensions moving forward.
International						
North America	•	•	•	●	•	The U.S. remains our preferred region despite ongoing uncertainty over the extent of the coronavirus effect on economic growth and corporate profits. Aggressive Fed support and record-low interest rates still favor equities over bonds. Large fiscal stimulus provides some offset to expected economic contraction in 2020, and in the early economic recovery phase.
Eurozone	•	▶	●	•	•	We are upgrading EU equities to neutral this month. Increased level of fiscal policy coordination across the EU should provide additional support for domestic demand. However, sensitivity to global trade implies ongoing risk from potential disruptions from cross-border activity due to coronavirus mitigation measures. Financial-sector exposure may be a headwind during longer periods of lower rates
U.K.	•	•	●	•	•	Large sector exposure to Energy and Financials is currently a headwind on low oil prices and longer periods of lower rates. Currency weakness is a relative support given large international revenue exposure. Exit from the European Union single market remains a negative for medium-term growth.
Japan	•	•	●	•	•	Support from exposure to technology and automation themes should be tailwinds, and valuations remain attractive. Large fiscal and monetary stimulus expected to provide some offset to economic contraction in first half of 2020
Pac Rim*	•	•	●	•	•	Headwinds from large regional market weights in Financials and Real Estate given longer period of lower rates and risk of lower occupancy. Export exposure to China means growth will remain sensitive to outlook for mainland Chinese demand. Ongoing uncertainty also remains from political unrest in Hong Kong..

* Pacific Rim refers to the geographic area surrounding the Pacific Ocean. The Pacific Rim covers the western shores of North America and South America, and the shores of Australia, eastern Asia and the islands of the Pacific.

Asset class table continued on the next page →

Asset Class	CIO View: Under-weight		Neutral		Over-weight	Comments
Global Fixed Income		●				Bonds provide portfolio diversification, income and stability. Below benchmark duration is recommended, as rates are extremely low, and the Fed is not expected to move rates into negative territory.
U.S. Governments		●				Yields are at historic lows, expensive relative to inflation, and are close to an effective floor if the Fed does not use negative rates as a policy tool. Some allocation for liquidity and less risk should still be considered.
U.S. Mortgages		●				Spreads have widened from their post-crisis tights as Fed purchases slowed and stabilized at $40B/month, and are again at the wider end of 5-year range. One of the uncertainties in mortgages now appears to be the path of pre-payments driven by record low mortgage rates on the one hand and coronavirus-related economic and housing uncertainty on the other. Consider conservative positioning.
U.S. Corporates				●		Spreads are currently halfway between recessionary levels and pre-coronavirus levels, after retracing much of the March move wider. Liquidity has currently improved materially. Potential opportunity to add exposure to investment-grade credit remains and we see relative valuations in BBB-rated industrials and financials in the front-end.
High Yield		●				Valuations present mediocre absolute long-term returns after factoring in an appropriate estimate of credit losses. Fundamentals will be challenged near term due to economic uncertainty; we expect default rates to rise and recoveries to suffer. Any additions to HY risk need to have a very long time frame as further drawdowns are possible. Within HY, an equal allocation to floating-rate loans and HY unsecured is advised.
U.S. Investment Grade Tax Exempt			●			Muni yields are back near post-crisis lows, but valuations to Treasurys are still relatively attractive. Credit is challenged by increased unemployment, suppressed economic activity, and stay-at-home behaviors. Further fiscal stimulus is expected to stabilize the market. We favor state and local governments with structurally-balanced budgets and strong balance sheets, as well as essential service revenue bonds with solid coverage and reserves.
U.S. High Yield Tax Exempt		●				Credit spreads markedly wider due to recessionary fears. Prefer actively managed solutions that are up in quality.
International Fixed Income	●					Compressed yields and risk premiums around the globe compared to the U.S., combined with potentially higher volatility in non-U.S. markets, present unfavorable risk/reward conditions for non-U.S. fixed income, justifying an underweight position.
Alternative Investments*						Given the differences in liquidity characteristics between AI and traditional investments, the AI portfolio positioning and CIO asset class views have been neutral rated versus our strategic allocations. These types of investments, in our opinion, should not be viewed at the asset class level on a tactical basis, rather the tactical positioning should be expressed at the subasset level. We will continue to provide strategy-level guidance for qualified AI investors and believe allocations to AI can introduce differentiated returns, which can help complement existing traditional holdings by potentially enhancing returns, reducing risk, and capitalizing on opportunities not available in traditional investments.
Hedge Funds						We believe the environment for active management remains favorable, and we recommend incremental allocations to equity long/short and equity market-neutral strategies. If recent trends persist, performance will likely be manager specific this year; we believe a diversified approach when investing in hedge fund strategies is most prudent for qualified investors.
Private Equity						We view private equity strategies as long-term potential portfolio return enhancers for qualified investors. We continue to favor special-situation strategies that could benefit from pockets of dislocation as a result of the coronavirus, ongoing trade disputes, and secular shifts across sectors due to disruptive technologies. These strategies may offer important diversification benefits (due in part to their counter-cyclicality) to a strategic private equity program.
Real Assets						Reflationary policy and lower real interest rates, and ultimately stabilizing global growth, should provide support for commodity prices. Gold is currently benefiting from low real interest rates. There are potential risks to the recent rebound in oil prices, and we do not expect price recovery to be linear. For the calendar year, Brent crude oil prices are expected to average $44 per barrel and West Texas Intermediate (WTI) to average $40 per barrel.
Cash						

Tactical qualitative investment strategy weightings are relative in nature versus the strategic weightings for a fully diversified portfolio. Weightings are based on the relative attractiveness of each asset class. Tactical strategy weightings are for a 12- to 36-month time horizon. CIO asset class views are relative to the CIO Strategic Asset Allocation (SAA) of a multi-asset portfolio. Because economic and market conditions change, recommended allocations may vary in the future. Asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns. All sector and asset allocation recommendations must be considered in the context of an individual investor's goals, time horizon and risk tolerance. Not all recommendations will be in the best interest of all investors. **Alternative investments such as derivatives, hedge funds, private equity funds and funds of funds can result in higher return potential, but also higher loss potential. Changes in economic conditions or other circumstances may adversely affect your investments. Before you invest in alternative investments, you should consider your overall financial situation, how much money you have to invest, your need for liquidity and your tolerance for risk.**

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

Source: Global Wealth & Investment Management Investment Strategy Committee as of August 4, 2020.

See next page on CIO Equity Sector Views →

CIO EQUITY SECTOR VIEWS

The CIO equity sector view is developed by applying a multi-input process combining the CIO's factor views and fundamental bottom-up industry outlook with top-down macroeconomic changes and trends. The factor approach emphasizes valuation and momentum as key inputs, with a fundamental overlay taking into consideration forward-looking views of growth, profits, policy, events and sentiment as well as inclusion of certain investment themes. BofA Global Research's sector strategy views are also captured as an input into the CIO process. Our sector views are developed with a 12- to 18-month outlook but are revisited monthly by the GWIM Investment Strategy Committee.

Sector	CIO View: Underweight		CIO View: Neutral		CIO View: Overweight	Comments
Communication Services	•	•	•	•	●	Relatively small negative effects from the coronavirus pandemic although traditional media continues to see pressure from cord-cutting. Accelerating trend in internet usage, video streaming and gaming should drive stronger growth. Weaker advertising in the near term should be transitional. Relatively attractive valuation and higher momentum.
Information Technology	•	•	•	•	●	Strong balance sheets, cash flow generation and dividend growth. Secular growth trends for cloud computing, machine learning and artificial intelligence (AI), data centers, software, cybersecurity and semiconductors. Traditional hardware exposure is increasingly commoditized. Valuation is extended, but momentum is high and Technology retains leadership year-to-date (YTD).
Healthcare	•	•	•	●	•	Expect rising spending on healthcare globally—focused primarily on diagnostics, consumables, drug development and medical devices. Hospital spending on capital equipment could be more pressured over the next few quarters due to coronavirus related challenges. Fewer headwinds near term regarding drug pricing, benefiting the pharmaceutical and biotech industries. Emphasize exposure to positive trends in animal health, medical technology and telemedicine, tools, diagnostics and select biotech. Relatively unattractive valuation and lower momentum.
Consumer Discretionary	•	•	•	●	•	E-commerce should accelerate due to social distancing measures. Fiscal stimulus should provide some support to consumer sentiment. Favor strong global consumer brands with solid balance sheets and a history of dividend growth over weaker brick and mortar retailers that could face declining store traffic trends. Relatively attractive valuation and higher momentum.
Financials	•	•	●	•	•	Bank stock repurchase programs have been suspended, and dividend capacity was capped at average earnings power, which should be an overhang for the banks in the short term. In addition, banks may see rising credit costs and increased loan loss reserves; however, these can be reversed in the post-coronavirus world, with the potential to add to earnings. Given structural headwinds in insurance, we prefer exchanges that evolved into fee-based data and analytics providers. U.S. banks seem to remain well capitalized and trade at attractive valuations with higher momentum.
Industrials	•	•	●	•	•	Mixed fundamental outlook for multiple industries. Concerns regarding the fundamental outlook for the aerospace and oil & gas related industries. Weaker dollar, higher commodity prices and PMIs recovering from lows are supportive of more cyclical industrial outperformance. Attractive valuation on a relative basis and higher momentum.
Consumer Staples	•	•	●	•	•	Moderate upside after recent relative outperformance and a wave of consumer staples purchases for stocking pantries due to the coronavirus. Risks of a rotation out of defensive positioning and into risk-on positioning, elevated valuation levels offset the strong fundamentals and consistent cash flows in this sector. Relatively unattractive valuation and lower momentum.
Energy	•	●	•	•	•	Energy prices recovered from first-quarter lows, and the extreme oversupplied situation is slowly moving toward supply and demand balance. The sector still faces headwinds from reduced global demand, the transition to clean energy, and increasing environmental, social and governance focus by investors. Continue to emphasize companies that are low-cost producers with balance sheet strength and low break-evens. Relatively attractive valuation but lower momentum.
Materials	•	●	•	•	•	Specialty chemicals and agriculture may benefit from a consumer-led recovery in the U.S. and China, while construction aggregates are helped by reshoring and fiscal stimulus. Depressed demand and inventory destocking remain headwinds for cyclical commodities, though nascent improvement in automotive and industrial end markets is encouraging. Relative valuations are neutral.
Utilities	●	•	•	•	•	Expect consistent earnings results; however, post the crisis, potential rotations out of defensive stocks is a headwind. Emphasize utilities with growing renewable power generation from wind and solar and de-emphasize ones that rely strictly on coal power generation. Relatively unattractive valuation and lower momentum.
Real Estate	●	•	•	•	•	Consumer and corporate changes like remote work, e-commerce, less travel, etc. are headwinds for commercial real estate companies, leisure (e.g., hotels), mall operators and owners. Emphasize data centers, communication infrastructure and industrial real estate with a focus on e-commerce distribution facilities. Relatively unattractive valuation and lower momentum.

Source: Chief Investment Office as of August 4, 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 Index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.

MSCI EM Index is an index used to measure equity market performance in global emerging markets. It is just one index created by MSCI, which has been constructing and maintaining them since the late 1960s.

The MOVE Index calculates the future volatility in U.S. Treasury yields implied by current prices of options on Treasuries of various maturities.

Chicago Board Options Exchange (CBOE) Volatility Index (VIX) is a real-time market index that represents the market's expectation of 30-day forward-looking volatility.

Purchasing Managers Index (PMI) is a measure of the prevailing direction of economic trends in manufacturing.

Citi Economic Surprise Indices are objective and quantitative measures of economic news. They are defined as weighted historical standard deviations of data surprises.

Consumer Price Index measures changes in the price level of a weighted average market basket of consumer goods and services purchased by households.

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Alternative investments such as derivatives, hedge funds, private equity funds, and funds of funds can result in higher return potential but also higher loss potential. Changes in economic conditions or other circumstances may adversely affect your investments. Before you invest in alternative investments, you should consider your overall financial situation, how much money you have to invest, your need for liquidity, and your tolerance for risk. Alternative investments are speculative and involve a high degree of risk. An investor could lose all or a substantial amount of his or her investment. There is no secondary market nor is one expected to develop, and there may be restrictions on transferring fund investments. Alternative investments may be leveraged, and performance may be volatile. Alternative investments have high fees and expenses that reduce returns and are generally subject to less regulation than the public markets. The information provided does not constitute an offer to purchase any security or investment or any other advice.

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