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CHIEF INVESTMENT OFFICE

Viewpoint

Positioning In A Foundational Year

January 2023

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IN BRIEF

- As we begin 2023, our thinking is that bonds are more relatively attractive than Equities but could swap places quickly and potentially earlier than expected. Moving further into a late cycle phase that includes slower growth, potential recession, and earnings deterioration supports our view of playing defense in the very short term and favoring high quality overall.
- This month the GWIM ISC is shifting to be tactically neutral across stocks and bonds, to maintain a defensive posture and preference for Quality. We are upgrading U.S. Government bonds as nominal and real rates are some of the most attractive in over a decade, while the economy deteriorates later in the economic cycle and recessionary signals increase.
- Within U.S. Equities, we are adjusting our sector views to reflect our preference for quality, by upgrading Healthcare from slight overweight to overweight, and downgrading Real Estate from slight overweight to neutral.
- As we move through the first half of the year, we will be looking for opportunities to add to Equities (and potentially areas such as Small-cap, non-U.S. Developed Markets, Emerging Markets (EM)) and to further emphasize more value oriented places in general since we expect the 12-to-18 month return outlook to be solid for stocks and for bonds to offer decent yields.

As we begin 2023 that we have titled *Back To The New Future*, we leave behind one of the worst years in history in terms of performance for a combined stock and bond portfolio. With economic volatility expected to remain in the immediate future, it is important to outline a handful of messages regarding the financial markets. This is especially imperative given the potential differences between the 3-to-6 month view (playing defense) and the 12-to-18 month outlook (moving to offense).

2022 included various shocks, from inflation to interest rates and liquidity, and we are now moving through a growth shock, in our opinion. This is the last stage of the cycle and can be one of the most confusing as it relates to asset class direction. We believe having a more defensive equity positioning to begin this year while maintaining a preference for Fixed Income—yield levels are attractive overall—makes sense. The last period of the reset is more than likely the phase in which fundamental earnings are called into question. Beginning with a defensive tone with a readiness to act and add risk once the broader outlook becomes clearer is our preferred stance. If it becomes clear that the Federal Reserve (Fed) is going to pause and markets discount a potential earnings decline then a tailwind could develop in the

CIO ASSET CLASS VIEWS

This month, the Global Wealth & Investment Management Investment Strategy Committee (GWIM ISC) shifted to neutral tactical positioning overall, and adjusted our Fixed Income allocation by raising U.S. Government to slight overweight, and lowering Investment-grade (IG) Corporate bonds to neutral. Within U.S. Equities, we adjusted our sector allocation by upgrading Healthcare to overweight, and lowering Real Estate to Neutral. We view 2023 as a foundational year for investors and maintain a high level of diversification across and within asset classes.

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Asset Class	Underweight		Neutral	Overweight	
Global Equities			●		
U.S. Large Cap Growth			●		
U.S. Large Cap Value				●	
U.S. Small Cap Growth			●		
U.S. Small Cap Value			●		
International Developed		●			
Emerging Markets			●		
Global Fixed Income			●	◀	
U.S. Governments			▶	●	
U.S. Mortgages			●		
U.S. Corporates			●	◀	
High Yield		●			
U.S. Investment-grade Tax Exempt			●		
U.S. High Yield Tax Exempt		●			
International Fixed Income			●		
Alternative Investments*					
Hedge Funds					
Private Equity					
Real Assets					
Cash					

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

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

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equity markets. This tailwind could be that rate cuts get pulled forward, which is certainly not consensus and is still too early to be a base case. This will depend on how much growth and employment slump, in our view.

Currently, as the Fed tightens financial conditions into a “recessionary” environment, a number of signals continue to unfold. The yield curve, which is currently significantly inverted, is suggesting growth and inflation could decline sharply, while Equities are indicating a rolling recession is already occurring. In the present environment, financial markets, particularly Fixed Income, are collectively pricing in a good portion of the reset period that we described back in 2022. At the tail end of most reset periods that include above average inflation, an ultra-hawkish Fed, and a rolling recession, economic data and the interplay of capital markets can be more volatile, contain quick reversals, and tend to be more technical in nature. In other words, short-term traders, technical momentum investors or trend followers can dominate the market direction. This can create a messy backdrop. Therefore, we believe it is important for longer-term investors to keep diversification at the top of the list of portfolio characteristics entering 2023 and focus on subasset classes for larger opportunities.

We fully recognize that market action is overly influenced by central bank communication, economic growth gauges, and the next few quarters of profit releases. However, we also understand that equity markets, in particular, could switch from a negative environment to a positive one quickly and without notice. Eventually central banks, namely the Fed, are likely to react to the slowdown sooner than they originally realized, leading indicators ultimately bottom, and markets fully discount a future trough in earnings. The timing of this, especially in the current reset post-pandemic cycle, is more uncertain for a number of reasons. Consumers and businesses have healthier balance sheets this time around, and the employment market is still relatively strong outside of the technology sector. Although consumer spending is showing signs of weakening, the level of spend is exhaling from a high mark. The pandemic and all of the stimulus put in place to fund it is still clearly distorting “normal” economic trends, which is why there are a wide array of opinions about where we go from here. At present, our thinking is that bonds are more relatively attractive than Equities but could swap places quickly and potentially earlier than expected.

Starting on the defensive end with the readiness to add risk requires an understanding that the short-term message could be different from the medium- or long-term thinking. Having a plan that allows for the transition from one environment to the next is imperative. As we move through the first half of the year, we will be looking for opportunities to add to Equities (potentially areas such as Small-caps, non-U.S. Developed Markets, EMs), and to further emphasize more Value-oriented places in general since we expect the 12-to-18 month return outlook to be solid for stock and for bonds to offer decent yields. Portfolio decisions could be more frequent in 2023 and 2024 given the changing dynamics coming out of the pandemic cycle and moving into this new one.

For the immediate future, we continue to focus on factors such as higher quality and defensiveness in both asset classes. We prefer Value to Growth overall, Large-caps to Small- and Mid-caps, the U.S. to the rest of the world, Treasurys and munis relative to credit. The tactical asset allocation exposure within asset classes for 2023 and the selection of individual managed investment solutions or securities are likely to be major contributors to relative portfolio performance more than at any time in recent past. In addition, the inclusion of Alternative Investments, for qualified investors, to help mitigate risk and/or potentially enhance portfolio returns should also increase in importance in 2023, in or opinion.

One final note on positioning: Trying to time the eventual turn higher in Equities could be more difficult than most suggest due to the economic distortions still filtering through from the pandemic. Therefore, for investors willing to ride through another bout of negative volatility, maintaining the current balanced approach between stocks and bonds or neutral stance could also make sense.

We will continue to remain active on our asset allocation views as we move further into this cycle and throughout 2023. Depending on the early trends in the capital markets and the

PORTFOLIO POSITIONING ON THE WATCH LIST

- Increase in non-U.S. relative to U.S. (including Emerging Markets)
- Further increase in Value relative to Growth
- Increase in Small-caps relative to Large
- Further increase in duration

policy adjustments that could happen without notice, we will continue to have plans ready to adjust our tactical asset allocation positioning. We prefer a dollar-cost averaging and a rebalancing approach to our overall portfolio strategy. We will look to take advantage of outsized weakness in Equities with the notion that the medium- and long-term outlooks are a renewed bull market cycle. We are calling this year a "foundational year" for diversified portfolios.

Three primary messages to consider and integrate into portfolio strategy:

1. New long-term capital market assumptions lead to adjustment in strategic asset allocation.
    - Higher cash and Fixed Income yields mixed with lower starting point equity valuations and an increase in potential excess return opportunities in Hedge Funds (and AI in general) supports a general increase to risk assets for investors with a long time horizon and higher risk tolerance.
2. Moving further into a late-cycle phase that includes slower growth, potential recession and earnings deterioration supports our view of playing defense in the very short term and favoring high quality overall.
    - Neutral positioning overall on a tactical basis between Fixed Income and Equities, with Fixed Income having a slightly stronger tailwind to begin the year, and U.S. assets over rest of world for now. But as interest rate differentials narrow and the dollar peaks, non-U.S. markets could have new tailwinds.
    - Stay tactical and have plans ready to switch to offense (become more favorable in Equities if a larger than expected correction ensues) as the Fed pauses and earnings deterioration is factored in.
3. Given our view that 2023 is a foundational year maintaining a high level of diversification across asset classes and within is imperative. Subasset classes such as size, style and geographic regions should have larger opportunity sets than the broad market indexes, in our view.
    - We expect both stocks and bonds on a full-year basis to perform reasonably well when looking back at the end of the year, even in the face of short-term volatility.
    - We expect both a more positive trend in Equities to develop later in 2023 as investors discount the turn and a much better profit outlook in 2024 and beyond.
    - Underowned investment arenas from the past decade-plus could be the "leaders" in the medium term in this new economic and market cycle regime.

CIO INVESTMENT DASHBOARD AS OF JANUARY 10, 2023

As we head into 2023, a global growth slowdown is continuing to unfold with economic data broadly weakening. Global central banks are continuing to tighten policy aggressively to combat inflationary pressures, leading to higher global short rates. In the U.S., inflation is still at elevated levels, having peaked in mid-2022. U.S. corporate profit trends are less supportive as downgrades continue, with consensus estimating annual earnings growth of 4.9% for 2023. Corporate credit spreads widened in 2022 amid tightening financial conditions, but spreads remain generally supportive. Absolute valuations for U.S. Equities declined by over 20% last year but are still not cheap given the cloudy earnings picture. Investor sentiment remains generally bearish. We continue to believe that market volatility will be elevated for most asset classes and expect the "grind-it-out" environment to persist for markets in the near-term before stabilizing later this year. In our view, asset allocation decisions could be more frequent this year as we move through the final phase of the reset period.

2022 KEY METRICS

- The S&P 500 delivered a price return of -19.4% in 2022, the fourth-worst calendar year performance in post-World War II history after 2008, 1974 and 2002.
- There was a 99 percentage point spread between Energy, the best performing sector (+59.0%) and Communication Services, the worst performing sector (-40.4%).
- The forward price-to-earnings ratio fell from 21.4x at the end of 2021 to 16.7x at the end of 2022, touching a low of 15.2x in mid-September.
- The S&P 500 Value index (-7.4%) outperformed the S&P 500 Growth index (-30.1%) by 23 percentage points for the year.
- The Fed raised its policy interest rate by 425 basis points, the most in any single year since the shift to floating exchange rates in 1971.
- Consumer price inflation in the U.S. peaked at 9.1% in June 2022, having started 2021 at just 1.4%.
- Emerging Europe (ex. Russia) was the worst performing major region globally in 2022 (-26.3%), with Hungary delivering the weakest returns in the region.
- Latin America was the best performing major region globally in 2022 (-0.1%), with Argentina delivering the strongest returns in the region.
- Commodity prices rose by 13.8% in 2022 (Bloomberg Commodity Index), with the strongest gains in energy prices (+33.5%) and a decline in industrial metals prices (-4.4%).
- The broad trade-weighted U.S. dollar appreciated by 5.4% in 2022, rising by 5.9% against the euro and 12.2% against the Japanese yen.

Source: Bloomberg as of December 2022. **Past performance is no guarantee of future results. Please refer to index definitions at the end of this report.**

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
Earnings		According to FactSet, consensus expects earnings growth of 4.9% with revenue expansion of 3.0% in 2023, versus an estimated 4.5% earnings growth with 10.4% revenue in 2022. However, estimates are declining. Analyst downgrades for earnings continue to outnumber upgrades globally, according to the BofA Global Research Global Earnings Revision Ratio.
Valuations		U.S. Equities have become more attractive but are still not cheap given the cloudy earnings picture. The S&P 500 price-to-earnings (P/E) ratio (next 12 months) is around 17x, down from 21.4x in late 2021. Elevated interest rates will likely continue to reduce the relative appeal of Equities versus Fixed Income in the first half of the year.
U.S. Macro		Real gross domestic product (GDP) grew by 3.2% in Q3 2022 on a seasonally adjusted annual growth rate. For Q4 2022, the Atlanta Fed's GDPNow tracker forecasts continued growth of 4.1%. Consumption and business investment were positive contributors, while investment residential and non-residential structures are detractors. On the demand side, the consumer continues to have support from a strong labor market and a cushion of savings. However, a more burdensome cost of living and rising interest rates are headwinds to growth. BofA Global Research expects growth of 1.9% for 2022 and -0.3% in 2023.
Global Growth		Geopolitical tensions, elevated inflation and monetary tightening by global central banks are sustaining global uncertainty. In Europe, the conflict in Ukraine continues to exacerbate commodity-related inflation, destabilizing the economic outlook. In China, there has been a shift away from the previous zero-COVID policy, but the potential effect of new cases on economic activity continues to cloud the near-term outlook. Overall, the global economy is expected to expand by 3.4% in 2022 and then by 2.3% in 2023, according to BofA Global Research.
Monetary Policy / Inflation		The target policy interest rate set by the Federal Open Market Committee (FOMC) stands at 4.25% to 4.50%. BofA Global Research anticipates a terminal range of 5.00% to 5.25% by early this year. The pace of the balance sheet runoff has increased since last summer, with the cap at $95 billion per month in Treasury bonds and Mortgage-backed Securities (MBS). Greater signs of a peak in inflation and a slowdown in wage growth have heightened anticipation for a slowing in the pace of interest rate hikes.
Fiscal Policy		According to the Brookings Institution, the fading of pandemic- era fiscal support, which totaled nearly 31% of GDP, has been dragging on U.S. economic growth. Since that initiative, a $280 billion plan to strengthen the country's industrial base, by investing in semiconductor production and research and development of new technologies, has been authorized. Also approved was the 2022 Inflation Reduction Act. Alongside measures to reduce the public fiscal deficit, it provides nearly $370 billion over 10 years for energy security and climate change projects, among other initiatives.
Corporate Credit		High yield (HY) and Investment-grade (IG) credit spreads vacillated in 2022, but their general upward trend to more elevated levels indicate less accommodative financial conditions and investor worries over the prospect of a notable economic slowdown.
Yield Curve		The 2s/10s spread within Treasury yield curve remains deeply inverted. Longer-dated yields are also below shorter-dated ones across the curve, including the 3-month/10s and the fed funds/10s spread. The Treasury market suggests a higher probability of a recession in the U.S.
Technical Indicators		The Chicago Board Options Exchange (CBOE) Volatility Index (VIX) is hovering around 20, slightly above historic averages but well below the level that would typically be considered a turning point for Equities. Measures of market breadth have shown signs of improvement recently and the BofA Global Breadth Indicator is signaling "neutral."
Investor Sentiment		Bearish sentiment remains at an unusually high level, according to the American Association of Individual Investors. Institutional portfolio cash levels remain elevated and continue to signal a tactical contrarian "buy" signal, according to BofA Global Research's Fund Manager Survey. The BofA Bull & Bear Indicator now signals "neutral," at 2.9.

Source: Chief Investment Office.

EQUITIES

We are neutral Equities: We maintain a neutral view on Equities, as risks to economic growth and corporate profits remain skewed to the downside. The Fed is likely to continue to hike policy rates in the next couple of meetings albeit at a potentially slower pace, while conducting balance sheet runoff. We expect stability in risk assets to come with a peak in the 2-year Treasury yield, peak labor market weakness, a spike in volatility and core inflation moving lower toward the Fed's target. These conditions are likely to materialize later in 2023, and, therefore, a defensive and high-quality bias is warranted in the near term. We favor U.S. Equities on a risk-adjusted basis for now, but as interest rate differentials narrow and the dollar continues to weaken, non-U.S. markets could see new tailwinds. We remain slightly underweight European Equities and International Developed Market Equities given that Eurozone growth is likely to weaken on the back of the energy

price shock, declining business and consumer confidence, and slowing money supply growth.

We are slightly overweight U.S. Equities overall: The U.S. currently remains our preferred Equity region relative to the rest of the world, given relatively stronger balance sheets on aggregate, healthy shareholder payouts, better consumer fundamentals and a greater degree of energy independence. We maintain a slight overweight to U.S. Large-caps given our higher-quality bias, with a preference for Value, which should continue to benefit from elevated inflation in the near term and still trades at a discount to Growth. We remain neutral Small-cap Equities, which have lower-quality balance sheets, a higher proportion of non-earning companies within the index, and less financial flexibility to generate shareholder payouts, which can be detrimental during an economic slowdown. In our view, Small-caps could be leaders of the next decade but need to stabilize in 2023 and margins need to expand relative to Large-caps in order to outperform consistently.

We expect earnings per share (EPS) for the S&P 500 to decline in 2023 by 9% to $200 on economic weakness and margin pressures. S&P 500 valuations have become more attractive but are still not cheap given the uncertain earnings picture. The valuation compression in 2022 was mostly due to the rise in rates, however multiples could see another leg lower once the focus shifts to weaker fundamentals for earnings. Near-term risks for Equities come from a global slowdown in growth and profits, persistently elevated levels of inflation and a Fed policy error. We would expect volatility to continue as financial conditions tighten as the Fed continues its hiking cycle.

Our "on guard" stance continues to tilt more defensive to start 2023. This month we adjust our sector views to reflect our preference for quality, by upgrading Healthcare from slight overweight to overweight, and downgrading Real Estate (RE) from slight overweight to neutral. We remain overweight sectors with strong free cash flows (FCF) and attractive valuations like Energy and Financials and also prefer more defensive sectors like Healthcare and Utilities which are likely to provide relative earnings stability. Given our view that we are in a late-cycle environment, we remain neutral Information Technology, Industrials and Consumer Staples. Stronger relative earnings from Consumer Staples is a positive but historically high valuations are concerning. We remain slightly underweight Materials as recession risk rises. We remain fully underweight Consumer Discretionary and Communication Services.

We believe strategic portfolios should incorporate both Growth and Value factors that would simultaneously gain from cyclical and secular forces gaining traction. In the long run, Growth should benefit from accelerated secular investments in 5G, artificial intelligence, cloud computing, robotics and health infrastructure globally. However, current economic conditions suggest that investors may want to consider emphasizing Value, which is trading at a relative discount to Growth and is seeing better earnings trends.

We are neutral Emerging Market Equities: EM Equities appear attractively valued but remain vulnerable to further escalation of the conflict in Eastern Europe, Fed tightening and a still elevated U.S. dollar. We continue to expect a wide return dispersion between individual EM countries and regions. Central and Eastern European markets are most exposed to the Ukraine/Russia crisis through trade links and high dependency on natural gas imports. Market direction in Latin America, the Middle East and Africa should remain broadly tied to the direction of natural resource prices. And Asian markets, in aggregate, are net commodity importers with more exposure to technology and other growth sectors. For the heavyweight Chinese market, we see ongoing uncertainty related to domestic policy but upside risks as certain restrictions are lifted. The structural rise in EM consumer spending remains a big reason that we believe investors should consider maintaining a strategic allocation to EM Equities, as appropriate. The emerging world now constitutes around 40% of global Personal Consumption Expenditures (PCE) according to the United Nations, and ongoing convergence with developed economies should support GDP growth and corporate earnings over the longer term. We favor active management[1] when investing in EM, as fundamentals differ across countries based on fiscal capacity, external funding needs, corporate governance and other factors.

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

EQUITY WATCH LIST

- Continued Fed tightening as inflationary pressures persist
- Economic data for production, labor, consumer expectations, and credit and liquidity conditions
- Progression of earnings estimates amid margin pressures
- Reorganization of global supply chains and U.S.-China relationship
- Ongoing conflict in Eastern Europe

We are slightly underweight International Developed Market Equities: We continue to prefer U.S. versus International Developed given our higher-quality view. We remain slightly underweight Europe given headwinds to economic growth and corporate profits from higher energy prices, elevated inflation and a hawkish European Central Bank (ECB). Diminished gas supplies from Russia continue to contribute to the likelihood of further economic weakness across the region. There are some preliminary signs of inflation peaking in Europe, but the ECB is likely to keep tightening monetary policy while balancing the risk caused to peripheral debt. We maintain a neutral view on Japanese Equities, which could see additional tailwinds from economic reopening. Despite near-term challenges, we believe long-term investors should consider maintaining some strategic exposure to International Developed Equities, as appropriate, as they trade at a discount relative to U.S. Equities, offer an attractive dividend yield, and provide strong diversification benefits.

FIXED INCOME

We have downgraded Global Fixed Income to neutral: Beyond our neutral allocation to Fixed Income, this month, we are upgrading U.S. Government Bonds as nominal and real rates are some of the most attractive in over a decade, while the economy deteriorates later in the economic cycle and recessionary signals increase. 10-year Treasurys are currently hovering around 3.60%, just off recent post-2008 highs. Real yields—the yield after inflation is taken into account, as measured by Treasury Inflation-Protected Securities (TIPS)—are approximately 1.5% across the curve. The ability to now earn a positive, substantial yield on U.S. Government-guaranteed securities after inflation is a welcome reprieve for savers after years of financial repression. We are therefore slightly positive on U.S. Governments.

The Fed delivered a 50 basis points (bps) interest rate hike in December, slowing the pace of rate hikes after four 75 bps hikes in a row—a large amount of monetary policy tightening in a short time frame, especially toward the end of the rate hike cycle. The targeted fed funds range is now 4.25% to 4.50%, and the market currently expects approximately another 50 bps of rate hikes before the Fed stops raising rates in 2023, with a peak fed funds rate of around 5%. Leading economic indicators have turned negative: the 2s/10s Treasury yield curve is around 60 bps inverted and the 3-month/10-year yield curve recently inverted. Inflation expectations have stabilized around 2.25% to 2.5%, highlighting that the market thinks the worst of the inflation spike is behind us and that Fed policy will be enough to get back to lower inflation. Therefore, while long rates may continue to move up, they are becoming less sensitive to moves in short rates. The amount and extent of further upside in rates has diminished, in our opinion, and although it is still very real, rate risk is more two-sided now. Fixed Income will do an even better job of diversifying multi-asset class portfolios from this point forward, in our opinion, since higher yields offer not only higher income but also can potentially move down substantially if another economic downturn occurs. We are therefore neutral duration versus a stated benchmark.

We have downgraded Investment-grade corporates to neutral and remain slightly underweight High Yield: IG credit spreads have been in a defined uptrend, i.e., higher highs and lower lows for the majority of 2022. Amid a worsening macro backdrop, interest rate volatility, and tightening central bank monetary policies, IG spreads recently notched fresh highs for the year last fall. However, spreads have since quickly rallied back to key support levels which have proven difficult to break through over the last several quarters. At +130 bps on the ICE BofA Investment Grade Index, credit spreads are well below levels that we would consider appropriate for pricing in a recession (around 175 to 200 bps).

We continue to advocate for an up-in-quality tilt with regard to positioning within credit and believe that the recent repricing in all-in yields presents a more balanced risk/return opportunity, particularly for investors with a longer time horizon. However, we do not want to downplay the risks that spreads could gap further toward 200 bps, should a soft landing not materialize and economic data worsen. That said, we would likely view this as an attractive rebalancing opportunity to add measured credit risk to Fixed Income portfolios.

FIXED INCOME WATCH LIST

- Deeper yield curve inversions
- Signs of any risk aversion or recessionary risk in terms of spreads, yields or new issue activity
- Signs of significantly negative Fixed Income fund flows
- Dislocations in Commercial Real Estate (CRE) markets
- Potential credit deterioration in the economic weakness

Credit losses in IG are generally manageable and not a large component of spreads or yields, but the same cannot be said in HY. Fortunately, HY yields-to-worst—while volatile of late—remain roughly around 9% after rallying into the mid-7% range in early August. We believe valuations once again provide reasonable compensation for credit losses and suggest favorable returns over medium to longer time frames. However, as sentiment remains depressed and concerns of a recession become more prevalent, yields could rise again, so there may still be additional price losses to come. Spreads, moreover, are in the 450 to 500 bps range, well below the 650 to 800+ level seen in many recessions. We therefore maintain our slight underweight positioning. Within HY allocations, we prefer a balanced allocation between secured floating-rate leveraged loans and unsecured high yield bonds.

We are neutral U.S. Investment-grade Tax Exempt: The muni yield curve became inverted in late December, and munis began 2023 with richer-than-average valuations relative to Treasurys. We believe munis continue to provide value over Treasurys for tax-sensitive investors. Technicals appear favorable, even with lackluster retail demand, given low issuance expected this year. We believe fundamental conditions remain solid for now, but concerns are likely to emerge due to weakening tax revenues, increased operating expenses, and higher required pension contributions. We expect defaults on IG muni bonds to remain low, but a focus on higher credit quality and lower-risk sectors (e.g., general obligations and essential service revenue bonds) should help mitigate the risk of spread widening. Extra caution may be warranted in sectors most affected by cyclical and longer-term pressures. For example, hospitals have been especially affected by higher labor and supply costs, while transit is effected by the secular, post-coronavirus shift to remote work, and higher education by declines in enrollment and weak revenue growth.

We are neutral Mortgage-backed Securities: To help combat high inflation, which has risen to a four-decade high, the Fed has steadily tightened financial conditions by raising interest rates and engaging in quantitative tightening. As a result, MBS spreads have been under pressure and have leaked wider toward levels seen more typically during market stress.

A portion of the key sector risk has been at least partially mitigated, with MBS duration now significantly lengthened with further extension now limited in a rising rate environment. However, interest rate volatility remains elevated at levels last seen during the height of the pandemic, which is negative for MBS investors. Furthermore, the technical picture for MBS demand appears challenged by banks' reduced savings and increased commercial and industrial (C&I) loan activities. Effectively, the Fed and financial institutions, which collectively own two-thirds of the MBS market, are less active participants currently. Given the Fed's lack of experience with quantitative tightening, especially active MBS sales, and the unsettling geopolitical situation, it's likely that MBS spreads will continue to widen, in our view—which holds back our neutral view on the sector despite current spreads of around 50 bps that look attractive at 1.5 times the 10-year average of 35.

ALTERNATIVE INVESTMENTS

We favor a strategic approach when allocating to Hedge Funds: Our outlook for Equity Hedge remains slightly positive for qualified investors. Given the heightened uncertainty surrounding global equity markets, we continue to favor strategies with low to moderate net market exposure and limited factor biases and believe there is an attractive opportunity set for alpha generation. In the short term, amidst a market environment heavily influenced by macro factors, we favor funds with strong risk management processes and the flexibility to become more aggressive once fundamentals prevail. Over the medium term, as market participants shift their focus to earnings, FCF generation and capital allocation efficiency, we expect higher stock dispersion and thus a more favorable backdrop for stock pickers generating alpha on both long and short positions. We believe that a hedged yet flexible approach to investing in Equities presents an opportunity to outperform broader equity markets amidst the current economic backdrop.

Looking at the year ahead, the outlook for Event Driven remains mixed. The opportunity set for Distressed strategies increasingly looks promising over the next 12 to 18 months. That said, there is a cognizance among managers that some patience is warranted when it comes to capital deployment, as market volatility is expected to remain elevated in the near term. Consistent with prior market downturns, Event Driven Multi-Strategy managers have been reducing exposure to Equities and pivoting their portfolios towards a higher exposure in credit. Managers are taking a balanced approach gradually leaning into stressed and distressed credit situations, given the already rich opportunity set, while retaining enough dry powder for future capital deployment over the next several quarters.

As the outlook has improved for Relative Value, we have upgraded the strategy from an underweight closer to a neutral weight preference. Yields and spreads are substantially higher and wider year-over-year (YoY) across almost all of credit, including corporates, munis and asset-backed securities, which compensates investors for taking on credit risk significantly more today than previously. At this time, defaults are expected to rise closer to average levels, but it seems unlikely that they will spike in the near term, making the downside risks feel partly mitigated or compensated for. Volatility has created opportunities to reallocate unconstrained portfolios to attractive risk-adjusted opportunities, though liquidity notably continues to remain poor.

Despite the reversal in certain trends and a slowdown in performance for Macro strategies recently, performance remains strong, and we continue to be positive on this strategy. In 2022, Macro managers made the bulk of their money from being short sovereign Fixed Income markets and long the U.S. dollar against currencies like the euro, pound and yen, two trends that recently reversed. Many managers do expect the unprecedented tightening to give rise to a recession, with uncertainty about its severity and effect on major asset classes. Many Macro managers had been predicting more monetary tightening was coming to combat inflation, and we saw this come to fruition with four 75 bps hikes in the fed funds rate topped off with 50 bps in December. As rates rise, traditional markets may continue to struggle, while opportunities for Macro managers could be quite strong.

We favor a strategic approach when allocating to Private Equity: Private Credit has continued to deliver for investors in this environment, providing positive and growing income while most other Fixed Income investments have declined materially. The continued rise in interest rates have caused duration-sensitive fixed-income to decline in value, on top of publicly traded bank loans falling in value as fund flows turn negative. However, even with this negative trend, direct lending portfolios experienced a low number of credit issues in 2022. Generally, coverage ratios have declined modestly, and we consider them to still be in a neutral zone. Floating rate resets were back-end loaded for the year, pushing income up materially over the last six months. Overall, this strategy has outperformed traditional Fixed Income in 2022. However, investors should be mindful of credit deterioration and rising default risk brought about by rising rates and likely recession in 2023.

The rapid repricing of yields and spreads over the past six months has improved the outlook for the Special Situations Private Equity (PE) strategy, in our view, from very limited and uninspiring to more average levels. Current corporate default rates remain low, but this may be changing. Moreover, forecasts for defaults in 2023 have now climbed to around 2.3% for HY and 2.8% for leverage loans compared to long-term averages of 3.2% and 3.1%. Forecasts have also been ratcheting up in recent months in a game reminiscent of catch up, similar to the dynamics seen in inflation expectations and earnings estimates. It is quite plausible that stress could metastasize as debt service burdens increase immediately for floating rate borrowers and upon refinancing for fixed rate borrowers. If economic growth slows beyond expectations, the stress would be compounded. At a minimum, we believe we have rapidly returned to a neutral posture with our eye on a potentially sizable future opportunity set.

In Buyout, deal activity continues to slow and closed deal activity diminished into the end of 2022. Deal pipelines in many sectors are softening, in technology especially, and debt is becoming more expensive. Given that the market for initial public offerings has all but dried

ALTERNATIVE INVESTMENTS

Given the differences in liquidity characteristics between Alternative Investments (AI) and traditional investments, the CIO asset class views on AI portfolio positioning continue to be 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 sub-asset 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, helping to reduce risk and capitalizing on opportunities not available through traditional investments.

up, public market woes in 2022 are now having a significant effect on exits. Global buyout-backed exit value hit $338 billion in the first six months of 2022, a decline of 37% from the same period a year ago. With that, fundraising in Private Equities is expecting a slowdown, especially with an anticipated global recession. While we remain positive on Venture/Growth Equity over the long term, we think it is likely that valuation resets will continue to trickle into current portfolios. The threat of a recession driven by rising interest rates portends a negative effect to portfolio company operating performance, as measured by their ability to meet targets and/or outperform the last two years. This effect is likely to be more acute with businesses that serve individual end-customers (B2C businesses).

We favor a strategic approach when allocating to Private Real Estate: In 2023, we remain constructive on Core/Core-plus RE as a strategic, long-term portfolio allocation, even as the macroeconomic landscape has changed dramatically from a year-ago. As expected, 2022 saw a moderation of the exceptional performance delivered by the asset class in 2021, and yet the strategy delivered attractive total returns in 2022 on both a risk-adjusted basis and relative to long-term targets. Our outlook for this year includes continued moderation of performance expectations, driven by potential for further pressure on cap rates and tapering of the outsized rental income growth achieved in 2022. In a more challenging environment due to higher interest rates and recessionary pressures, we expect to see performance dispersion between funds driven by portfolio construction and sector allocations. Opportunistic Real Estate remains a neutral asset category for Q1 2023. Facing rising interest rates adds to some uncertainty in this strategy, although Real Estate has a good historic record of outperforming during periods of inflation and economic growth. The uneven and fluctuating recoveries from the pandemic does continue to create pockets of opportunity globally, for larger investment managers who have a broad sourcing network. While technically not classified as RE, Private Infrastructure enjoys some of the positive characteristics of RE and offers some interesting opportunities. Infrastructure assets are well positioned, in our view, in the current inflationary, possibly recessionary, environment. Underlying hard assets with collateral-based cash flows, inflation-linked earnings and contractual cost inflation pass-through are key features of many sectors within the infrastructure market. Additionally, the essential nature of services provided by infrastructure assets provides a level of resiliency in otherwise challenging macro environments, in addition to the diversification aspects relative to traditional debt and equity investments.

Commodities and the dollar: After a strong start to 2022, commodity prices began to slide as the global economy slowed into year end and the likelihood of recession increased. However, over the long term, we believe that positive fundamentals remain in place and a moderate allocation in an investors' portfolio could be additive from a return and a diversification perspective. Commodities tend to do well in periods of elevated geopolitical risk and high inflation, both of which seem to be currently available in abundance.

The dollar had a very strong year until last November, when the trend reversed. The strength of the greenback up to that point came from three major forces: "safe haven" status in an uncertain geopolitical world; higher relative interest rates vs. Europe and Japan; and relatively better economic conditions. While it looks like the U.S. has reached peak inflation and that interest rate increases will likely be smaller going forward, the wind has gone out of the sails of this trade. As other global central banks continue to hike rates, the dollar will face further headwinds. In 2023, one risk to dollar strength is if inflation falls faster than the market expects and the Fed makes a dovish pivot.

Tangible assets: As inflation remains elevated, tangible assets—such as real estate, timber, and farm and ranch land—have historically done well in a high-inflationary environment and can add a real diversification benefit to a traditional portfolio. It can also add a diversification benefit to Hedge Funds and PE investments.

MACRO STRATEGY

- In the U.S., leading indicators suggest real growth and inflation will likely continue to lose momentum as the Fed withdraws liquidity from the system. Declining real growth and inflation will squeeze corporate revenues and profits, which will reinforce the slowdown in real activity.
- Global cyclical momentum is slowing. The JPMorgan Global Manufacturing Purchasing Managers' Index (PMI) declined for 7 consecutive months to close 2022 and is in contraction territory. China's reopening should eventually help but will be bumpy, in our view.

ECONOMIC FORECASTS (AS OF 1/6/2023)

	Q4 2022A	2022A	Q1 2023E	Q2 2023E	Q3 2023E	Q4 2023E	2023E
Real global GDP (% y/y annualized)	-	3.4*	-	-	-	-	2.3
Real U.S. GDP (% q/q annualized)	0.5*	1.9*	-1.0	-2.0	-1.5	1.0	-0.3
CPI inflation (% y/y)	7.2*	8.0*	5.4	3.9	3.3	2.9	4.0
Core CPI inflation (% y/y)	6.0*	6.2*	5.2	4.3	3.3	2.8	4.3
Unemployment rate (%)	3.7*	3.7*	3.7	4.2	4.8	5.4	4.5
Fed funds rate, end period (%)	4.33	4.33	5.13	5.13	5.13	4.88	4.88

The forecasts in the table are the baseline view from BofA Global Research. The Global Wealth & Investment Management (GWIM) Investment Strategy Committee (ISC) may make adjustments to this view over the course of the year and can express upside/downside to these forecasts. There can be no assurance that the forecasts will be achieved. Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment performance.
A = Actual. E/* = Estimate.
Sources: BofA Global Research; GWIM ISC as of January 10, 2023. Forecasts are subject to change.
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.

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

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. EPS forward P/E next 12 months.

2023 EPS	15.0x	16.0x	17.0x	18.0x	19.0x
$240	3,600	3,840	4,080	4,320	4,560
$230	3,450	3,680	3,910	4,140	4,370
$220	3,300	3,520	3,740	3,960	4,180
$210	3,150	3,360	3,570	3,780	3,990
$200	3,000	3,200	3,400	3,600	3,800
$190	2,850	3,040	3,230	3,420	3,610
$180	2,700	2,880	3,060	3,240	3,420

For illustrative purposes only. Source: Chief Investment Office as of January 10, 2023.

CIO ASSET CLASS VIEWS AS OF JANUARY 10, 2023

	CIO View					
Asset Class	**Underweight**		**Neutral**		**Overweight**	**Comments**
Global Equities			●			We are neutral Equities as risks to economic growth and corporate profits have recently increased. We remain overweight the U.S. and neutral EM, with a slight underweight to International Developed.
U.S. Large-cap Growth			●			We have a slight preference for Value over Growth, given better absolute and relative valuations. Higher interest rates should pressure Growth more, especially higher multiple, non-earning areas. We believe portfolios should incorporate both Growth and Value factors as appropriate.
U.S. Large-cap Value				●		
U.S. Small-cap Growth			●			We are neutral Small-caps, as they have lower-quality balance sheets, a higher proportion of non-earning companies within the index, and less financial flexibility to generate shareholder payouts. However, they maintain reasonably attractive absolute and relative valuation versus Large-caps..
U.S. Small-cap Value			●			
International Developed		●				International Developed Equities remain more vulnerable to rising oil and gas prices and elevated geopolitical risk, and underlying nominal growth is expected to trail behind U.S. levels
Emerging Markets			●			We are neutral EM Equities overall with regional markets likely to be driven by relative exposures to commodities and growth sectors. Key risks stem from further escalation of the conflict in Central and Eastern Europe, rising U.S. interest rates and dollar strength.
International						
North America				●		The U.S. remains our preferred region given balance sheet strength, better fundamentals for consumer spending and a lower likelihood of a deeper energy shock.
Eurozone		●				Downside risk stems from higher oil and gas prices and elevated geopolitical uncertainty in Eastern Europe, which may weigh on real household incomes, industrial profits and economic growth. Exchange rate weakness risks compounding inflation pressures.
U.K.			●			Domestic demand at risk from rising household fuel prices and higher interest rates. Exchange rate weakness risks compounding inflation pressures. Post-Brexit withdrawal from the European Union single market remains a negative for medium-term growth.
Japan			●			Fiscal and monetary stimulus are key sources of support for the local market, though nominal growth expectations remain among the lowest for the major developed economies.
Pac Rim*			●			Large weighting in Financials should be a relative advantage as rates rise. China exposure and international shifts on foreign policy toward Hong Kong remain an ongoing source of uncertainty for the region.
Global Fixed Income			●	◀		Bonds have become significantly more attractive and provide an even better ability to diversify multi-asset class portfolios by providing income and the ability to decline in yield substantially in an economic downturn. Neutral duration is recommended, balancing two-sided rate risk against significantly better valuations.
U.S. Governments			▶	●		Nominal and real yields are now very attractive across the curve relative to the last 10 to 15 years. A Treasury allocation for liquidity, principal preservation and diversification is advised, as Treasurys provide the best short-term diversification benefits to Equities among Fixed Income sectors. Interest rate volatility has increased and may remain high.
U.S. Mortgages			●			To combat the inflation rate, which has risen to a four-decade high, the Fed has steadily tightened financial conditions by raising interest rates and engaging in quantitative tightening. MBS spreads have widened to attractive levels as a result, both on an absolute and relative basis. Given the Fed's lack of prior experience with quantitative tightening and the chaotic geopolitical situation, there is a risk that the spread could continue to widen, but the current level of around 50, which is about 1.5 times the 10-year average of 35, offers long-term investors an attractive yield.
U.S. Corporates			●	◀		IG spreads have rallied back toward the summer tights and, at ~130 bps, are not appropriately reflecting a near-term recession. At current levels, we see risks of a move wider towards 200 bps, should the Fed not be successful in orchestrating a soft landing in 2023. However, this should be viewed as a rebalancing opportunity given strength in corporate balance sheets at this point in the cycle. With curves still relatively flat, we see the best risk adjusted opportunities in the front end of the curve (i.e., three to five years).
International Fixed Income			●			International rates markets have become significantly more attractive as global central banks raise rates to fight inflation, no longer trading at a significant discount to the U.S. except in Japan where the Bank of Japan continues to keep longer-term rates artificially low.
High Yield		●				Valuations now present significantly more attractive medium to long-term returns even after estimating credit losses. However, poor near-term sentiment and rising recession concerns may exacerbate near-term price losses, and spreads are not at recessionary levels. Any additions to HY, therefore, should have a long time horizon. Within HY, we prefer balanced exposure between floating-rate loans and HY unsecured.
U.S. High Yield Tax Exempt		●				An up-in-quality focus should help mitigate increased credit risk due to economic weakening.
U.S. Investment-grade Tax Exempt			●			The muni yield curve became inverted in late December, and munis began 2023 with richer-than-average valuations relative to Treasurys. Technicals appear favorable, with low issuance expected this year. We believe fundamental conditions remain solid for now, but concerns may emerge due to potentially weaker tax revenues, as well as increased operating expenses and higher required pension contributions. We expect defaults to remain low, but a focus on higher credit quality will help mitigate potential spread widening.

* 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	CIO View: Underweight	CIO View: Neutral	CIO View: Overweight	Comments
Alternative Investments*				Given the differences in liquidity characteristics between AI and traditional investments, the CIO asset class views on AI portfolio positioning continue to be 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 sub-asset 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, helping to reduce risk and capitalizing on opportunities not available through traditional investments.
Hedge Funds				The shift in Fed policy has led to greater volatility in the Equity and rate markets. An allocation to Hedge Funds has the potential to lower the effect of the volatility and possibly take advantage of the dislocation and sector rotation. For a Hedge Fund allocation at the strategy level, we continue to suggest incremental overweight to Equity Hedge strategies as part of a diversified portfolio of Hedge Fund strategies. Additionally, we continue to see opportunities in the macro space given the rise in geopolitical risk, the potential for uneven economic growth, interest rate differentials and inflation expectations between countries and regions and its effect on rates, commodities and foreign currencies.
Private Equity				We see opportunities across a number of different PE strategies. We believe that an allocation to buyout and Venture/Growth Equity managers gives investors access to new and innovative technologies as companies stay private for longer. Generally, Private Credit strategies have outperformed traditional Fixed Income portfolios in 2022, and they have the benefit of interest rate resets that are back-end loaded, and we have seen some meaningful resets. However, credit and default risks rise as the economy contracts, so investors need to keep this in mind when contemplating an allocation.
Real Assets				Recently, commodity prices have stalled as the global economy slows and the likelihood of recession increases. Many commodities are stuck in a trading range as the path of global economic growth is uncertain. However, over the long term, we believe that positive fundamentals remain in place and a moderate allocation in an investors' portfolio could be additive. Commodities tend to do well in periods of elevated geopolitical risk and high inflation.

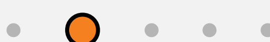
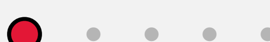
Tactical qualitative investment strategy weightings are relative in nature versus the strategic weightings for a fully diversified portfolio. Weightings are based on the relative attractiveness of each asset class. Tactical strategy weightings are for a 12- to 18-month time horizon. CIO asset class views 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, liquidity needs 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 qualified investors. Source: Global Wealth & Investment Management Investment Strategy Committee.

CIO EQUITY SECTOR VIEWS AS OF JANUARY 10, 2023

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 macro-economic 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
Healthcare			●	Upgrading the Healthcare sector from slight Overweight to strong Overweight and would use recent weakness to position in larger biopharma stocks with attractive valuations. In an environment where financial conditions are tightening and economic growth is slowing, Healthcare stocks provide attractive characteristics, including quality, dividend growth, dividend yield and lower beta. Healthcare fundamentals to date have been able to withstand much of the macro pressures seen globally. Distributors, life science equipment and large biopharma are best positioned, in our view, to weather pressure on margins, while innovation and breadth of portfolio should continue to allow for modest price taking in areas of medical technology and devices. Large pharmaceutical companies remain attractive as they trade at a material discount to Healthcare sector peers and the broader market. Further, significant cash on strong balance sheets, combined with more aggressive business development efforts and a greater focus on explaining long-term growth drivers make large pharma more attractive over the intermediate term. Over a longer duration, drug pricing headwinds may return as demographic shifts put more pressure on government payors and as value-based care initiatives gain momentum. Emphasize exposure to long-term positive trends in life science/bioprocessing equipment innovative and differentiated medical devices and animal health, as well as more intermediate opportunities in Large-cap biopharma and diversified medtech. Valuation remains attractive for the Healthcare sector.

Sector	CIO View					Comments
	Underweight		Neutral		Overweight	
Energy	○	○	○	●	○	Declining but still solid global energy demand, tight global inventories, limited spare capacity, risk of potential global disruptions, and the decline in long cycle energy investments are supportive for Energy stocks. Higher energy prices combined with substantial cost-cutting initiatives and capital discipline over recent years built significant operating leverage into Energy companies. Further, earnings and free cash flow outlooks remain strong for energy companies relative to other sectors. There remains room for positioning and sentiment to improve for the sector despite strong outperformance over the last two years. Despite tougher year-over-year (YoY) comps in 2023, remain positive on the Energy sector due to valuation, earnings power and higher cash returns to shareholders through base dividends, variable dividends, and stock buybacks. Longer term, secular headwinds still confront the sector, including the transition to clean energy, lower renewable energy costs and Environmental, Social and Governance (ESG) focus by investors. Continue to emphasize companies that are low-cost producers with high free cash flows, balance sheet strength and low break-evens. After two years as the top-rated equity sector, we remain overweight the Energy sector but due to tougher comps YoY it moves down on the sector list. Despite significant outperformance in recent years, Energy stocks still provide attractive valuations and strong dividends, but slowing momentum.
Financials	○	○	○	●	○	Banks should enjoy significant tailwinds from a higher interest rate regime after "under earning" on lending revenue since the global financial crisis. Coupled with robust loan growth, higher interest rates should drive double-digit growth in net interest income, with strong momentum that could carry through 2023. With typically half of a bank's revenue coming from net interest income, this sets the stage for above-trend revenue growth, which falls almost entirely to the bottom line. Importantly, this does not appear to be fully discounted in stock valuations which remain well below cycle averages. Enhanced earnings power should fuel ongoing capital return, which has been the cornerstone of the investment case for banks in recent years. We also favor life insurers which gain significant tailwinds from higher interest rates with higher-yielding investment portfolios. Investment income accounts for roughly one-third of life insurance revenues. Given structural headwinds in property and casualty insurance, we prefer alternative asset managers, like PE, which consistently draw fund inflows, typically find their most lucrative investment opportunities in times of economic stress and maintain pricing power in management fees. U.S. banks remain well capitalized and, in our view, are likely to return more capital to shareholders in coming quarters in buybacks and dividends and provide some attractive Price/Book valuation.
Utilities	○	○	○	●	○	Utilities provide stable and consistent earnings outlooks, especially relative to other more cyclical sectors. In addition, as we progress through later stages of this economic cycle, Utilities historically outperform in the late cycle and during economic growth slowdowns, especially regulated utilities. Utilities provide greater balance, lower beta, and help pair with our cyclical exposure in Equity portfolios. We expect consistent earnings results despite slowing economic growth. There is also the potential for higher interest rates that could potentially weigh on this interest-rate-sensitive sector and be a potential headwind near-term as a bond proxy sector. For the longer term, we emphasize Utilities with growing renewable power generation from wind and solar and de-emphasize ones that rely strictly on coal-power generation. The 2022 Inflation Reduction Act legislation provides a strong runway for future renewable energy investments and projects; and, also provides visibility and greater certainty for future earnings and dividend growth. Prefer utilities that can capitalize on the energy transition to greater renewable power generation and positive demographic trends. Valuation is above historical averages and momentum is neutral but defensive qualities remain.
Consumer Staples	○	○	●	○	○	The prospects for continued consistent demand for essential consumer packaged goods (CPG) products from an even more conservative consumer may support relatively better top-line revenue growth, when also coupled with selective but moderating retail price increases. Input and ingredient cost pressures could moderate further and may provide some downside gross margin protection over time. The Consumer Staples sector has historically outperformed other cyclical areas of the market during a period of negative earnings revisions due to the recurring nature of CPG company revenue streams, leading to better relative earnings growth. More visible and predictable earnings and a less severe period of downside earnings revisions help support the sector's relative valuation. Consistent cash flows through varying economic cycles help support higher dividend payouts and increased shareholder capital returns. The defensive characteristics of the sector could potentially attract "safe haven" investment flows over various cycle outcomes despite the already elevated valuations. Valuations are expensive, but momentum and relative performance has improved.
Industrials	○	○	●	○	○	The Industrial sector is neutral driven by divergent fundamental outlooks across subsectors. Softening domestic end markets, ongoing supply chain issues, elevated labor and energy costs, cautious guidance, and weaker export demand driven by Europe and China are weighing on the outlook for industrial conglomerates and transports. On the positive side, the global threat environment is heating up and driving an improving outlook for defense budgets in the U.S., Europe and Southeast Asia, underpinning favorable dynamics for defense companies. Aerospace is benefitting as well from the ongoing recovery in consumer and business air travel, which remain below pre-pandemic levels. Potential improvements in the global capex cycle, including re-shoring of supply chains and manufacturing, and investment in new equipment after years of focusing on productivity, could support the construction, transportation, machinery, and freight and logistics industries longer term. However, elevated inflation, tighter monetary policy and slower growth are weighing on general sentiment for Industrials. Valuation is slightly elevated, and momentum is improving.

Sector	CIO View (Underweight / Neutral / Overweight)	Comments
Real Estate		Downgrading the Real Estate (RE) sector from slight Overweight to Neutral as tighter financial conditions and higher cost of capital could slow growth in the sector. Higher interest rates could be a downside risk to sector earnings in 2023. Real Estate was a higher conviction sector when inflation was rising, but with some inflation measures moderating and higher costs of capital for the industry, we would be more selective within the Real Estate sector. There are mixed outlooks among its subsectors as a result of consumer and corporate changes like remote work, eCommerce, less business travel, etc., that are potential longer-term headwinds for CRE companies (e.g., office), mall operators and owners. With interest rates moving higher, the cost of capital for real estate growth projects could be a headwind depending how long rates remain elevated. Furthermore, risks are rising for downward pressure on rental rates as lease contracts expire and new contracts are negotiated. However, RE's positive correlation with inflation and attractive yield keeps the sector at Neutral. Continue to emphasize longer-term secular trends in data centers, communication infrastructure (towers), storage and industrial real estate. Valuations and momentum are neutral.
Information Technology		The Technology sector is neutral despite improvements in supply chains, but margin risks remain for companies in the sector. Despite some of the most expensive Technology stocks experiencing significant valuation re-ratings last year, we remain concerned about 2023 enterprise spending being under greater scrutiny on tighter spending budgets, potential for higher rates and the potential for additional valuation re-ratings in the sector. Further, the potential remains for downward revisions that are more likely to effect higher-beta, higher-valuation companies. Investors are debating if a bottom is in for semiconductor stocks as the group is looking more attractive. Despite strong Cloud tailwinds software margins could continue to deteriorate as cloud consumption could potentially come under some pressure near term and are not immune to a macro slowdown. We suggest a neutral weight in Tech, with a bias to higher quality and more fairly valued companies with both strong FCF and balance sheets. We continue to encourage investors to be careful about unprofitable, expensive and long-duration Tech companies. The pandemic accelerated the digital transitions for many industries but over the longer term, we remain positive on the secular growth trends for cloud computing, machine learning and artificial intelligence, and data centers, software, cybersecurity and semiconductors. Valuations in the sector declined in 2022 but are still elevated, and any additional moves higher in interest rates could pressure multiples for high-growth and high-valuation tech stocks with low to no profits; therefore, look for GARP (growth at a reasonable price) in software and semiconductors. The Tech sector still generates significant FCF and dividend growth and remain strong long term fundamental drivers for the sector. Technology is deflationary by nature; therefore long-term investors should look to add to transformational and industry leading businesses on weakness from the Fed's pivot and the re-rating of Technology stocks. Valuations remain elevated and momentum is weak.
Materials		Slower global growth, weaker commodity prices and tighter monetary conditions factor into our more cautious view on the Materials sector. We are seeing deceleration in the positive pricing cycle that has been driven by favorable supply and demand conditions over the last two years. Rising interest rates in the developed world and ongoing trials securing labor and materials are pushing industrial project timelines to the right, and with the additional challenge of higher energy costs, we are seeing some formerly profitable projects be reconsidered. Meanwhile, the supply side continues working at maximum capacity to meet the demand levels and thus may end up overshooting. We see this reflected in rising inventory level data across some value chains and are increasingly cautious as the dynamic may spread and become a trend. We want to reposition investment portfolios ahead of a potential contraction in the pricing cycle, as rising inventories and slowing volumes give buyers more bargaining power. Multiples could meaningfully contract if we start to see persistent pricing declines across the commodity complex. Such a trend would give some intermediaries relief on costs, but if they are also experiencing volumes decline, operating leverage could be at risk. We do still see some near-term tailwinds for demand, such as bipartisan support for U.S. infrastructure spending and potentially loosening policies in China, but on balance risks for performance are growing relative to potential rewards. Amidst softening demand trends and expected supply growth in the near term, consensus estimates appear elevated. As a result, the underlying sector valuation is neutral, while momentum is neutral.
Consumer Discretionary		Following a protracted period of above-trend post-pandemic spending levels, the consumer is facing persistent and troublesome inflation headwinds that could result in a more conservative spending pattern as a slowing economy and potential employment security issues weigh on consumer confidence. Big-ticket purchases of autos and homes have been deferred due to supply restraints and higher average selling prices, and, as a result, the consumer has pivoted to travel and leisure experiences that drove demand for hotels, airlines and theme parks. The potential exists for consumers to retrench and assess their personal financial position, further deferring big-ticket purchases, including travel and leisure, until they feel more confident about the economy and other macro headwind factors. A retrenched consumer may revert back to normalized spending patterns that drive demand for essentials only as the consumer attempts to deleverage their balance sheet and draw down savings balances for everyday needs. The ongoing period of declining real disposable income is being punctuated by stubbornly high energy costs and ongoing consumer goods inflation and potentially exacerbated by the removal of the student loan forbearance that has been extended into 2023, which could provide an additional strain on household incomes. The earnings revision life cycle has historically led to several quarters of negative earnings estimate revisions and declining relative valuations versus the more stable consumer products companies. Valuation for the sector is still elevated and momentum is negative.
Communication Services		We remain underweight the Communication Services sector due to concern for a heighted regulatory environment, potential shifts in advertising spending, and an increased competitive environment for content. Both European and U.S. advertising spend is slowing due to supply chain, inflation and ongoing macro uncertainties. Ad spending is moving from e-commerce to travel and leisure, hence advertisers are having to shift their targeting. Retailers are suffering from rising costs and slowing sales, which could drive lower advertising spend. This is also being exacerbated by increased competition in the streaming wars just as the consumer comes out of binge-watching post-coronavirus. Long duration stocks without profits could see additional valuation re-ratings. Valuations have declined and momentum is weak.

Source: Chief Investment Office. 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.

CIO THEMATIC INVESTING AS OF JANUARY 10, 2023

Taking the long view, the following themes and subthemes are considered among the most powerful structural forces in the world. They are macro in nature but carry significant risks and reward for companies, both large and small. These themes are transformational and carry long-term implications for economic growth, the cost of capital and global earnings. Gaining exposure to these themes is a key ingredient to investing, in our view.

Big Data	Demographics	Climate Change
The massive growth in unstructured data being created by connected machines, devices and systems is fueling data processing and data analytics. Complementing artificial intelligence technologies are replete with applications for big data. The size of the digital world and Internet of Things (IoT) is accelerating the migration of data and applications to a cloud computing environment. Data centers and cloud-based storage will likely capture incremental data created.	Several demographic transitions serve as important arbiters of future growth. With elongated life expectancies globally, longevity for older populations will likely mean a renewed focus on healthcare, aged-care, financial, and consumer products and services for longer, serving as a multitrillion-dollar potential opportunity. Both the Millennials (born 1981-1996) and Gen Z (born 1997-2012) could have greater influence over the next decade on consumer spending and preferences. While we are neutral the EM asset class on a tactical basis, we believe the EM consumer represents a powerful middle-class consuming cohort over the longer term. Uplifting the bottom billions, or poorest socioeconomic group with growing access to electricity, internet and sanitation can also offer a demographic dividend for multinational companies.	With emphasis from the White House, a much greater focus is on health, renewable energy, clean water and sanitation, and other industries that tend to support a more sustainable future. Companies that embrace more climate-friendly business models and operations, as well as consumer products and services, are likely to enjoy sustained growth opportunities over the long term. Globally, nuclear energy is re-emerging and increasingly acknowledged as a 'green' energy solution. Other key investment opportunities: Renewable energy (solar, wind and hydrogen), as well as energy-efficiency such as building systems, water/waste management, and energy storage and distribution.
Future Mobility	**Security**	**Post-crisis World**
The future of mobility hinges on next-gen infrastructure. This includes the telecom industry's deployment of the 5G network, which is expected to prove to be the greatest accelerant and enabler to smart cities (smart buildings, safety and security), autonomous vehicles and unmanned drones. The growing electric vehicle market will likely demand installation of charging equipment and fuel peripheral industries such as battery material demand.	Expanding the IoT means security for a growing ecosystem of devices and end points. With the increase in time spent on online platforms, (as well as adoption of online payments/FinTech), data privacy/surveillance and governance is expected to play a larger role in a post-pandemic world, as will bolstering cybersecurity defenses and budgets. With the commercialization of space, cybersecurity will likely extend to space-based assets (think satellites, data links, weather monitoring and GPS).	In the post-crisis world, reshoring policies are increasingly focused on building more resiliency into supply chains, helping to sculpt tripolar supply chains pivoting between North America, Asia and Europe. A number of labor force dynamics have converged to place unprecedented demand on labor not only in the U.S. but around the world, hastening the need for industrial and service automation/robotics. The extraction, sourcing, use and management of the world's resources will stay in focus as both the agriculture and commodity complexes are stretched given the geopolitical backdrop. If the future entails increased investments into electric vehicles and greener energies, then the future will be mineral and material-intensive, calling for more mining of copper, lithium, nickel, manganese, cobalt and graphite, etc. Lastly, real assets in the post-crisis world are a key buffer to above-trend inflation.

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Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Indexes are all based in U.S. dollars.

S&P 500 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.

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

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 an index of the prevailing direction of economic trends in the manufacturing and service sectors.

ICE BofA Investment-grade Index measures market performance of USD-denominated investment grade corporate debt publicly issued in the U.S. domestic market with a remaining term to final maturity.

Bloomberg's Commodity Index is a family of financial benchmarks designed to provide liquid and diversified exposure to physical commodities via futures contracts.

MSCI Emerging Markets Index is a selection of stocks that is designed to track the financial performance of key companies in fast-growing nations.

Broad Trade-Weighted Dollar Index is an index created by the Fed to measure the value of the USD, based on its competitiveness versus trading partner.

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S&P 500 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.

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