MERRILL
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CHIEF INVESTMENT OFFICE

Viewpoint

The Reflation Triangle

July 2020

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

IN BRIEF

- We believe we are in the early stages of another long-term bull market (one with higher than average valuation, slightly elevated volatility and lower rates for longer) and remain highly favorable on equities relative to fixed income and cash.
- 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 assets from a cash-flow and yield perspective.
- Looking forward, there remains uncertainty given rising coronavirus cases in the U.S and regional pause on reopenings, increasing U.S.-China tensions, and upcoming U.S. elections. We believe investors should consider emphasizing Quality, Yield and Growth in their equity allocations.
- We recommend short-duration relative to a stated benchmark, as rates are extremely low, but the Federal Reserve (Fed) is not expected to move rates into negative territory, therefore limiting how much further rates can reasonably drop.

The capital markets have settled into a higher zone in the last month as economies have reopened, mini V-shaped recoveries have developed, and the two—or three—month record-deep recession appears over. However, coronavirus case growth has risen sharply across parts of the southern belt in the U.S., and the wall of worry still remains high regarding the durability of the economic and profits recovery overall.

We believe there are three main points for investors to focus on heading into the second half of the year. First, the reflation triangle is alive and well and arguably its strongest in decades. The combination of unprecedented stimulus, liquidity and money growth mixed with a weaker U.S. dollar and a steeper yield curve is supporting the broader market backdrop. Given the recent inflation targeting communication from the Fed and potential next steps regarding yield curve control and extended negative real interest rates, reflation should remain a tailwind for much longer than most believe, in our view. The current backdrop is very different from the environment pre-pandemic, which included tighter monetary policy, a stronger dollar and an inverted yield curve. All major reasons why the last cycle expansions had stalled out, in our opinion. Financial conditions at present are supportive to risk assets and emblematic of the early stages of a long-term global synchronized expansion.

CIO ASSET CLASS VIEWS:

The Global Wealth & Investment Management Investment Strategy Committee did not make any tactical asset allocation adjustments this month, but we reaffirm our positive view on equities relative to fixed income, with an emphasis on U.S. large cap relative to the rest of the world. Investors should continue to maintain well-diversified portfolios, and consider emphasizing Quality, Growth and Yield.

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.

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Secondly, the profit cycle should gather much more momentum later this year and through 2021 given the extraordinary stimulus and liquidity in place and a broadening out of the global expansion currently unfolding. Business-model resiliency is gathering pace, and operating leverage is growing in areas able to accelerate new efficiencies learned during the early stages of the pandemic. This is having powerful positive effects on certain industries, particularly across Technology, Discretionary, Communication Services and Healthcare. In addition, we will be watching Europe's equity markets, U.S. small caps and U.S. cyclical sectors such as Industrials and Financials for more clues on the strength of the recovery in the coming weeks. We expect Q2 earnings to outpace consensus expectations by some 8% to 10% driven by strong housing data, consumer spending and now manufacturing indexes back into expansion territory.

Thirdly, the human healthcare crisis is still the number one risk to the economy and the markets. Rising coronavirus cases is another concern as we head into the heart of the summer and even before we get to a potential second wave. A question many are asking now is whether the new restrictions or the reopening phase pullback in some states will significantly affect the overall economic recovery and stunt the "V" shapes that are still developing. Only time will tell on this front. We expect a wavy economic recovery overall when we get to the other side and a profit cycle that gets back to "normal" sometime in 2022. We see 2021 as a pent-up-demand-cycle year with a tailwind from the excessive stimulus and negative real rates, which could help profits surprise to the upside. We continue to analyze various healthcare trends in order to gauge the direction of consumer and business confidence in the months ahead. As we have said before, science gets us back! Science and technology together get us through to the other side.

By September, investors should begin to factor in the outlook for the November election. At this point, uncertainty could rise, and investors may head to the sidelines. This could create another consolidation period in the markets but we would view excessive weakness as buying opportunities in equities. We believe we are in the early stages of another long-term bull market (one with higher-than-average valuation, slightly elevated volatility and lower rates for longer) and remain highly favorable on equities relative to fixed income and cash.

CIO INVESTMENT DASHBOARD

Global equities have rebounded in many parts of the world as markets begin to look toward a recovery that has shown signs of building and may accelerate later in the year and into 2021. In the near term, we expect the success of economic reopened plans to be among the key drivers of financial markets.

Corporate earnings are likely to fall sharply in the near term, with many companies suspending guidance amid uncertainty; however, recent economic data is illustrating seedlings of a recovery, and earning revisions ratios have begun to pick up, especially within the U.S. Monetary and fiscal policy continue to provide an accommodative backdrop for equities. Corporate credit conditions have generally improved as a result of measures taken by the Fed, with credit spreads tighter across investment-grade and high yield, while valuations continue to favor equities over fixed income on a relative basis.

Investor sentiment is slightly bearish and positioning remains slightly conservative, while market volatility, including the Chicago Board Options Exchanges (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				We expect 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 with others announcing dividend cuts and buyback suspensions. One-month earnings revisions jumped and now reflect more upgrades than downgrades.
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 79th 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 beginning to recover but we're mindful of choppiness. The Institute for Supply Management (ISM) Purchasing Manager's Index (PMI) expanded in June, housing activity has been robust, and the labor market is showing signs of firming. BofA Global Research expects 2Q GDP growth to contract by -35% on an annualized quarterly basis and growth of 20% in Q3.
4. Global Growth				The coronavirus pandemic represents an unprecedented shock to global economic activity. We expect global GDP to contract by -4.1% in 2020 but rebound at 5.8% 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 reiterated its concern about the economic outlook and its commitment to supporting the flow of credit in the economy.
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 but 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 high yield.
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 +62 basis points (bps) versus about -55 bps in early March.
9. Technical Indicators				Volatility has settled into a lower range, with the VIX breaking below 30 and the MOVE Index stabilizing at low levels. Just 26% of NYSE stocks are currently above their 200 day moving average, 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 remains bearish. The BofA Bull & Bear Indicator is at 2.3, 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 2, 2020.

EQUITIES

- **We expect equities to outperform fixed income**: Global equities have staged a sharp rally as investor optimism builds on regional reopenings 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 coronavirus, while equities remain reasonably valued relative to other asset classes from a cash-flow and yield perspective. Looking forward, there remains uncertainty given rising cases in the U.S and regional pause on reopenings, increasing U.S.-China tensions, and upcoming U.S. elections. We believe investors should continue to emphasize Quality, Yield and Growth in their equity allocations. We favor U.S. large caps, are slightly underweight 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 and greater exposure to secular cash flow streams. U.S. large caps offer an appropriate balance of aforementioned Quality, Yield and Growth factors, relative to International Developed and EM equities. We expect earnings per share (EPS) growth for the S&P

500 to drop, as BofA Global Research expects 2020 EPS for the S&P 500 of $115, a year-over-year decline of 29%. However, the trend of earnings revisions has reversed with one-month revisions in June surging from 0.41 to 1.09, reflecting more upgrades than downgrades. In addition, the ISM Manufacturing PMI and new orders surged in June, 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 of 4.0% is higher than the historical average of 3.3% and in the 79th percentile of its historical range, which supports the attractiveness of equities over fixed income. We take into account the change in composition of the U.S. equity market toward technology, a lower level of global interest rates, and stable profit margins as potential drivers supporting higher multiples longer term, but we caution that equities are still likely to be strongly influenced by developments pertaining to the virus. Given elevated volatility, we recommend higher-quality exposures such as large caps over small caps and U.S. over international allocations. In an environment with low interest rates in many parts of the world, income-seeking investors may consider supplementing their portfolios with selective exposure to high-quality dividend-paying equities. We believe Growth has secular tailwinds but Value can benefit from an early acceleration of profit growth. Consider a balance of both.

- **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.-China tensions, we remain underweight EM equities. In the near term, EM equities will likely face headwinds from a firm dollar and depressed global economic growth, but there have been early indications of a recovery with the JP Morgan Global Manufacturing PMI improving back toward February levels. Activity in China has accelerated as the Caixin Manufacturing PMI rose to 51.2 in June; however, weaker demand from abroad could remain as the reopening and 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 the resurfacing of 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 based on key vulnerabilities to commodity prices, borrowing costs, external financing conditions, sharp declines in economic output and other factors.

- **We are slightly underweight international developed market equities**: The outbreak significantly dampened global manufacturing and trade activity, with particular effects on Europe and Japan, which have strong sensitivities to each and have significant exposure to cyclical sectors like Financials and Industrials. However, there have been encouraging signs across the Eurozone as activity has picked up—notably in France—and earnings revisions have begun to improve. Fiscal stimulus in addition to accommodative monetary policy should help to bolster the recovery, and both Japan and Europe have recently put forward plans to significantly increase aid to their economies. These developments would be especially welcomed in Europe, which has remained hobbled by an incoherent fiscal union, negative interest rates, a weak banking system and Brexit uncertainties. This increased level of fiscal policy coordination may help cushion the relative economic weakness.

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

EQUITY WATCH LIST

- Implementation of regional economic reopened, virus case trends, medical advances
- Economic data around production, consumer expectations, and credit and liquidity conditions
- Acceleration of positive earnings revision
- Further central bank support and fiscal stimulus packages
- Reorganization of global supply chains and U.S.-China relationship
- 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 approximately halfway from recessionary levels (~200 bps) to pre-coronavirus levels at +144 bps, their tightest since the crisis. High yield spreads are also tighter at approximately +600 bps but wider than their tightest levels by about 60 bps, as the Fed has provided limited direct support to the high yield market. Municipal (Muni) yields have risen slightly but are still extremely low from an historical perspective, with AAA 10-year rates finishing June at 0.85%. This is consistent across all fixed income assets.

  Despite being near-record-low yields, longer-dated Treasurys still provide diversification in a risk-off environment. This recent episode again highlights the fact that Treasurys are one of the few asset classes that can 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 have direct support, as the Fed recently began purchasing individual corporate bonds in a more aggressive fashion than expected, while high yield corporates only 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 high yield, where significant credit losses are extremely likely and will meaningfully reduce total returns from yield income. The yields now available in high yield (approximately 6.6%) only provide adequate compensation for investors with a long-term time frame. We are still more constructive on Investment-grade corporates. For high yield allocations, we recommend an equal weighting between high yield unsecured bonds and secured leveraged loans, and caution that near term, strong performance may not be sustainable.

- Muni yields bear-flattened slightly in June, while muni-to-Treasury yield ratios increased somewhat. Investor demand remains strong, based on confidence that Congress will provide more stimulus to state and local governments. Technicals should remain strong over the summer, with seasonally high levels of bond maturities, 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 remain 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 high yield 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
- Longer-than-expected depressed economic activity would worsen municipal credit quality

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 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 deflationary shock from the coronavirus increased the value of the dollar, but the Fed has reinstated dollar liquidity facilities and cut rates to zero, causing the greenback to come off its highs. In addition, the proposed European Commission bond issuance has bolstered the euro, helping to ease upward pressure on the greenback and raising prospects for global growth. Further dollar softness would be evidence that funding stresses are easing and would help the global economy and the reflation effort. It should also help support commodity prices, which have been hit hard by the global shutdown. For the calendar year, BofA Global Research expects Brent crude oil prices to average $44 per barrel and West Texas Intermediate (WTI) to average $40 per barrel. It remains to be seen how much gold demand will increase given the crosscurrents, but 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

- The global economy is picking up as the coronavirus pandemic recedes and economies reopen. Overall global growth is stabilizing, with both domestic and international commerce set to improve as the pandemic subsides. Lower inflation allows more accommodative monetary policy around the world. Massive fiscal stimulus is helping to ignite a positive, self-reinforcing growth dynamic, boosting profits and jumpstarting growth. We believe this is a positive backdrop for equities.
- Inflation pressures have fallen sharply since peaking in the summer of 2018, with an additional deflationary shock as the coronavirus lockdowns hit oil, copper and other risk asset prices hard. Extended 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.-China relations and the U.S. presidential election cycle.

Economic and Market Forecasts (as of 07/03/20)

	Q3 2019A	Q4 2019A	2019A	Q1 2020A	Q2 2020A	2020E
Real global GDP (% y/y annualized)	–	–	2.9	–	–	-4.1
Real U.S. GDP (% q/q annualized)	2.1	2.1	2.3	-4.8	-35*	-5.7
CPI inflation (% y/y)	1.8	2.0	1.8	2.1	0.5*	1.0
Core CPI inflation (% y/y)	2.3	2.3	2.2	2.2	1.3*	1.4
Unemployment rate (%)	3.6	3.5	3.7	3.8	13.0	9.0
Fed funds rate, end period (%)	1.90	1.55	1.55	0.08	0.08	0.13
10-year Treasury, end period (%)	1.66	1.92	1.92	0.67	0.68	1.00
S&P 500 end period	2977	3231	3231	2585	3100	2900
S&P earnings ($/share)	42	42	163.0	34*	25*	115
Euro/U.S. dollar, end period	1.09	1.12	1.12	1.10	1.12	1.05
U.S. dollar/Japanese yen, end period	108	109	109	108	108	103
Oil ($/barrel, avg. of period, WTI**)	56	57	57	46	29	40

The forecasts in the table above are the base line view from BofA Global Research team. The Global Wealth & Investment Management (GWIM) Investment Strategy Committee (ISC) may make adjustments to this view over the course of the year and can express upside/downside to these forecasts.

Past performance is no guarantee of future results. There can be no assurance that the forecasts will be achieved. Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment performance.

A = Actual. E/* = Estimate. S&P 500 represents the year-end target for 2020. **West Texas Intermediate.
Sources: BofA Global Research; GWIM ISC as of July 3, 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: Under-weight		Neutral		Over-weight	Comments
Global Equities				●		We retain our positive view on equities based upon favorable relative valuations and the potential for upside in growth expectations. Corporate earnings are likely to remain under pressure from the effect of the pandemic, but revision trends have improved, as policy easing provides a cushion and reopenings accelerate economic recovery. We favor Growth, Quality and Yield. We remain overweight the U.S., underweight in EMs, and slightly underweight non-U.S. 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 has secular tailwinds but Value should benefit from an acceleration of global growth. 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 slightly underweight International Developed markets. A weaker outlook for global economic growth suggests that corporate earnings will remain under pressure although a pickup in data following regional reopenings may help. Additional fiscal and monetary easing may be on the way. Negative interest rates and Brexit uncertainties remain 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 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 before we return to growth later in the year.
Eurozone		●				Sensitivity to global trade implies greater impact from disruptions to crossborder activity due to coronavirus mitigation measures. Financial sector exposure remains a headwind during longer period of lower rates. Increased level of fiscal policy coordination may limit relative economic weakness.
U.K.			●			Large sector exposure to Energy and Financials is currently a headwind on low oil prices and longer period 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			●			Prefer Japan over Europe given more attractive valuations and higher exposure to technology and automation theme. 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: Underweight		CIO View: Neutral		CIO View: Overweight	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 moderate long-term returns after factoring in significant credit losses. Fundamentals will be challenged near term due to economic uncertainty; we expect volatility to remain high and default rates to rise. Any additions to high yield (HY) risk need to have a very long time frame as further drawdowns are possible and overall valuations are not excessively cheap. Within HY, an equal allocation to floating-rate loans and HY unsecured should be considered.
U.S. Investment Grade Tax Exempt			●			Muni yields are elevated; valuations to Treasurys are still attractive, although the muni market is catching up to other markets in terms of improvement. Credit is challenged by increased unemployment, suppressed economic activity and stay-at-home behaviors. Recent Fed and government initiatives are expected to help stabilize the market. 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 don't 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 interests 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 July 7, 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 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 Under-weight · Neutral · Over-weight	Comments
Communication Services	• • • • ●	Relatively small negative effects from coronavirus pandemic. 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—hospitals, equipment, testing and supplies. Fewer headwinds near term regarding drug pricing, benefiting the pharmaceutical and biotech industries. Emphasize exposure to positive trends in animal health, medical technology and telehealth, tools and devices, supplies 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. But relative performance is near cycle lows and reflecting pessimism. Emphasize thematic exposure to robotics and automation on shifting global supply chains, defense and cybersecurity companies, rails and high quality multi-industry exposure. 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 re-shoring 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 July 7, 2020.

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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.

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.

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

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

J.P. Morgan PMI data gives a detailed look at the manufacturing and services sectors, how busy it is and where things are headed.

Caixin PMI provides financial data products to Chinese institutional investors and is compiled and published monthly by IHS Markit.

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All recommendations must be considered in the context of an individual investor's goals, time horizon, liquidity needs and risk tolerance. Not all recommendations will be in the best interest of all investors. Asset allocation, diversification and rebalancing do not ensure a profit or protect against loss in declining markets.

Investments have varying degrees of risk. Some of the risks involved with equity securities include the possibility that the value of the stocks may fluctuate in response to events specific to the companies or markets, as well as economic, political or social events in the U.S. or abroad. Small cap and mid cap companies pose special risks, including possible illiquidity and greater price volatility than funds consisting of larger, more established companies. Bonds are subject to interest rate, inflation and credit risks. Municipal securities can be significantly affected by political changes as well as uncertainties in the municipal market related to taxation, legislative changes, or the rights of municipal security holders. Income from investing in municipal bonds is generally exempt from federal and state taxes for residents of the issuing state. While the interest income is tax-exempt, any capital gains distributed are taxable to the investor. Income for some investors may be subject to the Federal Alternative Minimum Tax. Investments in high-yield bonds (sometimes referred to as "junk bonds") offer the potential for high current income and attractive total return, but involves certain risks. Changes in economic conditions or other circumstances may adversely affect a junk bond issuer's ability to make principal and interest payments. Treasury bills are less volatile than longer-term fixed income securities and are guaranteed as to timely payment of principal and interest by the U.S. government. Mortgage-backed securities are subject to credit risk and the risk that the mortgages will be prepaid, so that portfolio management may be faced with replenishing the portfolio in a possibly disadvantageous interest rate environment. Investments in foreign securities (including ADRs) involve special risks, including foreign currency risk and the possibility of substantial volatility due to adverse political, economic or other developments. These risks are magnified for investments made in emerging markets. Investments in a certain industry or sector may pose additional risk due to lack of diversification and sector concentration. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates, and risk related to renting properties, such as rental defaults. There are special risks associated with an investment in commodities, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and the impact of adverse political or financial factors.

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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Private equity investments involve a significant degree of risk and should be regarded as speculative. They are only made available to qualified investors under the terms of a private offering memorandum. Holdings in a private equity fund may be highly leveraged and, therefore, more sensitive to adverse business or financial developments. Private equity investments are long term and unlikely to produce a realized return for investors for a number of years. Interests in a private equity investment are not transferable. The holdings of a private equity pool may be illiquid—very thinly traded or assets for which no market exists. A private equity investment may use leverage, which even on a short-term basis can magnify increases or decreases in the value of the private equity investment. The business of identifying private equity investment opportunities is competitive, and there is no assurance that the private equity pool will be able to complete attractive investments or fully commit its capital. In addition, a private equity fund's high fees and expenses may offset the fund's profits. Private equity investments should be discussed with financial, tax and legal professionals in light of an individual's objectives, liquidity needs and tolerance for risk.

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