

## CHIEF INVESTMENT OFFICE

# Viewpoint

## Welcome To Phase II — The Bridge

May 2020

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

### IN BRIEF

- With the Chief Investment Office (CIO) "Liquidity" Phase I past us, we are now fully in the "Bridge or Economic Buffer" Phase II, according to our most recent Investment Insights: The Great Separation 4/28/2020, as we await the re-opening of the economy.
- Given the uncertainty in the economic outlook and the path of coronavirus, we believe investors should consider emphasizing Quality, Yield and Growth.
- With volatility still elevated, we recommend adding to higher-quality exposures such as large- over small-caps and U.S. over international allocations.
- This month we initiate our sector guidance: Communication Services, Technology, and Healthcare are our favored sectors in the long-term due to the secular rise in spending on innovation, productivity and health infrastructure.
- Within Fixed Income, 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.

## Where are we in the workout cycle, and what are some of the short-term and long-term considerations?

Credit markets have stabilized. Equity volatility has come down, but commodity volatility is still unnerving despite recent stabilization. Phase I "Liquidity" is past us, and we are now fully in the "Bridge or Economic Buffer" Phase II as we await the re-opening of the economy. Signs are emerging that consumer spending is already stabilizing. Stimulus for households and small/mid-sized businesses are being released and are hitting as we speak. This stimulus mixed with the Fed's lending facilities and programs should eventually be released back into the broader economy in more force over time thereby helping to improve confidence. We believe the consumer ultimately drives the economy through 2020 and is, once again, the primary engine of growth for 2021 in our Phase III Economic Recovery and Phase IV Pent-Up Demand cycle. It will obviously take some work to get there, but we expect a U-shaped recovery overall as the economy returns to the level it was pre-shutdown for late 2021.

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### 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 prioritize diversification during periods of uncertainty 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.

## INVESTOR POSITIONING AND SENTIMENT CONSIDERATIONS

- Despite the April upswing in equity markets, the BofA Bull & Bear Indicator is still pinned at 0, which is maximum bearish positioning.
- Investor sentiment is past the height of panic but still very tenuous as most still point to the largest concern being a “second wave” of virus infections.
- The broader investment community is also waiting for the next big headline around the health side (science) as trial data is released in May and June.
- Through earnings season, investors are looking for clues in announcements about the health of balance sheets primarily and the potential for corporate dividends.
- The market is currently in exhale mode (choppy trade) while we await the level of economic re-opening plans.

### **We are looking for visible convergence trends within the market. What is a visible convergence trend?**

We also believe the medium- and longer-term focus is now science and technology. Science gets us back into both a phased-in re-opening and helps keep the re-opening smoother, in our opinion. However, it's also technology that keeps us moving forward all the way into 2021 and beyond. The use of predictive software, interactive hardware and virtual technology should rise exponentially. Big data is becoming bigger! Therefore, we expect an outsized increase in productivity, which is likely to be the driver of the next business cycle.

This technology wave is also supported by the need to onshore, build out a domestically led supply chain, and obviously advancements across healthcare and not just biotechnology and pharmaceutical research but also laboratory tools, testing, measurement, tracking and record keeping. In addition, 5G, the cloud and their next evolutions are coming fast, and the use of both is about to touch all corners of the economy.

With this in mind, we have eight—four short-term and four long-term considerations that should help shape portfolio allocation decisions in the year ahead.

#### **Short term**

1. Growth, Quality and Yield are rising in importance and therefore equities are the most attractive asset class in our view. The future cash flows in equities are much more attractive relative to fixed income.
2. Technology and Healthcare sectors have the highest growth and free cash flows of all sectors and should continue to be the drivers of the market into 2021.
3. Given the first two points above, we expect new market highs in the headline equity indices in the U.S. in the next 18 to 24 months.
4. Treatment advancements (science) and improvements in the next few months and potential vaccines are the most important catalysts to the markets in our view. If this ramps up, the consumer could shift from stabilizing to releasing some of their pent-up demand more aggressively in 2021.

#### **Long term**

1. The U.S. should continue to break away from the rest of the world as localization takes hold.
2. The technology cycle is early and entering an entirely new phase, creating a productivity wave for the first time in well over a decade.

3. The housing cycle is also early and about to experience a new demand cycle in the next 10 years. The 25- to 30-year-old age cohort includes the highest aggregate number of individuals of any five-year age bracket at present. This cycle should unfold slowly but potentially have more strength as the desire to build a “base” outside of metropolitan area grows.
4. Accommodative reflationary policies without an inflationary spiral lead to asset price reflation and the building of another equity culture given the low rates for longer dynamic.

Adjustments to procedures, re-worked configurations, and new personal and business “daily” life adjustments should allow for the development of new industries and businesses that are likely to be additive to growth, in our opinion, throughout the era that we call Phase V “The New Frontier” (2022 onward).

In summary, we expect to remain in a trading range in the equity markets as fixed income markets continue to exhibit stability. The new trading range is around 2650-2950. A breakout above 2950 will need further breakthroughs in science, in our view, and to stay at those higher levels, the coming re-opening needs to be smooth enough to lead to economic recovery in Q3/Q4. Our base case is chopiness in a wide range with an unclear profit picture for the middle of 2020. What matters most from our perspective, however, is the impact of a potential second wave, how well we are prepared, and what the prospects are for a consistent recovery driven by pent-up consumer demand in 2021.

We believe the markets will begin to try to factor in these forces by late July/the beginning of August—a time frame in which large treatment trial data could be available; economic re-opening is likely to be two months in for most areas of the country; and election trends should begin to develop. For now, we are encouraged by some stabilization signs in consumer spending in the U.S. that have picked up at the tail end of April.

## PORTFOLIO CONSIDERATIONS











- We favor equities relative to fixed income (10-year Treasuries at 0.5% have a 200 price-to-earnings ratio (P/E), while the equity dividend yield is 2% and P/E is below 20).
- We prefer U.S. large caps relative to the rest of the world, and we are underweight all non-U.S. assets.
- We are overweight Communications Services and Consumer Discretionary as spending improves with the high free cash flow sectors of tech and healthcare. We expect the economically sensitive sectors to perform better in the coming months but need to see some consistency before upgrading these areas.
- In fixed income, we favor investment-grade bonds.
- Overall on a portfolio rebalancing basis—for those with an 18-month or longer time frame—we are buyers of equities on large weakness and suggest having dollar cost averaging plans ready as we head fully into the spring and summer months.

## CIO INVESTOR DASHBOARD

Following their historic sell-off, global equities are rebounding in many parts of the world as markets begin to price in a potential economic recovery later in the year and in 2021. In the near term, we expect economic re-opening plans to be among the key drivers of financial markets.

With economic activity in the U.S. and globally at a standstill, corporate earnings are likely to fall sharply in the near term, with many companies suspending guidance amid uncertainty. At the same time, monetary and fiscal policy continue to provide an accommodative backdrop for equities, with stimulus measures so far totaling 36% of GDP in the U.S. and 20% globally. 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 remains bearish as measured by the BofA Bull & Bear Indicator, while market volatility including the Chicago Board Options Exchange's (CBOE) Volatility Index (VIX) has continued on its downward trend. We are mindful of the potential downside to equities over the near term if the economic fallout from the coronavirus becomes worse than expected and emphasize Quality, Yield and Growth in multi-asset portfolios.

Current readings on the key drivers of equities for investors to consider, with arrows representing the recent trend.				
Factor	Implication for Equities			CIO View
	Negative	Neutral	Positive	
1. Earnings				We expect earnings per share (EPS) for the S&P 500 to fall by 13% in the first quarter followed by -39% in Q2. A growing number of companies have suspended guidance amid uncertainty from the coronavirus, with others announcing dividend cuts and buyback suspensions. We continue to monitor earnings revisions, which remain on a downward trend.
2. Valuations				U.S. equity valuations remain attractive compared to fixed income, with the equity risk premium at 4.2% versus the historical average of 3.2%, and in the 83rd 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 has ground to a halt as a result of the ongoing pandemic. Gross domestic product (GDP) fell by 4.8% in the first quarter, the worst since the 2008/2009 Global Financial Crisis, driven by a 7.6% plunge in consumer spending. Companies continue to shed jobs with initial claims totaling 30 million since the middle of March. GDP growth should trough at some point into the second quarter and begin to rebound into year end.
4. Global Growth				The coronavirus pandemic represents an unprecedented shock to global economic activity. We expect global GDP to contract by 3% in 2020, with the duration and shape of the recovery depending on the trends in health data including the number of cases and advancements of testing and treatments.
5. Federal Reserve/ Inflation				<b>Shifted from Neutral to Positive:</b> The Fed has maintained its ultra-accommodative stance in combating the economic and financial impact of the coronavirus outbreak. After its latest meeting, the Federal Open Market Committee (FOMC) reiterated its concern about the economic outlook and its commitment to supporting the flow of credit in the economy. Announcements of new facilities have helped to ease credit markets.
6. Trade/ Fiscal Policy				Policymakers in Washington have passed more than \$2T in fiscal stimulus in response to the coronavirus outbreak, including stimulus checks for individuals, support for small businesses and aid to state and local governments. We continue to monitor signs that trade tensions between the U.S. and China may be starting to re-emerge.
7. Corporate Credit				Corporate credit conditions have generally improved as a result of measures taken by the Fed, with credit spreads tightening 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 +60 basis points (bps) versus about -55 bps in early March.
9. Technical Indicators				Equity market volatility continues to trend lower, with the VIX breaking below 40 and currently near a two-month low. Just 15% of NYSE stocks are currently above their 200 day moving average, which is in line with previous market bottoms in 2009, 2011, 2016 and 2018.
10. Investor Sentiment				Measures of investor sentiment remain bearish and could be signaling a contrarian buy signal. The BofA Bull & Bear Indicator remains pinned at 0, while the American Association of Individual Investors notes that investors remain bearish despite the strong rebound in equities over the past month.

Source: Chief Investment Office. Data as of April 30, 2020.

## EQUITIES

- **We expect equities to outperform fixed income:** Global equities have sharply rebounded after enduring a dramatic selloff as investors weigh the economic cost to help contain the coronavirus outbreak against the potential for regional reopenings, recovery and relative valuations to other assets. There remains much uncertainty, and the market continues to balance the magnitude of the global pandemic with substantial monetary and fiscal policy measures intended to help shore up those portions of the economy and markets most acutely affected. Aggressive policy support and record low interest rates still favor equities over bonds.

Given the uncertainty in the economic outlook and the path of the coronavirus, we believe investors should consider emphasizing Quality, Yield and Growth. 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 that should be better positioned through higher levels of economic stress and more secular sources of cash flow. U.S. large caps offer an appropriate balance of aforementioned quality, yield and growth factors, relative to International Developed and EM equities. However, coronavirus fears could continue to weigh on investor sentiment in the near term, and the U.S. presidential election cycle looms. Our base case is that EPS growth for the S&P 500 will likely drop sharply due to the containment effects of the coronavirus in addition to the collapse of oil prices. Many companies have cut forward guidance, and we continue to monitor earnings revisions, which have fallen at a rapid pace. BofA Global Research expects 2020 EPS for the S&P 500 of \$115, a year-over-year decline of 29%. However, expectations for stabilizing growth and profits later in the year and into 2021, along with any upside surprise, should act as support for 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.

The current equity risk premium of 4.2% is higher than the historical average of 3.2%, and in the 83rd percentile of its historical range, which makes equities more attractive than 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 a decline in inflation as potential drivers supporting higher multiples on a secular basis, but we caution that equities are still likely to be strongly influenced by developments pertaining to the virus. Given elevated volatility, we recommend adding to higher-quality exposures such as large- 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 could consider supplementing their portfolios with selective exposure to high-quality dividend-paying equities. We believe Growth has better fundamentals than Value, which has higher relative weight in Financials and Energy, as oil prices and interest rates remain depressed.

- **We are underweight EM equities:** Given the effects of the ongoing coronavirus outbreak and the potential for accelerated shifts in global supply chains out of China, we moved from a neutral view on EM equities to underweight in April. In the near term, EM equities will likely face headwinds from a strong dollar and slower global economic growth. In particular, a significant slowdown in China this year should weigh on corporate earnings in the region, since China accounts for around 43% of revenues for the MSCI EM Index. China may recover more rapidly from the coronavirus outbreak than other markets but face weaker demand from abroad as many other parts of the global economy remain shut down. Furthermore, once the effect from the coronavirus begins to fade, EM equities could still face headwinds from less fiscal flexibility relative to Developed Markets, a secular shift toward “localization” of supply chains and the

## DUE DILIGENCE VIEW ON EQUITIES

April's sharp recovery reduced ongoing concern for risk for many of the CIO-covered funds and firms, at least in the near term. Gold funds, thematic funds focused on technology, innovation and/or genomics, and some domestically based large-cap growth funds are those that performed better through April. On a relative basis, more fund managers have outperformed their benchmarks this year than have underperformed.

Reminiscent of what took place during and after the 2008/2009 Global Financial Crisis, we also note that there was once again a large dispersion of returns between the deeper and dividend value styles from the market peak to trough (when dividend value managers did well and deep value did not) and trough to peak, when the opposite was true. This was a strong reminder that diversification not just across but within investment styles matters—and that from a timing perspective, it often makes sense to rebalance from what has performed well to what has underperformed.

potential resurfacing of trade/technology 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 indices 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, higher borrowing costs, external financing condition, sharp declines in economic output and other factors.

- **We are slightly underweight international developed market equities:** Prior to the outbreak, the outlook for Europe and Japan had improved given early signs of stabilization in global manufacturing activity; however, this backdrop has been disrupted. A weaker outlook for global economic growth suggests that corporate earnings for International Developed markets could remain under pressure given their significant exposure to cyclical sectors like Financials and Industrials. The virus has disrupted consumer spending in particular, with Japan grappling with additional cases and numerous regions across Europe having been shut down. Gradual re-openings in some regions may provide a level of relief, but Europe and Japan have strong sensitivity to global trade and manufacturing, which largely remains impaired during shutdowns. In addition, Europe in particular remains saddled by an incoherent fiscal union, negative interest rates, a weak banking system and Brexit uncertainties. Monetary stimulus has shifted into high gear, with the European Central Bank (ECB) engineering easier financial conditions by launching a massive asset purchase program. In Japan, monetary policy also remains ultra-accommodative in an effort to help offset the slowdown.

## EQUITY WATCH LIST

- Implementation of regional economic reopenings, and positive virus case trends
- Momentum in drug development for prophylaxis, therapeutics and vaccines
- Economic data around production, consumer expectations, and credit and liquidity conditions
- Bottoming of earnings revision ratios
- Further central bank support and fiscal stimulus packages
- Reorganization of global supply chains and trading relationships

## 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.

The economic uncertainty caused by the pandemic has completely altered the fixed income investment landscape, but the policy response—both monetary and fiscal—has been substantial enough to keep credit markets functioning, and the financial system remains healthy and ready to help transmit monetary policy to companies and individuals.

Despite hitting record low yields, longer-dated Treasuries still provide diversification in a risk-off environment. This recent episode again highlights the fact that Treasuries are one of the few asset classes that can provide a meaningful, short-term hedge against

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

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.

- In terms of credit, investment-grade and high yield corporate spreads hit the all-time widest levels outside the 2008/2009 Financial Crisis. This created a compelling long-term opportunity for disciplined investors, and we moved to a slight positive view on investment-grade credit last month. Since then, the market has rebounded and spreads are now at typical "recessionary" levels—still providing decent long-term returns, although not as good as one month ago. Further market value drawdowns are possible, however—especially in high yield, where downside volatility should be expected as a base case as defaults and restructuring increase in the coming months. Investment-grade corporates have direct support from the Fed's monetary policy, which we find encouraging, while high yield corporates only have limited support via the Fed potentially purchasing "fallen angels." Furthermore, credit losses in investment-grade are manageable and not a huge component of spreads. 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 8%) 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 have bear-steepened due to weak investor demand, and muni-to-Treasury yield ratios remain very elevated, although down from record high levels in mid-March. We believe this represents an opportunity for investors. Credit risks are also elevated due to increased unemployment, suppressed economic activity, and "stay-at-home" behaviors, which will pressure state and local government budgets and finances. However, support from policy makers in Washington and the Fed are expected to soften the blow. 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 recently moved to slightly negative on the Mortgage-Backed Securities (MBS) sector. Agency MBS spreads quickly moved to the 2008 wides during this current crisis, but the aggressive Fed purchases over the last couple of weeks helped spreads retrace almost all of the recent widening. Many issues overhang the MBS market: extreme volatility, poor liquidity, in particular in specified pools and virtual shutdown of mortgage origination and refinancing. Additional concerns stem from Government-Sponsored Enterprise (GSE) forbearance programs and heightened risk of rising default rates from unemployment. However, we believe that unprecedented Fed support that already purchased more than \$0.6 trillion of MBS will ultimately stabilize the mortgage market, return liquidity and be a strong positive technical. 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, which has lagged agency MBS notably.

## DUE DILIGENCE VIEWS ON FIXED INCOME

The signs of stabilization across many fixed-income sectors looks to have created potential investment opportunities for managers across the corporate credit and securitized sectors.

The asset class categories among the highest risk under CIO coverage encompass Taxable and Tax-Exempt High Yield bonds.

Fund managers largely remained fully invested as they saw compelling valuations, although they have been very active in managing sector exposures in areas like energy where default rates are expected to be in the 30% range in the next 12 months.

Despite anticipated credit pressure across munis that may likely result in ratings downgrades, investment-grade munis rebounded strongly in April and high yield munis partially recovered, although expected defaults in the 2% to 5% range have managers cautious in that space. During the market downturn in March, the funds increased overall portfolio liquidity and cash levels but still remain well positioned to take advantage of price improvement within securitized credit.

## FIXED INCOME WATCH LIST

- More signs of continued thawing in new-issue credit markets—lower-quality investment-grade issuance, high yield issuance, and credit markets open for new issues even when equity markets are down
- Stability in high yield and leveraged loan prices and yields; decrease in volatility
- 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. 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 shutdowns. The spread of the coronavirus sapped global energy demand at the same time an already well-supplied market merged with an oil price war that saw a few of the largest producers raise production. Without coordinated production cuts, BofA Global Research sees downside risks for oil prices in the near term, with the potential for prices to fall below \$20 per barrel. For the calendar year, they expect Brent crude oil prices to average \$37 per barrel and West Texas Intermediate (WTI) to average \$32 per barrel with downside risk. 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, 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 potentially 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 coronavirus outbreak has imparted a big deflationary shock to the global economy that is depressing world GDP and inflation. Despite this setback, trade and Brexit headwinds have eased. Overall global growth should eventually stabilize, with both domestic and international commerce set to improve once the pandemic subsides. Lower inflation allows more accommodative monetary policy around the world. Massive fiscal stimulus will also help 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 has 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 05/01/20)

	Q3 2019A	Q4 2019A	2019A	Q1 2020A	Q2 2020E	2020E
Real global GDP (% y/y annualized)	–	–	2.9	–	–	-3.0
Real U.S. GDP (% q/q annualized)	2.1	2.1	2.3	-4.8	-30.0	-5.6
CPI inflation (% y/y)	1.8	2.0	1.8	2.1	0.3	0.7
Core CPI inflation (% y/y)	2.3	2.3	2.2	2.2	1.8	1.7
Unemployment rate (%)	3.6	3.5	3.7	3.8	15.6	10.6
Fed funds rate, end period (%)	1.90	1.55	1.55	0.08	0.13	0.13
10-year Treasury, end period (%)	1.66	1.92	1.92	0.67	0.50	1.00
S&P 500 end period	2977	3231	3231	2585	–	2600
S&P earnings (\$/share)	42	42	163	34*	25	115
Euro/U.S. dollar, end period	1.09	1.12	1.12	1.10	1.02	1.05
U.S. dollar/Japanese yen, end period	108	109	109	108	105	103
Oil (\$/barrel, avg. of period, WTI**)	56	57	57	46	20	32

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 May 1, 2020.

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

## CIO ASSET CLASS VIEWS

Asset Class	CIO View					Comments
	Under-weight		Neutral		Over-weight	
Global Equities	•	•	•	●	•	We retain our positive view on equities based upon favorable relative valuations and the potential for upside in growth expectations. Corporate earnings are likely to remain under pressure from the impact of the outbreak, but investors may be keen to look ahead toward next year for growth, as policy easing in response to the outbreak provides a cushion. Investors should favor Growth, Quality and Yield. We remain overweight the U.S., are underweight in EMs, and are 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-cap over small-cap equities. We believe that Growth could continue to outperform Value over the near term. At the sector level, we recommend being selective, with a preference for technology and communication services for long-term investors.
U.S. Large Cap Value	•	•	•	●	•	
U.S. Small Cap Growth	•	•	•	●	•	
U.S. Small Cap Value	•	•	●	•	•	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.
International Developed	•	●	•	•	•	We are slightly underweight International Developed markets. A weaker outlook for global economic growth suggests that corporate earnings will remain under pressure. Fiscal and monetary easing have ramped up but additional efforts may be needed. 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 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. Lack of policy coordination limits fiscal response to coronavirus fallout.
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 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.

\* 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					Comments
	Under-weight	Neutral	Over-weight			
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 safety is still advised.
U.S. Mortgages	•	●	•	•	•	MBS spreads improved faster than other credit assets on Fed purchases. Currently spreads are again at wider end of 5-year range, but issues remain: extreme volatility, poor liquidity, and virtual shut-down of mortgage origination/refinancing. However, unprecedented Fed support is a huge tailwind to the sector. Recommend conservative positioning.
U.S. Corporates	•	•	•	●	•	Spreads remain in recessionary territory after retracing nearly 50% of the March move wider. Dislocations that emerged in the front-end remain in some cases, however, liquidity has improved materially. Continue to view recent widening as an opportunity to add exposure to IG credit and see best relative valuations in BBB-rated Industrials and Financials in the front end.
High Yield	•	●	•	•	•	Valuations have improved and present reasonable long-term returns even 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 risk need to have a very long time frame as further drawdowns are possible. An equal allocation to floating-rate loans and high yield unsecured is advised.
U.S. Investment Grade Tax Exempt	•	•	●	•	•	Muni yields are elevated; valuations to Treasuries are much more attractive due to recent selling pressure presenting opportunities. A prudent approach is warranted; credit is challenged by increased unemployment, suppressed economic activity, and stay-at-home behaviors. Recent Fed and policy makers in Washington 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 strategies 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-cyclical) 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. Without coordinated production cuts, BofA Global Research sees downside risks for oil prices in the near term with the potential for prices to fall below \$20 per barrel. For the calendar year they expect Brent crude oil prices to average \$37 per barrel.
Cash						

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

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

Source: Global Wealth & Investment Management Investment Strategy Committee.

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					Comments
	Under-weight		Neutral		Over-weight	
Communication Services	•	•	•	•	●	Relatively small negative impacts from virus outbreak. 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, cyber security and semiconductors. Traditional hardware exposure is increasingly commoditized. Valuation is neutral.
Health Care	•	•	•	●	•	Expect rising spending on health care 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 but higher 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 bricks and mortar retailers that could face declining store traffic trends. Relatively attractive valuation and higher momentum.
Financials	•	•	●	•	•	Near term, banks will see rising credit costs and increased loan loss reserves; however, these can be reversed in the post-virus world, adding to earnings. U.S. banks 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 automotive, 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 companies, rails and high quality multi-industry exposure. Attractive valuation.
Consumer Staples	•	•	●	•	•	Moderate upside after recent relative outperformance and a wave of consumer staples purchases for stocking pantries due to the virus. 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	•	●	•	•	•	Sector faces historic collapse in oil demand from the virus, significant oversupply, elevated balance sheet leverage in some cases, high capital needs, declining cash flows from low realized energy prices, and the long term transition to clean energy. Emphasize companies with balance sheet strength. Relatively attractive valuation but lower momentum.
Materials	•	●	•	•	•	Headwinds from deflationary pressures, economic slowdown, lower commodity prices impacting chemicals, metals and mining companies. Relatively unattractive valuations and lower momentum.
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, ecommerce, 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 May 5, 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.

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The GWIM Investment Strategy Committee (GWIM ISC) is responsible for developing and coordinating recommendations for short-term and long-term investment strategy and market views encompassing markets, economic indicators, asset classes and other market-related projections affecting GWIM.

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Keep in mind that dollar cost averaging cannot guarantee a profit or prevent a loss in declining markets. Since such an investment plan involves continual investment in securities regardless of fluctuating price levels, you should consider your willingness to continue purchasing during periods of high or low price levels.

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

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**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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