

Capital Market Outlook

April 22, 2024

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

IN THIS ISSUE

Macro Strategy—*What Global Monetary Divergence Means For The U.S. Dollar—And For U.S. Investors:* Entering 2024, central banks were expected to run policy in lockstep with each other—ergo, they were expected to ease in the face of mounting evidence of disinflation-cum-slownominal growth. However, three straight hot inflation readings in the U.S., coupled with a tight labor market, have flipped the script. Monetary policies among the world’s largest central banks are poised to diverge this year, setting the stage for another leg up in the U.S. dollar.

Higher-for-longer U.S. interest rates entail a stronger-for-longer U.S. dollar. A bullish outlook for the greenback could entail a widening in the U.S. trade deficit and attendant pressure for more U.S. trade protectionism; a downdraft in U.S. import prices; the threat of higher imported inflation in Europe, Canada and other weak currency nations; lower earnings for U.S. multinationals; and lower net returns on foreign assets for U.S. investors.

Market View—*The Not-So-Little Bull That Could... and Still Can:* U.S. Equities wobbled to kick off Q2. Concerns over heightened geopolitical risks in the Middle East, rising commodity prices, and upside inflation and economic surprises, which sent bond yields higher and pushed Federal Reserve (Fed) rate cut expectations out, drove a pickup in volatility.

The whiplash from the latest market action has been bruising to investor sentiment, but the wheels of this bull market do not seem to have fully steered off track. Positive earnings and economic momentum have not revealed any major cracks in the fundamental backdrop. While slower inflation progress could push out the start date for easier monetary policy, this scenario mixed with the resilient economy still seems better to the one where stagflation or a major economic downturn dominate the narrative.

We will continue to monitor the tail risks that could potentially derail this bull market, including a widening conflict in the Middle East or a clear reacceleration in inflation, but we overall remain constructive on U.S. Equities.

Thought of the Week—*The Confluence of Geopolitical Risks and Market Risks:* Geopolitical tensions have come to a boil globally. Consider: The recent attack and counterstrike between Iran-Israel, the Russia-Ukraine war dragging into a third year, just as North Atlantic Treaty Organization (NATO) and U.S. supply feeds to Ukraine of arms and military capabilities have worn dangerously low. More subtly, China’s military might is growing, including an ominous presence in the South China Sea. All that is coincident with U.S. policy potentially in flux following the outcome of November’s presidential vote.

The confluence of these risks has the potential to induce volatility into the financial markets. A few stress points seen in markets as these geopolitical events unfold include risks to oil disruptions/prices, the runup in gold as a perceived “safe haven,” and a spike in volatility measures. Given this unpredictable geopolitical backdrop, from an investment perspective, we’d emphasize diversified, high-quality investments as the best defense.

MACRO STRATEGY ►

Joseph Quinlan
Managing Director and Head of CIO Market Strategy

MARKET VIEW ►

Kirsten Cabacungan
Vice President and Investment Strategist

THOUGHT OF THE WEEK ►

Lauren Sanfilippo
Director and Senior Investment Strategist

MARKETS IN REVIEW ►

Data as of 4/22/2024,
and subject to change

Portfolio Considerations

The economy shows early signs of reaccelerating, consumers remain healthy, corporate profits are turning higher, and monetary policy is pivoting from tightening to easing. We expect markets to take a small breather and enter a brief consolidation phase as we enter the “no fundamental news” period between now and mid-April. Weakness is a buying opportunity, in our view. We believe the broadening out of the market is just beginning. We maintain an overweight to Equities, with a preference for higher quality U.S. Large- and Small-caps, and still favor a significant allocation to bonds in a diversified portfolio. For qualified investors, Alternative Investments should be considered for long-term growth and various sources of yield as a complement to public investments.

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What Global Monetary Divergence Means For The U.S. Dollar—And For U.S. Investors

Joseph Quinlan, Managing Director and Head of CIO Market Strategy

For much of the post-pandemic era, central banks have largely followed the same policy paths, with the global spike in inflation, followed by the subsequent pivot toward disinflation, resulting in highly correlated moves in global interest rates and monetary policy expectations. Entering 2024, central banks were expected to run policy in lockstep with each other—ergo, they were expected to ease in the face of mounting evidence of disinflation-cum-slowing nominal growth.

However, three straight hot inflation readings in the U.S., coupled with a tight labor market, have flipped the script. Interest rate cut expectations in the U.S. have been pushed out and lowered, with some investors even taking rate cuts off the table for this year. For the record, our economists now expect the easing cycle to start in December.

While firmer-than-expected inflation readings in the U.S. have the Fed on hold, the European Central Bank (ECB), in contrast, appears set to start easing in June. The ECB kept rates unchanged at its April meeting but strongly signaled its intent to start cutting rates in June. Indeed, some members of the ECB were in favor of April cuts given the sluggish economic backdrop of the eurozone. And not waiting on the Fed, ECB President Christine Lagarde asserted the ECB's independence from the Fed by proclaiming that “we are data-dependent, not Fed-dependent.”

Ditto for Swiss National Bank, which has already eased interest rates in the face of weak growth, and the Bank of Canada, which has also signaled its intent to cut rates sooner rather than later. Presently, the currency markets are expecting the ECB to cut rates three times this year, and the Bank of England and Bank of Canada to cut two times, versus just one or two in the U.S. Meanwhile, widening spreads between the U.S. and Japan have pushed the yen to multidecade lows against the dollar.

All the above is the beginning of a more divergent monetary policy cycle among the world's largest central banks—and by extension, the beginning of another potential leg up in the U.S. dollar. It's hardly surprising the greenback staged its strongest weekly performance since 2022 following the hot U.S. inflation read and the ECB's declaration of independence.

What sustained U.S. dollar strength means for investors. Higher-for-longer U.S. interest rates entail a stronger-for-longer U.S. dollar. Exhibit 1A tells the story of dollar strength, with the greenback up nearly 10% and 9% against the yen and Swiss franc year-to-date (YTD) respectively, and up solidly, in general, against many G-10 currencies.

Many variables are supporting the U.S. dollar at the moment, ranging from government spreads on 10-year Treasury yields; to volatile geopolitics, which has been contributing to the “safe haven” status of the dollar; and to the compelling fact that the U.S. economy remains among the most resilient and strongest in the world—a dynamic that creates its own demand for U.S. assets among foreign investors.

Foreign demand for dollars remains robust, but what does that mean for the economy, asset prices and ultimately for investors?

First, sustained dollar strength, by making U.S. exports less price competitive, could reverse the 2023 narrowing of the U.S. trade deficit in goods and services, and emerge as an overall drag on nominal growth as the year progresses. Trade deficits, meanwhile, are not looked upon kindly by either presidential candidate or Congress, so a widening deficit thanks to a strong dollar could continue to stoke protectionist sentiment in the U.S.

Investment Implications

A stronger U.S. dollar is generally bullish for U.S. assets; dollar strength reflects widening interest rate differentials and expectations, geopolitical uncertainty, and the dynamic and innovative capacity of the U.S. economy.

Second, some good news: A strong greenback translates into lower import prices and could emerge as a key variable in keeping U.S. inflation in check or in a downward trend.

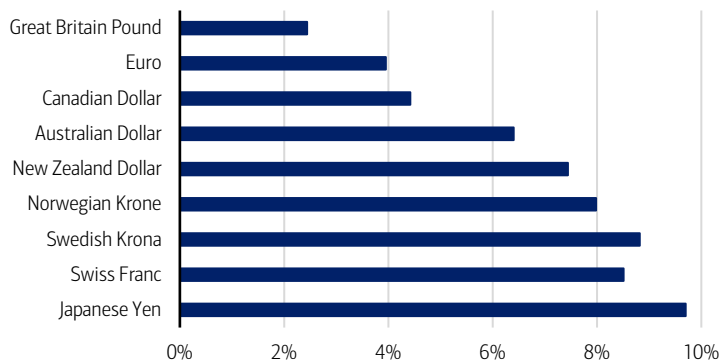
Third (and the converse of two), the stronger the dollar, the weaker other currencies become, and the greater the risks of Europe, Canada and other nations of importing inflation. Weak currencies are inflationary; strong currencies deflationary.

Fourth, a stronger dollar means corporate profits from U.S. foreign affiliate sales will be worth less after converting local currencies into U.S. dollars. A stronger dollar, in other words, could set up for earnings disappointment among the most globally exposed sectors of the S&P 500. Think Technology, Materials, and Communication Services (Exhibit 1B). By geography, we are keeping a wary eye on Europe and the euro given that nearly two-thirds of U.S. foreign affiliate income (a proxy for global earnings) is derived from the region (Exhibit 1C).

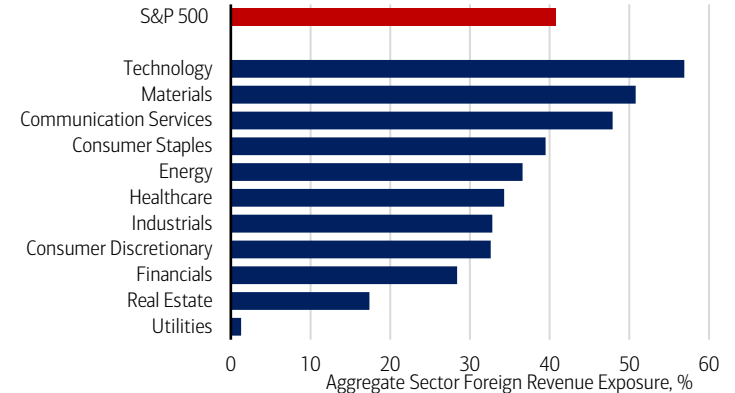
And fifth, a stronger dollar results in lower net returns on foreign assets for U.S. investors. That is readily apparent in Exhibit 1D which compares MSCI eurozone returns in local terms vs. U.S. dollar returns. To wit, YTD through April 15, the index in local currency terms has generated a return of 8.4%. Yet when translated back to U.S. dollars, the net return for a U.S.-based investor was less than half, or just 4.2%. The bottom line: A strong dollar entails lower returns on foreign assets for U.S. investors, a dynamic that requires close watching.

Exhibit 1: A Strong U.S. Dollar Generates Multiple Ripple Effects...

1A) USD Appreciation vs. G10 Currencies YTD

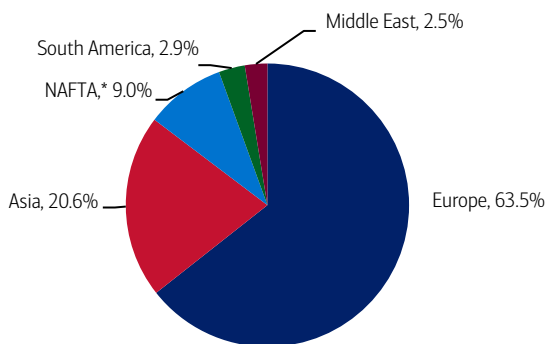


1B) S&P 500 Revenue International Exposure, by Sector

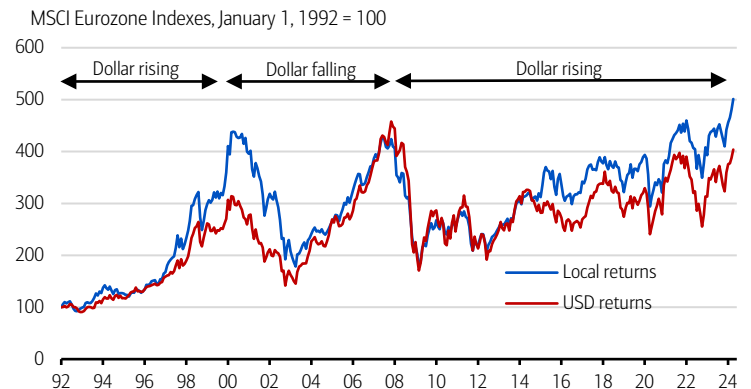


1C) U.S. Affiliate Income Earned Abroad: By Region

% of World Total; Average of 2010-2023



1D) USD-Based International Returns Lag When the Dollar Rises



*North American Free Trade Agreement. Exhibit 1A) Source: Bloomberg. Data as of April 15, 2024. Exhibit 1B) Source: FactSet. Data as of April 2024. Exhibit 1C) Source: Bureau of Economic Analysis. Data as of April 15, 2024. Exhibit 1D) Source: Bloomberg. Data as of March 2024. Price returns shown. **It is not possible to invest directly in an index. Please refer to index definitions at the end of this report.**

The Not-So-Little Bull That Could... and Still Can

Kirsten Cabacungan, Vice President and Investment Strategist

U.S. Equities wobbled to kick off Q2. The S&P 500 is 5.5% lower from its highs in late March.¹ Volatility also picked up, with the Volatility Index (VIX) surging above 19 for the first time since October (Exhibit 2A). Behind the spike lay concerns over heightened geopolitical risks in the Middle East, rising commodity prices, and upside inflation and economic surprises, which sent bond yields higher and pushed Fed rate cut expectations out.

The volatility also left the S&P 500 with some technical damage. The index closed below its 50-day moving average for the first time since November (Exhibit 2B). Risks of a market breather were building though, since it had been the longest running period with the index above the 50-day moving average since 2011. There have only been 11 other streaks this long since 1950 (Exhibit 2C). We also can't forget seasonality pressures on stocks since April and May tend to be historically weaker periods during presidential election years (Exhibit 2D).

Whiplash from the latest market action has been bruising to investor sentiment, but the wheels of this bull market have not fully steered off track. The S&P 500 is still up 4.1% for the year and 38.9% from the start of this bull market in late 2022. The index has also remained well above its longer-term 200-day moving average for 116 trading days, which is still less than half the average length of the 40 other streaks that exceeded the current one since 1950.¹

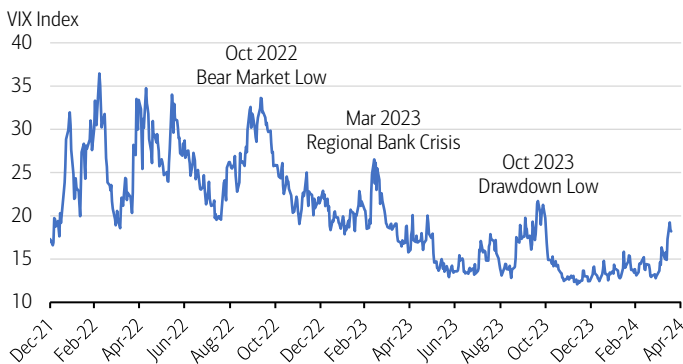
Looking ahead, how do we determine whether this consolidation will turn out to be more modest or the beginning of the end for this cycle? The answer is to turn to the fundamentals to really get the pulse on the stock market trend.

Portfolio Considerations

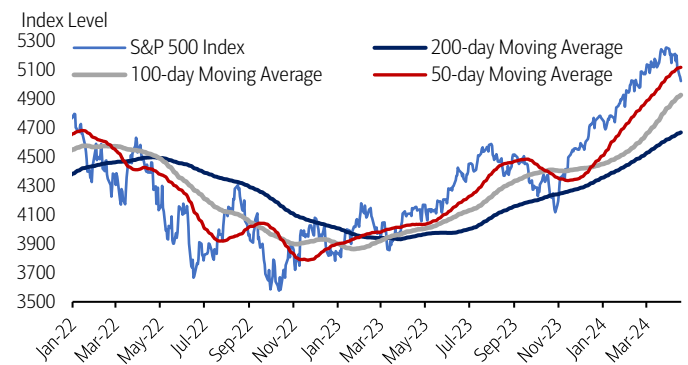
We maintain our overall constructive view on U.S. Equities, as we believe the fundamental story remains intact. We could see further choppiness given all the crosscurrents in the market landscape, so we reemphasize a focus on diversification within portfolios.

Exhibit 2: Market Breather in Charts.

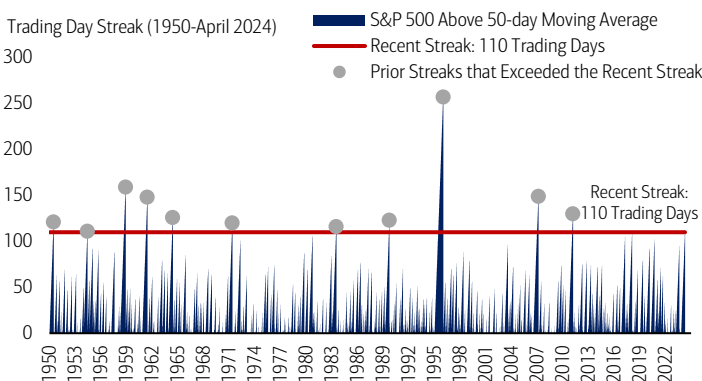
2A) Equity volatility has spiked



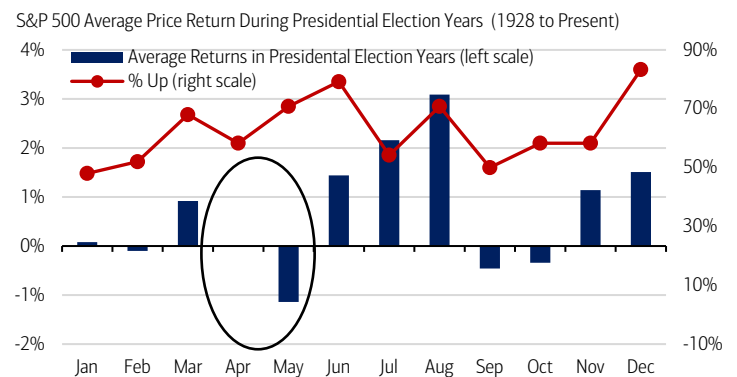
2B) The S&P 500 took some technical damage



2C) A market breather made sense



2D) April/May tend to be weak in presidential election years



Exhibits 2A, 2B, 2C) Source: Bloomberg. Data as of April 19, 2024. Exhibit 2D) Sources: BofA Global Research; Bloomberg. Data as of April 15, 2024. **Past performance is no guarantee of future results. It is not possible to invest directly in an index. Please refer to index definitions at the end of this report.**

¹ Bloomberg. Data as of April 19, 2024.

Are there cracks in the fundamental picture?

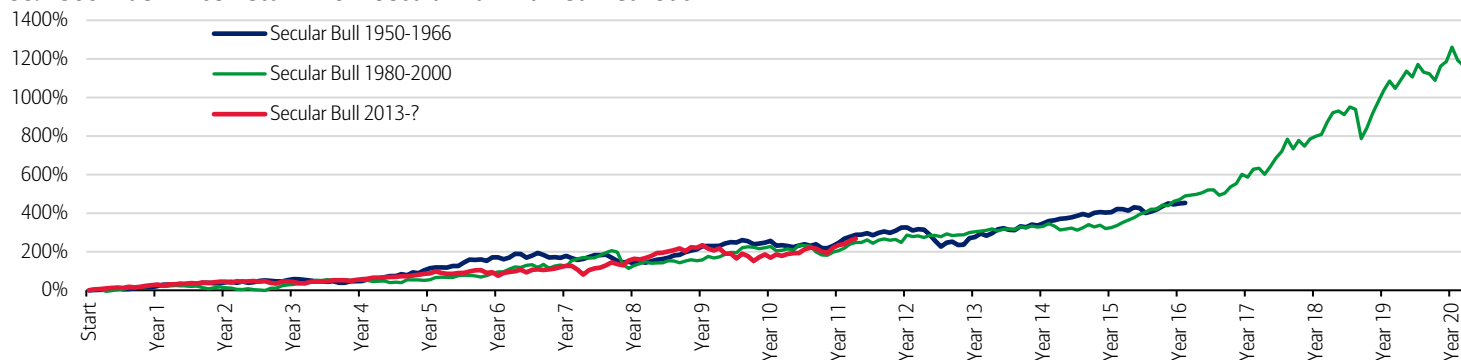
- **Earnings:** Q1 earnings season appears to be shaping up similarly to the last one, when corporate earnings beat expectations by 4% and grew by 8% year-over-year (YoY) for the quarter. So far, reported earnings are 6% above estimates², and BofA Global Research is forecasting 7% YoY earnings growth for the quarter. Positive earnings growth for the quarter would make it the third consecutive quarter of profit gains this cycle, a nice support for the overall earnings recovery.
- **U.S. Economic Growth:** The economy is showing few signs of slowing. Consumer demand continues to be backed by a solid labor market and a massive buildup in household wealth. Even in weaker areas of the economy, conditions appear to be turning up. Manufacturing activity expanded in March for the first time in 17 months. If Q1 real gross domestic product growth comes in above 2%, it would be the seventh quarter in a row, an enduring string of economic strength that the economy has not seen in 20 years.³
- **Monetary Policy:** A rethink on the outlook for Fed easing is underway amid signs inflation may be plateauing. The market is now pricing in closer to 1.5 cuts for the year compared to six cuts at the start.² While slower inflation progress could push out the start date for policy easing, this scenario mixed with the resilient economy still seems less bleak than the one where stagflation or a major economic downturn dominate the narrative. Risk assets, in fact, have historically fared better during longer Fed pauses. In previous periods when the Fed was on hold longer than 100 days, the S&P 500 gained 13% on average, compared to the average negative return for the index during shorter periods.⁴

What could derail the market? A key tail risk is a wider conflict in the Middle East that sets off a commodity shock and elevates global recession risk. In that case, the uncertainty overhang would likely destabilize financial markets and turn companies more cautious on investment and hiring plans. The other risk to watch would be signs of a reacceleration in inflation, which would raise the potential for Fed rate hikes. We are still far from contemplating that scenario though.

How should investors proceed? Bumps along the track are to be expected given all the crosscurrents in this market environment. The fundamentals, however, remain supportive, so we would view any period of weakness as a buying opportunity. Long-term investors also shouldn't lose sight of the secular bull market, which continues to chug along (Exhibit 3). So, let's end it where we always end it: It's time in the market not timing the market that matters.

Exhibit 3: Don't Lose Sight of the Longer-term Secular Bull Market Trend.

S&P 500 Index Price Return From Secular Bull Market Breakout



Source: Bloomberg. Secular bull market periods defined by BofA Global Research. Data as of April 19, 2024. **Past performance is no guarantee of future results. It is not possible to invest directly in an index. Please refer to index definitions at the end of this report.**

² BofA Global Research. Data as of April 11, 2024.

³ Bloomberg. Data as of April 19, 2024.

⁴ Strategas Research Partners. Fed pauses since 1974. Data as of February 7, 2024.

The Confluence of Geopolitical Risks and Market Risks

Lauren Sanfilippo, Director and Senior Investment Strategist

A world order supported by favorable geoeconomics has now succumbed to a world fraught with geopolitical risk. Escalating tensions in the Middle East, a war in the heart of Europe now entering a third year, and China’s growing military might have all upended the geopolitical landscape of the past few decades. Adding more complexity: the outcome of November’s U.S. presidential vote.

The confluence of these risks has the potential to induce volatility in financial markets. Still, what the markets fear most is the combination of slower-than-expected global growth against a backdrop of higher-for-longer inflation. Below we highlight key stress points seen in markets and areas to monitor as these geopolitical events unfold:

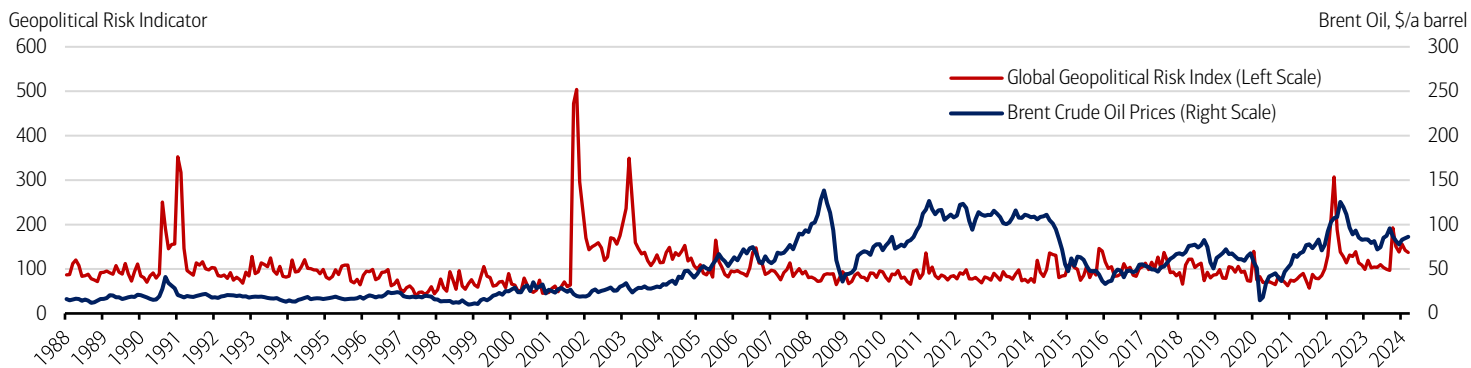
Acute risks to oil: Concerns over disruption to Iranian production, it being the third-largest producer in the OPEC⁵ oil cartel, drove an initial Brent spike above \$90 per barrel and put the oil markets on edge. Iran produces 3% of the world’s oil output according to the International Energy Agency (IEA), but more disruptive would be to the Straits of Hormuz, which accounts for 20% of global oil flows. Reverberations to the disruption of supply/exports would be most severe for countries heavily reliant on Middle East oil, namely China, the largest importer of Iranian oil.

Beyond oil, gold and volatility on the move: Often viewed as a “safe haven” bid, gold prices have touched new highs this year, rallying 20% since mid-February—far exceeding the advance over all of last year as record central bank buying has firmed gold prices. Commensurate with that move, the VIX Index (measuring S&P 500 volatility) spiked above 19, a level not seen since October of last year. U.S. bond market volatility, measured by the MOVE Index, hit its highest level since early January.⁶

Longer-term effect to growth and inflation: Additional flareups in the Middle East could intensify an energy price spike and exacerbate inflationary pressures. This is true to a lesser degree for the U.S. as compared to Europe or Asian Emerging Markets, given the U.S.’s energy independence as a net oil exporter. Generally, though, oil tends to be in the crosshairs, as Exhibit 4 shows the relationship between geopolitical risks and the world’s benchmark crude oil. As of late, oil prices have found relative stability to this point.

Barring an expanded regional conflict in the Middle East, we expect limited consequence on growth rates from what’s unfolded so far. However, as identified by the International Monetary Fund (IMF) in its April World Economic Outlook, geopolitical strife has the potential to weigh on longer-term growth rates. Plausible, as they put it, are further commodity price spikes giving way to ongoing inflation pressures, with the potential to delay global central bank’s policy easing. That’s a scenario not priced into markets.

Exhibit 4: Measuring the Geopolitical Effect on Oil Prices.



Sources: IMF; Global Geopolitical Index-authored by Dario Caldara and Matteo Iacoviello; Bloomberg. Data as of March 2024. **It is not possible to invest directly in an index. Please refer to index definitions at the end of this report.**

⁵ Organization of the Petroleum Exporting Countries.

⁶ Data as of April 16, 2024.

Investment Implications

Most vulnerable to a world of elevated geopolitical risk are countries that lack resources, are most susceptible to “perpetual” conflict and are deficient in military capabilities. These dynamics outweigh the fact that international Equity valuations trade at a relative discount to the U.S., leading us to remain cautious on the rest of the world. The heightened state of geopolitics, given conflicts and warfare, is bullish for the defense industry generally, with the global military complex committed to remilitarizing arms and military capability stockpiles. An actively managed, high-quality, diversified and U.S.-centric portfolio is the best defense in a world of multipolar disorders.

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	37,986.40	0.0	-4.5	1.4
NASDAQ	15,282.01	-5.5	-6.7	2.0
S&P 500	4,967.23	-3.0	-5.4	4.6
S&P 400 Mid Cap	2,836.88	-2.2	-6.8	2.4
Russell 2000	1,947.66	-2.8	-8.3	-3.5
MSCI World	3,255.62	-2.8	-5.2	3.2
MSCI EAFE	2,236.31	-2.3	-4.7	0.8
MSCI Emerging Markets	1,004.17	-3.6	-3.6	-1.4

Fixed Income[†]

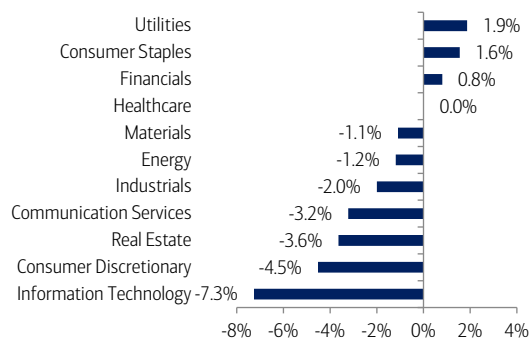
	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	5.15	-0.54	-2.24	-2.95
Agencies	5.13	-0.18	-0.96	-0.89
Municipals	3.70	-0.30	-1.02	-1.40
U.S. Investment Grade Credit	5.25	-0.61	-2.36	-3.11
International	5.71	-0.72	-2.55	-2.94
High Yield	8.27	-0.58	-1.64	-0.19
90 Day Yield	5.37	5.38	5.36	5.33
2 Year Yield	4.99	4.90	4.62	4.25
10 Year Yield	4.62	4.52	4.20	3.88
30 Year Yield	4.71	4.63	4.34	4.03

Commodities & Currencies

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Commodities				
Bloomberg Commodity	240.47	0.2	3.9	6.2
WTI Crude \$/Barrel ^{††}	83.14	-2.9	0.0	16.0
Gold Spot \$/Ounce ^{††}	2391.93	2.0	7.3	15.9

	Total Return in USD (%)			
	Current	Prior Week End	Prior Month End	2022 Year End
Currencies				
EUR/USD	1.07	1.06	1.08	1.10
USD/JPY	154.64	153.23	151.35	141.04
USD/CNH	7.25	7.27	7.26	7.13

S&P Sector Returns



Sources: Bloomberg; Factset. Total Returns from the period of 4/15/2024 to 4/19/2024. [†]Bloomberg Barclays Indices. ^{††}Spot price returns. All data as of the 4/19/2024 close. Data would differ if a different time period was displayed. Short-term performance shown to illustrate more recent trend. **Past performance is no guarantee of future results.**

Economic Forecasts (as of 4/19/2024)

	2023A	Q1 2024A	Q2 2024E	Q3 2024E	Q4 2024E	2024E
Real global GDP (% y/y annualized)	3.0*	-	-	-	-	3.0
Real U.S. GDP (% q/q annualized)	2.5	2.5*	2.0	2.0	2.0	2.7
CPI inflation (% y/y)	4.1	3.2*	3.8	3.5	3.3	3.5
Core CPI inflation (% y/y)	4.8	3.8*	3.6	3.6	3.5	3.6
Unemployment rate (%)	3.6	3.8*	3.9	3.9	4.0	3.9
Fed funds rate, end period (%)	5.33	5.33*	5.38	5.38	5.13	5.13

The forecasts in the table above are the base line view from BofA Global Research. The Global Wealth & Investment Management (GWIM) Investment Strategy Committee (ISC) may make adjustments to this view over the course of the year and can express upside/downside to these forecasts. Historical data is sourced from Bloomberg, FactSet, and Haver Analytics. **There can be no assurance that the forecasts will be achieved. Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment performance.**

A = Actual. E/* = Estimate.

Sources: BofA Global Research; GWIM ISC as of April 19, 2024..

Asset Class Weightings (as of 4/2/2024)

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

*Many products that pursue Alternative Investment strategies, specifically Private Equity and Hedge Funds, are available only to qualified investors. CIO asset class views are relative to the CIO Strategic Asset Allocation (SAA) of a multi-asset portfolio. Source: Chief Investment Office as of April 2, 2024. All sector and asset allocation recommendations must be considered in the context of an individual investor's goals, time horizon, liquidity needs and risk tolerance. Not all recommendations will be in the best interest of all investors.

CIO Equity Sector Views

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

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 U.S. dollars.

S&P 500 Index is a stock market index tracking the stock performance of 500 of the largest companies listed on stock exchanges in the United States.

S&P 500 Index Price Return measures the value of the stocks of the 500 largest corporations by market capitalization listed on the New York Stock Exchange or Nasdaq.

MSCI Eurozone Indexes captures large cap representation across the 10 Developed Markets (DM) countries in the EMU.

Volatility Index/VIX is the ticker symbol and the popular name for the Chicago Board Options Exchange's CBOE Volatility Index, a popular measure of the stock market's expectation of volatility based on S&P 500 index options.

The MOVE Index is a market-implied measure of bond market volatility. It calculates options prices to reflect the expectations of market participants on future volatility.

Geopolitical Risk Index is compiled by Fed economists Dario Caldara and Matteo Iacoviello. It measures the occurrence of impactful geopolitical events/threats/conflicts since 1985 by counting the keywords used in the press.

Brent Crude is the most traded of all of the oil benchmarks, and is defined as crude mostly drilled from the North Sea oilfields: Brent, Forties, Oseberg and Ekofisk (collectively known as BFOE). This oil type is widely used as it is both sweet and light, making it easy to refine into diesel fuel and gasoline.

Important Disclosures

Investing involves risk, including the possible loss of principal. Past performance is no guarantee of future results.

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