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CHIEF INVESTMENT OFFICE

Capital Market Outlook

July 8, 2024

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

IN THIS ISSUE

Macro Strategy—*Fed Boost Needed For A Sustained Positive Profits Outlook:* Headwinds from high interest rates, tight bank credit, and a strong dollar persist, keeping economic growth below potential and on a weakening trend. Looking through the monthly noise, year-to-date real consumer spending has barely increased. Sentiment has not only declined among lower-income households. According to some surveys, even higher-income consumers are starting to feel uncomfortable with interest rates and economic conditions. The housing sector struggles with high mortgage rates. Absent a catalyst for stronger growth, the June Institute for Supply Management (ISM) manufacturing index remained in contraction territory, with no sign of decisively coming out of its funk.

U.S. corporate profits rose at a healthy clip year-over-year (YoY) and profit margins remained elevated in Q1, keeping credit spreads narrow and equity market volatility low. Still, with U.S. economic surprises remaining to the downside, inflation cooling, and more U.S. earnings revised lower than higher, labor demand is likely to come under increased downward pressure as well. Labor market indicators are already cooling. Fortunately, with inflation easing, the Federal Reserve (Fed) has space to step in to support growth before excessive weakness develops.

Market View—*A Less Concentrated Path Forward?:* U.S. Equity concentration reached new heights over the first half of this year, as a small number of stocks were responsible for a disproportionate weight in the overall market capitalization. The 10 largest U.S. companies account for over 37% of the total index market cap which has raised concerns of a developing bubble or overconcentration. Of mammoth proportions, three companies in the S&P 500 have market caps north of $3 trillion.

Key to the U.S. earnings backdrop and resiliency of recent quarters has been the contribution from these mega caps, with consensus estimates penciling in two earnings developments, both of which would be significant rotations. First, to see a slowing rate of earnings growth in the coming quarters for the market's leaders. And second, for a durable and sustained broadening out of earnings growth across the laggard sectors, which we would view as a positive development for Equities.

Thought of the Week—*The Nexus Between Big Data and Big Energy Supports America's Global Competitiveness:* Big Data requires Big Energy, and no country in the world is better positioned to power its Artificial Intelligence (AI) revolution than the U.S., owing to America's status as an energy superpower. A typical ChatGPT query, for instance, requires 10 times the electricity of a Google search, according to the International Energy Agency (IEA). Electricity generation comes primarily from coal and natural gas, which the U.S. enjoys abundant supplies. Ditto for renewables, although getting renewables like wind and solar plugged into the U.S. grid remains challenging.

While the effects of the AI revolution are still evolving, one clear consequence is already upon us: voracious consumption of energy. That means the country with the lowest-cost energy infrastructure is in pole position to lead the globe's AI revolution. That country: the U.S.

MACRO STRATEGY ▶

Chief Investment Office
Macro Strategy Team

MARKET VIEW ▶

Lauren J. Sanfilippo
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THOUGHT OF THE WEEK ▶

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MARKETS IN REVIEW ▶

Data as of 7/8/2024, and subject to change

Portfolio Considerations

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. We maintain our view of buying into Equity market weakness and maintaining exposure to Fixed Income for the purpose of cash flow and diversification benefits. Within Fixed Income, we maintain our preference for quality across the segments and curve while considering liquidity and a slight above benchmark weight in duration.

MACRO STRATEGY

Fed Boost Needed For A Sustained Positive Profits Outlook

Chief Investment Office, Macro Strategy Team

As anticipated in our June 24, 2024, Capital Market Outlook, evidence of an economic “soft landing in progress” is accumulating. Indeed, while U.S. economic indicators continue to surprise to the downside, the economy is still chugging along, and inflation is gradually cooling.

In one of the few but welcome upside surprises, real consumer spending growth spiked in May, more than reversing its April drop. The rebound was led by a sharp snapback in goods demand following a decline in April, with services spending growth quite soft. Overall, spending for the month was strong enough to alleviate concerns of a severe consumer sector retrenchment that would endanger the economic expansion.

A snapback in spending was portended by the employment surge in May and related 10.2% annualized increase in wages and salaries. This much-above-average gain in wages and salaries combined with slowing inflation not only encouraged consumers to open up their wallets. It also allowed for a welcome increase in the saving rate from 3.7% to 3.9%. Though still low, more saving now means greater potential for consumers to maintain spending in coming months, hopefully keeping the economy afloat until the Fed cuts interest rates.

Indeed, with consumer spending softening significantly year to date, and housing and manufacturing activity restrained by high rates, the need for Fed rate cuts is likely to become increasingly apparent as the year progresses. Looking through the monthly volatility, it’s clear that consumer spending has weakened significantly. Year to date, real disposable income has increased just 1.5% at an annualized rate, keeping real consumer spending on a slowing trend. Real spending is up less than 1% year-to-date (YTD), compared to a 2.4% average over the 20 years prior to the pandemic, with services up at a normal 2.3% annualized rate, but real spending on goods contracting outright, as it’s correcting its pandemic surge above trend.

Prolonged strains from elevated interest rates are causing residential investment and nonresidential structures investment to fall short of expectations this year, as well, with weak May construction data spurring another downgrade to forecasts for Q2 real gross domestic product (GDP). The large drop in pending home sales for May to a record low, and declining building permits show strong persistent headwinds to residential investment.

Things are not looking up on the manufacturing side, either, if the weak ISM manufacturing index for June is any indication. The production, employment and inventories components were down in June and in contraction territory. Having hovered around 50 for almost two years, the production subindex fell back into contractionary territory after three months of modest growth. While the new orders index rose, it remained in slight contraction territory at 49.3, far from signaling a rebound on the industrial production front anytime soon. All in all, with persistent downside economic surprises, real GDP growth estimates have been revised below 2% over the past two weeks, according to the Atlanta Fed GDPNow, on the heels of a soft 1.4% increase in Q1. It is becoming clear that high interest rates, past tightening of banks credit policies, and a strong dollar are creating headwinds for U.S. economic activity across more fronts.

With growth below potential in the first half of 2024, it is not surprising that the disinflation process has continued. Headline personal consumption expenditures (PCE) inflation declined slightly in May, while “core” PCE inflation rose the least in almost four years. Soft May inflation readings brought YoY headline and “core” inflation down to 2.6%. With leading indicators and headwinds to growth suggesting that GDP growth is likely to remain below trend, further disinflation is likely toward the 2% target. Goods prices are in outright deflation territory, and the latest ISM Manufacturing survey prices index fell sharply to 52.1 from 57.0, suggesting slowing producer cost inflation despite rising oil prices and higher shipping costs. Consumer inflation expectations have also returned to their prepandemic

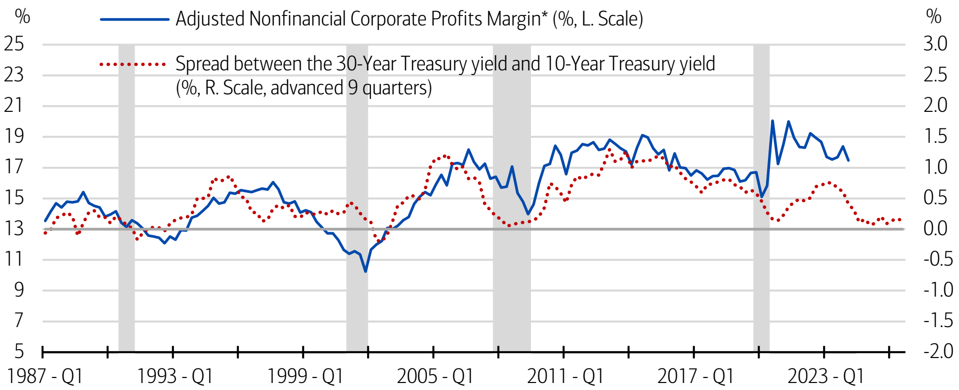
Investment Implications

According to BofA Global Research, positive trends in stock-related news sentiment and a rising Global Earnings Revision Ratio point to continued strength in equity markets. With inflation cooling alongside real growth, the Fed can step in to prevent a recession and a worrisome profit decline, helping to support risk-asset performance.

range, according to the University of Michigan survey, strengthening the likelihood of inflation moving closer to the Fed 2% target in coming quarters.

While Q1 profits increased and U.S. corporate profit margins remained near an all-time high, an outlook for below potential real growth and slowing inflation is not a recipe for stronger revenue growth. With already elevated profit margins, this casts doubt over the U.S. profits growth outlook as well (Exhibit 1).

Exhibit 1: Profit Margins On A Downtrend As Fed Restrains Nominal Growth.



*Nonfinancial corporate profits before tax and adjusted for net interest payments as a % of Gross value added of nonfinancial corporate business. Gray bars represent recessionary periods. Sources: Bureau of Economic Analysis; Federal Reserve Board/Haver Analytics. Data as of June 2, 2024. **Past performance is no guarantee of future results.**

The pandemic-related infusion of trillions of dollars in stimulus caused massive, unexpected inflation, sharply boosting revenues relative to wages, which are more rigid in the short term. Profit margins surged as a result. An atypical and massive fall in corporate net-interest expense further enhanced margins. Basically, rising interest rates have boosted corporate interest income faster than increasing interest expense because of the combination of significant corporate cash assets and long-term fixed-rate debt. In other words, rather than constraining profits, and in turn hiring and economic growth, rising interest rates have so far caused a sharp decline in corporate net interest expense relative to output. That is starting to change as companies refinance debt in the new, higher-rate environment.

Looking ahead, these forces are likely to work in reverse. With wages still catching up to past inflation, revenue growth is likely to slow faster than wages, causing profit margins to erode and forcing businesses to start reducing payrolls. As interest rates on longer-term debt reset and rate cuts reduce interest income on corporate cash, a steep rebound in corporate net interest expense over the coming year is likely, further hurting profit margins. These headwinds suggest declines in corporate profits may be in store absent interest rate relief from Fed policy.

For now, elevated margins still support a low unemployment rate and until they start declining, the unemployment rate is unlikely to increase much. Profit margins tend to lead the unemployment rate by about four quarters. High profit margins, tight corporate credit spreads and low equity-market volatility tend to go hand in hand. Also suggesting the adjustment process is likely to remain gradual, according to June 27, 2024, BofA Global Research, the trend in its News Pulse—a ratio of the number of significant stock-related news articles which are positive versus the number of negative news articles—has continued to improve. Based on an analysis of billions of news articles over the last 20 years, this indicator has been found to be useful for stock selection and for determining the direction of equity markets, and it's currently flashing a positive signal for equity markets. It corroborates the improvement observed in the Global Earnings Revision Ratio from 0.82 to 0.95 in June, the highest monthly level in 29 months. The MSCI All-Country World Index (ACWI) tends to move in tandem with the Global Earnings Revision Ratio (60% correlation since 1988), so the rising Global Ratio remains a positive signal for global equity market performance in the second half of 2024.

MARKET VIEW

A Less Concentrated Path Forward?

Lauren J. Sanfilippo, Director and Senior Investment Strategist

U.S. mega cap Technology blazed new records over the first half of the year. Of mammoth proportions, just three companies in the S&P 500 now total a combined $10 trillion in market cap.[1] That trio is not just outsized compared to their domestic peers but also to international peers. To find a similarly sized cohort, the collective and combined values of the U.K., Japanese and French stock indexes (inclusive of 365 companies) are comparable in size.[2]

Suffice it to say, the technology-centric, AI boom is breeding some U.S. thoroughbreds. No other place on the map—not Japan, nor India, came close to rivaling performance like that of the U.S. Even a rarity for U.S. Equities, the first half advance of 14.5% is one of only 14 instances of returns of that magnitude dating back to 1950.

The U.S. Allure: A Crowded Trade. Such impressive performance has pushed the S&P 500 to all-time highs more than 30 times so far this year, until reaching 5,567 in early July, while raising concerns of a developing bubble or overconcentration given the narrow performance. Concentration has been a consistent feature of this market, with a small number of stocks responsible for a disproportionate weight in the overall market cap. The 10 largest U.S. companies account for over 37% of the total index market cap (Exhibit 2A), higher than the prepandemic level of 23%, or the peak of the dotcom bubble in 2000 of 27%. Priced close to perfection, valuations have become stretched, trading at a collective price-to-earnings forward multiple of 30x-for the ten, while the remaining group of stocks trade at 18x.

But concentration risk doesn't always have to end badly. Dare we say it could be different this time; that unlike the lead up to the dotcom meltdown, when mega-valuations followed meager earnings, today's mega caps are underpinned by real earnings. Most compelling is that the top 10 have higher profit margins compared to prior periods of elevated concentration while also being attached to strong growth narratives.

In years of mega cap leadership since 1986, Equities were up the subsequent year nearly 75% of the time according to BofA Global Research. More important than the absolute level of concentration is the group's commensurate contribution to earnings, a dynamic we are watching closely given the direction of earnings estimates for the back half of the year. More on that below.

Further, as for concentration on a global scale, the first half U.S. hegemony has ratcheted up its share of market cap (the concentration in global Equity indexes) to an extreme of 64% and the highest on record (Exhibit 2B). The MSCI ACWI Index's global list of superstars features only five of the top 25 contributors domiciled outside of the U.S. That's proof of the U.S.'s capacity to outearn, outperform and outgrow on an absolute and relative basis.

And still, the U.S. continues to be the region of choice, as investors have piled into the momentum trade. Just last month $30 billion in global investor dollars were committed to stock funds, of which 94% were directed at U.S. assets—the Technology sector in particular a money magnet.[3]

Portfolio Considerations

Our broad expectation is for Equities to continue to trend higher over the back half of this year, albeit at a more moderate pace compared to the first six months. Given index construction and the mega cap Technology run, concentration was pushed to extremes. We are mindful of overconcentration and continue to emphasize a diversified approach to portfolio construction, inherently broader than just Technology core holdings, and includes a balance between Value and Growth.

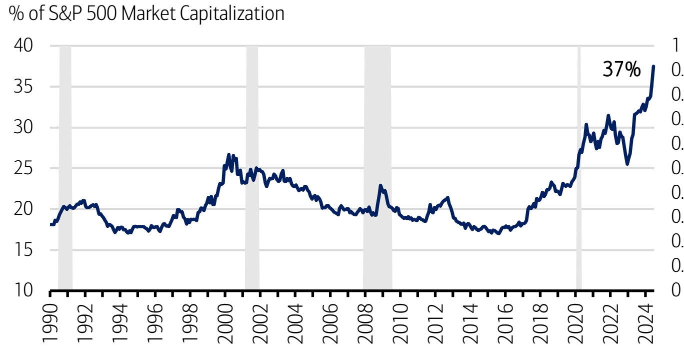
[1] Microsoft, Nvidia, Apple. Data as of July 2024.

[2] Combined market cap of the FTSE 100, the Nikkei 225, and CAC 40. U.S. dollar terms, based on data as of July 1, 2024.

[3] Data according to EPFR Global. Source: Bloomberg, "Global Traders Flood American Markets in Search for Safety," June 14, 2024.

Exhibit 2: When Giants Dance: Concentration Plagues the U.S. and Global Equity Markets.

2A) The Top 10 Names in the S&P 500 are 37% of the Index Market Cap.



2B) U.S. Concentration Within the Global Equity Benchmark also at an Extreme.

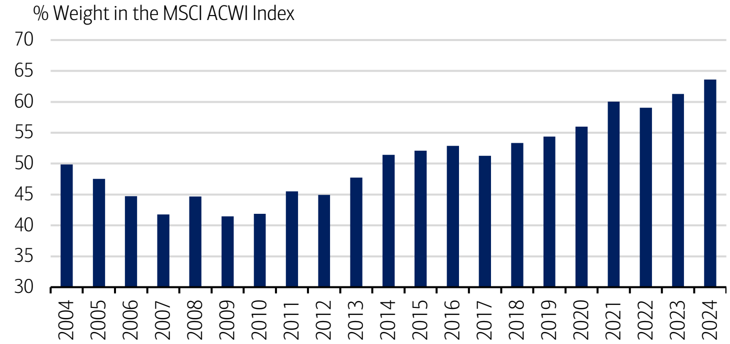


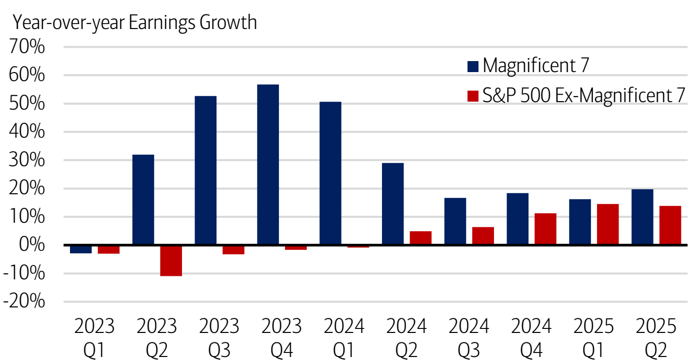
Exhibit 2A) Shaded bars indicate recessionary periods as defined by the National Bureau of Economic Research. Top 10 market cap June 2024 includes: Microsoft, Apple, Nvidia, Amazon, Meta, Alphabet, Berkshire Hathaway, Eli Lilly, JP Morgan, and Broadcom. Source: Bloomberg. Data as of July 2024. Exhibit 2B) 2024 data point as of June 30, 2024. Source: Bloomberg. Data as of July 8, 2024. **Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Past performance is no guarantee of future results.**

Directionality of Earnings and Seasonality Providing a Roadmap. Key to the earnings resiliency and recovery of recent quarters has been the contribution from the Magnificent 7.[4] Since the second quarter of last year, the Magnificent 7 growth rates have been far above the rest of the index earnings. Ahead, consensus estimates suggest a more moderate Magnificent 7 earnings profile, set to decelerate from elevated YoY growth rates north of 50% in the most recent earnings quarter, falling to a high-teens pace by Q3 2024 (Exhibit 3A). Alongside that deceleration, a catch-up is being penciled in for the rest of the 493 to grow earnings by mid-single digits. That's assuming two significant earnings inflections: both a catch-up for the 493 and a catch down for the 7.

Coincident with Q2 earnings season beginning at the end of this week are favorable seasonality trends. July has ranked as the most seasonably favorable month of the year since 1930 before breaking into August and September, a two-month spread that typically exhibits less than superior performance—with an average gain of 0.5% and average decline of 1.2% respectively (Exhibit 3B). It being an election year, volatility typically rises by 25% beginning in July through to November while peaking right before election day. Returns closing out an election year yielded comparatively stronger averages (of 2.6%) than non-election years (2.3%) over the November to December timeframe. Ergo our assertion to stay invested during election years even given the associated volatility.

Exhibit 3: A Look at Earnings and Seasonality.

3A) Magnificent 7 Earnings are Growing, but Rate is Slowing, while the "493" Catch Up.



3B) July Seasonality is the Most Favorable Time of the Year.

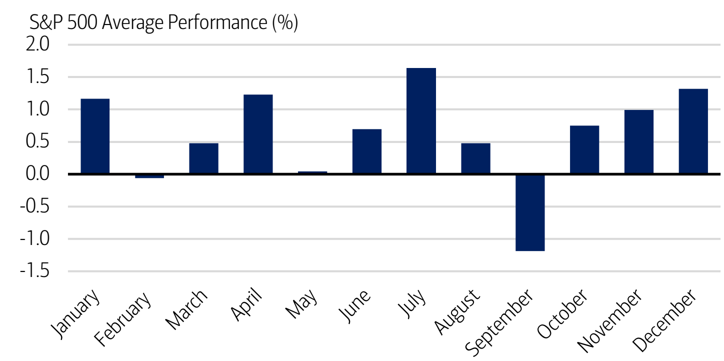


Exhibit 3A) Estimates from Q2 2024 to Q2 2025. Source: Bloomberg. Data as of June 2024. Exhibit 3B) Monthly data 1930 through June 2024. Source: Bloomberg. Data as of July 2024. **Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Past performance is no guarantee of future results.**

[4] Apple, Microsoft, Alphabet, Amazon, Meta, Nvidia, and Tesla.

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THOUGHT OF THE WEEK

The Nexus Between Big Data and Big Energy Supports America's Global Competitiveness

Joseph P. Quinlan, Managing Director and Head of CIO Market Strategy

Ariana Chiu, Investment Analyst

If data is the new oil—as many proclaim—then America is the Saudi Arabia of data. As Exhibit 4A depicts, when it comes to building data centers, no one does it like the U.S., which currently houses roughly half (5,381) of the globe's 10,655 data centers. That's another way of saying that no other economy in the world is as data-driven, data-dependent and data-immersed as the U.S. economy. Digitalization is now part of America's economic DNA—but the digital infrastructure remains a work in progress.

Indeed, add in the AI revolution, which requires enormous amounts of computing power and data storage, and the demand for data center storage capacity is set to soar over the near term. According to Data Bridge Market Research, spending on the global AI infrastructure market (which includes data centers) is expected to grow at a compound annual rate of 44% over the next six years.

The challenge is that Big Data requires Big Energy. AI data centers (and applications) are extraordinarily energy intensive. A typical ChatGPT query, for instance, requires 10 times the electricity of a Google search, according to the IEA. Also, according to the IEA, the share of electric-power generation devoted to data centers is projected to rise from 4% today to up to 9% by the end of the decade.

That said, no other large country in the world is positioned to power its AI revolution like the U.S., owing to America's status as an energy superpower (Exhibit 4B). Electricity generation comes primarily from coal and natural gas, of which the U.S. enjoys abundant supplies. Ditto for renewables, although getting renewables like wind and solar plugged into the U.S. grid remains challenging.

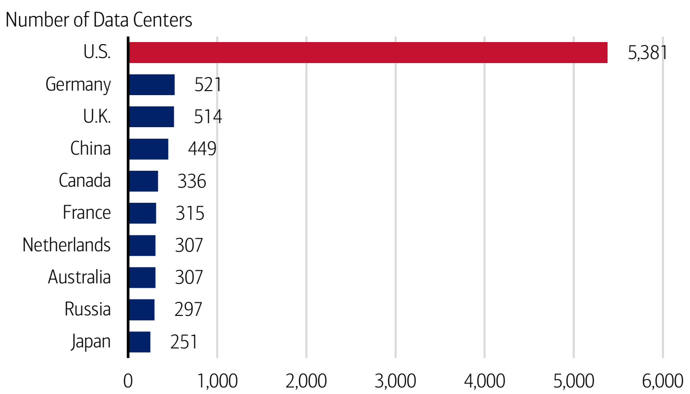
The bottom line is that while the effects of the AI revolution are still evolving, one clear consequence is already upon us: voracious consumption of energy. That means the country with the lowest-cost energy infrastructure is in pole position to lead the globe's AI revolution. That country: the United States.

Portfolio Considerations

The AI infrastructure buildout is just getting started and will maintain upside pressure on a host of commodities, namely copper and natural gas. We remain overweight the Energy sector in general and continue to favor commodity exposure over the long run.

Exhibit 4: Big Data Centers Are A Key Source Of Big Energy Needs.

4A) The U.S. Leads the World in Data Centers.



4B) U.S. Summer Electricity Generation by Source.

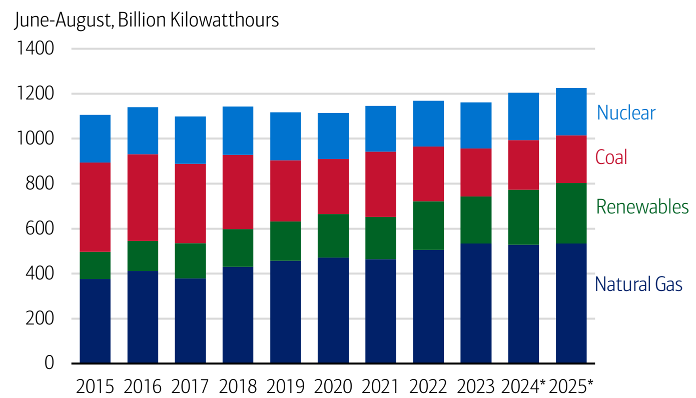


Exhibit 4A) Source: U.S. Global Investors. Data as of July 1, 2024. Exhibit 4B) *Projection. Source: U.S. Energy Information Administration. Data as of July 2, 2024.

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	39,375.87	0.7	0.7	5.5
NASDAQ	18,352.76	3.5	3.5	22.7
S&P 500	5,567.19	2.0	2.0	17.6
S&P 400 Mid Cap	2,895.80	-1.2	-1.2	4.9
Russell 2000	2,026.73	-1.0	-1.0	0.7
MSCI World	3,580.90	2.0	2.0	14.0
MSCI EAFE	2,364.30	2.2	2.2	7.6
MSCI Emerging Markets	1,104.88	1.9	1.9	9.6

Fixed Income†

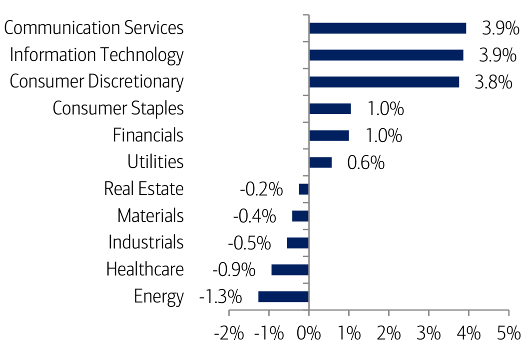
	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	4.78	0.71	0.71	0.03
Agencies	4.83	0.40	0.40	1.24
Municipals	3.72	0.06	0.06	-0.34
U.S. Investment Grade Credit	4.88	0.71	0.71	0.00
International	5.34	0.96	0.96	0.47
High Yield	7.86	0.28	0.28	2.87
90 Day Yield	5.37	5.35	5.35	5.33
2 Year Yield	4.60	4.75	4.75	4.25
10 Year Yield	4.28	4.40	4.40	3.88
30 Year Yield	4.48	4.56	4.56	4.03

Commodities & Currencies

	Total Return in USD (%)			
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	241.89	1.6	1.6	6.8
WTI Crude $/Barrel††	83.16	2.0	2.0	16.1
Gold Spot $/Ounce††	2392.16	2.8	2.8	16.0

	Total Return in USD (%)			
Currencies	Current	Prior Week End	Prior Month End	2022 Year End
EUR/USD	1.08	1.07	1.07	1.10
USD/JPY	160.75	160.88	160.88	141.04
USD/CNH	7.29	7.30	7.30	7.13

S&P Sector Returns



Sources: Bloomberg; Factset. Total Returns from the period of 7/1/2024 to 7/5/2024. †Bloomberg Barclays Indices. ††Spot price returns. All data as of the 7/5/2024 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 7/5/2024)

	2024E	Q1 2024A	Q2 2024A	Q3 2024E	Q4 2024E	2025E
Real global GDP (% y/y annualized)	3.2	-	-	-	-	3.3
Real U.S. GDP (% q/q annualized)	2.6	1.4	2.0*	2.5	2.0	2.1
CPI inflation (% y/y)	3.0	3.2	3.3*	2.9	2.7	2.1
Core CPI inflation (% y/y)	3.5	3.8	3.5*	3.4	3.3	2.7
Unemployment rate (%)	3.9	3.8	4.0*	4.0	4.0	4.1
Fed funds rate, end period (%)	5.13	5.33	5.33	5.38	5.13	4.13

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 July 5, 2024.

Asset Class Weightings (as of 6/4/2024)

	CIO View				
Asset Class	Underweight		Neutral	Overweight	
Global Equities				●	
U.S. Large Cap Growth			●		
U.S. Large Cap Value				●	
U.S. Small Cap Growth				●	
U.S. Small Cap Value				●	
International Developed		●			
Emerging Markets			●		
Global Fixed Income		●			
U.S. Governments				●	
U.S. Mortgages				●	
U.S. Corporates		●			
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					

CIO Equity Sector Views

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

*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 June 4, 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.

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 market-capitalization-weighted index that is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

Institute for Supply Management (ISM) manufacturing index is a composite index that gives equal weight to new orders, production, employment, supplier deliveries, and inventories.

ISM new orders index shows the number of new orders from customers of manufacturing firms reported by survey respondents compared to the previous month.

ISM Manufacturing survey prices index a subindex of the ISM Manufacturing PMI, represents purchasing managers' outlook for future raw material prices.

MSCI All-Country World Index (ACWI) is a global equity index that measures the equity performance in both the developed and emerging markets.

FTSE 100 Index is the United Kingdom's best-known stock market index of the 100 most highly capitalized blue chip companies listed on the London Stock Exchange.

Nikkei 225 Index is a stock market index for the Tokyo Stock Exchange. It is a price-weighted index, operating in the Japanese Yen, and its components are reviewed twice a year.

CAC 40 Index is a benchmark French stock market index. The index represents a capitalization-weighted measure of the 40 most significant stocks among the 100 largest market caps on the Euronext Paris.

Important Disclosures

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