

Viewpoint

Back To The 1990s

February 2024

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

IN BRIEF

- The U.S. economy shows early signs of reaccelerating, consumers remain healthy, corporate profits turning higher and monetary policy is pivoting from tightening to easing.
- We continue to favor both stocks and bonds overall. This month we made tactical adjustments designed to increase our exposure to areas that are more correlated with easier financial conditions in the coming year, by raising our allocation to U.S. Small-caps and some cyclical sectors, and not due to a change to our positive view on higher-quality bonds.
- This month we are upgrading Small-cap Equities on very attractive valuations, lower interest rates and cost of capital, improving technical trends, and a potential earnings inflection later in 2024.
- While we are still favorable on a significant allocation to bonds in diversified portfolios, this month we used Fixed Income, a move to neutral in U.S. Investment-grade Taxable, as a source of funds to reposition favorably within Equities.

The month of January included two main narratives that developed within the capital markets. One was of a belief that the equity markets are poised to gather further momentum from the close of 2023 and the other that, at its core, had a base belief that the Federal Reserve (Fed) would begin cutting rates in March to help engineer the much-anticipated soft landing in the economy. In our view, those were the baseline beliefs with other stories and concerns such as rising geopolitical risk, Technology sector dominance, the wide deficit and interest cost, slumping China growth, and issues in the commercial real estate markets circulating around them. We think it's important to understand the baseline narratives in any given year but that it is imperative to assess what type of business cycle is developing, what is priced into the capital markets, and how capital will move across asset classes as the cycle develops. Some are suggesting a harder landing is likely to develop given the pressure from an inverted yield curve, deficit financing issues, and "tired" consumers while others indicate we are already in a new expansion. From our perspective, it doesn't have to be one or the other. We believe there are still a number of crosscurrents in the economy that are still normalizing. In this regard, we believe the economic and investment narratives are beginning to transition as expected in a relatively transparent manner. The key is the degree of "certainty" in what drives liquidity and how that ultimately filters into the level of growth, all things considered. This does not mean that the path is going to be easy. In fact, we still believe this is a "chop and grind" type of investment environment in which the positives and negatives continue to trade places from month-to-month but end the full year in the green for both stocks and bonds.

CIO ASSET CLASS VIEWS

This month, the Global Wealth & Investment Management Investment Strategy Committee (GWIM ISC) raised our U.S Equity allocation to a slight overweight, driven by an increase in Small-caps, and used Fixed Income as a source of funds for this upgrade, lowering our allocation to Taxable bonds, where appropriate. We also adjusted our U.S. Equity sector exposure to increase cyclicals and reduce some defensive sectors. We continue to emphasize balance and a fully invested strategy while using potential excess cash to support a portfolio strategy that is highly diversified.

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Asset Class	CIO View		
	Underweight	Neutral	Overweight
Equities	● ● ▶	●	● ●
U.S. Large-cap	● ● ●	●	● ●
U.S. Mid-cap	● ● ●	●	● ●
U.S. Small-cap	● ● ▶	●	● ●
International Developed	● ● ●	●	● ●
Emerging Markets	● ● ●	●	● ●
Fixed Income	● ● ●	● ● ▶	● ●
U.S. Investment-grade Taxable	● ● ●	● ● ▶	● ●
International	● ● ●	●	● ●
Global High Yield Taxable	● ● ●	●	● ●
Alternative Investments*			
Hedge Funds			
Private Equity			
Tangible Assets /			
Commodities			
Real Estate			
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.

Trust and fiduciary services are provided by Bank of America, N.A., Member FDIC and a wholly owned subsidiary of Bank of America Corporation ("BofA Corp.").
Investment products:

Are Not FDIC Insured	Are Not Bank Guaranteed	May Lose Value
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That said, we expect this next business cycle to combine areas of expansion and contraction and workouts to ultimately create one that reminds us of the 1990s. The economy, the Fed's action, corporate earnings, the yield curve and level of rates, and elevated geopolitical activity all are developing in similar types of patterns—not exactly but similar behaviors—from some three decades ago. Obviously, there are some stark differences such as the level of national debt and the size of the Fed's balance sheet, come to mind. However, both of these issues will need to be either dealt with over time or addressed across multiple cycles with perhaps new tools not yet created.

At the beginning of the 1990s, a restructuring from the savings and loan crisis ensued, the yield curve adjusted, a less clear Fed communication backdrop was present, but their power was dominant, the internet was starting up/taking form, and corporate America was using new knowledge to help expand margins and operating leverage, and while the peace dividend was in place concerns were rising across the Middle East. We characterize this current (1990s look-alike) cycle as the road to normalization.

The level of certainty and liquidity matters. On the road to normalization, investors, in our view, will continue to pay a premium for certainty and transparency, particularly in a world that is uncertain. In this regard, the mini melt-up phase to close out 2023 and begin 2024 was driven by good inflation trends, solid earnings, and expectations for future Fed cuts and a tapering of its balance sheet decline. All of which could create a backdrop that produced easier financial conditions. Therefore, some of the excess cash on the sidelines has found its way into both stocks and bonds. We don't see this story changing much for this year overall, but this enthusiasm will likely come with checks and balances that we call "wildcards." The top two wildcards continue to be geopolitical risk (including in the U.S.) and concerns over Commercial Real Estate (CRE) exposure. As new information is factored into the markets we expect three potential periods of overall weakness—February, mid-year and the traditionally weaker months of September/October time frame—that could provide attractive buying opportunities in the equity markets and repositioning opportunities in bonds. We continue to emphasize balance and a fully invested strategy while using potential excess cash to support a portfolio strategy that is highly diversified.

We expect the market to broaden out as more asset allocators increase diversification via exposure to secular underperformers. Quality factors are still the drivers of the market which is in line with our view that certainty matters. We expect this to continue. The Technology sector's high profit margins are still applauded by investors, but selectivity is rising within the sector. We believe the narrow leadership of 2023 broadens out somewhat to other areas that exhibit quality, certainty, and/or are very cheap by historical standards with a new catalyst as the Fed cuts rates and general election year patterns. We maintain balance within the Technology sector.

Once the Fed cuts, investor focus will likely shift to:

- Why are they cutting? Is it to normalize yields, or is it because growth worries are accelerating?
- What will be the frequency of the cuts? Quarterly or more frequent?
- Does this accelerate another expansion or help the normalization process?

Portfolio strategy considerations:

- Remain fully invested.
- Use cash to support new positions in Equities and bonds if under your benchmarks.
- Stay diversified with a light increase to Equities.
- Be ready for opportunities to broaden your exposure slightly to small capitalization shares.
- Use weak periods as an opportunity to rebalance and reposition.
- While recognizing favorable valuations in some developed/emerging markets, our asset allocation bias remains tilted towards U.S. assets.

Given all of this, we have made the following tactical asset allocation adjustments at the latest GWIM ISC meeting in February:

- Raised Equities to slight overweight from neutral.
- Funded the increase in Equities from exposure to areas of richness in Fixed Income.
- Increased small capitalization shares to slight overweight from neutral with a tilt toward value in this asset class.
- Increased our exposure to cyclical Equity sectors.

We are increasing our exposure to cyclical Equity sectors as monetary policy may pivot from tightening towards easing, earnings trends are improving, and early indicators are showing economic green shoots. If economic indicators continue to show resiliency, we

expect cyclical areas to perform better than defensive. Moreover, if the Fed ultimately lowers rates, we believe the next expansion could be accelerated.

In addition, we are reducing some defensive sector exposure to increase cyclical and earlier cycle sector exposure. With the resilient consumer, we are increasing our exposure to the Consumer Discretionary sector and with improving readings from Institute for Supply Management and Purchasing Managers' Index (PMI) indicators, we are increasing our exposure to the Industrials sector.

We maintain a positive view on both stocks and bonds overall. The latest tactical adjustments are designed to increase our exposure in the coming year to areas that are more correlated with easier financial conditions—and are at secular lows versus large capitalization shares in the U.S.—and not due to a change to our positive view on higher-quality bonds.

CIO INVESTMENT DASHBOARD AS OF FEBRUARY 6, 2024

Our view for 2024 remains constructive as recession concerns have abated, inflation has continued to moderate, and the potential for a soft landing has materialized. While valuations for U.S. Equities remain elevated relative to long-term averages, with the S&P 500 forward price to earnings (P/E) ratio hovering around 20.0x, earnings are becoming more supportive with consensus estimating annual earnings growth of 11.0% for 2024, according to FactSet. We continue to see crosscurrents in the market landscape and anticipate bouts of chopiness, but ultimately maintain a positive bias for equity markets this year.

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	
Earnings				<p>According to FactSet, estimated S&P 500 revenue and earnings annual growth rates in 2023 were 2.4% and 0.7%, respectively. Accordingly, this year, consensus expects growth of 5.4% and 11.0%. For 2023, Q4 estimates call for sales growth of 3.4% and profits growth of 1.5% on a year-over year (YoY) basis. In Q1 of this year, consensus expects growth of 3.6% and 4.5% respectively. Meanwhile, according to BofA Global Research, the Global Earnings Revision Ratio moderated in January, in line with its historical early-year tendency. The ratio remains below its long-term average, while the number of downgrades to profit estimates surpasses upgrades. Globally, this scenario stands for 17 of 20 countries and in 15 of 16 tracked industries.</p>
Valuations				<p>The S&P 500 P/E ratio (next 12 months) has risen to about 20.0x, the highest in about two years and above the long-term average. This headline measure suggests that U.S. Equities remain expensive amidst an outlook for slowing economic growth. Elevated interest rates should continue to suppress the relative appeal of Equities versus Fixed Income.</p>
U.S. Macro				<p>Real gross domestic product (GDP) grew by 3.3% in Q4 2023 at a seasonally adjusted annual growth rate, resulting in full-year growth of 2.5%. On the demand side, a strong labor market and a cushion of savings have helped support consumer spending. Longer-run fiscal programs have helped support investment. A burdensome cost of living and elevated interest rates remain headwinds to growth. BofA Global Research expects Q1 GDP growth of 1.0% and 2.1% for all of 2024.</p>
Global Growth				<p>Diverse headwinds face the global economy. In the Euro area, strict monetary policy has factored in slowing economic growth while fiscal policy is tightening in Germany. Inflation has also subsided, though conflict in the Middle East has raised uncertainty. In China, officials have taken steps to loosen regulation and credit availability, among other measures, to help combat weakness in the property market and financial stress, which has fueled concern over the outlook. In the U.S., there remains economic resilience in general. After growth of 3.5% in 2022, the global economy is expected to have expanded by 3.1% in 2023 and should grow by 2.8% in 2024, according to BofA Global Research. This compares to average growth of 3.8% from 2000 to 2019, according to the International Monetary Fund.</p>
U.S. Monetary Policy / Inflation				<p>Recently, the Federal Open Market Committee adopted a more neutral monetary policy stance and has adjusted their communication with a bias toward easing. However, Chairman Jerome Powell signaled the need for greater confidence in a sustained decline in inflation, disappointing market expectations of a policy rate cut in early Spring. For 2024, BofA Global Research expects three cuts of 0.25% to the policy interest rate, occurring in June, September, and December. This would take the target range from 5.25% to 5.50% presently to 4.50% to 4.75% by the end of the year.</p>

Factor	Implication for Equities			CIO View
	Negative	Neutral	Positive	
Fiscal Policy				U.S. pandemic-era fiscal support totaled nearly 31% of GDP. Moreover, a \$280 billion plan to strengthen the country's industrial base by investing in semiconductor production and research and development of new technologies has been authorized. Also approved was the 2022 Inflation Reduction Act (IRA). Among other elements, it provides nearly \$370 billion over 10 years for energy security and climate change projects. Despite these initiatives, nearer-term fiscal support has waned, with the latest example being the end to a moratorium on student loan debt payments. Yet amid ongoing negotiations, a bipartisan tax bill aims to retroactively enhance the child tax credit while liberalizing certain corporate tax provisions. Moreover, talks continue around federal spending plans for fiscal year 2024, with a two-tiered stopgap measure to continue to fund the U.S. government set to expire on March 1 and March 8.
Corporate Credit				U.S. High Yield (HY) and Investment-grade (IG) credit spreads continue to reflect lessened concern about an economic slowdown. However, current levels remain above those registered in 2022.
Yield Curve				Inversions, whereby longer-dated yields are below shorter-dated ones, exist in most sections across the U.S. Treasury yield curve. These include the fed funds (FF)/10s, 3-month/10s and 2/10s segments. The lessening of many of these inversions has paused. Longer-dated yields have recently declined relative to those shorter-dated. Overall, the Treasury market suggests a higher probability of a recession in the U.S.
Technical Indicators				The S&P 500 remains above its 200-day moving average, which is also in an uptrend. Measures of market breadth, such as the percentage of New York Stock Exchange stocks closing above their 200-day moving average and the cumulative advance/decline indicator, are gradually improving from relative weakness. The Chicago Board Options Exchange (CBOE) Volatility Index (VIX) remains near pre-pandemic levels.
Investor Sentiment				According to the American Association of Individual Investors, optimism in the outlook dominates lessened pessimism. However, cash levels in institutional portfolios signal "neutral," according to the BofA Global Research Fund Manager Survey. The BofA Bull & Bear Indicator is also flashing a neutral signal at 6.1.

Source: Chief Investment Office.

EQUITIES

We are upgrading Equities to slightly overweight: The economy shows early signs of reaccelerating, consumers remain healthy, corporate profits turning higher, and monetary policy pivoting from tightening to easing. The Equity rally that emerged in 2023 continued through the first month of 2024. Risks remain for moderating or mixed economic data, but dovish Fed communications continued to fuel investor confidence that the interest rate cycle has peaked, helping to drive interest rates lower and equity valuations higher. We see the potential for tailwinds in Equities and early indicators turning positive that may provide additional upside. These include a durable earnings recovery, broadening market leadership, and easier monetary policy. We maintain a balanced approach in the near term.

We are slightly overweight U.S. Equities: The U.S. currently remains our preferred Equity region relative to the rest of the world, given relatively stronger balance sheets in aggregate and better consumer fundamentals. Our outlook for U.S. Large-caps is positive, with strong fundamentals and the ability to produce healthy shareholder payouts. This month we are upgrading Small-cap Equities on very attractive valuations, lower interest rates and cost of capital, improving technical trends for Small-caps, and a potential earnings inflection later in 2024. Small-caps could be leaders of the next decade if interest rates remain at reasonable levels and fundamentals improve.

We are optimistic that peak rates and peak inflation are behind us, and combined with a resilient economy and consumer, we are adding to cyclical exposure in our sector views. We emphasize Healthcare to reflect a balance between Value and Growth, low positioning and negative sentiment coming out of 2023, and our preference for quality at a reasonable price. We also maintain overweight exposure to Energy for strong free cash flows (FCF), capital return to shareholders and as a hedge for energy security, inflation reaccelerating, and geopolitical tensions. Energy remains the cheapest sector on valuation metrics and can provide some of the most attractive FCF yields. However, we move our recommended exposure for both Healthcare and Energy one spot lower this month to help fund sector upgrades that add exposure to cyclical and early cycle areas of the market. We lower our sector recommended weighting to the defensive Consumer Staples and Utility sectors and upgrade the Consumer Discretionary, Real Estate (RE) and Industrial sectors. The higher cost of capital could delay and push-out some renewable energy projects, which were expected to drive earnings growth for the Utilities sector. While we are

EQUITY WATCH LIST

- Heightened geopolitical risk and conflict in the Middle East
- Inflationary pressures are moving lower but remain above the Fed's target level
- Economic data for production, labor, consumer expectations, and credit and liquidity conditions
- Progression of earnings estimates amid margin pressures
- Reorganization of global supply chains and U.S.-China relationship
- Pressures within the Office segment of CRE
- A broader rotation that favors Small-caps, cyclicals, and Emerging Markets

constructive on Information Technology and Communications Services as longer-term thematic trends, we maintain our neutral view in the near term on elevated valuations and post strong outperformance. We deemphasize Materials as demand slows, supplies increase, and pricing power remains questionable. With interest rates moving lower over the last couple of months, we move RE exposure up to neutral and prefer being selective in the RE subsectors due to positive fundamentals in some areas of RE but weaker trends in other areas like CRE. We remain neutral Financials, as higher interest rates and higher capital reserves could increase volatility, but valuations are attractive, and banks rerated in 2023. Risks remain for higher costs of deposits and the higher cost of capital could weigh on earnings for both the Financials and RE sectors in coming quarters.

We believe strategic portfolios should continue to incorporate both Growth and Value factors that would simultaneously benefit from cyclical and secular forces gaining traction. Growth outperformed Value by the second largest margin on record in 2023 and should continue to benefit from accelerated secular investments in artificial intelligence (AI) moving forward. Meanwhile, Value continues to trade at a relative discount to Growth and has led Growth when the Fed paused in past periods of elevated inflation. Looking at the past four easing cycles, Value-oriented dividend stocks have outperformed the S&P 500 on average after the first Fed rate cut, according to Bloomberg. We continue to suggest a disciplined and balanced approach between Value and Growth for long-term investors.

We are neutral Emerging Market Equities: Emerging Market (EM) Equities appear attractively valued, but prospective Fed rate cuts are unlikely to have a major positive effect given small current account deficits across the EM universe. We continue to expect a wide return dispersion between individual EM countries and regions. Growth in the heavyweight China market is likely to remain soft on a protracted basis, given structural weakness in the construction sector and constraints on the Technology sector from a tighter domestic regulatory environment and global export controls. Stronger domestic demand in the broader Asia-Pacific region should help to offset external weakness from China exposure. Central and Eastern European markets remain most exposed to the Russia-Ukraine war through trade links and high dependency on natural gas imports, while market direction in Latin America, the Middle East, and Africa should remain broadly tied to the direction of natural resource prices, particularly on any broadening of the Israel-Hamas conflict. The structural rise in EM consumer spending remains a big reason why we believe investors should consider maintaining a strategic allocation to EM Equities, as appropriate. The emerging world now constitutes around 40% of global Personal Consumption Expenditures according to the United Nations, and ongoing convergence with developed economies should support GDP growth and corporate earnings over the longer term. We favor active management¹ when investing in EM, as fundamentals differ across countries based on fiscal capacity, external funding needs, corporate governance, and other factors.

We are slightly underweight International Developed Market Equities: We continue to prefer U.S. versus International Developed given our higher-quality view. We remain slightly underweight Europe, given headwinds to economic growth and corporate profits and the potential for fiscal tightening in high-budget-deficit European Union (EU) countries. Natural gas prices have fallen from their crisis peaks, but ongoing curtailment of Russian supply and growing demand from Asia mean that supply constraints could reemerge at a later stage. We maintain a neutral view on Japanese Equities, which should see a near-term continuation of central bank accommodation relative to the rest of the world. But monetary policy should be normalized this year as inflation returns to more normal levels on a sustained basis. As aggregate net energy importers, International Developed markets would also be more vulnerable to any potential rise in energy prices on any broadening of the Middle East conflict. We believe long-term investors should maintain some strategic exposure to International Developed Equities, as appropriate, given that they trade at a discount relative to U.S. Equities, contain more of a balance between Value and Growth sectors, can offer attractive dividend yields and provide diversification.

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

FIXED INCOME

We are lowering Fixed Income to slightly underweight: While we are still favorable on a significant allocation to bonds in diversified portfolios, this month we used Fixed Income as a source of funds to reposition favorably within Equities. We accomplished this with a move to a neutral in U.S. Investment-grade Taxable. For investors only allocated within Fixed Income, we still favor rate risk over credit risk.

The Fed clearly signaled at its January meeting that both rate cuts and a slowing of quantitative tightening (“QT”) are on the table this year—with expectations for the slowing of QT in May, and rate cuts starting in May or June. The Fed also signaled that it no longer expected significant economic weakness to be necessary in its fight against inflation.

We maintain our slightly positive view on U.S. Governments. While rates have been consolidating since rallying strongly in Q4 2023, nominal and real rates are still some of the most attractive in 20 years. Longer-term yields not witnessed since the pre-Global Financial Crisis (GFC) of 2008/2009 era provide excellent income-generating power, in our opinion. Real yields—the yield after inflation, as measured by Treasury Inflation-Protected Securities (TIPS)—are close to or above 2% across the curve, the higher end of the range since 2008. Earning a positive, substantial yield after inflation on U.S. government-guaranteed securities is a welcome relief for savers after years of financial repression. We still recommend a slightly long-duration position versus a stated benchmark to take advantage of these higher yields, and as prudent positioning against macro risk in the increased equity positioning of a diversified portfolio.

We are slightly underweight both Investment-grade Corporates and High Yield: For Investment-grade (IG), this reflects our view that despite relatively attractive all-in yields of around 5.25%, credit spreads screen rich—exceedingly so in some parts of the market, such as high-quality Industrials. Credit markets have fully embraced the soft/no-land scenario for 2024, and while the case for easing monetary policy keeps getting pushed to the right, we believe this has little effect on the intermediate term macro-outlook, with recent data supporting the case of a re-acceleration of growth in the U.S.—which is positive for risk assets.

That being said, current valuations already fully reflect this improved macro backdrop, as IG spreads trend near post-GFC lows of around 95 basis points (bps) to 100 bps despite significant technical headwinds to start the year with issuance coming at a record pace for January. Demand has also surprised to the upside, with deals well oversubscribed, and in some cases, pricing with negative concessions. While certainly a welcomed sign of investor risk appetites, these conditions are not sustainable over the long term.

To be clear, we don’t see a risk or catalyst for spreads to move materially wider over the intermediate term, and history has shown that credit spreads can trend at low/rich levels for an extended period of time (i.e., late-1990s and mid-2000s). With the U.S. economy on such strong footing, any move wider in credit spreads would likely be more contained. However, the margin for error at current valuations remains slim, and we see more limited upside in credit spreads. On average, at starting spread levels of 100 bps or less, IG underperforms duration-matched Treasuries 12 months forward.

We therefore believe that an up-in-quality and defensive tilt within a corporate allocation is prudent and would look to rerisk portfolios should we see spreads move closer to the 120 bps to 130 bps level.

Credit losses in IG are generally minimal and not a large component of spreads or yields, but the same cannot be said in HY. Fortunately, HY yields-to-worst—while volatile of late—remain around 8%. Valuations provide modest compensation for credit losses and suggest reasonable returns over medium-to-longer time frames. Spreads, however, remain in the 375 bps to 400 bps range, below the 650 bps to 800+ bps level seen in many recessions, and similar to IG, fully reflect a soft/no-land outcome and a moderation or improvement in default losses over the next 12-months. We therefore maintain our slight underweight positioning, and see better risk adjusted opportunities in other asset classes

FIXED INCOME WATCH LIST

- Resilient or resurgent inflation
- Increased risk aversion or recessionary risk via spreads, yields or new issue activity
- Signs of significantly negative Fixed Income fund flows
- Dislocations in CRE markets
- Potential credit deterioration if economic weakness

such as Equities. Within HY allocations, we prefer a balanced allocation between secured floating-rate leveraged loans and unsecured HY bonds.

We are slightly overweight on Mortgage-backed Securities: Aiming to bring down stubbornly high inflation, the Fed has steadily tightened financial conditions by raising interest rates and engaging in QT. Weaker technical dynamics led to a material widening of Mortgage-backed Securities (MBS) spreads last year, breaking into the 70 bps range in October 2023 before retracing back to the current near-50 bps range. In our opinion, the current level of MBS spreads after the rally still represents value when compared to corporates, using the long-term average.

Duration extension, a key risk for MBS investors, has been substantially mitigated, with MBS duration now significantly lengthened. Another important risk, interest rate volatility, remains elevated at levels that make MBS bonds more appealing, as their spreads are likely to outperform should interest rate volatility subside. Although weak demand from the Fed, the financial institutions holding two-thirds of the MBS market and an unsettling geopolitical/macro environment make it possible for MBS spreads to widen further, MBS spreads and yields appear attractive relative to Treasuries and IG corporate bonds over the long term.

ALTERNATIVE INVESTMENTS

Unlike Traditional asset classes, establishing and exiting allocations to Alternative Investments (Alts) can be a long-dated process given liquidity constraints. Because of their illiquid and long-term nature, Alts should be viewed in terms of strategic allocations. Therefore, our views on Alts strategies within each asset class reflect potential tilts in new dollar deployment based on relative opportunity, in contrast to a tactical repositioning in public markets.

Some key CIO principles for qualified investors to consider when investing in Alts include:

- **Think strategically and long term:** Alts are largely illiquid and therefore require a long time horizon when incorporating into portfolios.
- **Invest methodically, including in downturns:** A properly implemented Alts program requires a consistent commitment, particularly within private markets strategies; withdrawing during periods of volatility can undermine the long-term benefits of the asset classes and result in underallocation.
- **Diversify:** Seek diversification by strategies and managers. Investing methodically within private markets strategies also improves vintage year diversification.
- **Prioritize high-conviction managers:** Performance dispersion is significantly wider within Alts than in Traditional investment strategies; manager selection is therefore a potential opportunity.

Hedge Funds: With muted relative performance last year, investor allocations to Hedge Funds (HF) were weak. Overall, HFs saw outflows of \$95 billion, though total assets under management (AUM) rose to a record \$4.1 trillion due to appreciation.² In terms of performance, HFs overall returned 8.1% in 2023.³ Equity Hedge (EH) strategies returned 11.4%⁴ with challenging technicals hampering short alpha at various points in the year. The concentrated gains of U.S. Equity Indexes were largely a headwind to EH strategies in 2023; thus, the setup in 2024 could be more favorable if equity dispersion increases or if there is a broad-based Equity market sell-off.

Macro strategies similarly faced challenging dynamics last year, returning -0.3%⁵ due to several sharp reversals in Treasury yields and Equity volatility. As the world shifts from hawkish monetary policy toward central bank easing cycles, the opportunity set for Macro

² HFR, Inc. HFR Global Hedge Fund Industry Report – December 2023.

³ HFR, Inc. HFRI Fund-Weighted Composite Index. As of December 30, 2023.

⁴ HFR, Inc., Bloomberg. HFRI Equity Hedge (Total) Index. As of December 30, 2023.

⁵ HFR, Inc. HFRI Macro (Total) Index. As of December 30, 2023.

CIO Views on Alts Strategies

Hedge Funds

Equity Hedge +

Bull case	Potential alpha* generation opportunities for low net strategies in volatile or high dispersion markets; short alpha improving after difficult start last year; low net better positioned if Equities sell off
Bear case	Narrow breadth and low dispersion continues to challenge active management; beta**-driven market would limit opportunity set

Event Driven

Bull case	Higher rates pressuring levered balance sheets creating potential for distressed; merger deal spreads moderately wide and higher risk-free rate positive for merger arbitrage
Bear case	Distress may not materialize in size or may be delayed; low mergers & acquisition volumes and high regulatory uncertainty

Relative Value

Bull case	Still in world of higher yields; economic resiliency supportive of credit; decent dispersion in HY
Bear case	Spreads not attractively wide; potential increase in credit risk and defaults in coming year

Macro +

Bull case	Possible "higher-for-longer" rate regime could create cross-asset volatility in rates and foreign exchange; next leg down in inflation could prove more challenging to achieve
Bear case	Fed pause could take direction out of Fixed Income; choppy markets difficult for trend-following

*Alpha is a measure of the active return on an investment, the performance of that investment compared with a suitable market index. **Beta is a concept that measures the expected move in a stock relative to movements in the overall market. **Bull case** is an environment or set of factors that could represent tailwinds for the strategy. **Bear case** is an environment or set of factors that could represent headwinds for the strategy. **+ symbol** indicates the strategies CIO views as having the most favorable opportunity set for new investment within the Alts asset classes.

strategies may evolve. Relative value trades may take precedence in an environment lacking large trends. In addition, Macro strategies can offer significant portfolio utility by virtue of low historical correlations to Equities and Fixed Income and a propensity to generate “crisis alpha.”

Private Equity: Both fundraising and performance were similarly muted across Private Equity (PE) strategies in 2023. Fundraising across private markets was poised to end the year down year-over-year, with \$793 billion raised over the first three quarters, a pace commensurate with 2016 levels.⁶ In terms of performance, Buyout was modestly positive in Q3, bringing the 1-year internal rate of return (IRR) to 10.2%. Meanwhile Venture Capital’s (VC) challenges continued with Q3 returns of approximately -2.4%, bringing the 1-year IRR to -8.9%.⁷

Beyond performance, PE markets have primarily been characterized by depressed investment and exit activity. Sponsors and investors are eyeing 2024 for a potential reprieve. For the time being, PE strategies still face an environment in which public and private debt are offering Equity-like potential returns, making the relative value calculation for PE more challenging. With that said, there is a path to PE’s reinvigoration coming into view. If the cycle were to unfold definitively away from the higher “resting rate” of inflation and interest rates that some investors fear, then Buyout and VC strategies could be kickstarted into new bull cycles with surges in transaction volumes. Conversely, if inflation and interest rates surprise to the upside, then PE strategies may find 2024 to be a third consecutive challenging year.

Private Credit (PC), meanwhile, continues to perform well and remains, in our view, a compelling asset class to commit fresh capital to given the macro backdrop. However, while last year proved to be a goldilocks environment for PC, 2024 is likely to bring additional challenges. Using private fund performance data from Cambridge Associates, PC generated returns of 0.9% in Q3⁸, bringing the 1-year IRR to 12.2%. Looking at the more narrow Cliffwater Direct Lending Index, private senior direct loans generated returns of 3.2% in Q3, bringing the 1-year returns to 11.1%. Q4 returns are expected to be solidly positive given the market environment that prevailed.

PC continues to offer Equity-like yields while enjoying a position at the top of the capital stack. At the same time, several headwinds for the asset class are coalescing. One is that base rates are likely to begin declining given the expectations for Fed rate cuts in 2024. The effect of the declines will take some time to play through and the timing and magnitude of policy rate cuts is still uncertain. To some extent lower rates will have a partly offsetting effect by reducing the interest expense burden on borrowers. Another factor is that with slowing economic growth, defaults and credit losses are expected to increase across high yield bonds, leveraged loans, and PC. And yet, despite higher default rates over the next year, BofA Global Research sees a good margin of safety for new money entering the asset class. Using privately-held single-B/CCC HY bonds (which have similar credit characteristics to PC) as a proxy, they calculate a 7.5% break-even default rate for new vintages of PC given where yields currently stand and spreads to HY of between 250 bps to 300 bps.⁹

Private Real Estate: As has been the case for the last two years, Private Real Estate (PRE) continues to face significant challenges. And yet the pervasive negative sentiment in the market may be beginning to turn. BofA Global Research has noted that the tenor of U.S. banks’ management when discussing CRE on earnings calls has become decidedly less bearish, if not yet bullish. The rally in Treasury yields in November and December also helped soften the outlook, ultimately flowing through to lower mortgage rates and strong public REITs, though January showed some moderation.

PRE fund performance data from Cambridge Associates (which skews to opportunistic and value-add strategies and is only available through the third quarter) showed Q3 returns of

Private Equity

Buyout

	Current vintages likely attractive for long-term given lower valuations and profitability focus; within PE, Secondaries benefiting from secular growth and institutional investors seeking liquidity; deal activity likely to surge if rates and inflation fall
Bull case	
Bear case	Higher rates require larger Equity investments; deal and exit activity still low

Venture/Growth

	Significant correction in the last two years benefits capital providers; AI could drive investment supercycle; early VC stages more insulated than later stages; falling rates would likely be tailwind
Bull case	
Bear case	Ex-AI VC market still challenged; VCs focused on supporting portfolio companies; initial public offering (IPO) drought continues; timelines extended plus increased risk of dilution; higher rates drag on unprofitable companies

Special Situations

	Default rates rising; “higher-for-longer” would increase pressure on levered balance sheets; RE-adjacent opportunities; companies seeking creative financing before maturities
Bull case	
Bear case	Fed-engineered soft or no landing could smooth out credit cycle, keeping it more average

Private Credit +

	High current yields; healthy spread to public credit; economic resiliency supportive of credit; secular tailwinds supporting growth; fresh capital can underwrite to current risks
Bull case	
Bear case	Fed poised to lower rates; credit risk likely to rise; regulatory attention could change dynamics; significant capital allocating to PC

Real Estate

Private Real Estate

	Supply/demand imbalance in Residential driving secular opportunities; sectors like Data Centers rising; transaction cap rates slowly reflecting lower valuations; lower mortgage rates may unlock markets; lending strategies offering compelling profiles; distressed/opportunistic could emerge given stress
Bull case	
Bear case	Appraisal cap rates yet to fully adjust and wide to implied public real estate investment trust (REIT) cap rates; transactions depressed; pressure rising in value-add multi-family financed with floating rate debt

Infrastructure +

	Within Real Estate, Infrastructure to continue benefiting from fiscal spend; large need for energy transition and upgrading ageing infrastructure; potential to be inflation beneficiary if new resting rate structurally higher
Bull case	
Bear case	Higher rates challenging project financing; lower inflation could mitigate relative attractiveness

Bull case is an environment or set of factors that could represent tailwinds for the strategy. **Bear case** is an environment or set of factors that could represent headwinds for the strategy. **+ symbol** indicates the strategies CIO views as having the most favorable opportunity set for new investment within the Alts asset classes.

⁶ PitchBook, Inc. As of December 31, 2023.

⁷ Refinitiv EIKON, Cambridge Associates. Cambridge Associates Buyout and Cambridge Associates Venture Capital benchmarks, as of September 30, 2023. Q3 performance is preliminary and subject to revision.

⁸ Cambridge Associates Private Credit Index. As of December 31, 2023.

⁹ BofA Global Research. “High Yield Strategy: The Private Premium,” January 12, 2024.

-1.5%, bringing the 1-year IRR to -2.0%. Other Real Estate Indexes such as the NFI-Open End Diversified Core Equity (ODCE) Index and the Green Street Commercial Property Price Index (which skew toward core strategies and/or broad-based representations of institutional-quality CRE) showed full-year 2023 returns of -10% to -12%. Such discrepancies in performance, which are driven in part by composition (property types, geography and strategy) as well as valuation methodologies, continue to pose challenges for investors. Similarly, there remains a sizable gap between the implied cap rates of public REITs and appraisal-based cap rates across PRE. Transaction-based cap rates show some level of adjustment reflecting the increase in risk-free rates, but transaction volumes remain depressed thereby mitigating their informational value.

Transaction volumes will need to increase to facilitate price discovery given the disconnect in public and private valuations. Buyers and sellers have been sitting on their hands, but that may begin to change over the coming year. Sector and geographic differentiation are warranted and can provide opportunity for discerning investors. New capital deployment in general, and PRE lending strategies in particular, look increasingly interesting. For the longer-term, PRE continues to make sense as a strategic allocation given the diversification benefits and income features.

Infrastructure: Within Real Estate, Infrastructure remains a key long-term theme. The U.S. has a widely acknowledged ageing infrastructure base that will require significant public and private investment. Hundreds of billions of dollars have already been earmarked for infrastructure spend through several federal bills in recent years. Infrastructure also has direct links to the Energy Transition theme, which will play out over the coming decades. In addition, Infrastructure has historically performed well on a relative basis during inflationary periods and has the potential to improve diversification in portfolios.

Tangible Assets: Global growth anchors demand for commodities and is showing some signs of stabilization, led by the U.S. Still, global growth remains below-trend with the JP Morgan Global manufacturing PMI still in contraction territory despite an above consensus increase in January. Weak global demand is reflected in cyclical commodity prices like industrial metals, which declined by 14% last year, according to Bloomberg, and continued to move lower in January. We believe global growth and commodity demand will remain muted to start the year, but geopolitical risk and geoeconomic maneuvering are wild cards for energy commodity prices. Elevated geopolitical risk also supported gold prices in 2023, but interest rate volatility has caused the asset class to oscillate. Most recently, the Fed decision to push back interest rate cuts has pressured gold prices. We continue to believe gold is most effectively implemented as a strategic diversifier.

With the Fed eventually shifting to an easier monetary policy stance, the dollar will likely remain under pressure even as it has exhibited near-term strength. It is likely that a Fed shift is also coinciding with weaker U.S. growth on an absolute basis and relative to other countries, where it has held clear advantages. Importantly, the U.S. dollar remains overvalued versus a number of major currencies.

Tangible Assets

Bull case	Geopolitical risk could spill over and pressure commodities supply; macro factors including currency could support oil prices; potential for diversification and inflation hedge
Bear case	Slowing global growth reduces demand support for commodities; increasing energy supply has offset Mid-East tensions; real rates staying high could pressure "safe" havens like gold

Bull case is an environment or set of factors that could represent tailwinds for the strategy. **Bear case** is an environment or set of factors that could represent headwinds for the strategy. **+ symbol** indicates the strategies CIO views as having the most favorable opportunity set for new investment within the Alts asset classes.

MACRO STRATEGY

- Upside surprises to liquidity conditions and deficit-funded fiscal stimulus defined the macro backdrop in 2023 and have continued into 2024 with additional fiscal packages and expansionary monetary liquidity. Solid risk-asset performance, including Equities, reflect this fiscal incontinence and monetary liquidity party that started last March with the bailout of regional banks. Equity bull markets are built on the back of ample liquidity and strong real growth and the market is getting both from monetary and fiscal policy.
- The U.S. labor market is reaccelerating as the massive easing in financial conditions stimulates faster growth with payrolls averaging near 300,000 per month after revisions since October. Given firm real growth and strong jobs, the Fed will likely hold off until June to start cutting rates.
- Global cyclical momentum is showing some signs of stabilization on the back of firm U.S. growth. The Global Manufacturing PMI for January rose to its highest level in over a year but remains in contraction territory.

ECONOMIC FORECASTS (AS OF 2/2/2024)

	Q4 2023A	2023A	Q1 2024E	Q2 2024E	Q3 2024E	Q4 2024E	2024E
Real global GDP (% y/y annualized)	-	3.1*	-	-	-	-	2.8
Real U.S. GDP (% q/q annualized)	3.3	2.5	1.0	1.0	1.5	1.5	2.1
CPI inflation (% y/y)	3.2	4.1	2.9	2.9	2.6	2.4	2.7
Core CPI inflation (% y/y)	4.0	4.8	3.6	3.1	3.2	3.0	3.2
Unemployment rate (%)	3.8	3.6	3.8	4.0	4.1	4.2	4.0
Fed funds rate, end period (%)	5.33	5.33	5.38	5.13	4.88	4.63	4.63

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

A = Actual. E/* = Estimate.

Sources: BofA Global Research; GWIM ISC as of February 6, 2024. Forecasts are subject to change.

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

S&P 500 SCENARIOS BASED ON FORWARD P/E AND 2024

The table below provides a rough indication of where the S&P 500 Index's central tendency could be, given various scenarios for EPS in 2024 and P/E ratio multiples. These scenarios are not official price targets and are not meant to signal levels where portfolio actions may always be needed. However, during times of market volatility, it's useful to keep this basic framework in mind when considering whether to incrementally add to or trim risk from portfolios while staying invested in one's strategic asset allocation framework.

2024 EPS	EPS Forward P/E (Next 12 months)				
	17.0x	18.0x	19.0x	20.0x	21.0x
\$265	4,505	4,770	5,035	5,300	5,565
\$255	4,335	4,590	4,845	5,100	5,355
\$245	4,165	4,410	4,655	4,900	5,145
\$235	3,995	4,230	4,465	4,700	4,935
\$225	3,825	4,050	4,275	4,500	4,725
\$215	3,655	3,870	4,085	4,300	4,515
\$205	3,485	3,690	3,895	4,100	4,305

For illustrative purposes only. Source: Chief Investment Office as of February 6, 2024.

CIO ASSET CLASS VIEWS AS OF FEBRUARY 6, 2024

Asset Class	CIO View					Comments
	Underweight	Neutral	Overweight			
Equities	●	●	▶	●	●	We are upgrading Equities to slight overweight and upgrading Small-caps on valuation, lower interest rates, and potential inflection in Small-cap earnings in 2024. The Fed's pivot combined with significant cash on the sidelines and in short term Fixed Income instruments could result in rotations into Equities, cyclicals and Small-caps this year, while mega cap growth stocks remain core positions in equity portfolios. We remain overweight the U.S. and neutral EM, with a slight underweight to International Developed.
U.S. Large-cap	●	●	●	●	●	We have a slight preference for Value over Growth, given better absolute and relative valuations. We believe portfolios should incorporate both Growth and Value factors as appropriate.
U.S. Mid-cap	●	●	●	●	●	We remain positive on the outlook for Mid-caps and potential earnings improvements in this area of Equities.
U.S. Small-cap	●	●	▶	●	●	We are upgrading Small-caps on the historically wide valuation gap between Large-caps and Small-caps, the declining cost of capital, signs of economic green shoots, improving Small-cap technical trends and the resilient U.S. consumer.
International Developed	●	●	●	●	●	International Developed Equities remain attractively valued, but central bank policy is likely to remain restrictive for longer than in the U.S. and markets remain more vulnerable to any potential broadening of the Middle East conflict. Underlying rates of nominal growth are also expected to trail U.S. levels.
Emerging Markets	●	●	●	●	●	We are neutral EM Equities overall with regional markets likely to be driven by relative exposures to weaker China growth, the ongoing Russia-Ukraine conflict and natural resource prices. Valuations appear attractive, but Fed rate cuts unlikely to have a major positive impact.
International						
North America	●	●	●	●	●	The U.S. remains our preferred region given balance sheet strength, better fundamentals for consumer spending and healthy shareholder payouts.
Eurozone	●	●	●	●	●	Lower natural gas prices are a source of relief, but key risks stem from potential fiscal tightening in high-budget-deficit EU countries, weaker economic growth, and the potential for energy supply constraints to reemerge amid the ongoing Russia-Ukraine and Middle East conflicts.
U.K.	●	●	●	●	●	Domestic demand at risk from still high mortgage rates. Historically weak exchange rate risks compounding inflation pressures. Withdrawal from EU single market remains a negative for medium-term growth.
Japan	●	●	●	●	●	Near-term relative support expected from monetary accommodation versus the rest of the world, but headwinds likely to increase from ongoing normalization of interest rates. Official efforts to increase corporate returns to shareholders a potential boost for valuation.
Pac Rim*	●	●	●	●	●	Regional activity to be dampened by exposure to weaker China growth but offset by relative strength in domestic demand. Large weighting in Financials increases vulnerability to any potential broadening in banking sector stress.
Fixed Income	●	●	●	●	●	Bonds remain attractive and provide good diversification for multi-asset class portfolios with both reasonable income and the ability to decline substantially in yield in an economic downturn. Slightly long-duration positioning recommended, balancing the risk of further tightening/high yields against significantly better valuations.
U.S. Investment-grade Taxable	●	●	●	●	●	Preference for Treasuries relative to credit and spread products, as nominal and real rates are some of the most attractive in over a decade, while the economy slows, and recessionary signals remain.
International	●	●	●	●	●	International rates markets have become significantly more attractive as global Central Banks raise rates to help fight inflation, no longer trading at a significant discount to the U.S. except in Japan where the Bank of Japan is still keeping longer-term rates artificially low.
Global High Yield Taxable	●	●	●	●	●	Valuations present more attractive medium-to-long-term returns even after estimating credit losses. However, increased recession concerns could cause near term price losses, and spreads are not at recessionary levels. Any additions to HY, therefore, should have a long-time horizon. Within HY, we prefer balanced exposure between floating-rate loans and HY unsecured.

* 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. Tactical qualitative investment strategy weightings are relative in nature versus the strategic weightings for a fully diversified portfolio. Weightings are based on the relative attractiveness of each asset class. Tactical strategy weightings are for a 12- to 18-month time horizon. CIO asset class views are relative to the CIO Strategic Asset Allocation (SAA) of a multi-asset portfolio. Because economic and market conditions change, recommended allocations may vary in the future. Asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns. All sector and asset allocation recommendations must be considered in the context of an individual investor's goals, time horizon, liquidity needs and risk tolerance. Not all recommendations will be in the best interest of all investors.

CIO EQUITY SECTOR VIEWS AS OF FEBRUARY 6, 2024

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
	Underweight	Neutral	Overweight	
Energy	●	●	● ●	<p>Despite signs of slowing demand and moving the Energy sector down one notch, we remain overweight the Energy sector for three key reasons: 1) Attractive valuation as the lowest valued sector in the S&P 500 on cash flows and earnings, 2) High FCF generation at current oil price levels and attractive FCF yields, and, 3) The decline in Energy in 2023 combined with negative sentiment and low conviction for Energy provides attractive hedge for energy security, inflation, disruptions in energy production and geopolitical risks. OPEC+ supply cuts and limited spare capacity provide additional support for the sector. And the decline in capital expenditures and lack of long-cycle energy investments in recent years are supportive for Energy stocks. Above-average energy prices combined with substantial cost-cutting initiatives and capital discipline over recent years built significant operating leverage into Energy companies. We also highlight higher cash returns to shareholders through base dividends, variable dividends, and stock buybacks. Longer term, secular headwinds still confront the sector, including the transition to clean energy, lower renewable energy costs and Environmental, Social and Governance (ESG) focus by investors. Continue to emphasize companies that are low-cost producers with high FCF, balance sheet strength and low break-even oil prices. Energy stocks still provide attractive valuations and strong dividends with slowing momentum.</p>
Healthcare	●	●	● ●	<p>Consider positions in larger biopharma stocks with attractive relative valuations and upcoming catalysts. In an environment where financial conditions are in flux and economic growth is slowing, Healthcare stocks provide attractive characteristics, including quality, dividend growth, dividend yield and lower beta. Healthcare fundamentals have been able to withstand much of the macro pressures seen globally, but flows last year were weak in the Healthcare sector. Further, in 2023 negative earnings revisions were made by analysts across the sector. Distributors, medical devices, and large biopharma are best positioned, in our view, to weather pressure on margins, while a return to a more normalized environment should benefit life science equipment and tools companies as we progress through 2024. As a whole, large pharmaceutical companies remain attractive as they trade at a material discount to Healthcare sector peers and the broader market. Further, significant cash on strong balance sheets, combined with more aggressive business development efforts and a greater focus on explaining long-term growth drivers make large pharma more attractive over the intermediate term. Over a longer duration, drug pricing headwinds may return as demographic shifts put more pressure on government payors and as value-based care initiatives gain momentum. Emphasize exposure to long-term positive trends in life science/bioprocessing equipment, innovative and differentiated medical devices and animal health, as well as more intermediate opportunities in Large-cap biopharma and diversified med tech. We are moving Healthcare down one spot to slight overweight to help fund other sector upgrades, but importantly, remain overweight the Healthcare sector. Valuation remains attractive and momentum is improving recently.</p>
Consumer Discretionary	▶	●	● ●	<p>With a resilient consumer, strong job market and better than expected economic backdrop, we are upgrading Consumer Discretionary exposure to slight overweight. Slightly lower energy costs, wage increases and a strong job market with only selective job cuts confined largely to the technology related industries, is helping to maintain solid consumer spending. Consumers remain resilient and are finding ways to alter their budgets to accommodate both experiences and necessities. Further, with inflation declining from the highs experienced last summer and interest rates also moving lower, this is helping to improve consumer confidence. Consumer retail channels are shifting back to online spending as value-oriented consumers utilize alternative payment methods to supplement their spending and seek out bargains. More evidence of economic strength and a resilient consumer could help support relative earnings growth and relative valuation levels. Valuation for the sector is elevated and momentum improved over the last two months of 2023.</p>
Industrials	●	●	▶ ●	<p>Moving the Industrials sector up to slight overweight to add exposure to cyclicality and some short cycle/early cycle exposure. There are multiple thematic drivers over the next three to five years including improving outlooks for international defense budgets outside the U.S. as the global risk environment is elevated, underpinning favorable dynamics for defense companies. Aerospace is benefiting as well from the ongoing recovery in consumer and business air travel and a multi-year backlog of commercial plane orders to build and deliver. Potential improvements in the global capital expenditures cycle, including the normalization and reshoring of supply chains and manufacturing, and investment in new equipment after years of focusing on productivity, and fiscal stimulus plans could support the construction, transportation, machinery, and freight and logistics industries longer term. However, weaker import/export demand from Europe and China could be a drag on earnings growth for industrial conglomerates and transport stocks. Secular growth drivers support the longer-term view for Industrials. Valuation is slightly elevated, and momentum is improving.</p>

CIO View

Sector	CIO View					Comments
	Underweight	Neutral	Overweight			
Information Technology	●	●	●	●	●	The Technology sector is neutral despite improvements in supply chains and AI-driven flows into mega-cap Technology stocks. However, margin risks remain for companies in the sector as Information Technology (IT) budgets and technology investments are showing signs of slowing. The potential remains for downward earnings revisions that are more likely to affect higher-beta, higher-valuation companies. Despite strong long-term Cloud and AI trends, software margins could continue to deteriorate, as Cloud consumption could potentially come under some pressure near term and is not immune to a macro slowdown. We suggest a neutral weight in IT, with a bias to larger and higher-quality companies with both strong FCF and balance sheets. We continue to encourage investors to be careful about unprofitable, expensive, and long-duration IT companies. The pandemic accelerated the digital transitions for many industries, but, over the longer term, we remain positive on the secular growth trends for Cloud computing, machine learning and AI, data centers, software, cybersecurity, and semiconductors. Valuations in the sector declined in 2022 but were still elevated after rising again in 2023, especially after the rally in AI-related companies. Further, any additional moves higher in interest rates could pressure multiples for high-growth and high-valuation technology stocks with low to no profits; therefore, look for GARP (growth at a reasonable price) in software and semiconductors. The IT sector still generates significant FCF, dividend growth and remain long-term fundamental drivers for the sector. Technology is deflationary by nature; therefore, long-term investors should look to add to transformational and industry-leading businesses on market weakness. Valuations remain elevated and momentum is strong.
Communication Services	●	●	●	●	●	We are neutral on the Communication Services sector, as some of the largest companies in this sector have had higher-quality fundamental characteristics and could be more attractive in a slow growth economic environment. Despite our concern for ongoing regulatory oversight and the never-ending battle over content, management teams are now adjusting their business models to reduce costs and become more efficient. Ad spending is moving from e-commerce to travel and leisure, hence advertisers are having to shift their targeting. Retailers are suffering from rising costs and slowing sales, which could drive changes in advertising spend. We are more constructive on the sector based on three key factors: 1) Valuation multiples were largely de-risked last year, 2) Earnings estimates were reduced, and 3) More importantly, broad cost-reduction plans could create potential earnings upside. Valuations are neutral and momentum improved into yearend 2023.
Financials	●	●	●	●	●	We are neutral on the Financials sector. Despite the arrival of a higher-interest rate regime, U.S. banks collectively had roughly \$0.5 trillion in deposit outflows last year, according to Fed data, and more than \$0.75 trillion since peaking in April 2022. Depositors have sought the perceived "safety" of the biggest banks and the higher yield offered by money market funds. Funding pressure coupled with higher regulatory capital requirements will likely lead to tighter credit standards and slow the pace of lending going forward. Despite headwinds, including an expected decline in 2024 net interest income, bigger banks are better positioned than regional peers (especially regarding commercial real estate exposure) and valuations appear to already discount a lot of potential bad news. Risks to the downside appear balanced compared to potential upside for banks, despite the potential for higher capital requirements that could be a near-term headwind. Capital return will remain the cornerstone of the investment case for banks. Overall, the volatility of the Financials sector should improve with the recent addition of large e-payment and credit card networks that have been stable earnings compounders historically. We also favor life insurers, which gain significant tailwinds from higher interest rates with higher-yielding investment portfolios. Investment income accounts for roughly one-third of life insurance revenues. Given structural headwinds in property and casualty insurance, we prefer alternative asset managers, like PE, that consistently draw fund inflows, typically find their most lucrative investment opportunities in times of economic stress and maintain pricing power in management fees. Overall, valuation is attractive, and momentum recently improved, but fundamentals are mixed in the sector.
Real Estate	●	▶	●	●	●	We are upgrading RE to neutral as the recent decline in interest rates from 2023 peak levels reduces some risks regarding refinancing. Further, expectations of Fed rate cuts in the future in addition to negative positioning and very bearish sentiment last year in the RE sector could lead to increased Equity portfolio exposure to the sector in 2024. With interest rates still elevated compared to the zero-rate policy environment, increased interest expenses could still weigh on RE sector earnings in coming quarters, therefore, we would be more selective within the RE sector and prefer neutral sector exposure. There are mixed outlooks among its subsectors because of consumer and corporate changes like remote work, eCommerce, less business travel, etc., that are potential longer-term headwinds for CRE companies (e.g., office), mall operators and retail-related property owners as companies consolidate RE footprints. Furthermore, risks are rising for downward pressure on rental rates as lease contracts expire and new contracts are negotiated. Continue to emphasize longer-term secular trends in data centers, communication infrastructure (towers), storage and industrial RE. Valuations are neutral and momentum started to improve.

CIO View

Sector	Underweight Neutral Overweight	Comments
Utilities		<p>The sharp move lower in key rates seen for much of Q4 2023 helped propel Utilities to a positive return in the quarter. This sets up an incrementally more challenging entry point for Utility stocks at the start of the year as investors reassess the trajectory of potential Fed rate cuts. As a result, we are lowering our sector recommendation from neutral to slight underweight. A still elevated cost of capital compared to the past decade could delay and push out renewable energy and grid hardening projects at utilities, with these projects expected to be key drivers of earnings growth in the sector. Regulatory reviews are an important risk factor for the sector, and we note this risk is elevated in 2024 as state-level regulators have become increasingly sensitive to passing along increases to ratepayers who are financially stretched by lingering inflation. Utilities historically provide reliable earnings and outperform in the late cycle and during economic growth slowdowns, especially regulated utilities that provide a defensive hedge to portfolios. Utilities have provided greater balance and lower beta and helped diversify cyclical Equity exposure in portfolios. For the longer term, we emphasize Utilities with growing renewable power generation from solar and de-emphasize ones that rely strictly on coal-power generation. Over the next decade, the 2022 Inflation Reduction Act (IRA) legislation provides a strong runway for future renewable energy investments and projects—though we expect noise around potential IRA repeal to dominate much of the coming year ahead of the November election, with potential for volatility among Utility stocks perceived as IRA “leaders.” Prefer Utilities with strong balance sheets, constructive regulatory mechanisms, and low-volatility business models. Valuation is slightly elevated, and momentum has declined.</p>
Materials		<p>Slower global growth and weaker commodity prices factor into our more cautious view on the Materials sector. We are seeing deceleration in the pricing cycle from higher pricing levels in 2022 and 2023. Higher interest rates in the developed world and ongoing trials securing labor and materials are pushing some industrial project timelines to the right, and, with the additional challenge of higher energy costs, we are seeing some formerly profitable projects being reconsidered. On the supply side concerns remain around too much new capacity for petro-chemicals and commodity chemicals with questions regarding demand levels for 2024. Multiples could contract if we see persistent pricing declines across the commodity complex. Such a trend would give some intermediaries relief on costs, but if they are also experiencing volumes decline, operating leverage could be at risk. We still see some longer-term tailwinds for demand, such as bipartisan support for U.S. infrastructure and energy transition spending; however, mixed data and the slower than expected reopening in China makes the risk-reward outlook less attractive with both inflation and pricing power moving lower. Amidst softer demand trends and supply growth, consensus estimates appear elevated. Negative earnings revisions continued in the Materials sector over Q4. As a result, the underlying sector valuation and momentum are neutral.</p>
Consumer Staples		<p>Lowering exposure to the more defensive Consumer Staples sector and swapping exposure to the more cyclical Consumer Discretionary sector. Broad based slowdown in demand for consumer-packaged goods products is a function of trade down, substitution and a more discerning bargain seeking consumer. Demand for needs and necessities across personal care and household products has held up better than most other consumer packaged goods products. It’s too early to tell whether the popularity of the new weight loss drugs is having an effect on food and beverage volumes or if consumers are altering their budgets to reflect the still elevated consumer goods prices. Without a predictable return to positive volume growth, traditional consumer packaged goods companies will struggle to show improvement in profits and margins needed to support current relative valuation levels. Valuations are rich and momentum declined.</p>

Source: Chief Investment Office. All sector and asset allocation recommendations must be considered in the context of an individual investor’s goals, time horizon, liquidity needs and risk tolerance. Not all recommendations will be in the best interest of all investors.

CIO THEMATIC INVESTING AS OF FEBRUARY 6, 2024

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

ARTIFICIAL INTELLIGENCE (AI)	Building on last year's AI-enthusiasm, the next act for Generative AI is about adoption and deployment. The promise that AI will eventually aid productivity and efficiencies while reducing costs is also hastening the need for complementary industrial and service Robotics/Automation . Use cases of Generative AI and robotics within Healthcare Innovation abound, with the potential to aid drug discovery, age-related disease treatments and gene therapies/ mapping. The massive growth in unstructured data being created and processed by machines, devices and systems is feeding Big Data Analytics and Storage . An ongoing migration of data and applications to Cloud Computing infrastructure as well as hardware providers supports the AI data boom.
DEMOGRAPHICS	Several demographic transitions serve as important arbiters of future growth. That's true about the Great Wealth Transfer of over \$84 trillion in assets likely to be inherited through 2045, according to Cerulli Associates. As main recipients, both the Millennials (born 1981-1996) and Gen Z (born 1997-2012) could have greater influence on consumer spending patterns and preferences. Tax treatment and business regulation continue to drive an intra-U.S. migration, while a Global Migration cycle is also underway given displaced populations owing to conflict, forced migration and other factors. Changing the face of consumerism globally is the Emerging Market Consumer , which represents a powerful middle-class cohort with rising incomes and improved health outcomes. With lengthening life expectancies globally, Global Ageing puts a renewed focus on healthcare, aged-care, financial, and consumer products and services. So too does the Silver Tsunami of ageing and wealthy Baby Boomers, who represent the bulk of consumer spending in the U.S.
INFRASTRUCTURE	Infrastructure needs today span physical infrastructure well beyond its useful life, to energy assets, both traditional and renewable. As the sought-after Energy Transition toward renewable energy sources such as solar, wind, hydrogen, and nuclear remain in focus, so does reliable Energy Storage and Distribution of our energy sources. If the Future Mobility of the global car fleet is electric, Electric Vehicle (EV) production demands more mining of copper, lithium, nickel, manganese, cobalt and graphite, etc. to produce EVs as compared to internal combustion engines. Other key investment opportunities exist given disruptions through climate related events, cyber threats, or general impairments to the National Grid ; but also globally, the risk of scarcity/stress to resource facilities among Water/Waste Management .
SECURITY	Industrial Policies are in, as the "visible hand" of the government is just as prominent as the "invisible hand" of the private sector, with hundreds of billions of dollars committed from the White House to incentivize security and self-reliance of suppliers and resources. Regulation pertaining to Surveillance and adjacent technologies, as well as legislation of data privacy rights will be a topic on Capitol Hill in 2024. Of national security concern, defense spending in the years ahead likely remains elevated given ongoing Ukraine-Russia and Israel-Hamas wars in addition to simmering U.S.-China tensions. Aerospace and Defense should benefit from the remilitarization in the wake of shrinking stockpiles. Ongoing and sophisticated ransomware and data breaches bolsters Cybersecurity budgets across industries. With the commercialization of space, security extends to Space and space-based assets (such as drones, satellites, data links, weather monitoring and Global Positioning System (GPS)).
POLYCRISIS	Growing conflict and crisis globally can be described as Multipolar Disorder , leading to unforeseen realities for the macroeconomic backdrop and markets. Resource Protectionism has been on the rise as the extraction, sourcing and management of the world's resources will stay in focus with commodities, metals and mining complexes already stretched. Although net zero commitments are widespread, the current path to Decarbonization targets remains narrow. Also at crisis levels, global debt reached a staggering \$307 trillion last year according to Institute of International Finance, putting in focus Debt and Deficit concerns. A million people in the U.S. have died of drug overdose since 2000 while suicide rates are at their highest level in over 80 years—All tragedies related to Deaths of Despair , and of particular impact to our healthcare system.

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.

Equity/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.

Chicago Board Options Exchange (CBOE) Volatility Index (VIX) is a real-time market index that represents the market's expectation of 30-day forward-looking volatility.

Purchasing Managers' Index is a monthly indicator of U.S. economic activity based on a survey of purchasing managers at more than 300 manufacturing firms.

J.P. Morgan Global Manufacturing PMI data give a detailed look at the manufacturing sector including the pace of manufacturing growth and the direction of growth for this sector.

Bloomberg Municipal Index measures the performance of the Bloomberg U.S. Municipal bond market, which covers the USD-denominated Long-Term tax-exempt bond market with four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

Treasury/Bloomberg US Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury.

HFRI Fund Weighted Composite Index is a global, equal-weighted index of hedge funds with minimum assets under management of USD \$500MM which report to the HFR Database and are open to new investments.

HFRI Macro (Total) Index is when investment managers which trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard currency and commodity markets.

Cliffwater Direct Lending Index seeks to measure the unlevered, gross of fee performance of U.S. middle market corporate loans, as represented by the asset-weighted performance of the underlying assets of Business Development Companies (BDCs), including both exchange-traded and unlisted BDCs, subject to certain eligibility requirements.

Green Street Commercial Property Price Index is a time series of unleveraged U.S. commercial property values that captures the prices at which commercial real estate transactions are currently being negotiated and contracted.

NCREIF Fund Index - Open End Diversified Core Equity (NFI-ODCE) is an index of investment returns of the largest private real estate funds pursuing lower risk investment strategies utilizing low leverage and generally represented by equity ownership positions in stable U.S. operating properties diversified across regions and property types.

HFRI Equity Hedge (Total) Index investment Managers who maintain positions both long and short in primarily equity and equity derivative securities.

Private Credit/Cambridge Associates Private Credit Index is a horizon calculation based on data compiled from 461 credit opportunities (i.e. general credit opps and distressed), subordinated capital (i.e. mezz and capital appreciation opps), and senior debt (i.e. direct lending) funds, including fully liquidated partnerships, formed between 1986 and 2018.

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Alternative investments are speculative and involve a high degree of risk.

Alternative investments are intended for qualified investors only. 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.

Nonfinancial assets, such as closely-held businesses, real estate, fine art, oil, gas and mineral properties, and timber, farm and ranch land, are complex in nature and involve risks including total loss of value. Special risk considerations include natural events (for example, earthquakes or fires), complex tax considerations, and lack of liquidity. Nonfinancial assets are not in the best interest of all investors. Always consult with your independent attorney, tax advisor, investment manager, and insurance agent for final recommendations and before changing or implementing any financial, tax, or estate planning strategy.

Sustainable and Impact Investing and/or Environmental, Social and Governance (ESG) managers may take into consideration factors beyond traditional financial information to select securities, which could result in relative investment performance deviating from other strategies or broad market benchmarks, depending on whether such sectors or investments are in or out of favor in the market. Further, ESG strategies may rely on certain values based criteria to eliminate exposures found in similar strategies or broad market benchmarks, which could also result in relative investment performance deviating.

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