CHIEF INVESTMENT OFFICE

Viewpoint

The Great Debate Continues

October 2023

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

IN BRIEF

- Our strategy is to maintain a high level of diversification and to use excess cash to add to higher-quality areas that have drifted below strategic asset allocation targets in both Equities and Fixed Income. As more economic data confirms a slower growth path is indeed unfolding, we'd be active in rebalancing early next year.
- The seasonal downdraft in Equities continued in September as worries over a potential government shutdown, higher yields, and labor strikes weighed on the market. Given multiple crosscurrents, we maintain a balanced approach and a high-quality bias in the near term. This month, the ISC has decided to lower Utilities one notch to neutral and upgrade Energy by one notch as technical factors and higher yields are weighing on certain sectors.
- In Fixed Income, we have adjusted our Chief Investment Office (CIO) portfolio strategy to be slightly more defensive. Within Investment-grade Taxable, we have increased our exposure to Agency Mortgage-backed Securities (MBS) by moving to a slight overweight and are decreasing our exposure to Investment-grade Corporates to a slight underweight.

With the drawdown in September canvassing equity and debt markets on the back of rising yields, higher-than-expected oil prices, and concerns over a government shutdown (not to mention strikes), the great debate continues about the direction of the U.S. and global economies and, therefore, the overall trend in future corporate profits.

The broader equity markets in the U.S. have fallen some 8% plus from their peaks in late July with a 5% pull-back in September alone. In a non-traditional way, the weakest sectors have been the more defensive areas of Utilities and Healthcare overall. As growth slows, we expected these areas to attract investment flows, but not be the source of them. With technical factors and higher yields weighing on these sectors, we have decided to lower Utilities one notch to neutral and upgrade Energy by one notch. The Utility sector has been unable to restore momentum, and we don't expect this to change soon.

The 10-year yield climbed around 70 basis points (bps) in September in one of the sharper moves experienced in the last year. The "higher rates-for-longer" timeframe understanding is now gathering momentum which is pushing global yields higher across the board and supporting the strong Dollar. Better-than-expected economic data, which is likely fueled mostly by the growing deficit, and, at times, still healthy consumer spending, has also caused the Federal Reserve (Fed) to keep the November Federal Open Market Committee (FOMC) live for a potential additional rate hike of 25 bps. However, we are noticing some signs of a growth slowdown and some consumer data is now being revised lower. This

CIO ASSET CLASS VIEWS

This month, the Global Wealth & Investment Management Investment Strategy Committee (ISC) adjusted our U.S Equity sector allocations. As yields have sharply risen across Fixed Income, we have adjusted our CIO Fixed Income portfolio strategy to be slightly more defensive, while recommending a slightly long-duration position versus a stated benchmark. We remain committed to our balanced approach across asset classes while maintaining a high level of diversification.

Listen to the audio cast ▶

	CIO View				
Asset Class	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.

will likely be picked up in the coming months in employment data and potentially filter into earnings revisions early next year. In other words, revisions to the downside in the economy could be the catalyst to a peak in yields. If yields begin to crest and then fall as they price in slower growth, we expect equity markets to rally to close the year. Of course, markets will have to look past any government shutdown if it should occur.

As yields have sharply risen across Fixed Income, we have adjusted our CIO portfolio strategy to be slightly more defensive. We have decreased our exposure to Investment-grade Corporates and are now slightly negative on the asset class.

Moreover, in addition to the backup in yields, the steady increase in oil prices has also been a wedge in the capital markets throughout September and to start October. We expect oil prices to maintain their current levels and potentially rise further given supply issues. Therefore, the expected Q4 rally in Equities is likely more due to an unwind of "risk-off" positioning and some subtle long-term buying than a fear of missing out.

In environments that continue to remain cloudy or overcast with many crosscurrents and two wedges—rising yields and oil prices—still in the way, we expect a choppy type of rally in Q4 overall. Our strategy is to remain balanced across all asset classes, maintain a high level of diversification, use excess cash to add to higher-quality areas that have drifted below strategic asset allocation targets in both Equities and Fixed Income, leverage Alternatives for qualified investors to help mitigate risk and/or add to potential returns, and be more active in rebalancing strategy early next year as more economic data confirms a slower growth path is indeed unfolding. Once we move through the first half of next year, we expect a new profit cycle to begin to build, once again, and establish a more sustainable long-term bull equity market. Until then we use the next nine plus months to reposition portfolios toward a balanced manner in case a harder slowdown than expected develops or if it is indeed "different this time," and the Fed can engineer the much discussed "soft landing."

The biggest risks to asset prices in the next six to 12 months continues to be the debt shelf in Commercial Real Estate (CRE) and the ability to extend or develop workouts, a rising default cycle, the geopolitical landscape, and financial conditions that tighten too much. If the Fed goes too far—while a much slower growth environment than expected is building under the surface—then the concerns mentioned above could be pulled forward. Stay balanced and active into next year.

We continue to view core mega Technology as an area to maintain exposure to and view Energy as a sector to emphasize with newer allocations. We still expect large-caps to outperform small-caps until the next expansion builds in earnest. Non-U.S. exposure could struggle through a slowdown but is on the watch list for potential upgrades if a weak Dollar cycle builds next year and/or the next expansion soon becomes visible. We believe small-cap core holdings and Large-cap Value in the U.S., specifically, are the major outperformers in the next cycle, but not in the intermediate term.

Are we in an entirely new cycle regime that could prompt portfolio adjustments?
The surge in inflation and interest rates in the last few years present compelling evidence of a shift to a new macroeconomic regime. It marks a clear departure from a pre-pandemic period of secular stagnation during which financial conditions were extraordinarily easy amid inflation that ran persistently below the Fed's 2% target, a feature of a 40-year-long disinflationary trend, and economic growth that remained sluggish. In the current environment, the economy has remained largely resilient despite the Fed aggressively tightening financial conditions by lifting the fed funds rate to a 22-year high and instituting quantitative tightening (QT). This dynamic suggests that the bigger challenge facing the Fed has transitioned from preventing deflation to instead keeping rising inflation under control. This evolution has compelled the Fed toward a more hawkish tilt where rates could stay "higher for longer", especially as global central banks contend with longer-run inflationary pressures from the global transition to greener forms of energy, climate change, shifting supply chains and the potential for extended fiscal programs to power these trends.

For investors navigating this transition period, we believe it is imperative to build diversified and balanced portfolios across and within asset classes, including Alternative Investments, for qualified investors. We maintain our emphasis on high quality overall. For Equity investors, that means investing in companies with strong balance sheets and the ability to produce cash flows and grow dividends. We continue to believe portfolios should incorporate both Growth and Value, but we have a bias for Value which trades at an attractive relative discount and may benefit from the broadening out of an equity advance in a soft landing.

For Fixed Income, maintain a slightly long-duration position given attractive nominal and real rates. We would view periods of market volatility as opportunities to rebalance portfolios. For longer-term investors with excess cash, we suggest a dollar-cost averaging approach.

In Equities, how should we think about sector exposures? What matters most with sector views? When considering Equity sector exposures, there are multiple factors that come into the analysis; however, it is critical to first assess where we are in the business cycle. We are currently progressing through the late cycle phase where earnings are in decline, financial conditions are weaker, the Fed is tightening monetary policy by raising interest rates and executing QT to help fight inflation and remove liquidity from the system. In the later part of the business cycle, it is recommended to have diversification across sectors and some exposure to defensive sectors as the crosscurrents in the economy can give conflicting signals. An important and specific issue in the current late phase of this cycle is that interest rates are reaching levels not seen in over a decade. This dynamic can pressure interest rate-sensitive sectors like Utilities and Real Estate—the two worst performing sectors Q3 and year-to-date (YTD).

Further, assessing the earnings trends and the fundamental outlook for sectors is critical in determining sector exposures. Currently there are mixed earnings trends and outlooks across Equity sectors and different trends in the subsectors, but this can be expected in the later parts of the business cycle. We also look at sector valuations and sector movement in both absolute and relative terms for finding extreme levels that can be a signal. Additional factors analyzed to arrive at sector views include technical (trend) analysis, momentum, positioning, longer-term secular and thematic drivers and investor sentiment. The late cycle stage can often be confusing due to mixed and conflicting signals coming from different sectors. We currently suggest a balance between Growth, like Technology and Communication Services, and Value such as Energy. In addition, portfolios should maintain some positioning in defensive areas like Healthcare, while reducing exposure to the more interest rate-sensitive sectors, such as Utilities and Real Estate.

What are the CIO's latest thoughts on international exposure? We remain cautious on the tactical outlook for International markets. The early-year investor optimism about International equity markets stemmed from two major positive shocks in the form of China's relaxation of pandemic restrictions and the steep fall in European natural gas prices. Each gave a respective boost to these large markets as well as the broader Asia-Pacific region from late 2022.

But their effect has since faded. In Europe, natural gas prices have stabilized (even rising slightly over recent months), and the Consumer Discretionary sector has given up its leadership in the equity market on the back of China's lost demand momentum. Furthermore, resilient core inflation implies a "higher-for-longer" interest rate path for the European Central Bank (ECB). Elsewhere within developed markets, Japan may continue to receive near-term support from accommodative monetary policy and the recent campaign from regulators pushing corporates to boost shareholder value by using their high cash holdings for more buybacks or payouts. However, monetary policy is likely to be normalized over the months ahead, which should make for higher rates and a stronger currency and could hurt export-driven segments of the local market.

Emerging markets continue to be held back by underperformance in Asia, and we see reasons to de-emphasize China in particular on the back of several structural constraints. These include the legacy of regulatory tightening in the Technology sector in addition to U.S. semiconductor export controls, structural weakness in housing construction, the shrinking labor force and flatlining consumer price inflation. Meanwhile for Latin America, we do not expect to see the same boost from industrial commodities that has typically come during past periods of construction-led Chinese growth.

We nonetheless remain more constructive on Emerging and International Developed markets over the medium to longer terms. Both trade at a discount relative to U.S. Equities, contain more of a balance between Value and Growth sectors and offer relatively attractive dividend yields.

The years of double-digit and high-single-digit economic expansion in China that have supported growth across the emerging world may now be behind us, but the more important question for markets over the medium term will be the future composition of China's growth. This is more likely to be concentrated in areas that are aligned with the strategic goals of the authorities such as information technology and advanced manufacturing. At the same time, markets such as southeast Asia, India and Mexico are likely to benefit from a longer-term reorientation of global supply chains and consequent expansion of their domestic manufacturing capacity, while producers of key material inputs to clean energy hardware and equipment in Latin America and Africa remain exposed to growth in demand for these commodities.

While we remain of the view that current conditions do not warrant a tactical upgrade to International market equities at this stage, we therefore continue to maintain longer-term exposure.

In Fixed Income, what is the state of the state given the current move higher in yields, the eventual path of inflation, and Fed policy? What are the CIO's thoughts on Fixed Income sectors and duration? After years of underplaying the risks of inflation and too-easy monetary policy, the Fed has finally changed its communication strategy. In the last three meetings, Fed Chair Powell has consistently tried to manage the market to expect short-term rates to be "higher for longer" to help deal with the consequences of too-easy fiscal and monetary policy. From our perspective, this is the right track for the FOMC to take. It is much better to get the market acclimated to more rate hikes and then under-deliver, as opposed to continually being behind the curve and attempting to play catch-up. This month the market finally took the FOMC's message to heart, with the 10-year breaking out to over 4.8% intra-day, the highest level in 16 years. Based on interest rate futures, the market now expects the fed funds rate to average 4.5% for the next decade. With the fed funds having averaged less than 1.5% over the past 20 years, that would be a total "regime shift"—a change from a secular low-inflation and -rate environment to an altogether different one.

In reality, no one—neither the Fed nor the market—knows the ultimate duration of this regime shift, nor how many counter-trend rallies in rates there may be until and if it is firmly established. What the CIO can say, however, is that with real (inflation-adjusted) rates approximately 2.25% to 2.5% across the curve currently, the pricing in rates markets offers much better valuations if we are in that regime shift and, as such, are quite reasonable. Alternatively, if we are not in a secular inflation and rate regime change, if disinflation reasserts itself or if we have a recession and the Fed once again resorts to cutting rates and using its balance sheet significantly, then the real rates available right now in the market are extremely attractive, in our opinion. Five-year real rates are currently 2.5%; their average over the last 20 years of a very proactive Fed was a meager 0.31%.

Therefore, as always, our aim is to be prudent and try to construct portfolios that can be resilient to different economic outcomes. We openly acknowledge this potential regime shift and that inflation may be more persistent, and rates could continue to move higher or stay higher; we are therefore not recommending excessively long-duration positioning. On the other hand, we are close to the end of the rate hike cycle, the Fed has shown little inclination to abandon its balance sheet policies, the market is convinced the inflation problem is behind us, monetary policy acts with a significant lag, and global growth is already slowing. Therefore, in our opinion, the balanced and risk-aware approach is to recommend slightly long-duration positioning, balancing the possibilities of either outcome against favorable absolute valuations, as well as valuations relative to risk assets. Cash provides unpredictable income; short rates are significantly more volatile than longer rates. Extending duration in high-quality Fixed Income therefore would be a better way to provide more predictable, reliable and steady yield on a multiyear time horizon.

Within Fixed Income, we are favorable on more defensive assets, including Treasurys and Agency MBS, which are finally being priced to acknowledge the risk of higher inflation. We are more cautious on Investment-grade credit; spreads do not seem to be pricing in significant economic risk, and we are currently slightly negative on the asset class and looking for volatility to potentially create a more attractive entry point.

What is the likely direction of the U.S. dollar all things considered in the next year? QT plays a key role in reducing the supply of dollars and will be important to watch for the direction of the dollar over the next year, in our view. As long as the Fed remains restrictive in rhetoric and action (QT plus interest rate hikes), the broad dollar indexes will remain firm, in our view. Once the Fed starts to ease policy, the dollar will likely resume the weakening trend that persisted in the first half of the year. It is likely that a Fed shift would also coincide 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, especially the Japanese Yen and Swedish Krona, and to a smaller extent versus the Euro. The Japanese Yen is a key currency to watch from an investment strategy perspective as it typically benefits from a risk-off environment, but with short- and long-term domestic interest rates pegged near zero, rate differentials versus other countries, including the U.S., are swamping risk. The Yen is a popular funding source for carry trades that could unwind if there is a more acute financial or growth shock, or if the Bank of Japan (BoJ) unexpectedly raises rates. This could be a source of volatility for broader markets.

CIO INVESTMENT DASHBOARD AS OF OCTOBER 3, 2023

We continue to see many crosscurrents across the market and economic landscape. While recession concerns have abated, growth is expected to fall below trend in 2024, and economic reports show signs of moderation. Near-term risks remain as the lagged effects of tighter monetary policy filter through the economy. U.S. corporate profit trends are less supportive, with consensus now estimating annual earnings growth of 1.4% for 2023, according to FactSet. Valuations for U.S. Equities fell in September but remain elevated relative to long-term averages, with the S&P 500 forward price-to-earnings (P/E) ratio hovering around 18.0x. We expect a "grind-it-out" market environment as we move through the remainder of the year.

Current readings on the key drivers of Equities for investors to consider, with arrows representing the recent trend:

	Implication for Equities			
Factor	**Negative**	**Neutral**	**Positive**	**CIO View**
Earnings				According to FactSet, actual S&P 500 revenue and earnings growth in 2022 were 11.1% and 3.9%, respectively. Accordingly, this year, consensus expects growth of 2.4% and 1.4%. In Q3, estimates call for sales growth of 1.5%, and profits growth of 0.2%, on a year-over-year (YoY) basis. Meanwhile, according to BofA Global Research, the Global Earnings Revision Ratio pulled back from its highest level in 18 months. Still, on average over the past three months, the number of downgrades to profit estimates surpasses upgrades. Globally, downgrades outpace upgrades in 13 of 20 countries and in 15 of 16 tracked industries.

Factor	Implication for Equities: Negative	Neutral	Positive	CIO View
Valuations		●		The S&P 500 P/E ratio (next 12 months) is around 18.0x, up from 16.8x at the end of 2022. This headline measure suggests U.S. Equities are more expensive amidst a less certain earnings outlook. Elevated interest rates should continue to suppress the relative appeal of Equities versus Fixed Income.
U.S. Macro		●		Real gross domestic product (GDP) grew by 2.1% in Q2 2023 at a seasonally adjusted annual growth rate, decelerating from growth of 2.2% in Q1. 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 rising interest rates remains headwinds to growth. BofA Global Research expects Q3 GDP growth of 2.0% and 2.1% for all of 2023. Next year, annual growth is expected at 1.1%.
Global Growth	←	●		Diverse headwinds face the global economy. In the Euro area, a taut labor market has factored in elevated core inflation and tight monetary policy, which has weighed on economic growth. In China, officials have taken steps to loosen regulation and credit availability, among other measures, to combat weakness in the property market and financial stress, which has fueled concern over the sustainability of the economic recovery. In the U.S., economic resilience has surprised, despite bank-related stress, which has weighed on credit creation. After growth of 3.6% last year, the global economy is expected to expand by 3.0% this year and by 2.8% in 2024, according to BofA Global Research.
U.S. Monetary Policy / Inflation	●			BofA Global Research anticipates one more rate hike in November of 25 bps to a terminal policy interest range of 5.50% to 5.75%. The market is less certain and is only pricing in a 50% chance of one more rate hike at either the December 2023 or January 2024 meeting.
Fiscal Policy	←	●		U.S. pandemic-era fiscal support totaled nearly 31% of GDP. The latest examples of its fading are the end to a moratorium on student loan debt payments and the expiration of a child-care subsidy at September-end. While these developments may hinder economic growth, the Brookings Institution reports that the overall drag from the passing of pandemic-era fiscal policy has lessened. Since that initiative, 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. Among other elements, it provides nearly $370 billion over 10 years for energy security and climate change projects.
Corporate Credit	● →			Though off their YTD lows, U.S. High Yield (HY) credit spreads remain tight, while those of Investment-Grade (IG) are also relatively low. Nonetheless, both sectors remain higher than 2021 levels, reflecting some concern about an economic slowdown.
Yield Curve	←	●		Inversions, whereby longer-dated yields are below shorter-dated ones, largely exist across the U.S. Treasury yield curve. This includes the fed funds (FF)/10s, 3-month/10s and 2/10s segments. The degree of many of these inversions has begun to lessen, with longer-dated yields moving higher relative to those shorter-dated. Overall, the Treasury market suggests a higher probability of a recession in the U.S.
Technical Indicators	←	●		The Chicago Board Options Exchange (CBOE) Volatility Index (VIX) recently rose to its highest level since May. Relative weakness in 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, remain. The BofA Global Breadth Indicator is signaling "neutral."
Investor Sentiment	←	●		According to the American Association of Individual Investors, sentiment has begun to deteriorate as market volatility has risen. Institutional portfolio cash levels reflect neutral investor sentiment, according to BofA Global Research's Fund Manager Survey. Meanwhile, the BofA Bull & Bear Indicator also signals "neutral," at 3.0.

Source: Chief Investment Office.

EQUITIES

We are neutral Equities: The seasonal downdraft in Equities continued in September as worries over a potential government shutdown, higher yields and labor strikes weighed on the market. Catalysts that could potentially drive the market higher from here include high cash levels in money market mutual funds, which could support a subtle drift up in Equities as flows come back into the market. We continue to search for additional conditions to support a sustainable, broad-based rally. In our view, the current economic backdrop warrants a balanced approach and a high-quality bias in the near term.

We are slightly overweight U.S. Equities overall: 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 high-quality bias favors U.S. Large-caps with strong fundamentals and the ability to produce healthy shareholder payouts. We remain neutral Small-cap Equities, which have lower-quality balance sheets, rising cost of capital, a higher proportion of nonearning companies within the index, and less financial flexibility to generate shareholder payouts. In our view, Small-caps have favorable valuations and could be leaders of the next decade but need to stabilize relative to Large-caps to outperform consistently.

EQUITY WATCH LIST

- 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
- Heightened geopolitical risk and ongoing conflict in Eastern Europe
- Pressures within the Office segment of Commercial Real Estate (CRE)

We expect 2023 earnings per share (EPS) for the S&P 500 to remain relatively flat compared to 2022's earnings. In our view, analyst's estimates are still too high for 2023 and 2024. Once the focus shifts to weaker fundamentals for earnings, valuation multiples could potentially see another leg lower from current levels. Additional near-term risks for Equities come from a global slowdown in growth and profits, persistently elevated levels of inflation, higher interest rates, a Fed policy error, and tightening credit conditions. Given these factors, we maintain a neutral stance.

Our "on guard" stance continues to suggest a balanced and diversified Equity exposure for the late phase of the business cycle. From a sector perspective, we emphasize Healthcare to reflect a balance between Value and Growth, and our preference for quality at a reasonable price. We are increasing exposure to Energy because the recent rally in oil prices could drive stronger free cash flow and earnings in Q3 and Q4 earnings seasons. Energy remains the cheapest sector on valuation metrics and continued capital discipline by energy companies should support the trend of returning more cash to shareholders. Fundamentally, the global oil supply and demand balance remains very tight and is supportive of energy prices and cash flow generation. We are reducing exposure in Utilities to neutral as higher interest rates are a key overhang for this bond proxy sector. In addition, the higher cost of capital could delay some renewable energy projects which were expected to drive earnings growth for the Utility sector. While we are constructive on Industrials and Information Technology (IT) as longer-term thematic trends, we maintain our neutral view in the near term. We deemphasize Materials, as demand slows, and pricing power may have peaked in this sector. We remain underweight Consumer Discretionary, as risks remain for future job cuts and as consumers continue to work down excess savings from the pandemic. We remain slightly underweight Real Estate (RE) and prefer being selective in the RE subsectors due to positive fundamentals in some areas of RE but weaker trends in other areas like commercial real estate. We remain neutral Financials as higher interest rates and higher capital reserves could increase volatility. The higher costs of deposits and the higher cost of capital are likely to weigh on earnings for both the Financials and RE sectors in coming quarters. We remain neutral Communication Services after it being the worst performing sector in 2022.

We believe strategic portfolios should continue to incorporate both Growth and Value factors that would simultaneously gain from cyclical and secular forces gaining traction. We currently maintain a slight preference for Value, which is trading at a relative discount to Growth and has led Growth when the Fed paused in past periods of elevated inflation. However, in the long run, Growth should benefit from accelerated secular investments in 5G, artificial intelligence, cloud computing, robotics and health infrastructure globally. 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 may struggle to sustain a return advantage in an environment of persistently high global interest rates, a still relatively strong U.S. dollar and any potential broadening in banking sector stress. We continue to expect a wide return dispersion between individual EM countries and regions. Growth in the heavyweight Chinese 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. The structural rise in EM consumer spending remains a big reason that 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 management[1] 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, greater exposure to any potential broadening in banking sector stress, upward pressures on core inflation and a hawkish ECB. 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 supportive monetary policy relative to the rest of the world but a gradual unwind of yield curve control as inflation returns to more normal levels on a sustained basis. 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.

FIXED INCOME

We are neutral on Fixed Income: Nominal and real rates are some of the most attractive in 15 years and have risen again recently, with the 10-year Treasury breaching the key 4.5% threshold following resilient economic data and the Fed messaging that they intend to keep rates "higher for longer". The Fed delivered an expected pause at its September meeting while indicating that it may increase rates one more time this year and that short rates may have to stay elevated for some time. Markets, however, are forecasting only a 50% chance that the Fed is going to hike one more time in 2023. In addition, the market is reducing its expectations for the amount of rate cuts in 2024, a direct consequence of Fed communication, in our opinion.

Real yields—the yield after inflation, as measured by Treasury Inflation-Protected Securities (TIPS)—are 2% or higher across the curve. The 5-year TIPS is currently yielding 2.35%, the highest since 2008. Earning a positive, substantial real yield on U.S. government-guaranteed securities after inflation is a welcome reprieve for savers after years of financial repression. We are therefore favorable on Fixed Income near term, although our positioning is neutral relative to Equities on the 12- to 18-month time horizon.

We recommend a slightly long-duration position versus a stated benchmark to take advantage of higher nominal and real yields and as prudent positioning against macro risk in the Equity portion of a diversified portfolio. The ISC may continue to look for prudent opportunities to potentially extend duration further in the future if longer-term rates rise substantially from here.

While banking sector stress remains relatively low, however, lending standards will likely continue to tighten. Leading economic indicators remain weak, money supply growth is still negative, and yield curves remain inverted. Inflation expectations have been relatively stable at around 2% to 2.5% across the curve, highlighting the market's belief that the inflation problem is behind us, and that Fed policy will successfully bring inflation back to target.

Within U.S. Investment-grade Taxable, we are moving to slightly underweight view on Investment-grade Corporates, and remain slightly underweight High Yield: This change reflects our view that despite relatively attractive all-in yields of around 6%, credit spreads do not appropriately reflect the risk of continued deterioration in corporate credit fundamentals as the economic cycle matures and growth slows

FIXED INCOME WATCH LIST

- Deeper yield-curve inversions, or increased rate volatility in either direction
- 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 in the economic weakness

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

heading into 2024 in response to tighter financial conditions. Credit spreads, currently trading in the 115 bps to 120 bps range have been remarkably resilient despite the pressure of heightened interest rate volatility, trading in a very tight range—close to post-pandemic lows over the last several months.

In our view, this strength has been largely a function of yield-orientated buyers, better-than-expected economic data and corporate earnings, and the soft-landing narrative gaining momentum. To be clear, we don't see a risk or catalyst for spreads to move materially wider over the intermediate term, macro uncertainties included. However, the margin for error at current valuations remains slim, and we see more limited upside in credit spreads at current levels suggesting that the path of least resistance could be wider over the coming quarters. We therefore believe that an up-in-quality and defensive tilt within a corporate allocation is prudent and would look to re-risk portfolios should we see valuations move closer to the 150 bps level and/or an improvement in data drives a shift our fundamental views.

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 8.5%. Valuations provide modest compensation for credit losses and suggest reasonable returns over medium to longer time frames. Spreads, however, are in the 375 bps to 400 bps range, below the 650 bps to 800+ bps level seen in many recessions. We therefore maintain our slight underweight positioning. Within HY allocations, we prefer a balanced allocation between secured floating-rate leveraged loans and unsecured HY bonds.

Also within U.S. Investment-grade Taxable, we are moving to slight overweight from neutral 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 have caused MBS spreads to widen this year materially, and they have now broken into the 60 bps to 70 bps range in September, generating an excess return of -0.3% for the month, underperforming IG corporates by a wide margin. This backup in MBS spreads represents an attractive entry point, in our view.

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, which makes MBS bonds more appealing as their spreads are likely to outperform should interest rate volatility subside. Although weak demand from the Fed and 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 Treasurys and IG corporate bonds over the long term.

ALTERNATIVE INVESTMENTS

We favor a strategic approach when allocating to Hedge Funds, Private Equity, Private Real Estate and Tangible Assets. Within Alternative Investments (Alts) asset classes, however, we see opportunities and challenges in the current environment for qualified investors.

Hedge Funds: The shift in the macroenvironment in August and September has affected Hedge Fund (HF) positioning and performance. Through August, HFs overall have returned 4.5%.[2] As we have noted, Equity Hedge (EH) strategies have been hampered from an alpha perspective for most of this year due to a difficult shorting environment. This trend has swung in the other direction in August and September, with short alpha reemerging and contributing to stronger performance relative to broad market equity indexes. With a more fruitful environment, EH managers have added to short positioning.

ALTERNATIVE INVESTMENTS WATCH LIST

- Slowing pace of monetary policy moves potentially reducing near-term opportunity for Macro Hedge Funds
- Greater-than-expected defaults affecting Private Credit
- For CRE, stress shifting from Office to Apartments
- Whether "down rounds"* become commonplace in Venture Capital

* Down rounds are when a company raises a financing round of venture capital funding and the pre-money valuation of the company is lower than the postmoney valuation of the previous round. Down rounds are different from bridge rounds, which help founders extend their last round of fundraising.

[2] HFR, Inc. HFRI Fund-Weighted Composite Index. As of August 31, 2023.

Quantitative EH strategies in particular have benefited from factor reversals, with short alpha picking up steam in September amid the rate-driven difficulties for growth stocks.

Upward pressure on yields in developed markets (ex-UK) has recentered the theme of shorting Fixed Income for Macro strategies broadly. Following the bout of volatility in March, Macro managers had largely taken a “wait and see” posture before loading up on directional risk—that moment may have come with the recent rise in Treasury yields in August and September. Though the disinflation narrative dominated for the better part of this year, the rise in long-dated yields in the last two months is expected to provide a more robust opportunity for Macro strategies.

With a more aggressive antitrust posture from the Federal Trade Commission and the Department of Justice, Event Driven (ED) strategies are finding greater opportunities in merger arbitrage. The risks associated with mergers and acquisitions have increased thereby increasing the expected returns for ED managers that can effectively navigate the greater uncertainty of deal closures.

Private Equity: The overall environment remains challenging for Private Equity (PE) strategies. Deal and exit activity remain stagnant overall for PE and Venture Capital (VC). Although decently strong equity market performance this year has bolstered hopes of a “bottom” in PE and VC, headwinds remain. The “denominator effect” for institutional investors may have eased slightly in 2023 due to the improved performance of public market asset classes, but the sharply lower velocity of net cash flows (distributions minus contributions) for private markets strategies continues to put pressure on Limited Partners, who in turn are slowing new commitments to the space. PE sponsors have proven to be adaptable, shifting strategies, financing sources, and sector emphases. However, more time will be needed for these markets to switch to a bullish tenor.

For all its tailwinds and headwinds, Private Credit remains a compelling asset class to commit fresh capital to within a diversified portfolio construct. On the positive side of the ledger, secular forces are driving its absolute and relative growth, yields have risen with policy rates, and interest rate duration is low given its largely floating rate nature. The downside risks, as we have long noted, include deteriorating interest coverage and rising defaults. The higher-for-longer plus resilient economy combination ultimately augurs well for the asset class. Fresh capital, in particular, can underwrite new loans to high rates of return with the downside risks associated with this environment factored in.

Private Real Estate: The asset class unsurprisingly continues to face challenges from high interest and mortgage rates. The adjustment process of private valuations falling to reflect the reality of a higher risk-free rate is proceeding, albeit slowly and haltingly. Transaction-based cap rates, as expected, have been increasing (reaching 5.3% as of Q2 2023) and closing the gap with the implied cap rates of public Real Estate Investment Trusts (REITs), which have been range bound around 6% since Q3 2022.[3] However, with significantly reduced transaction volume ($3.9 billion through Q2 YTD), transaction-based cap rates only represent a sliver of the $302 billion appraised value of the universe.[4] Appraisal-based cap rates, on the other hand, have been slower to adjust, reaching 4.2% as of Q2 2023. A significant decline in appraisal values would still be required for appraisal cap rates to catch up to transaction cap rates, let alone public REIT implied cap rates.

Like with PE, patience will be needed for real estate markets to find their footing. Transactions will need to pick up to aid in price discovery given the disconnect in public and private valuations. Sector and geographic differentiation are warranted and can provide opportunity for discerning investors. New capital deployment in general, and Real Estate credit in particular, look increasingly interesting. For the longer-term, Private RE

3 Bloomberg. National Association of Real Estate Investment Trusts (Nareit). “Real Estate Cap Rates and the Slow Wheels of Progress”, June 20, 2023.

4 National Council of Real Estate Investment Fiduciaries (NCREIF). Transaction and appraisal values using the NPI-Open End Diversified Core Equity (ODCE) Index. As of June 30, 2023.

continues to make sense as a strategic allocation given the diversification benefits and income features.

Commodities: Global growth anchors demand for commodities and remains under pressure, but energy supply cuts and dwindling inventories in the U.S. are supporting oil prices and broader indexes. Weaker global growth is showing up in cyclical commodity prices like industrial metals (including copper), which experienced double-digit declines YTD through September. We believe global growth and commodity demand will remain muted in the rest of the year, but geopolitical risk is a wild card and geoeconomic maneuvering by major oil suppliers is having an effect. Elevated geopolitical risk supported gold prices in the first half but rising real interest rates have emerged as a headwind, especially in the U.S. We continue to believe gold is most effectively implemented as a strategic diversifier.

As long as the Fed remains restrictive in rhetoric and action (QT plus interest rate hikes), the broad dollar indexes will remain firm, in our view. Once the Fed starts to ease policy the dollar will likely resume the weakening trend that persisted in the first half of the year.

It is likely that a Fed shift would also coincide 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: Tangible Assets—such as RE, timber, and farm and ranch land—have historically performed well in high-inflationary environments, providing potential diversification to traditional portfolios. Tangible Assets can also add diversification to other Alts such as HF and PE investments.

MACRO STRATEGY

- In the U.S., the deceleration in nominal growth continued in Q2 with nominal GDP growing at a 3.8% seasonally adjusted annual rate (SAAR), down from an 8.5% SAAR in Q2 last year. The slowdown in top-line growth while wage growth remains firm continues to weigh on profits. In the absence of a more significant labor market deterioration or a pickup in real growth, the profits stagnation will likely persist.
- The global growth cycle appears unlikely to provide a significant boost to U.S. growth and profits over the balance of the year. Cyclical momentum, as gauged by the Global Manufacturing Purchasing Managers' Index ex-U.S., remains under pressure. China's efforts to reignite consumer appetites have so far come up short, while survey data in Germany point to a recession in Europe.
- The U.S. Equity market and HY spreads are notably disconnected from a macroeconomic-based profits outlook that suggests 2024 corporate earnings will remain under pressure with the potential of a downside risk.

ECONOMIC FORECASTS (AS OF SEPTEMBER 29, 2023)

	2022A	Q1 2023A	Q2 2023A	Q3 2023E	Q4 2023E	2023E
Real global GDP (% y/y annualized)	3.6	-	-	-	-	3.0
Real U.S. GDP (% q/q annualized)	1.9	2.2	2.1	2.0	1.5	2.1
CPI inflation (% y/y)	8.0	5.8	4.0	3.5	3.4	4.2
Core CPI inflation (% y/y)	6.1	5.6	5.2	4.4	3.9	4.8
Unemployment rate (%)	3.6	3.5	3.5	3.6	3.8	3.6
Fed funds rate, end period (%)	4.33	4.83	5.08	5.33	5.63	5.63

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 October 3, 2023. 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 2023

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 2023 and price-to-earnings (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.

2023 EPS	EPS Forward P/E (Next 12 months)				
	15.0x	16.0x	17.0x	18.0x	19.0x
$240	3,600	3,840	4,080	4,320	4,560
$230	3,450	3,680	3,910	4,140	4,370
$220	3,300	3,520	3,740	3,960	4,180
$210	3,150	3,360	3,570	3,780	3,990
$200	3,000	3,200	3,400	3,600	3,800
$190	2,850	3,040	3,230	3,420	3,610
$180	2,700	2,880	3,060	3,240	3,420

For illustrative purposes only. Source: Chief Investment Office as of October 3, 2023.

CIO ASSET CLASS VIEWS AS OF SEPTEMBER 5, 2023

Asset Class	CIO View: Underweight		Neutral	Overweight		Comments
Equities			●			We are neutral Equities, as risks to economic growth and corporate profits remain. 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. Higher interest rates should pressure Growth more, especially higher multiple, nonearning areas. We believe portfolios should incorporate both Growth and Value factors as appropriate.
U.S. Mid-cap				●		Our preference to stay higher up in the size scale keeps us favoring Large- and Mid-caps compared to Small-caps.
U.S. Small-cap			●			We are neutral Small-caps, as they have lower-quality balance sheets, a higher proportion of nonearning companies within the index, and less financial flexibility to generate shareholder payouts. However, they maintain reasonably attractive absolute and relative valuation versus Large-caps.
International Developed		●				International Developed Equities remain attractively valued, but additional central bank policy tightening is likely to exceed the U.S. 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 Chinese growth, the ongoing Russia-Ukraine conflict and natural resource prices. Valuations appear attractive, but high global rates remain a headwind.

Asset Class	CIO View: Underweight		Neutral		Overweight	Comments
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 elevated inflation, hawkish central bank policy, weaker economic growth and the potential for energy supply constraints to reemerge amid the ongoing Russia-Ukraine conflict.
U.K.			●			Domestic demand at risk from still high mortgage rates. Historically weak exchange rate risks compounding inflation pressures. Withdrawal from European Union single market remains a negative for medium-term growth.
Japan			●			Near-term support expected from monetary accommodation, but headwinds likely to increase from gradual normalization of interest rates. Nominal growth expectations remain among the lowest for the major developed economies.
Pac Rim*			●			Regional activity to be dampened by exposure to weaker Chinese 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 are 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 Treasurys 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 in the later in the economic cycle and recessionary signals remain.
International			●			International rates markets have become significantly more attractive as global Central Banks raise rates to fight inflation, no longer trading at a significant discount to the U.S. except in Japan where the BoJ is still keeping longer-term rates artificially low.
Global High Yield Taxable		●				Valuations now 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.
Alternative Investments**						Given the differences in liquidity characteristics between Alternative Investments and traditional investments, the CIO asset class views on Alts portfolio positioning continue to be neutral-rated versus our strategic allocations. These types of investments, in our opinion, should not be viewed at the asset class level on a tactical basis, but rather the tactical positioning should be expressed at the sub-asset class level. We will continue to provide strategy-level guidance for qualified Alts investors. We believe allocations to Alts can introduce differentiated returns that can help complement existing traditional holdings by potentially enhancing returns, helping to reduce risk and capitalizing on opportunities not available through traditional investments.
Hedge Funds						An allocation to HFs has the potential to reduce volatility and add some diversification to portfolios. At the strategy level, we continue to favor EH and Macro strategies (as part of a diversified portfolio of HF) given the macro environment.
Private Equity						Buyout and Venture/Growth strategies will likely continue to face performance headwinds in the near term given the pressures from higher rates. Prospectively, we see potential opportunities for current- and coming-year vintages given lower entry valuations and the long-term nature of the strategies. Given the challenging exit environment, Secondaries continue to attract investor interest. Private Credit faces credit deterioration risks in a slowdown, though the strategy is enjoying attractive yields and has historically proven resilient.
Tangible Assets / Commodities						Global growth anchors demand for commodities and remains weak as the U.S. economy cools. Cyclical commodities like copper and oil are nearly unchanged for the year, and industrial metals as a group are down double digits, whereas oil prices are slightly higher, supported by supply cuts and inventory accumulation in China. Elevated geopolitical risks are supported gold in the first half of 2023, but we continue to believe gold is most effectively implemented as a strategic diversifier. Over the medium term, the dollar continues to look expensive, in our view.
Real Estate						CRE has been in the spotlight given cost-of-capital pressures and more recently questions about regional banks' appetite for CRE mortgages. We expect more of a slow-moving reset, with significant variation by sector and geography, rather than a GFC-style collapse. CRE lending and distressed strategies may emerge as opportunities. Private Infrastructure offers interesting long-term yield opportunities as many of these hard assets often have contractual cost inflation pass-throughs.

* 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. ****Alternative investments such as derivatives, hedge funds, private equity funds and funds of funds can result in higher return potential, but also higher loss potential. Changes in economic conditions or other circumstances may adversely affect your investments. Before you invest in alternative investments, you should consider your overall financial situation, how much money you have to invest, your need for liquidity and your tolerance for risk.** **Many products that pursue Alternative Investment strategies, specifically Private Equity and Hedge Funds, are available only to qualified investors. Source: Global Wealth & Investment Management Investment Strategy Committee.

CIO EQUITY SECTOR VIEWS AS OF OCTOBER 3, 2023

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.

	CIO View					
Sector	**Underweight**		**Neutral**	**Overweight**		**Comments**
Energy	•	•	•	▶	●	Energy is upgraded to strong overweight as rising oil prices could drive higher than expected cash flows, FCF and earnings in the third and fourth quarters. The current environment of solid energy demand, tight global supplies, OPEC+ supply cuts, limited spare capacity, risk of potential global disruptions, plus the decline in capital expenditures and long-cycle energy investments are all supportive for Energy stocks. Higher energy prices combined with substantial cost-cutting initiatives and capital discipline over recent years built significant operating leverage into Energy companies. Despite declines in energy prices earlier this year, earnings and FCF outlooks remain strong in absolute terms for energy companies and relative to other sectors. There remains room for positioning to improve despite strong outperformance over the last two years. YoY comps are tough in 2023, but we remain positive on the Energy sector due to valuation, earnings power and higher cash returns to shareholders through base dividends, variable dividends and stock buybacks. Further, China's reopening, while choppy and not linear, could add to global demand for energy and support prices at higher levels as the year progresses. 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-evens. Energy stocks still provide attractive valuations and strong dividends with improved momentum.
Healthcare	•	•	•	•	●	Consider positions in larger biopharma stocks with attractive valuations. In an environment where financial conditions are tightening and economic growth is slowing, Healthcare stocks provide attractive characteristics, including quality, dividend growth, dividend yield and lower beta. Healthcare fundamentals to date have been able to withstand much of the macro pressures seen globally. Distributors, life science equipment and large biopharma are best positioned, in our view, to weather pressure on margins, while innovation and breadth of portfolio should continue to allow for modest price taking in areas of medical technology and devices. 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. Valuation remains attractive and momentum is neutral.
Utilities	•	•	●	◀	•	Utilities are downgraded to Neutral as higher interest rates are a headwind for this bond proxy sector. Further, the higher cost of capital could delay and push out renewable energy projects at utilities, and these projects are potential drivers of earnings growth in the sector. Utilities historically provide reliable earnings and outperform in the late cycle and during economic growth slowdowns, especially regulated utilities. Utilities provide greater balance and lower beta and help diversify cyclical Equity exposure. Higher interest rates recently weighed on this interest rate-sensitive sector and could be a potential near-term headwind. For the longer term, we emphasize Utilities with growing renewable power generation from wind and 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 while also providing visibility and greater certainty for future earnings and dividend growth. Prefer utilities that can capitalize on the energy transition to greater renewable power generation and positive demographic trends. Valuation is neutral and momentum is negative.
Consumer Staples	•	•	●	•	•	The prospects for continued consistent demand for essential consumer packaged goods (CPG) products from an even more conservative consumer may support relatively better top-line revenue growth when also coupled with selective but moderating retail price increases. Input and ingredient cost pressures could moderate further and may provide some modest defense to margins over time. The Consumer Staples sector has historically outperformed other cyclical areas of the market during a period of negative earnings revisions due to the recurring nature of consumer product company revenue streams, leading to better relative earnings growth. More visible and predictable earnings and a less severe period of downside earnings revisions help support the sector's relative valuation. Consistent cash flows through varying economic cycles help support higher dividend payouts and increased shareholder capital returns. The defensive characteristics of the sector could potentially attract "safe haven" investment flows over various cycle outcomes despite the already elevated valuations. Valuations are elevated and momentum is neutral.

Sector	CIO View					Comments
	Underweight		Neutral		Overweight	
Information Technology			●			The Technology sector is neutral despite improvements in supply chains and recent flight-to-quality and artificial intelligence-driven flows into mega-cap Technology stocks. However, margin risks remain for companies in the sector as IT budgets and technology investments are showing signs of slowing. Despite some of the most expensive Technology stocks experiencing significant valuation re-ratings last year, we remain concerned about enterprise spending being under greater scrutiny on tighter spending budgets and the potential for additional valuation re-ratings in the sector. Further, the potential remains for downward earnings revisions that are more likely to affect higher-beta, higher-valuation companies. Despite strong long-term Cloud 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 Tech, 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-durationTech 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 artificial intelligence, data centers, software, cybersecurity, and semiconductors. Valuations in the sector declined in 2022 but are still elevated, especially after the recent rally in artificial intelligence-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 Technology 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 weakness from the Fed's tightening and the re-rating of Technology stocks. Valuations remain elevated and momentum recently stalled.
Communication Services			●			We are neutral on the Communication Services sector, as some of the largest companies in this sector have higher-quality fundamental characteristics and could be more attractive in an economic slowdown. 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; 3) and, more importantly, broad cost-reduction plans could create potential earnings upside. Valuations are neutral and momentum improved.
Industrials			●			The Industrial sector is neutral, driven by divergent fundamental outlooks across subsectors. Softening international end markets, ongoing supply chain issues, elevated labor and energy costs, cautious guidance, and weaker export demand driven by Europe and China are weighing on the outlook for industrial conglomerates and transports. On the positive side, the global threat environment is heating up and driving an improving outlook for defense budgets in the U.S., Europe and Southeast Asia, underpinning favorable dynamics for defense companies. Aerospace is benefiting as well from the ongoing recovery in consumer and business air travel. Potential improvements in the global capex cycle, including reshoring of supply chains and manufacturing, and investment in new equipment after years of focusing on productivity, could support the construction, transportation, machinery and freight and logistics industries longer term. However, elevated inflation, tighter monetary policy and slower growth are potential headwinds near term, but secular growth drivers support the longer-term view for Industrials. Valuation is slightly elevated, and momentum is neutral.
Financials			●			We are neutral on the Financials sector. Despite the arrival of a high-interest rate regime, U.S. banks collectively have seen nearly \$0.7 trillion in deposit outflows so far this year, according to Fed data, and more than \$1.1 trillion since peaking a year ago (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, net interest income is still expected to grow modestly this year and improve earnings power, 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 higher capital requirements that could be 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, but momentum declined in the sector.
Materials		●				Slower global growth, weaker commodity prices and tighter monetary conditions factor into our more cautious view on the Materials sector. We are seeing deceleration in the positive pricing cycle that has been driven by favorable supply and demand conditions over the last two years. Higher interest rates in the developed world and ongoing trials securing labor and materials are pushing industrial project timelines to the right, and, with the additional challenge of higher energy costs, we are seeing some formerly profitable projects being reconsidered. Meanwhile, the supply side continues working at maximum capacity to meet the demand levels and thus may end up overshooting. We see this reflected in rising inventory level data across some value chains and are increasingly cautious, as the dynamic may spread and become a trend. We want to reposition investment portfolios ahead of a potential contraction in the pricing cycle, as rising inventories and slowing volumes give buyers more bargaining power. Multiples could meaningfully contract if we start to 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 spending and reopening policies in China, but on a risk-reward outlook appeared less attractive with inflation and pricing power moving lower. Amidst softening demand trends and expected supply growth in the near term, consensus estimates appear elevated. As a result, the underlying sector valuation and momentum are neutral.

Sector	CIO View					Comments
	Underweight		Neutral	Overweight		
Real Estate		●				We are underweight the RE sector on CRE concerns. Tighter financial conditions and higher cost of capital could slow growth and weigh on earnings in the RE sector. Higher interest rates could increase refinancing risks and increase interest expenses, which could be a downside risk to sector earnings in 2023. RE was a higher-conviction sector when inflation was rising, but with inflation measures moderating and higher costs of capital for the industry, we would be more selective within the RE sector. 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 real estate footprints. With interest rates moving higher, the cost of capital for real estate growth projects could be a headwind depending on how long rates remain elevated. 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 real estate. Valuations are neutral and momentum is negative.
Consumer Discretionary	●					Following a protracted period of above-trend, post-pandemic spending levels, the consumer is facing persistent and troublesome inflation headwinds that could result in a more conservative discretionary spending pattern as a slowing economy and potential employment security issues gradually weigh on consumer confidence. Big-ticket purchases of autos and homes have been deferred due to supply restraints and higher average selling prices, and, as a result, the consumer has pivoted to travel and leisure experiences that have driven demand for hotels, airlines and theme parks. The potential exists for consumers to retrench and assess their personal financial position, further deferring big-ticket purchases, including travel and leisure, until they feel more confident about the economy and other macro headwind factors. A retrenched consumer may revert to normalized spending patterns that drive demand for essentials only as the consumer attempts to deleverage their balance sheet and draw down savings balances for everyday needs. The ongoing period of declining real disposable income is being punctuated by stubbornly high energy costs and ongoing consumer goods inflation and is potentially exacerbated by the removal of the student loan forbearance, which could provide an additional strain on household incomes. The earnings revision life cycle has historically led to several quarters of negative earnings-estimate revisions and declining relative valuations versus the more stable consumer products companies. Valuation for the sector is still elevated and momentum declined in recent weeks.

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 OCTOBER 3, 2023

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 significant 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.

Big Data	Demographics	Climate Change
The massive growth in unstructured data being created by connected machines, devices and systems is fueling data processing and data analytics. Complementing artificial intelligence technologies are replete with applications for big data. The size of the digital world and Internet of Things (IoT) is accelerating the migration of data and applications to a cloud computing environment. Data centers and cloud-based storage will likely capture incremental data created.	Several demographic transitions serve as important arbiters of future growth. With elongated life expectancies globally, longevity for older populations will likely mean a renewed focus on healthcare, aged-care, financial, and consumer products and services for longer, serving as a multitrillion-dollar potential opportunity. Both the Millennials (born 1981-1996) and Gen Z (born 1997-2012) could have greater influence over the next decade on consumer spending and preferences. While we are neutral the EM asset class on a tactical basis, we believe the EM consumer represents a powerful middle-class consuming cohort over the longer term. Uplifting the bottom billions, or poorest socioeconomic group with growing access to electricity, internet and sanitation can also offer a demographic dividend for multinational companies.	With emphasis from the White House, a much greater focus is on health, renewable energy, clean water and sanitation, and other industries that tend to support a more sustainable future. Companies that embrace more climate-friendly business models and operations, as well as consumer products and services, are likely to enjoy sustained growth opportunities over the long term. Globally, nuclear energy is re-emerging and increasingly acknowledged as a 'green' energy solution. Other key investment opportunities: Renewable energy (solar, wind and hydrogen), as well as energy-efficiency such as building systems, water/waste management, and energy storage and distribution.
Future Mobility	**Security**	**Post-crisis World**
The future of mobility hinges on next-gen infrastructure. This includes the telecom industry's deployment of the 5G network, which is expected to prove to be the greatest accelerant and enabler to smart cities (smart buildings, safety and security), autonomous vehicles and unmanned drones. The growing electric vehicle market will likely demand installation of charging equipment and fuel peripheral industries such as battery material demand.	Expanding the IoT means security for a growing ecosystem of devices and end points. With the increase in time spent on online platforms, (as well as adoption of online payments/FinTech), data privacy/surveillance and governance is expected to play a larger role in a post-pandemic world, as will bolstering cybersecurity defenses and budgets. With the commercialization of space, cybersecurity will likely extend to space-based assets (think satellites, data links, weather monitoring and GPS).	In the post-crisis world, reshoring policies are increasingly focused on building more resiliency into supply chains, helping to sculpt tripolar supply chains pivoting between North America, Asia and Europe. A number of labor force dynamics have converged to place unprecedented demand on labor not only in the U.S. but around the world, hastening the need for industrial and service automation/robotics. The extraction, sourcing, use and management of the world's resources will stay in focus as both the agriculture and commodity complexes are stretched given the geopolitical backdrop. If the future entails increased investments into electric vehicles and greener energies, then the future will be mineral- and material-intensive, calling for more mining of copper, lithium, nickel, manganese, cobalt and graphite, etc. Lastly, real assets in the post-crisis world are a key buffer to above-trend inflation.

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.

Broad dollar index is a measure of the value of the United States dollar relative to other world currencies.

Nasdaq Composite is a stock market index that includes almost all stocks listed on the Nasdaq stock exchange.

Global Manufacturing Purchasing Managers' Index (PMI) ex-U.S. is an index of the prevailing direction of economic trends in the manufacturing and service sectors.

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.

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.

JPMorgan Purchasing Managers' Index (PMI) consists of a diffusion index that summarizes whether market conditions, as viewed by purchasing managers, are expanding, staying the same, or contracting.

NCREIF NPI-Open End Diversified Core Equity (ODCE) Index is an index of investment returns reporting on both a historical and current basis the results of 38 open-end commingled funds pursuing a core investment strategy.

Important Disclosures

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

Bank of America, Merrill, their affiliates, and advisors do not provide legal, tax, or accounting advice. Clients should consult their legal and/or tax advisors before making any financial decisions.

This information should not be construed as investment advice and is subject to change. It is provided for informational purposes only and is not intended to be either a specific offer by Bank of America, Merrill or any affiliate to sell or provide, or a specific invitation for a consumer to apply for, any particular retail financial product or service that may be available.

The Chief Investment Office (CIO) provides thought leadership on wealth management, investment strategy and global markets; portfolio management solutions; due diligence; and solutions oversight and data analytics. CIO viewpoints are developed for Bank of America Private Bank, a division of Bank of America, N.A., ("Bank of America") and Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S" or "Merrill"), a registered broker-dealer, registered investment adviser and a wholly owned subsidiary of Bank of America Corporation ("BofA Corp.").

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

BofA Global Research is research produced by BofA Securities, Inc. ("BofAS") and/or one or more of its affiliates. BofAS is a registered broker-dealer, Member SIPC and wholly owned subsidiary of Bank of America Corporation.

All recommendations must be considered in the context of an individual investor's goals, time horizon, liquidity needs and risk tolerance. Not all recommendations will be in the best interest of all investors.

Asset allocation, diversification, rebalancing and dollar cost averaging do not ensure a profit or protect against loss in declining markets.

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

Dividend payments are not guaranteed, and are paid only when declared by an issuer's board of directors. The amount of a dividend payment, if any, can vary over time.

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

Alternative investments 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.