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CHIEF INVESTMENT OFFICE

Capital Market Outlook

July 1, 2024

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Macro Strategy—*European Equity Risks Increase, Caution Still Warranted:* Last month's European Union (EU) parliamentary elections have marked a turning point in relative performance between European and U.S. equity markets. European Equities had largely kept pace with the U.S. for much of 2024. But returns across the two regions have diverged in the wake of the EU vote and particularly in light of French President Macron's decision to call for a snap domestic election in the EU's second-largest economy.

Absent the catalysts for an improvement in valuation and with increased post-election uncertainty, we stay with our cautious positioning across international developed markets in Europe.

Market View—*Can U.S. Equities Take the Heat?:* The bull market rally barely broke a sweat in the first half of the year. Any signs of a market struggle were quickly wiped away, propelling the S&P 500 to new all-time highs. Heading into the second half of the year, summer is here along with a new heat wave. That means we can expect developments on the election, the economy and policy to really start to turn the temperature up (at least from a headline perspective). The question is how much heat can U.S. Equities take?

To explore this topic, we respond to three questions covering what happens to the market after a strong first half, how the health of the market rally is looking and how investors are reacting to a moderating economic backdrop.

Thought of the Week—*Zooming Out on the U.S. Consumer:* Credit card delinquency rates have risen, excess savings are running dry, and mentions of "trade down" among lower-income consumers littered Q1 2024 earnings season. Add to the list weaker retail sales data over recent months, and the question becomes: Is time running out for the U.S. consumer—and, thus, the broader economy?

Not quite. With household net worth reaching a record $160.8 trillion in Q1 2024, consumer balance sheets remain relatively healthy. Case in point: Household debt as a share of household net worth now hovers around lows not seen since the mid-1970s. Bolstered by an unemployment rate at or below 4% for two-and-a-half years straight, the U.S. consumer still appears to be in good shape. Whether the labor market continues to support healthy consumer activity will demand close watching in the second half of this year.

MACRO STRATEGY ▶

Ehiwario Efeyini
Director and Senior Investment Strategist

MARKET VIEW ▶

Kirsten Cabacungan
Vice President and Investment Strategist

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MARKETS IN REVIEW ▶

Data as of 7/1/2024, and subject to change

Portfolio Considerations

We maintain an overweight to Equities, with a preference for higher-quality U.S. Large- and Small-caps, and still favor a significant allocation to bonds in a diversified portfolio. We maintain our view of buying into Equity market weakness and maintaining exposure to Fixed Income for the purpose of cash flow and diversification benefits. Within Fixed Income, we maintain our preference for quality across the segments and curve while considering liquidity and a slight above benchmark weight in duration.

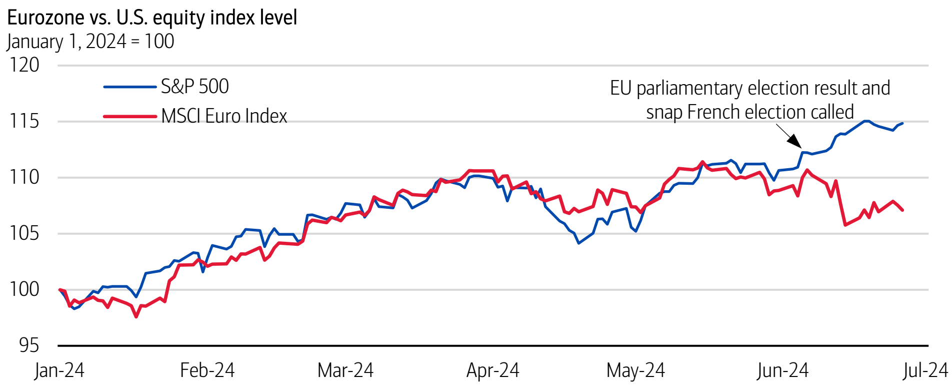
MACRO STRATEGY

European Equity Risks Increase, Caution Still Warranted

Ehiwario Efeyini, Director and Senior Investment Strategist

Last month's EU parliamentary elections have marked a turning point in relative performance between European and U.S. equity markets. European Equities had largely kept pace with the U.S. for much of 2024. But returns across the two regions have diverged in the wake of the EU vote (Exhibit 1), and particularly in light of French President Macron's decision to call for a snap domestic election in the EU's second-largest economy.

Exhibit 1: European Equity Markets Have Diverged From The U.S. Since Recent Parliamentary Elections.



Indexes shown in price terms (local). Sources: Chief Investment Office; Bloomberg. Data as of June 26, 2024. **Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Past performance is no guarantee of future results.**

In the end, mainstream centrist parties kept their majority in the European Parliament, retaining around 60% of the seats in the lower chamber. And, as a result, broad continuity in leadership at the EU-wide level is likely to be maintained over the next five-year term. But gains made by fringe parties from France and Germany in particular have undermined support for incumbents in Europe's two regional leaders, increasing domestic policy risks just at a time when economic activity across the continent appeared to be recovering from two consecutive quarters of flat-to-negative growth.

For France in particular, investors will get a clearer sense of policy direction later this week after the second round of voting takes place for control of the National Assembly. But the key risk is that a new government introduces any of a range of less market-friendly fiscal and regulatory policies including tax increases, a reversal of pension reforms to raise the retirement age, higher minimum wages and more generous wage indexation for civil servants. This would in turn make for higher business costs, less fiscal sustainability and higher interest rates, which would likely weigh further on local equity markets.

The outlook for fiscal sustainability in France had already deteriorated ahead of recent events, as reflected in the credit rating downgrade by Standard and Poor's from AA to AA- at the end of May. France's debt to GDP ratio currently stands as the third highest in the eurozone at 110% (as at the end of 2023), behind only Greece and Italy. And the French government failed to meet its 2023 deficit target on weaker than expected revenues last year. In this regard and given the increased risk of a more strained relationship with EU institutions (including on EU budget rules), it will be important to watch spreads on local sovereign debt for signs of rising investor risk aversion. So far, spread widening in France has been relatively modest, with limited spillover into other eurozone markets (Exhibit 2). But a worsening in credit conditions would only further increase the risk premium for European Equities.

Investment Implications

Recent parliamentary elections in Europe and coming national elections in France have created a riskier backdrop for European equity markets. Concerns over fiscal policy, regulatory policy and higher credit risk and their effect on interest rates and economic growth could weigh on European markets in the second half of 2024, adding to persistent headwinds from slower nominal gross domestic product (GDP) and less market exposure to the Technology sector. Despite still attractive relative valuations, we therefore stay with our cautious positioning across international developed markets in Europe.

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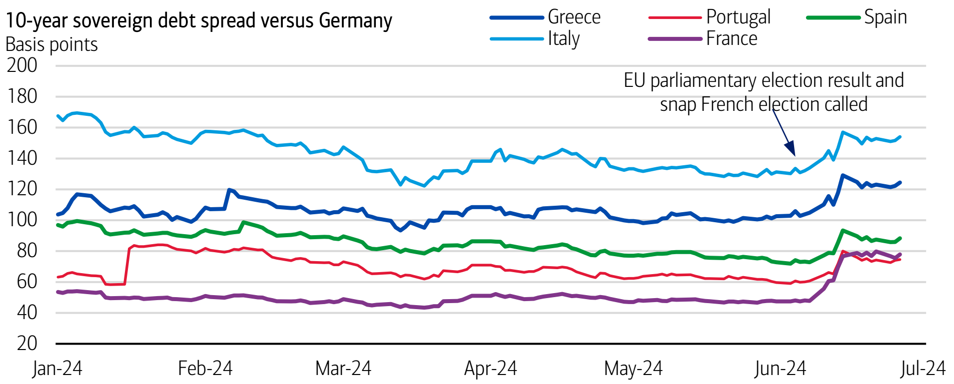
Exhibit 2: Credit Risk Has Risen In Europe Since Recent Parliamentary Elections.



Sources: Chief Investment Office; Bloomberg. Data as of June 26, 2024. **Past performance is no guarantee of future results.**

The risk of additional spillover to eurozone markets outside France largely stems from a weaker outlook for EU integration under a new French government. In particular, Europe's banking union remains incomplete in the absence of a common deposit insurance system, and its prospects would be further diminished with a more Eurosceptic French parliament. Banks have been major underperformers in Europe since the parliamentary vote and Macron's call for fresh elections in France and given the significant weighting of Financials in the MSCI Euro Index (19% as at the end of Q1 2024, compared to 13% for the S&P 500), European Equities would be particularly vulnerable to further weakness in the sector.

Recent political developments and their implications for fiscal and regulatory policy therefore have the potential to influence the direction of equity markets through their effect on interest rates and investor risk appetite, but also through economic growth. After contracting in the second half of last year, GDP in the eurozone recovered in the first quarter of 2024, posting positive annualized growth of 1.2%. And at the same time, region-wide inflation has fallen sufficiently to allow the European Central Bank (ECB) to trim its policy interest rate from 4.5% to 4.25%, with fed funds futures market expecting two more 25 basis-point rate cuts in 2024. But following the EU election result, the manufacturing and services Purchasing Managers' Indexes (a more timely gauge of economic activity) released in late June for both France and the eurozone showed renewed weakness with each falling back from the prior month. By deterring both domestic and foreign investment, the increase in policy uncertainty could therefore also contribute to a growth relapse and additional market pressures in the second half of 2024. And separately in the U.K., the general election set to take place later this week may have similar implications, if for different reasons. The U.K. equity market has also diverged from the U.S. market over recent weeks, but investor concerns here are largely focused on the prospect of higher taxes under an incoming Labor government.

European Equities have trailed behind the U.S. in 11 of the past 14 years since the 2008/2009 financial crisis[1] (and led by no more than a few percentage points in the other three). And though market valuations for both the eurozone and U.K. appear more attractive than for the U.S. on a relative basis, they remain broadly in line with their own long-term averages across price-to-earnings and price-to-book ratios. Structural weaknesses for European markets from slower nominal GDP growth and less exposure to artificial intelligence-driven expansion in the Technology sector (which accounted for 14% and 1% of the MSCI Euro Index and MSCI UK Index, respectively, as at the end of Q1 2024, compared to 30% for the S&P 500) also remain persistent headwinds. Meanwhile the likelihood of earlier and more aggressive interest rate cuts from the ECB and Bank of England than from the Federal Reserve (Fed) should exert downward pressure on local exchange rates and common currency returns. Absent the catalysts for an improvement in valuation and with increased post-election uncertainty, we therefore stay with our cautious positioning across international developed markets in Europe.

[1] S&P 500 Index and MSCI Europe Index.

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MARKET VIEW

Can U.S. Equities Take the Heat?

Kirsten Cabacungan, Vice President and Investment Strategist

If the recent heat wave was not enough of a sign, summer is here in full force, and it is ushering in the start of the second half of the year. That means we can expect developments on the election, the economy and policy to really start to turn up the temperature (at least from a headlines perspective). Can the rally in U.S. Equities sustain the heat? Three questions below to explore the second-half set up:

Investment Implications

We remain constructive on the outlook for Equities but remain cautious about some choppiness that could move the trend more sideways before a definitive push higher. We would be buyers on weakness in Equities and continue to emphasize a diversified approach to portfolio construction.

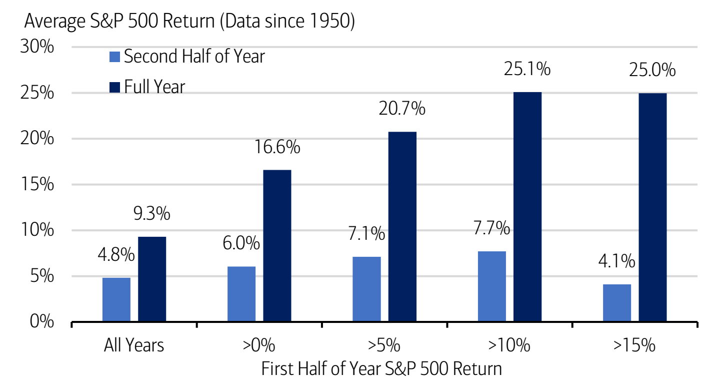
After a strong first half, are most of the market's gains this year already logged? The S&P 500 rose 3.9% in the second quarter, bringing the index to 14.5% for the year.[2] The story behind the moves was more of the same: moderating but better-than-expected economic activity, cooling inflation, a solid labor market underpinning the consumer, and generative artificial intelligence (GAI) enthusiasm. The strong start bodes well for the remaining six months. In fact, in years when the S&P 500 returned greater than 10% for the first half, the index was higher 82.6% of the time in the second half and up 7.7% on average (Exhibit 3A).

The improving earnings outlook should be a tailwind for Equites ahead. The S&P 500 reported 6.0% earnings growth in Q1 for a third consecutive positive quarter, confirming this profits cycle remains well into its recovery. Consensus analyst forecasts expect S&P 500 earnings to grow 10.9% and 9.7% this year and 2025, a major pick-up from just 1.0% growth in 2023.[3] As this fundamental story pulls through, it may also help ease some of the worries over lofty valuations given that the S&P 500 trading at 21.0x forward earnings remains well above its 16.5x long-term average.[1]

Volatility though could pick up. The maximum drawdown for the S&P 500 so far this year is only 5.5%. Since 1930, the S&P 500 typically sees three 5% pullbacks and at least one 10% correction a year.[4] Not to forget, election year seasonality also sets up the market for choppiness. The Chicago Board Options Exchange Volatility Index (VIX) has historically risen 25% on average from July to November during election years, but stocks tend to rally once election uncertainty fades in the last months of the year.[3] As such, the market direction in the second half could drift more sideways in the near term until the overall trend pushes higher as the fundamental story builds out and election volatility subsides. **We remain constructive on Equities and continue to emphasize a diversified approach ahead.**

Exhibit 3: The First Half In Perspective.

3A) A Strong First Half Could See Further Gains In The Second.



3B) Market Breadth Has Weakened.

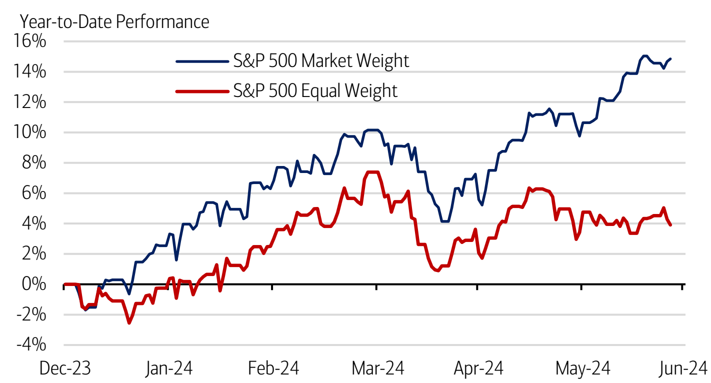


Exhibit 3A) Refers to data since 1950. Source: Bloomberg. Data as of June 26, 2024. Exhibit 3B) Source: Bloomberg. Data as of June 26, 2024. **Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Past performance is no guarantee of future results.**

[2] Bloomberg. Data as of June 28, 2024.

[3] FactSet. Data as of June 28, 2024.

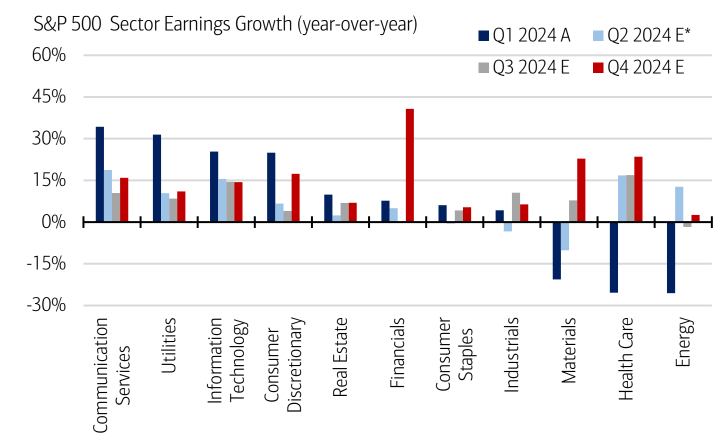
[4] BofA Global Research. March 2024.

What about the overall health below the surface of the rally? Despite the strong market returns, market breadth remains narrow and even weakened in recent weeks. The divergence between the market- and equal-weight S&P 500 indexes widened in Q2, with the market-weight index now outperforming by 10.2 percentage points year-to-date (YTD) (Exhibit 3B).[5] Indicators of market breadth had seen some improvement earlier this year. The S&P 500 at one point saw its first sustained period of more than 80% of its constituents above their 200-day moving averages since May 2021.[4] The index also recorded its highest number of members at new 52-week highs since May 2021 as well.

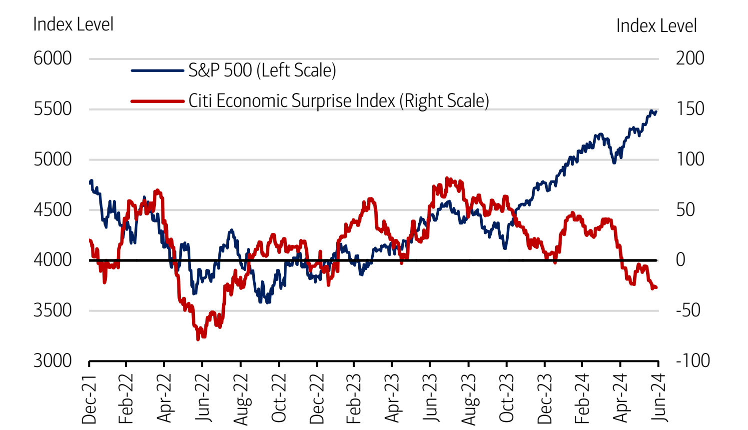
The recent reversal of the market's broadening attempt therefore sparked renewed concerns over market concentration. Strong gains in only a handful of mega-cap GAI-related stocks since last year have not only propelled the S&P 500 but also their weight in the index. The top five holdings in the S&P 500 now make up 26.8% of the index, the highest level going back at least three decades.[4] That said, the positive earnings outlook that suggests earnings growth could broaden out beyond current market leaders could be the tailwind needed for leadership to expand. All 11 of the S&P 500's sectors are expected to see positive earnings growth by Q4, notably with sectors like Materials and Healthcare that reported significant earnings contractions in Q1 returning to strong growth (Exhibit 4A). **We would be buyers on weakness given our view that earnings have a solid base to support further broadening in the market.**

Exhibit 4: Where The Trends Are Moving.

4A) Earnings Growth Is Expected To Broaden Out.



4B) Stocks Higher On Economic Surprises Trending Lower.



A=Actual; E=Estimates. Exhibit 4A) *Blended estimates. Source: FactSet. Data as of June 26, 2024. Exhibit 4B) Source: Bloomberg. Data as of June 26, 2024. **Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Past performance is no guarantee of future results.**

Could bad news turn bad again for markets? U.S. Equities have been in a patten of "bad news" is "good news," or a dynamic where investors react positively to negative economic surprises (Exhibit 4B). The logic is that moderating economic activity would be viewed positively by the Fed. It boosts expectations that the Fed will be successful in bringing inflation back down to its target which in turn would support greater conviction by the central bank to start to cut interest rates.

Inflation continues to gradually move lower but remains above the Fed's 2% target, which suggests further softness in economic data may continue to be a positive market dynamic. That trend could quickly flip if economic data, especially the labor market, deteriorates materially to suggest a major economic slowdown ahead, though not our base case. An environment where the market hangs on to each data release can create a lot of short-term volatility. **In the noise, we would suggest maintaining a disciplined investment process and remaining anchored to your long-term strategic asset allocation.**

[5] Bloomberg. Data as of June 28, 2024.

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THOUGHT OF THE WEEK

Zooming Out on the U.S. Consumer

Ariana Chiu, Wealth Management Analyst

As goes the U.S. consumer, so goes the U.S. economy. Now, with credit card delinquency rates rising, remnant excess savings from the pandemic running dry,[6] and lower-income consumers "trading down" according to America's largest retailers, investors are left wondering: Is time running out for the U.S. consumer—and, thus, the broader economy?

Not quite. While inflation continues to challenge consumers, driving sentiment lower over recent months, a quick "zoom out" in Exhibit 5A points to a better-than-reported backdrop. Yes, household debt is elevated compared to pre-pandemic levels. Credit card debt, for example, has risen some 20% since Q4 2019.[7] Yet over the same period, the U.S. economy expanded by 29%, consumption by 31%, and household net worth by nearly 40% to a record $160.8 trillion in Q1 2024. Still more impressive, as Exhibit 5B shows, household debt as a share of household net worth is hovering around lows not seen since the mid-1970s—and stands at almost half of the ratio's peak during the 2008/2009 Great Financial Crisis.

In other words, consumer balance sheets appear relatively healthy. Key supports include still-strong wage growth and an unemployment rate at or below 4% for two-and-a-half years straight—the longest such streak since the late 1960s.[8] This is not to mention $4.7 trillion added to household assets from equity holdings and real estate in Q1 2024 alone.[9] With the S&P 500 up 15% YTD and 60% of mortgage holders having locked in sub4% rates,[10] the U.S. wealth creation machine is alive and well.

Looking ahead, deeper deterioration in the labor market or a reacceleration in inflation would be cause for concern. For now, though, the collective endurance of the U.S. consumer remains supportive of corporate earnings and U.S. economic growth.

Portfolio Considerations

Driving nearly 70% of GDP, consumption plays a major role in the health of the U.S. economy. While recent months have highlighted mixed economic data and weakness in the lower-income consumer cohort, we believe that outsized gains in household net worth and continued labor market resiliency provide a still-healthy backdrop for the U.S. consumer.

Exhibit 5: Consumer Balance Sheets Remain Healthy.

5A) Consumer Debt in Context.

	Q4 2019	Q1 2024	% Change
Household Debt*	$16.2 Trillion	$20.1 Trillion	24%
Credit Card Debt	$927 Billion	$1.1 Trillion	20%
Household Net Worth	$116.9 Trillion	$160.8 Trillion	38%
U.S. GDP	$21.9 Trillion	$28.3 Trillion	29%
Consumption	$14.7 Trillion	$19.1 Trillion	31%

5B) Household Debt as a Share of Household Net Worth.

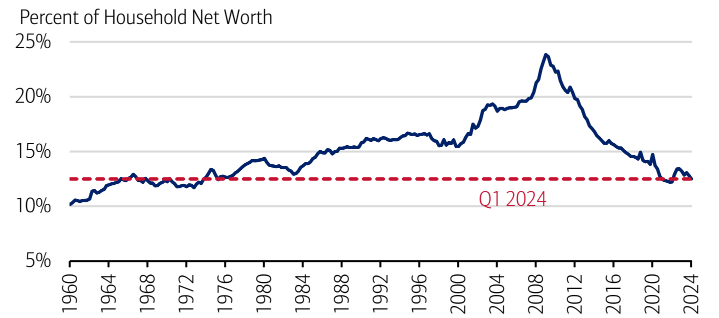


Exhibit 5A) *Household liabilities per the Federal Reserve's Financial Accounts of the U.S. Sources: Bureau of Economic Analysis; Federal Reserve; Federal Reserve Bank of New York. Data as of July 1, 2024. Exhibit 5B) Source: Federal Reserve. Data as of June 20, 2024.

6 "Pandemic Savings Are Gone: What's Next for U.S. Consumers?" Federal Reserve Bank of San Francisco, May 2024.
7 Q1 2024 Quarterly Report on Household Debt and Credit, Federal Reserve Bank of New York, May 2024.
8 Bloomberg. Data as of June 20, 2024.
9 Refers to direct and indirect holdings of corporate equity. Federal Reserve. Data as of June 7, 2024.
10 Redfin. Data through Q3 2023, as of June 2024. Latest data available.

MARKETS IN REVIEW

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	39,118.86	-0.1	1.2	4.8
NASDAQ	17,732.60	0.3	6.0	18.6
S&P 500	5,460.48	-0.1	3.6	15.3
S&P 400 Mid Cap	2,930.09	0.0	-1.6	6.2
Russell 2000	2,047.69	1.3	-0.9	1.7
MSCI World	3,511.78	0.1	2.0	11.7
MSCI EAFE	2,314.63	0.4	-1.6	5.3
MSCI Emerging Markets	1,086.25	0.1	3.9	7.5

Fixed Income[†]

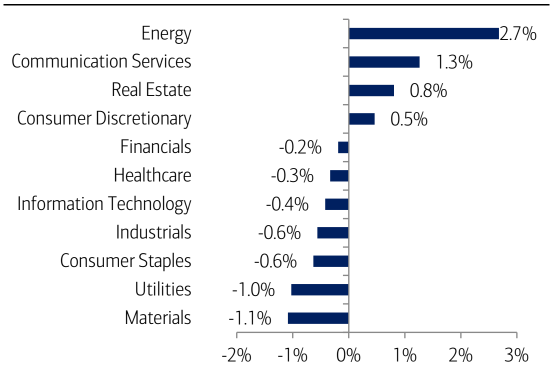
	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	4.91	-0.57	0.87	-0.68
Agencies	4.95	-0.13	0.77	0.83
Municipals	3.72	-0.22	1.53	-0.40
U.S. Investment Grade Credit	5.00	-0.65	0.95	-0.71
International	5.48	-0.65	0.64	-0.49
High Yield	7.91	0.04	0.94	2.58
90 Day Yield	5.35	5.36	5.40	5.33
2 Year Yield	4.75	4.73	4.87	4.25
10 Year Yield	4.40	4.26	4.50	3.88
30 Year Yield	4.56	4.40	4.65	4.03

Commodities & Currencies

	Total Return in USD (%)			
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	238.08	-0.6	-1.5	5.1
WTI Crude $/Barrel[††]	81.54	1.0	5.9	13.8
Gold Spot $/Ounce[††]	2326.75	0.2	0.0	12.8

		Total Return in USD (%)		
Currencies	Current	Prior Week End	Prior Month End	2022 Year End
EUR/USD	1.07	1.07	1.08	1.10
USD/JPY	160.88	159.80	157.31	141.04
USD/CNH	7.30	7.29	7.26	7.13

S&P Sector Returns



Sources: Bloomberg; Factset. Total Returns from the period of 6/24/2024 to 6/28/2024. [†]Bloomberg Barclays Indices. [††]Spot price returns. All data as of the 6/28/2024 close. Data would differ if a different time period was displayed. Short-term performance shown to illustrate more recent trend. **Past performance is no guarantee of future results.**

Economic Forecasts (as of 6/28/2024)

	2024E	Q1 2024A	Q2 2024E	Q3 2024E	Q4 2024E	2025E
Real global GDP (% y/y annualized)	3.2	-	-	-	-	3.3
Real U.S. GDP (% q/q annualized)	2.6	1.4	2.0	2.5	2.0	2.1
CPI inflation (% y/y)	3.1	3.2	3.3	3.0	2.8	2.2
Core CPI inflation (% y/y)	3.5	3.8	3.5	3.4	3.3	2.7
Unemployment rate (%)	3.9	3.8	3.9	4.0	4.0	4.1
Fed funds rate, end period (%)	5.13	5.33	5.33	5.38	5.13	4.13

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

A = Actual. E/* = Estimate.

Sources: BofA Global Research; GWIM ISC as of June 28, 2024.

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

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

CIO Equity Sector Views

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

*Many products that pursue Alternative Investment strategies, specifically Private Equity and Hedge Funds, are available only to qualified investors. CIO asset class views are relative to the CIO Strategic Asset Allocation (SAA) of a multi-asset portfolio. Source: Chief Investment Office as of June 4, 2024. All sector and asset allocation recommendations must be considered in the context of an individual investor's goals, time horizon, liquidity needs and risk tolerance. Not all recommendations will be in the best interest of all investors.

Index Definitions

Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Indexes are all based in U.S. dollars.

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

S&P Price Return Index measures the value of the stocks of the 500 largest corporations by market capitalization listed on the New York Stock Exchange or Nasdaq. A price return index only considers price movements (capital gains or losses) of the securities that make up the index, while a total return index includes dividends, interest, rights offerings and other distributions realized over a given period of time.

MSCI Euro Price Return Index captures large and mid cap securities exhibiting overall value style characteristics across the 15 Developed. A price return index only considers price movements (capital gains or losses) of the securities that make up the index, while a total return index includes dividends, interest, rights offerings and other distributions realized over a given period of time.

MSCI Europe index is an equity index which tracks the return of stocks from European developed markets. With its 420 constituents (as of 31/05/2024), the MSCI Europe index covers approximately 85% of the free float-adjusted market capitalization of the European developed markets.

Manufacturing Purchasing Managers' Indexes is a measure of the prevailing direction of economic trends in manufacturing.

Services Purchasing Managers' Index gauges activity level in industries with a less tangible product, such as financial services, health care, and hospitality.

MSCI UK Index is designed to measure the performance of the large and mid cap segments of the UK market.

Volatility index is a popular measure of the stock market's expectation of volatility based on S&P 500 index options.

S&P 500 Market Weight Index measures the performance of the same 500 companies, in equal weights.

S&P 500 Equal Weighted Index is the equal-weight version of the widely-used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance.

Citi Economic Surprise Index represents the sum of the difference between official economic results and forecasts.

S&P 500 sub-sectors and industry groups refer to Global Industry Classification Standard (GICS®)/S&P 500 Total Return Index, including Information Technology Total Return TR USD; Consumer Discretionary TR USD; Industrials TR USD; Real Estate TR USD; Communication Services TR USD; Materials TR USD; Financials TR USD; Consumer Staples TR USD; Utilities TR USD; Energy TR USD; Healthcare TR USD.

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