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CHIEF INVESTMENT OFFICE

Capital Market Outlook

July 10, 2023

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

IN THIS ISSUE

Macro Strategy—*Message in the Yield Curve:* Over the past month, the front of the yield curve has steepened as the market prices in more Federal Reserve (Fed) tightening and a longer period of higher interest rates.

This is likely to keep the yield curve inverted for longer, putting more strains on the economy and raising the odds of a "hard landing" as inflation proves more intractable than the market realizes.

Market View—*2023: A Midyear Market Assessment:* With the midpoint of 2023 now behind us, we review what has been a strong start to the year for global Equity markets and identify some of the key trends that could determine market direction going into the second half.

As we move into Q3 and further into the second half of 2023, at least five forces could dictate the relative prospects across global markets—a potential U.S. recession, additional stimulus in China, higher inflation in Europe, a monetary policy shift in Japan and a price breakout for the U.S. dollar.

Thought of the Week—*Who's Hiring?:* Small and medium-sized businesses in leisure and hospitality industries drove job gains in the first half of the year, according to the latest ADP private sector jobs report. Construction hiring has also been very strong, as new home construction has a tailwind from a lack of existing homes for sale. On the other hand, larger firms and information and financial services industries have been shedding workers.

We continue to expect job growth to slow in the back half of the year as a deteriorating profits cycle forces firms to take more aggressive cost-cutting measures to support margins. For now, though, still firm jobs data likely keeps the Fed concerned about wage growth reinforcing inflation that is still well above its 2% target.

MACRO STRATEGY ▶

CIO Macro Strategy Team

MARKET VIEW ▶

Ehiwario Efeyini
Director and Senior Market Strategy Analyst

THOUGHT OF THE WEEK ▶

Jonathan W. Kozy
Managing Director and Senior Macro Strategy Analyst

MARKETS IN REVIEW ▶

Data as of 7/10/2023, and subject to change

Portfolio Considerations

We are in the realistic camp that emphasizes on diversification, balance, an understanding that a mixed environment can be confusing at times, and a focus on higher-quality investments makes the most sense. We remain neutral Equities and Fixed Income relative to our strategic benchmarks. Opportunities to add to Equities for long-term exposure should present themselves given the prospects for a liquidity drain in the coming few months. At this point, we would emphasize a solid mix of both Growth and Value investments, Small- and Large-capitalization stocks, and in Fixed Income, a mix of higher-grade bonds across multiple sectors.

MACRO STRATEGY

Message in the Yield Curve

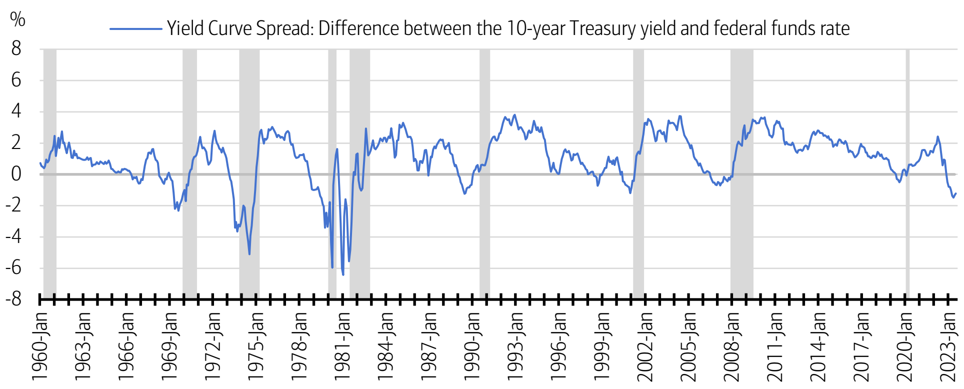
CIO Macro Strategy Team

The Fed decision to skip another rate hike at its June 14, 2023, rate-setting meeting was partially motivated by the desire to see how the "long and variable" lags of monetary policy play out in the months ahead. With 500 basis points (bps) of rate hikes over the past year or so already in the pipeline, there is a lot of uncertainty about just how much restraint policy will exert on the economy in the year ahead.

One of the primary indicators of the degree of restraint or stance of monetary policy is the shape of the yield curve. This has made it an important leading indicator of where the economy is headed. When the yield curve is steepest, with longer-term interest rates (such as the 10-year Treasury yield) furthest above short-term money market yields (such as the 3-month Treasury bill or the fed funds rate), monetary policy is generally at its most stimulative point in the business cycle. Conversely, when short-term rates are the furthest above long-term rates, as currently is the case, monetary policy is generally at the most restrictive phase of the cycle.

As shown in Exhibit 1, over the past 60 years, the yield curve has inverted ahead of recessions and reached its steepest point coming out of recessions in the early stage of economic expansions. Over the middle phase of most cycles, the curve begins to flatten, as monetary stimulus is reduced until eventually a tight monetary policy phase causes short-term rates to rise above long-term rates, inverting the yield curve.

Exhibit 1: Hard To Ignore The Deep Inversion Of The Yield Curve This Year, As It Occurs Before Recessions.



Source: Federal Reserve Board/Haver Analytics. Data as of July 3, 2023.

As the curve started to invert last fall, the markets have naturally been on a recession watch. Earlier this year, there was an expectation that a recession would come quickly, and the Fed would reverse its tightening aggressively, causing rates to fall dramatically in the second half of this year. Now that the second half is here, and the economy and inflation have remained resilient, the outlook for interest rate policy has changed significantly, with expectations for the peak policy rate up by about a half of a percentage point, and the duration of peak policy rates expected to be much longer than previously thought. This change in the Fed policy outlook is reflected in the fact that the 2-year Treasury yield has risen about 50 bps over the past month, while rates at the very short end (3 months) and very long end (30 years) of the Treasury yield curve have barely budged. Also of significance, the real yields on Treasury Inflation-Protected Securities (TIPS) have risen more at shorter maturities, causing the real yield curve to invert more. This simply reflects the fact that the Fed has reached the point in the cycle where tight policy to squelch inflation is its primary objective.

"Recession watch" usually becomes the markets' focus when the yield curve inverts, and this time has been no different. Because the lags with which monetary policy affects the economy are long and variable, so are the lags between when the yield curve inverts and

Investment Implications

Tighter-for-longer monetary policy raises the risk that the 2023 stock market rally fizzles, making high-quality assets preferable for investors looking to help maintain portfolio gains to date.

when the economy goes into recession. This should not be surprising since the inflation problem that follows policy stimulus and economic expansions varies in every cycle.

Generally, the more excessive the economic stimulus, the bigger the inflation problem and the longer it takes for tighter policy to bring the economy back into a lower, more stable inflation environment. A longer, tighter policy period implies that the yield curve stays inverted for a longer period before the excessive stimulus is overcome and inflation settles down, typically following a recession. This is illustrated by the fact that the yield curve was inverted for an unusually long time before the early 1980s recessions as well as ahead of the 2008-2009 recession. It's also not a coincidence that those were the most severe recessions of the post-World War II (WWII) period. The imbalances and/or inflation generated ahead of those recessions required a longer, more aggressive period of monetary tightening before the inflation genie was back in the bottle.

These observations raise the possibility that the current "soft landing" or "mild recession" consensus is overly optimistic. The inflation problem created by excessive monetary and fiscal stimulus during and after the pandemic has been the greatest since WWII. Inflation rose the most and the fastest since the 1940s. While inflation is now receding, it's highly uncertain how much economic damage will result from the Fed's determined efforts to restrain the economy in order to achieve its 2% inflation target. Basically, the longer the yield curve stays inverted at the deepest levels in over 40 years, the more likely the economy will experience a "hard landing," if past yield curve experience is any indication.

An inverted yield curve implies that nominal gross domestic product (GDP) growth is going to slow down. So far, it has weakened from the high teens on a year-over-year basis at the peak in 2021 to mid-single digits by the end of 2022. Its slowdown stalled in the first half of 2023 because households enjoyed a large catch-up boost in personal income when the government cost-of-living increase was activated in January for Social Security recipients and many other pensioners. In addition, liquidity jumped when the debt-constrained Treasury flooded banks with about half the reserves lost as a result of Fed quantitative tightening (QT) in the second half of 2022.

As these temporary effects dissipate, the interruption in the nominal GDP slowdown is likely to end in the months ahead, as the liquidity drain resumes and as the Fed rate hikes continue to move through the economic pipeline. With inflation already falling, and real growth likely to fall back toward the zero pace that was prevailing before the first-half spurt, nominal GDP growth is likely to fall toward low single digits, or even less, in our view.

This implies that the earnings recession already under way is likely to worsen in the months ahead, as corporate revenue growth remains constrained by slowing nominal GDP growth, and margins remain under downward pressure, causing earnings to grow less than revenues. The pandemic stimulus pushed revenues and margins well above their underlying trends, likely making the current earnings recession bigger than normal as the economy eventually returns to its longer-term trend.

Mean reversion of macro variables, including profits, implies an unusually big decline from unusually high levels. As profits come under increasing pressure in a slowing economy, businesses are forced to scale back capital expenditures and hiring, a process that has barely begun because the tightening to date has only brought growth in nominal magnitudes down from multidecade highs to moderate levels that still look healthy by prepandemic standards. The next stage of the slowdown is likely to bite harder if the yield curve is any indication. What's more, the yield curve is likely to remain inverted until the Fed reverses course, which Fed Chair Powell has made clear is unlikely any time soon.

The markets' hope is that slowing nominal GDP growth will come mainly from inflation without much effect on real growth and employment. However, numerous companies are reporting revenue growth from price increases, while unit sales declined. The pressure for lower inflation is making their ability to raise prices to offset declining real sales more difficult, while labor costs catch up to past inflation, squeezing margins and incentivizing layoffs. This dynamic makes a "soft landing" increasingly unlikely the longer it goes on. Recent movements in interest rates, with the front of the yield curve from the overnight funds rate to the 2-year Treasury rate steepening, show the market is preparing for a longer period of monetary tightening over the year ahead, with diminishing hopes for Fed easing in 2023.

MARKET VIEW

2023: A Midyear Market Assessment

Ehiwario Efeyini, Director and Senior Market Strategy Analyst

Investment Implications

Equity valuations have deteriorated since the start of the year, but stronger growth continues to favor U.S. Equities and the fading of early-year supports for international markets still warrants a more cautious view on the rest of the world. Economic and policy developments in the U.S., China, Europe and Japan are likely to be the major determinants of market direction in the second half of 2023.

With the midpoint of 2023 now behind us, we review what has been a strong start to the year for global equity markets and identify some of the key forces that could determine market direction going into the second half. Equities came into this year on the heels of a historically deep selloff in 2022. Of all the pullbacks recorded outside of recessions, last year's 25% peak-to-trough decline for the S&P 500 between January and October was the fourth largest in post-WWII history, exceeded only by the bear markets of 1947, 1962 and 1987. The valuation drop in the equity market was nonetheless more than matched by that in Fixed Income given the sharp rise in interest rates. On an earnings yield basis, S&P 500 valuation improved by 175 bps—less than the 225 bps rise in the 10-year Treasury yield, reducing the gap between the two and implying a relative value deterioration for Equities. This year's double-digit advance for equity markets alongside stable bond yields has only narrowed the gap further (Exhibit 2).

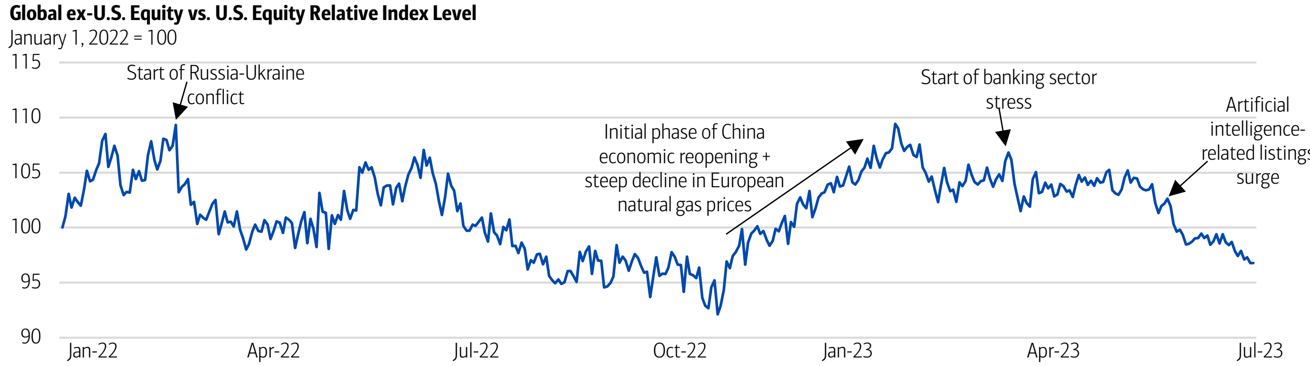
Exhibit 2: Relative Equity Valuations Have Deteriorated On Recent Price Gains And Higher Bond Yields.

Source: Bloomberg. Data as of June 2023. **Past performance is no guarantee of future results. Please refer to index definitions at the end of this report. It is not possible to invest directly in an index.**

But at same time, expectations for growth have been upgraded since the start of the year. U.S. economic activity has not fallen into recession as widely feared coming into 2023. S&P 500 corporate profits have flatlined but not slumped, with full-year consensus expectations remaining essentially flat. And bond yields appear unlikely to rise much further as the Fed approaches the end of its tightening cycle. Though valuations appear less favorable than a year ago, we therefore maintain a neutral position in global equity with a bias toward the U.S. market.

Despite a relatively strong start to the year for international markets, we also retain a preference for the U.S. over the rest of the world. The early-year investor optimism over non-U.S. 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 markets from late 2022. But their effect has since faded. Levels of consumption and service activity in China remain high but have decelerated over recent months, disappointing expectations. Relief in the consumer internet sector from the ending of the regulatory crackdown of recent years has been replaced by new curbs on access to Western technology in semiconductors and chipmaking equipment. And targeted support for local property developers to finance housing completions has failed to kickstart a recovery in housing demand, with residential floor space under construction down by close to 15% so far in 2023. Meanwhile 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 demand slowdown. Two key additional turning points this year have been the March banking sector stress and the May surge in artificial intelligence-related listings. Both have come as further relative setbacks for international markets given their higher exposure to financials and lower exposure to technology (Exhibit 3).

Exhibit 3: International Markets Have Retreated From Their Relative Peaks.



Sources: Chief Investment Office; Bloomberg. Data as of June 2023. Equity indexes are MSCI All-Country World ex-U.S. and MSCI U.S. Indexes shown in price terms (USD). **Past performance is no guarantee of future results. Please refer to index definitions at the end of this report. It is not possible to invest directly in an index.**

As we move into the second half of 2023, at least five trends should dictate the relative prospects for global markets over the remainder of the year:

1. A U.S. economic slowdown or mild recession driven by the lagged effects of monetary tightening remains a key risk for later this year and early 2024. Recession would likely cause a renewed downshift in projected earnings, increasing downside market risk from current levels. However, at present, key economic indicators such as initial unemployment claims and housing starts still point away from this outcome. Our internal recession indicator suggests only moderate recession risk based on the most recent input data on consumption, industrial output, housing and the labor market.

2. China could potentially unveil additional stimulus measures beginning this month, with meetings of the State Council and Politburo expected in mid- and late July. Recent actions have been confined to a small 10 bps cut in policy interest rates and an extension of tax breaks on electric vehicle purchases out to 2027. The Chinese authorities now see the housing sector remaining in structural decline and have stated their aim of pursuing "high-quality development." As a result, we would expect any additional stimulus measures to remain moderate, targeted and consumer-focused rather than construction-driven. This would not only limit the effect on Chinese equity markets but would also not provide the typical boost for global commodity prices that we have seen in past periods of policy support.

3. Eurozone headline inflation has almost halved to 5.5% from its 10.6% peak, but the European Central Bank (ECB) has made less progress on core inflation, which ticked higher in June. Markets firmly expect the ECB to raise rates later this month, with at least one more hike likely in September. Following its June policy decision, the ECB made major upward revisions of 0.5 percentage point to its core inflation estimates for both 2023 and 2024, largely on expectations for labor costs. And higher shipping prices for commodity deliveries due to drought conditions in Germany and lower river Rhine levels pose further upside inflation risk. A more hawkish turn from the central bank over the coming months could put additional relative pressure on European markets.

4. Japan is likely to begin normalizing its monetary policy in the second half of the year. The new central bank governor maintained a dovish stance at his first two meetings in April and June, but pressure to relax or abandon the yield curve control policy and allow 10-year government bond yields to rise beyond their current 0.5% upper limit is likely to increase. Ex-food inflation currently stands at 3.2% (well above the 2% Bank of Japan (BoJ) target threshold), fueled by a tight labor market, and the BoJ balance sheet already stands well in excess of 100% of GDP. An eventual shift in policy would likely make for higher rates and a stronger currency, which could hurt export-driven segments of the Japanese market.

5. The U.S. dollar remains 5% to 10% off its late-2022 peaks but has stayed rangebound this year above its long-term average. A hawkish shift in policy stances from the ECB and BoJ relative to the Fed could begin to put more downward pressure on the dollar in the second half of the year, which would likely come as a source of support for Emerging Markets (EM) as we saw in the latter part of 2022. But as in past cycles, an outright U.S. recession could potentially lift the dollar back toward its recent highs and contribute to further underperformance in EM Equities.

THOUGHT OF THE WEEK

Who's Hiring?

Jonathan W. Kozy, Managing Director and Senior Macro Strategy Analyst

Labor market data are top-of-mind for investors for two reasons. For one, the Fed has a dual mandate. A very tight labor market that reinforces strong wage growth makes it more difficult for it to achieve its 2% inflation goal. Second, the labor market is the transmission mechanism from already-below-trend economic growth into a full-fledged recession. Job losses tend to lead to weaker demand and, in this case, would reinforce a domestic profits cycle that is already contracting.

But the labor market has been resilient. The ADP National Employment report released last week showed private sector employers added 497,000 jobs in June even as headline jobs data showed some softening. In the ADP data, smaller businesses appear to be on a hiring binge, while larger companies cut jobs for the second straight month.

The goods sector showed job losses in manufacturing for the fourth consecutive month, while the construction sector posted the biggest month/month gain on record and very strong gains to date. Within services, information and financial services firms are cutting jobs, but leisure and hospitality firms have returned the level of employment back to pre-pandemic trend levels.

We see a weaker labor market emerging in the back half of the year. Rising layoffs—particularly in temporary help services workers—and declining job openings reported last week suggest the unemployment rate will move higher into year-end. While labor hoarding in the post-pandemic world, particularly in leisure and hospitality, is a unique dynamic, we think the historically significant slowdown in nominal economic growth (top-line growth) will drive a continuation of the profit's recession and will pressure firms to take more aggressive cost cutting initiatives, including labor.

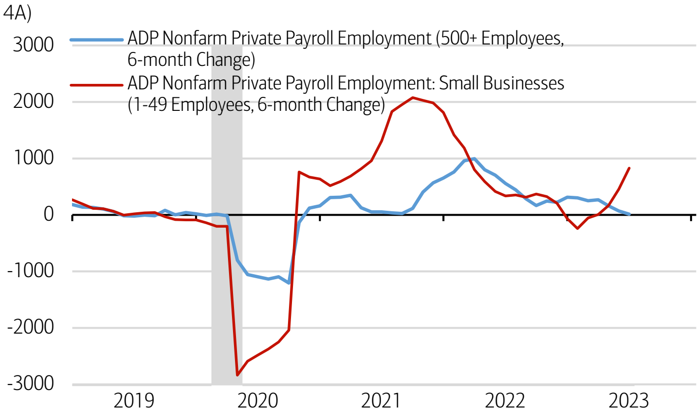
Essentially, U.S. firms in aggregate have been trading profits and productivity for jobs. We don't suspect that will last long.

Investment Implications

While the labor market has been resilient, we think the rapid slowdown in nominal economic growth (top-line growth) will pressure firms to take more aggressive cost-cutting initiatives in the second half. Job losses tend to lead to weaker demand and, in this case, would reinforce a domestic profits cycle that is already contracting. This is a headwind for Equity investors in the back half of the year.

Exhibit 4: Small- And Medium-Sized Firms And Leisure And Hospitality Firms Driving Year-to-Date Job Gains.

4A)



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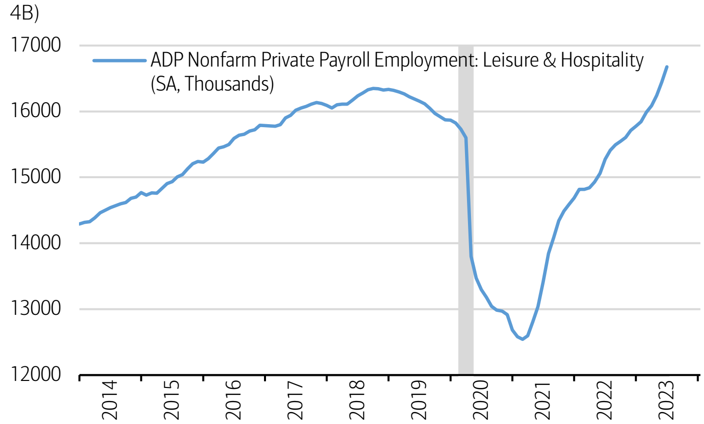


Sources: ADP Research Institute; Haver Analytics. Data as of July 6, 2023

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	33,734.88	-1.9	-1.9	2.9
NASDAQ	13,660.72	-0.9	-0.9	31.1
S&P 500	4,398.95	-1.1	-1.1	15.6
S&P 400 Mid Cap	2,603.24	-0.7	-0.7	8.1
Russell 2000	1,864.66	-1.3	-1.3	6.7
MSCI World	2,924.19	-1.4	-1.4	13.5
MSCI EAFE	2,087.72	-2.0	-2.0	9.4
MSCI Emerging Markets	980.66	-0.6	-0.6	4.2

Fixed Income†

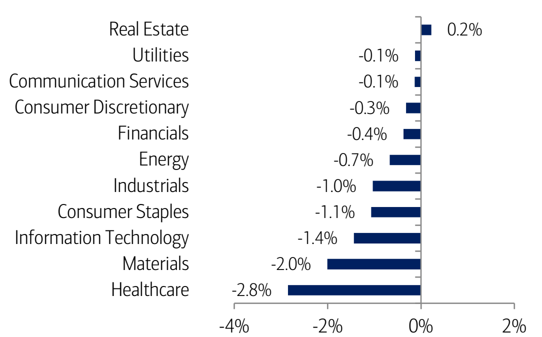
	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	4.97	-1.26	-1.26	0.92
Agencies	5.04	-0.47	-0.47	1.17
Municipals	3.58	-0.32	-0.32	2.34
U.S. Investment Grade Credit	5.00	-1.29	-1.29	0.77
International	5.67	-1.43	-1.43	1.74
High Yield	8.72	-0.60	-0.60	4.74
90 Day Yield	5.34	5.28	5.28	4.34
2 Year Yield	4.95	4.90	4.90	4.43
10 Year Yield	4.06	3.84	3.84	3.87
30 Year Yield	4.05	3.86	3.86	3.96

Commodities & Currencies

	Total Return in USD (%)			
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	227.94	0.5	0.5	-7.3
WTI Crude $/Barrel††	73.86	4.6	4.6	-8.0
Gold Spot $/Ounce††	1,925.05	0.3	0.3	5.5

		Total Return in USD (%)		
Currencies	Current	Prior Week End	Prior Month End	2022 Year End
EUR/USD	1.10	1.09	1.09	1.07
USD/JPY	142.21	144.31	144.31	131.12
USD/CNH	7.23	7.27	7.27	6.92

S&P Sector Returns



Sources: Bloomberg; Factset. Total Returns from the period of 6/30/2023 to 7/7/2023. †Bloomberg Barclays Indices. ††Spot price returns. All data as of the 7/7/2023 close. Data would differ if a different time period was displayed. Short-term performance shown to illustrate more recent trend. **Past performance is no guarantee of future results.**

Economic Forecasts (as of 7/7/2023)

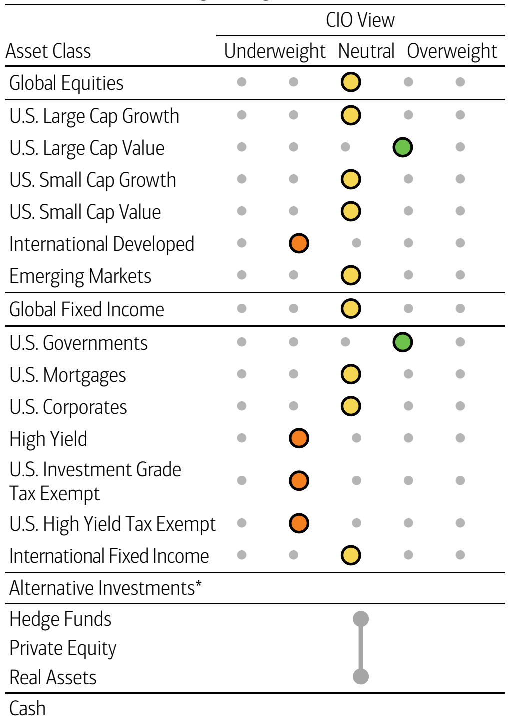
	2022A	Q1 2023A	Q2 2023E	Q3 2023E	Q4 2023E	2023E
Real global GDP (% y/y annualized)	3.6*	-	-	-	-	3.0
Real U.S. GDP (% q/q annualized)	2.1	2.0	1.5	1.0	0.5	1.8
CPI inflation (% y/y)	8.0	5.8	4.1	3.3	2.9	4.0
Core CPI inflation (% y/y)	6.1	5.6	5.3	4.6	4.0	4.8
Unemployment rate (%)	3.6	3.5	3.6	3.7	3.9	3.7
Fed funds rate, end period (%)	4.33	4.83	5.13	5.63	5.63	5.63

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

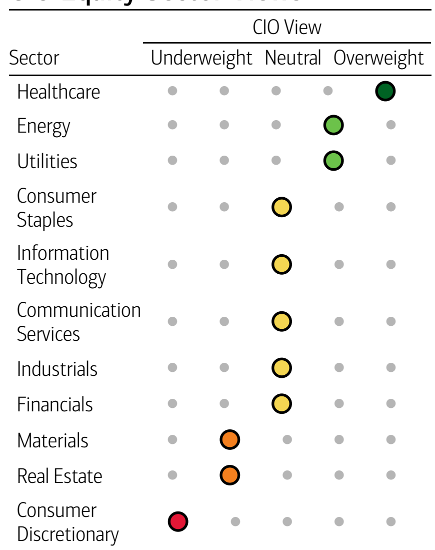
A = Actual. E/* = Estimate.

Sources: BofA Global Research; GWIM ISC as of July 7, 2023.

Asset Class Weightings (as of 6/1/2023)



CIO Equity Sector Views



*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 1, 2023. 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 stock market index tracking the stock performance of 500 of the largest companies listed on stock exchanges in the United States.

MSCI All Country World Index (ACWI) Index ex-US is a stock market index comprising of non-U.S. stocks from 22 developed markets and 24 emerging markets.

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

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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. Stocks of small-cap companies pose special risks, including possible illiquidity and greater price volatility than stocks 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. 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. 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. 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.