BANK OF AMERICA

CHIEF INVESTMENT OFFICE

# Viewpoint

## Fizzle to Sizzle

January 2025

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

### IN BRIEF

- As we look ahead, we believe the recent “fizzle” environment in Equities, turns to “sizzle” as investors turn their focus back toward corporate fundamentals. We expect Q4 corporate profits to outperform, productivity to surprise upward, the job market to remain healthy and stable, and some relief on the inflation front believe it or not.
- Investors should consider a more diversified approach to Equities in the coming year as the more highly valued areas share some of the spotlight with the rest of the market in 2025.
- This month, the GWIM ISC adjusted our U.S. Equity sector views, with a downgrade of Healthcare to neutral from slight overweight, and in turn we reduce the magnitude of our underweight to Consumer Staples with an upgrade to slight underweight.
- Within Fixed Income, our highest conviction call remains that the yield curve will normalize by short rates moving lower, and investors should therefore consider moving out investable cash into their strategic duration target as cash yields are likely to decrease from here, and the backup in yields may be an opportunity.

The final month of the 2024 year produced a market environment in which the median S&P 500 stocks fell about 6.5%. The momentum in the mega-capitalization, high growth Equities fizzled as investors used the final weeks to take profits and rebalance portfolios (S&P 500 fell 2.5% in December). The rebalancing of portfolios was led by institutional investors that have diversified mandates across asset classes and specifically, within Equities as the top echelon of mega names produced a majority of the 23% gain for the S&P 500 in 2024. This was the second straight year of over 20% gains for the index as U.S. bonds were flat-to-slightly positive around 1%. On an overall basis, U.S. bonds are now down approximately 2% over a five-year period, which is one of the worst five-year periods for the asset class.

On a global basis, the MSCI All-Country World Index rose almost 16% in 2024, once again led by the U.S. (S&P 500 up 23%), while Europe (Euro Stoxx 600 down almost 1%) detracted from performance. Within the U.S., the sectors that outperformed were Communication Services (up 39%), Information Technology (up 36%), Consumer Discretionary (up 29%) and Financials (up 28%). In terms of U.S. size and style, Large-cap Growth led the way again with over a 33% gain while Small-cap Value was the worst performer with about a 6% rise.

As we indicated in our Year Ahead report from mid-December, we expected a loss of momentum to begin 2025 given the outsized gains in Equities the past two years, portfolio rebalancing, premium valuations, the backup in yields, concerns over debt and deficits, and the hyper focus on Federal Reserve (Fed) policy. However, we believe this “fizzle” environment

### CIO ASSET CLASS VIEWS

This month, the Global Wealth & Investment Management Investment Strategy Committee (GWIM ISC) adjusted our US Equity sector views, with a downgrade of Healthcare to neutral from slight overweight, and in turn we reduce the magnitude of our underweight to Consumer Staples with an upgrade to slight underweight. In a well-diversified portfolio, we maintain an overweight to Equities with a preference for U.S. Equities, both Large- and Small-caps, relative to the rest of the world, while still favoring a significant allocation to bonds.

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| | 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 Strategies | | | ● | | |
| Private Equity & Credit | | | ● | | |
| Private Real Estate | | | ● | | |
| Tangible Assets | | | ● | | |
| Cash | | | | | |

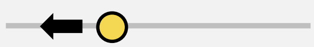
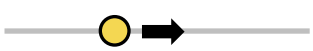
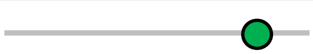
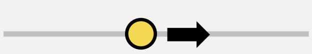
*Many products that pursue Alternative Investment strategies, specifically Private Equity and Hedge Funds, are available only to qualified investors.
CIO asset class views are relative to the CIO Strategic Asset Allocation (SAA) of a multi-asset portfolio.

turns to “sizzle” as investors turn their focus back toward corporate fundamentals. We expect Q4 corporate profits to outperform, productivity to surprise upward, the job market to remain healthy and stable, and some relief on the inflation front, believe it or not. We need to remain aware of the elevated geopolitical risks and keep a watchful eye on longer dated bond yields. But we believe, on balance, the surplus of sidelined cash could be repositioned back into the market in the middle of Q1. In our view, the bull market is only in mid-cycle in terms of timeframe, which can last through the balance of the decade. Investors should consider a more diversified approach to Equities in the coming year, as the more highly valued areas share some of the spotlight with the rest of the market in 2025.

## CIO INVESTMENT DASHBOARD AS OF JANUARY 7, 2025

Entering 2025, Equities remain well supported by elements like earnings expansion, a relatively solid economic backdrop and easier monetary policy. However, we continue to see crosscurrents in the market landscape moving forward. Long-term investors should consider using any episodic market volatility to their advantage and remain fully invested and diversified across portfolios.

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

| Factor | Implication for Equities<br>Negative Neutral Positive | CIO View |
|---|---|---|
| **Earnings** |  | U.S. earnings growth remains strong and is growing on a year-over-year (YoY) basis. According to FactSet, consensus expects S&P 500 growth in revenue and earnings of 5.1% and 9.4% in 2024, respectively, followed by an acceleration to 5.7% and 14.6% this year. Accordingly, in Q4 2024, revenue and profits are expected to expand YoY by 4.5% and 11.6%, followed by a faster pace of 5.1% and 11.9% in Q1 2025. Meanwhile, according to BofA Global Research, in December, the Global Earnings Revision Ratio showed improvement from the prior months. The three-month average of the ratio remains below its long-term average. The number of upgrades to profit estimates surpasses downgrades in 3 of 20 countries and in 4 of 16 tracked industries. |
| **Valuations** |  | The S&P 500 price-to-earnings (P/E) ratio (next 12 months) stands at around 21.6x above its long-term average. This headline measure suggests that Large-cap U.S. Equities in general remain expensive, although relative discounts can be found in areas like Small-cap and Value. |
| **U.S. Macro** |  | Following an expansion of 2.9% last year, growth in real gross domestic product (GDP) through Q3 of 2024 has slightly cooled to an average of 2.6% at a seasonally adjusted annual growth rate. Excluding volatile measures in trade and inventories, final sales to domestic purchasers have averaged a solid 3.1% over the same timeframe, from an annual expansion of 2.7% last year. Consistently strong data has raised expectations of a quicker pace of normalized economic growth. BofA Global Research expects GDP growth of 2.0% for Q4 and 2.7% for all of 2024. For 2025, an annual growth rate of 2.4% is anticipated. |
| **Global Growth** |  | Excluding the U.S., pockets of weakness have become more apparent in the global economy. In the Eurozone, marginal cooling of the services sector, together with manufacturing weakness, has raised some economic uncertainty. In China, new policies have been announced to support the property market, consumption, local government finances and investor sentiment. Recent mixed economic data suggests some stabilizing elements. Meanwhile in the U.S., consumption in general has remained a sturdy economic support. After growth of 3.3% in 2023, the global economy is expected to grow by 3.1% in 2024, followed by an expansion of 3.2% in 2025 and 3.3% in 2026, according to BofA Global Research. This compares to average growth of 3.8% from 2000 to 2019, according to the International Monetary Fund. |
| **U.S. Monetary Policy / Inflation** |  | After a quarter-point cut in December, the Fed’s policy interest rate stands at 4.25% to 4.50%. Overall, Fed officials have argued for easing monetary policy while also stressing a cautious approach amid a bumpier downward path in inflation, economic resilience and uncertainty related to fiscal and trade policies. Over the past few months, markets have anticipated a lessened pace of interest rate cuts. BofA Global Research expects two 25 basis points (bps) cuts this year, one in March and another in June, before holding at an expected terminal rate of 3.75% to 4.00% through year-end. |
| **Fiscal Policy** |  | U.S. pandemic-era fiscal support totaled nearly 31% of GDP, much of which has faded. Longer-term initiatives include the 2022 CHIPS and Science Act, a $280 billion plan to bolster the country’s technological industrial base, and the 2022 Inflation Reduction Act (IRA), a $370 billion effort largely to develop a renewable energy supply chain, among other elements. On December 21, a bill was passed to fund federal agencies through March 14, 2025. Left pending were talks over the federal debt ceiling, expected to resume earlier this year. The Republican sweep of the U.S. general election has raised the prospect for easing tax policy offset by enhanced efficiency in government spending and a greater preference for tariffs as a source of government spending and a greater preference for tariffs as a source of government revenue. |
| **Corporate Credit** |  | Credit spreads overall reflect little concern about an economic slowdown. For both investment-grade (IG) and High Yield (HY), they stand just off levels last seen over a decade ago. |
| **Yield Curve** |  | Inversions, whereby longer-dated yields are below shorter-dated ones, have lessened in the fed funds (FF)/10s and 3-month/10s sections. These types of structures may suggest anticipation of policy interest rate cuts in the future, historically because of increased near-term economic risk. However, the 2/30s segment portrays a normal yield curve formation, which may anticipate firmer inflation expectations and those relating to future fiscal policy, among other factors. |

| Factor | Implication for Equities<br>Negative Neutral Positive | CIO View |
|---|---|---|
| **Technical Indicators** | | The S&P 500 remains above its 200-day moving average, which is also in an uptrend. The percentage of New York Stock Exchange stocks closing above their 200-day moving average and the cumulative advance/decline indicator, measures of market breadth, suggest lessened nearer-term participation within the U.S. Equity rally. |
| **Investor Sentiment** | | According to the American Association of Individual Investors, the large imbalance between bullish sentiment and that of bearish sentiment has decreased somewhat. However, cash levels in institutional portfolios have declined to a level triggering a “sell” signal, according to the BofA Global Research Fund Manager Survey. Meanwhile, as of December 19, the BofA Bull & Bear Indicator signals “neutral” 3.4. The Chicago Board Options Exchange Volatility Index has increased above its 12-month average. |

Source: Chief Investment Office.

## EQUITIES

**We are slightly overweight Equities:** Elevated geopolitical risk, policy uncertainty, shifting expectations for the pace of interest rate cuts, normalizing economic data, and sticky inflationary pressures could act as potential headwinds. However, we ultimately maintain a positive bias for Equities amid a broad based and continuing earnings recovery, resilient consumer, and a solid growth outlook.

**We are slightly overweight U.S. Equities:** The U.S. currently remains our preferred Equity region relative to the rest of the world, given relatively stronger forecasted earnings growth, balance sheets in aggregate and better consumer fundamentals. Index level valuations remain elevated above long-term averages, but earnings have recently become more supportive. Our view on U.S. Large-caps remains positive on strong fundamentals and the ability to produce free cash flow (FCF) and healthy shareholder payouts. We maintain a slight Small- and Mid-cap overweight considering expectations for solid economic growth, a broadening profits cycle, and lower costs of capital moving forward.

At this point in the cycle, we suggest a balance in Equity portfolios and broader exposure across sectors. In addition to the leadership and fundamental strength in recent years from the Information Technology (IT) and Communication Services sectors, we are starting to see improvement in earnings from other sectors, including Financials, Utilities, Consumer Discretionary and Healthcare. As the cycle starts to broaden out and as financial conditions further ease, it is important to have Equity exposure across cyclical, interest rate-sensitive and growth sectors. We continue to emphasize exposure to Financials amid forecasts for lower interest rates that can help improve credit risks, default rates, revenues, net interest income and asset valuations on Financials balance sheets. We are less favorable on Industrials after mixed results from Q2 and Q3 earnings reports, few green shoots, and cautious company guidance for the end of 2024. However, infrastructure-related investments and projects related to secular growth trends in electric power demand, energy transmission and distribution, data center builds, and next-generation AI-focused semiconductor technology that is increasingly power hungry could drive multi-year demand for select growth and cyclical stocks. We are slightly increasing exposure to the Consumer Staples sector, by reducing the underweight to a slight underweight, after underperformance against both the broader equity market and the Consumer Discretionary sector last year, valuation measures at multi-year lows and early signs of fundamentals stabilizing.

Uncertainties pertaining to potential changes to Healthcare policies from the new administration could drive rebalancing in portfolios; therefore, this month we are reducing exposure to the Healthcare sector from a slight overweight to neutral. We also remain cautious on the Energy sector, as weaker demand from China combined with a growing supply outlook for 2025 is a concern and could weigh on oil prices, energy cash flows and earnings in coming quarters. Our positive outlook for Utilities is based on accelerating electric power demand for the first time since the early 2000s, driven by the growth in Artificial Intelligence (AI) and increasing electrification of the economy. While we are constructive on IT and Communication Services as longer-term thematic trends, we maintain our neutral view in the near term on elevated valuations, crowded positioning, which was a significant factor in the early August sell-off and declining earnings growth rates sequentially, despite well-above-market earnings growth from these two important sectors. We remain cautious on Materials, as demand is weak, especially from China, and pricing power remains questionable. With interest rate volatility in recent months, we are neutral Real Estate (RE) and prefer being

### EQUITY WATCH LIST

- Economic data for production, labor, consumer expectations, and credit and liquidity conditions
- Progression of earnings estimates and margins
- Reorganization of global supply chains and U.S.-China relationship
- A sustained broader rotation that favors Small-caps, cyclicals and Emerging Markets (EM)

### RISK CONSIDERATIONS

- Heightened geopolitical risk and conflict in the Middle East
- Shifting expectations surrounding the outlook for Fed rate cuts
- Inflationary pressures that remain above the Fed’s target level
- Pressures within the Office segment of Commercial Real Estate (CRE)

selective in the RE subsectors due to positive fundamentals in some areas of RE but remain cautious about weaker trends in other areas like CRE.

We believe strategic portfolios should continue to incorporate both Growth and Value factors that would simultaneously benefit from the possibility of cyclical and secular forces gaining traction. While we believe that AI and related investments have long-term momentum, the summer reversal in mega-cap Growth stocks acted as a reminder to avoid overexposure. Meanwhile, Value continues to trade at a relative discount to Growth and dividend-oriented Value stocks remain attractive. We suggest a disciplined and balanced approach between Value and Growth for long-term investors and emphasize the importance of diversification in portfolios.

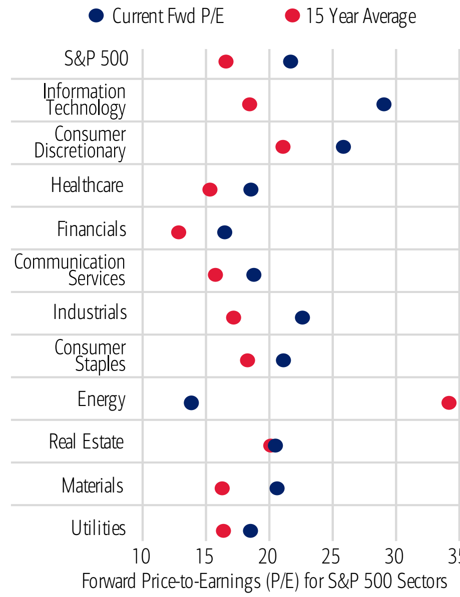
**We are neutral Emerging Market Equities:** EM Equities appear attractively valued, but the Fed rate-cutting cycle is unlikely to have a major positive effect given small current account deficits across the EM universe, and the potential imposition of U.S. import tariffs poses downside risks to more goods trade-oriented economies. We continue to expect a wide return dispersion between individual EM countries and regions. Recent stimulus measures in China so far appear insufficient to provide a significant boost to growth, and activity is likely to remain constrained on a structural basis by headwinds from the real estate sector, weak household balance sheets, a tighter domestic regulatory environment and global export controls. Central and Eastern European markets remain most exposed to the Russia-Ukraine war through trade links and high dependency on natural gas imports, while market direction in Latin America, the Middle East and Africa should remain broadly tied to the direction of natural resource prices, particularly on any broadening of the Middle East conflict. The structural rise in EM consumer spending remains a big reason why we believe investors should consider maintaining a strategic allocation to EM Equities, as appropriate. The emerging world now constitutes around 40% of global Personal Consumption Expenditures, according to the United Nations, and ongoing convergence with developed economies should support GDP growth and corporate earnings over the longer term. We favor active 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 Equities:** We continue to prefer U.S. versus International Developed given our higher-quality view. We remain slightly underweight Europe. Downside risk remains from the potential for fiscal tightening in high-budget-deficit European Union (EU) countries and increased political uncertainty following national and EU parliamentary elections. Potential imposition of U.S. import tariffs and growing competition from China is an additional risk for Germany and other manufacturing-led EU economies. We are slightly overweight Japan Equities. The potential for faster interest rate hikes could represent a headwind for Japan if yen weakness persists, but sustained positive inflation and corporate reforms remain fundamental supports for valuation. As aggregate net energy importers, International Developed markets would also be more vulnerable to a potential rise in energy prices on any broadening of the Middle East conflict. We believe long-term investors should maintain some strategic exposure to International Developed Equities, as appropriate, given that they trade at a discount relative to U.S. Equities, contain more of a balance between Value and Growth sectors, can offer attractive dividend yields, and provide diversification.

## FIXED INCOME

**We are slightly underweight Fixed Income:** We are still favorable with a strategic allocation to bonds in diversified portfolios but are currently slightly overweight Equities. The Fed's ability and willingness to change rate policy to aggressively protect the labor market is largely positive for the economy but increases the risk of higher inflation (all things being equal). We therefore maintain our neutral duration position for now. We still believe, on balance, that rates may drift lower from here over the medium term. The relative rates opportunity has become more compelling again as the 10-year approaches the 4.75% to 5.00% area, and real rates approach 2.00% to 2.50%. Our highest conviction call remains that the yield curve will normalize by short rates moving lower, and investors should

### Sector Valuations




Source: Bloomberg as of January 3, 2025. 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. **Performance is no guarantee of future results.**

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

therefore consider moving out investable cash into their strategic duration target as cash yields are likely to decrease from here, and the backup in yields may be an opportunity.

Nominal and real rates are more attractive due to the recent back-up, and provide good income-generating power, in our opinion, as well as a decently priced hedge to high risk-asset valuations. Therefore, we have a slight overweight to U.S. Governments. Real yields—the yield after inflation, as measured by Treasury Inflation-Indexed Securities—are now 2.00% to 2.50% across the curve, the higher end of the range since 2008. Substantially positive yields that are higher than inflation levels on U.S. government-guaranteed securities is a welcome relief for savers after years of financial repression. We recommend a neutral duration position versus a stated benchmark, to take advantage of these higher yields, protect against declining rates on cash balances, and as prudent positioning against macro risk in the increased Equity positioning of a diversified portfolio by moving to their long-term strategic duration target.

**We remain slightly underweight both Investment-grade Corporates and High Yield:** This view is largely predicated on valuations that continue to screen expensive, leaving less room for upside and outperformance relative to duration matched Treasurys. Over the last 12 months, credit markets have fully embraced the improved macro and technical backdrops. With IG at around 80 bps and HY at around 275 bps, spreads have continued to grind post-election and continue to reflect a healthy growth picture in addition to relatively strong demand with yields solidly in the 5.0% to 5.5% area for high-quality corporates. More compelling yields, and a continued strong technical backdrop is the single biggest risk to our underweight thesis, in our opinion.

To be clear, we don’t see a risk or catalyst for spreads to move meaningfully wider over the short term. Bouts of volatility and mean reversion moves in credit spreads are normal. History has shown that credit spreads can trend at low/rich levels for an extended period (i.e., mid-to-late 1990s and mid-2000s). With the U.S. economy still on strong footing and earnings growth reaccelerating, any move wider in credit spreads could be more contained, in our view. However, the margin for error at current valuations is still slim. On average, at starting spread levels of 100 bps or less, IG underperforms duration-matched Treasurys 12 months forward.

We therefore continue to 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 spreads move above 130 bps—all else being equal.

HY yield-to-worst remains around 7%, above the median level seen over the last 25 years and provides modest compensation for credit losses, in our view. However, similar to IG, HY spreads look priced to perfection and continue to price in a soft/no-landing outcome and a continued improvement in default losses. Current spreads in the BB-rated and B-rated cohorts are both roughly inside of the 10th percentile historically, and we would look for substantially wider levels as a more attractive entry point. We therefore maintain our slight underweight positioning and see better risk-adjusted opportunities in other asset classes such as Equities.

**We remain slightly overweight Mortgage-backed Securities:** Mortgage-backed Securities (MBS) spreads remain relatively attractive compared to other high-quality Fixed Income sectors, particularly IG corporates. The risk of duration extension, a primary concern for MBS investors, has largely been mitigated. However, while interest rate volatility has moderated, it remains elevated from a longer-term perspective. Additionally, a potential rise in inflation poses a risk to our slightly overweight stance, as it could push Treasury yields higher, resulting in wider MBS spreads and/or increased volatility—both of which could negatively affect MBS returns.

Despite the additional supply resulting from quantitative tightening (QT), the sector's relative attractiveness, coupled with the potential for banking deregulation—likely to spur additional bank demand—provides meaningful counterbalances. Banking deregulation will be a critical factor to monitor in 2025. As long as Treasury yields remain range-bound near current levels, these risks are expected to have a limited effect on the sector.

## FIXED INCOME WATCH LIST

- Economic and fiscal implications of the U.S. election
- Level of real rates in the U.S.
- Credit Spreads
- Global central bank activity
- Global economic growth
- U.S. short-term funding markets
- U.S. inflation

## RISK CONSIDERATIONS

- Heightened U.S. deficit spending
- Resilient or accelerating inflation
- Any increase in risk aversion at current tight credit spreads
- Potential for a short-term liquidity crunch

## ALTERNATIVE INVESTMENTS

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

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

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

**Hedge Strategies:** Performance of Hedge Strategies (HS) was positive in November, with overall returns coming in at 2.4% for the month.[2] Early estimates for December suggest a pullback as Equity markets cooled following the post-election rally and a strong year overall. Equity Hedge (EH) led all other HS in terms of 2024 performance with gains of 13.1% through November. In December, EH likely saw losses of around 1.5% driven by beta (market exposure), offset modestly by positive alpha.[3] The main dynamics impacting EH strategies for the year just concluded include: 1) an improved backdrop for alpha generation with lower pair-wise stock correlations; 2) high and increasing gross exposures, and 3) the strength of systematic equity strategies. As managers look ahead to the new year and a new administration, focus is quickly shifting to an accelerating mergers & acquisitions (M&A) environment as well as differential sectoral impacts of new trade, fiscal, and immigration policies. Macro Hedge Funds (HF) strategies continued their post-election momentum based on early estimates. Trend-following strategies appear to have generated gains on the back of trends in currencies and Fixed Income. Interest rate volatility increased in the back half of December[4] as the markets digested slowing progress on inflation and the potential impacts of new Federal policies, which could ultimately create opportunities for Macro strategies broadly, in our view.

**Private Equity & Credit:** Private Equity & Credit: Private Equity (PE) notched gains of approximately 1.6% in Q2. Early estimates suggest further positive performance of around 3% in Q3, once more lagging public Equities.[5]

Buyout strategies have been resilient, if muted, throughout the challenging rising rates environment in 2022 to 2023 and they continue to exhibit outperformance over longer time horizons. Venture Capital (VC) has been enduring a more acute valuation reset that, while not as severe as the dot-com peak-to-trough drawdown, has exceeded declines during the 2008/2009 Global Financial Crisis.[6] Thematically, PE strategies have been contending with a slower velocity of capital recycling, though exit activity has accelerated in Q2 and Q3 and is now up over 50% YoY.[7]

The election outcome has put several market-friendly policies potentially in play. PE, in particular, could see a boost from higher M&A activity and a reinvigoration of animal spirits. However, as is always the case with new policies, the details matter. In public markets,

[2] HFR, Inc. As of November 31, 2024.
[3]. Alpha is the excess return of an investment relative to the return of a benchmark index.
[4] Bloomberg. As of January 6, 2025.
[5] Cambridge Associates, PitchBook, Inc. As of January 6, 2025.
[6] Cambridge Associates, PitchBook, Inc. As of January 6, 2025.
[7] PitchBook, Inc. As of January 6, 2025.

### CIO Views on Alts Strategies

#### HEDGE STRATEGIES

| Equity Hedge + | |
|---|---|
| Bull case | Potential alpha generation opportunities for low net strategies in volatile or high-dispersion markets; sustained improvement in short alpha; low net better positioned if Equities sell off |
| Bear case | Return of concentrated and beta-driven market would limit opportunity set; a challenging environment for shorting could limit alpha |

| Event Driven | |
|---|---|
| Bull case | Higher rates pressuring levered balance sheets creating potential for distress; if merger activity were to increase and deal spreads widen; higher risk-free rate positive for merger arbitrage |
| Bear case | Distress may not materialize in size or may be delayed; if merger activity fails to materialize; lower rates negative |

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

| Macro + | |
|---|---|
| Bull case | Possible "higher-for-longer" rate regime could create cross-asset volatility in rates and foreign exchange; inflation stickiness could exacerbate macro volatility; sharp-change in policy direction |
| Bear case | Coordinated central bank rate moves could limit dispersion; choppy markets difficult for trend-following; if rate volatility declined |

#### PRIVATE EQUITY & CREDIT

| Buyout | |
|---|---|
| Bull case | Current vintages likely attractive for long-term given profitability focus; within PE, Secondaries benefiting from secular growth and institutional investors seeking liquidity; deal activity starting to pick up and could surge if momentum builds |
| Bear case | Higher rates require larger Equity investments; deal and exit activity susceptible to higher-for-longer |

| Venture/Growth | |
|---|---|
| Bull case | Significant correction benefits providers of capital; AI could drive investment supercycle; early VC stages more insulated than later stages; falling rates would likely be tailwind |
| Bear case | Ex-AI VC market still challenged; VCs focused on supporting portfolio companies; initial public offering drought could continue; timelines extended plus increased risk of dilution; higher rates drag on unprofitable companies |

| Special Situations | |
|---|---|
| Bull case | Default rates rising; higher-for-longer would increase pressure on levered balance sheets; RE-adjacent opportunities; companies seeking creative financing before maturities |
| Bear case | Rate cuts could smooth out credit cycle, keeping it more average |

| Private Credit + | |
|---|---|
| Bull case | High though declining current yields; healthy spread to public credit over time; economic resiliency supportive of credit; secular tailwinds supporting growth; fresh capital can underwrite to current risks |
| Bear case | Credit risk could rise and lower-quality most at risk; regulatory scrutiny; public leveraged credit competition; significant capital allocating to PC; interest rates declining |

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

investors can speculate on new policy direction and reposition if those views prove incorrect. By contrast, their relative illiquidity means that Alts strategies and asset classes operate on longer timescales, making the specifics of policy mix, degree and personnel critical. We look for additional clarity on these questions once the new administration is officially in place before altering our relative preferences.

Private Credit (PC), meanwhile, has continued to perform well. Using private fund performance data, PC generated returns of 1.7% in Q2, bringing the one-year internal rate of return to 8.3%.[8] Other PC indexes show continued positive performance in Q3 of approximately 2.7%.[9] While PC has proven itself resilient, market dynamics throughout most of last year have led to declining yields and spreads. Interest rate cuts will likely depress yields further. As we have communicated, the Goldilocks environment for PC has been slowly receding as new headwinds emerge, including competition from public leveraged credit markets, potential increases in credit losses, and a lack of net new issuance. Mitigating this is the fact that overall yields still remain high and, as discussed, could climb higher depending on policy implementation. The potential pickup in PE deal activity could also help with weak new issuance. The substantial pile of global PE dry powder that will ultimately need to be invested will likely require hundreds of billions of dollars in annual PC financing.

We continue to emphasize partnering with established and well-resourced managers, and think PC is best positioned within a diversified allocation to Alts and should be tactically compared to other Alts asset classes and strategies, in particular PE.

**Private Real Estate:** Overall, Private Real Estate (PRE) has shown some signs of stabilization, although prices in October and November were still modestly negative. Cap rates have similarly been relatively steady in the back half of the year, though variations across sectors and geographies remain.[10] PRE entered the year with optimism that the asset class would bottom out and find market clearing prices. Performance momentum and fair value estimates have seemed to bolster that view. Expectations of interest rate declines also fueled part of the improving outlook, but the degree to which mortgage rates ultimately decline given potential policy impacts has tempered enthusiasm. Accordingly, deal activity has remained anemic if stable YoY. Market participants are still hoping for a pickup in activity in the coming year, driven by clarity on the interest rate picture and improving return expectations.

Overall, PRE values have declined 1% over the last twelve months and approximately 11% from their recent peak[11] suggesting the valuation reset has been working its way through the system. New supply is hampering rent growth in certain sectors and geographies, such as apartments and industrial; however, supply growth is projected to ease in the coming year. With publicly listed real estate investment trusts (REITs) trading at net asset value plus-or-minus, public markets appear to no longer view PRE as overvalued.[12]

We continue to expect systemic issues to be contained but for the PRE cycle to continue to play out as a slow burn. As suggested, reduced interest rate uncertainty would likely spur transaction activity and aid in price discovery. For the longer term, PRE continues to make sense as a strategic allocation given the potential diversification benefits and income features.

**Infrastructure:** Infrastructure remains a key long-term theme. The U.S. has a widely acknowledged aging infrastructure base that will require significant public and private investment. Hundreds of billions of dollars have already been earmarked for infrastructure spend through several federal bills in recent years. Though some of those dollars may be at risk, given the election results, expectations are for more surgical changes to existing funding. Infrastructure also has direct links to the Energy Addition theme, which will play out over the coming decades. In addition, Infrastructure has historically performed well on a relative basis during inflationary periods and has the potential to improve diversification in portfolios. Notably, in this era of higher inflation, PE deal activity, which can serve as a gauge of higher long-term return on investments, has shifted on a relative basis toward Infrastructure and away from Technology over the last three years.[13]

## PRIVATE REAL ESTATE

| Private Real Estate | |
|---|---|
| Bull case | Supply/demand imbalance in Residential driving secular opportunities; sectors like Data Centers rising; cap rates slowly reflecting lower valuations; lower mortgage rates may unlock markets; lending strategies offering compelling profiles; distressed/opportunistic could emerge given stress |
| Bear case | Transactions remain depressed; risk of mortgage rates not declining as much as market hoped; pressure rising in value-add multifamily financed with floating-rate debt and over-supply in certain markets |
| **Infrastructure +** | |
| Bull case | Within RE, Infrastructure to continue benefiting from fiscal spend; large need for energy transition and upgrading aging infrastructure; potential to be inflation beneficiary if new resting rate structurally higher |
| Bear case | Higher rates challenging project financing; lower inflation could mitigate relative attractiveness |

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

[8] Cambridge Associates, Refinitiv EIKON. As of January 6, 2025.
[9] Lincoln International, Lincoln Senior Debt Index. As of January 6, 2025.
[10] MSCI Real Capital Analytics. As of January 6, 2025
[11] MSCI Real Capital Analytics. As of January 6, 2025
[12] Green Street, "U.S. Commercial Property Monthly". January 2, 2025.
[13] Preqin. Infrastructure includes Industrials, Energy, Utilities, Raw Materials and Natural Resources. As of December 11, 2024.

**Tangible Assets:** Global growth anchors demand for commodities and remains subdued. Market expectations for impactful fiscal and monetary stimulus in China have thus far not been met, and the rebound in cyclical commodities since August has stalled for now. Geopolitical risk and geoeconomic maneuvering are wild cards for energy commodity prices. Absent a supply disruption, the oil market appears fundamentally balanced with ample supply and restrained demand. For Gold, additional Fed interest rate cuts, a likely weakening of the dollar from overvalued territory, untethered U.S. government debt, and geopolitical tensions should continue to support prices. We continue to believe gold is most effectively implemented as a strategic diversifier. With the Fed considering an easier monetary policy stance on labor market concerns, the dollar will likely remain under pressure even as it has exhibited bouts of strength. Importantly, the U.S. dollar remains overvalued versus a number of major currencies.

## TANGIBLE ASSETS

| | |
|---|---|
| Bull case | Geopolitical risk could spill over and pressure commodities supply; China stimulus could drive demand; macro factors including currency could support oil prices; untethered U.S. government debt; potential for diversification and inflation hedge |
| Bear case | Muted global growth may reduce demand; balanced energy supply has offset Middle East Middle East tensions; real rates staying high could pressure "safe" havens like gold |

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

## MACRO STRATEGY

- Personal income and spending data were strong in November, with both measures continuing to grow above a 5% year-over-year pace. The stronger data caused the Atlanta Fed's GDPNOW estimate for Q4 real consumer spending to rise to 3% following a 3.1% Q3 pace , but the overall estimate for Q4 has recently moderated to 2.4% following a 2.8%  Q3 pace.
- Claims for unemployment compensation show layoffs are still very low, but continuing claims are rising because it is taking longer for the unemployed to find new jobs because of a lower level of unfilled job openings.
- Core personal consumption expenditures (PCE) inflation picked up in November to 2.8% on a year-over-year basis from 2.7% in September. Overall PCE inflation rose 2.4% in November compared to 2.1% in the 12 months through September. Core consumer price index inflation was 3.3% in the 12 months through November and up 3.7% in the latest three months through November. Core inflation has stalled at these levels for several months now as the disinflation trend seems to have ended with core inflation around 3%.
- The profits cycle for large U.S. companies and policy tailwind from existing fiscal stimulus and deregulation remains supportive of economic growth and risk-assets in the near term.

## ECONOMIC FORECASTS (AS OF 1/3/2025)

| | Q4 2024E | 2024E | Q1 2025E | Q2 2025E | Q3 2025E | Q4 2025E | 2025E |
|---|---|---|---|---|---|---|---|
| **Real global GDP (% y/y annualized)** | - | 3.1 | - | - | - | - | 3.2 |
| **Real U.S. GDP (% q/q annualized)** | 2.0 | 2.7 | 2.5 | 2.3 | 2.2 | 2.2 | 2.4 |
| **CPI inflation (% y/y)** | 2.6 | 2.9 | 2.2 | 2.2 | 2.5 | 2.4 | 2.4 |
| **Core CPI inflation (% y/y)** | 3.2 | 3.4 | 2.9 | 2.8 | 3.1 | 3.1 | 3.0 |
| **Unemployment rate (%)** | 4.2 | 4.0 | 4.3 | 4.3 | 4.4 | 4.4 | 4.3 |
| **Fed funds rate, end period (%)** | 4.33 | 4.33 | 4.13 | 3.88 | 3.88 | 3.88 | 3.88 |

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 January 7, 2025. 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 2025 EARNINGS PER SHARE (EPS)

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 2025 and P/E ratio multiples. These scenarios are not official price targets and are not meant to signal levels where portfolio actions may always be needed. However, during times of market volatility, it's useful to keep this basic framework in mind when considering whether to incrementally add to or trim risk from portfolios while staying invested in one's strategic asset allocation framework.

| 2025 EPS | EPS Forward P/E (Next 12 months) | | | | |
|---|---|---|---|---|---|
| | 19.0x | 20.0x | 21.0x | 22.0x | 23.0x |
| $305 | 5,795 | 6,100 | 6,405 | 6,710 | 7,015 |
| $295 | 5,605 | 5,900 | 6,195 | 6,490 | 6,785 |
| $285 | 5,415 | 5,700 | 5,985 | 6,270 | 6,555 |
| $275 | 5,225 | 5,500 | 5,775 | 6,050 | 6,325 |
| $265 | 5,035 | 5,300 | 5,565 | 5,830 | 6,095 |
| $255 | 4,845 | 5,100 | 5,355 | 5,610 | 5,865 |
| $245 | 4,655 | 4,900 | 5,145 | 5,390 | 5,635 |

For illustrative purposes only. Source: Chief Investment Office as of January 7, 2025.

## CIO ASSET CLASS VIEWS AS OF JANUARY 7, 2025

| Asset Class | CIO View: Underweight | | CIO View: Neutral | | CIO View: Overweight | Comments |
|---|---|---|---|---|---|---|
| **Equities** | | | | ● | | We are slightly overweight Equities and continue to view weakness as a buying opportunity for long-term investors. We remain overweight the U.S. and neutral EM, with a slight underweight to International Developed. |
| **U.S. Large-cap** | | | | ● | | We have a slight preference for Value over Growth, given better absolute and relative valuations. We believe portfolios should incorporate both Growth and Value factors as appropriate. |
| **U.S. Mid-cap** | | | | ● | | We remain positive on the outlook for Mid-caps and potential earnings improvements in this area of Equities. |
| **U.S. Small-cap** | | | | ● | | We maintain a slight overweight to Small-caps on attractive valuations, the declining cost of capital and the stable U.S. consumer. |
| **International Developed** | | ● | | | | International Developed equity valuations appear attractive, but underlying rates of nominal growth should trail U.S. levels. International markets also remain more vulnerable to any broadening of conflicts in Ukraine and the Middle East, and to potential imposition of U.S. import tariffs. |
| **Emerging Markets** | | | ● | | | We are neutral EM Equities overall with regional markets likely to be driven by relative exposures to China, the ongoing Russia-Ukraine conflict and natural resource prices. Valuations appear attractive, but Fed rate cuts are unlikely to have a major positive impact and tariffs pose risks to more goods trade-oriented economies. |
| **International** | | | | | | |
| **North America** | | | | ● | | The U.S. remains our preferred region given balance sheet strength, better fundamentals for consumer spending and healthy shareholder payouts. |
| **Eurozone** | | ● | | | | Risks remain from potential fiscal tightening in high-budget-deficit EU countries, increased political uncertainty and manufacturing pressures from growing competition with China and potential U.S. trade restrictions. |
| **U.K.** | | | ● | | | Domestic demand at risk from still high mortgage rates, alongside higher business taxes from government budget. Withdrawal from EU single market remains a negative for medium-term growth, though trade insulated from potential tariffs by high service share of exports. |
| **Japan** | | | | ● | | Sustained positive inflation and official efforts to increase corporate returns to shareholders remain fundamental supports for valuation. Potential for faster interest rate hikes could represent a potential headwind if yen weakness persists. |
| **Asia Pac ex-Japan** | | ● | | | | Regional market likely to be driven in near-term by expectations around China stimulus measures and impact on consumption and resource demand. Longer-term outlook dampened by exposure to ongoing structural constraints for Chinese economy. |
| **Fixed Income** | | ● | | | | Bonds remain attractive and provide good diversification for multi-asset class portfolios with both reasonable income and the ability to decline substantially in yield in an economic downturn. Neutral positioning recommended, balancing the risk of further tightening/higher 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 and recessionary signals remain. |
| **International** | | | ● | | | International rates markets remain attractive and are no longer trading at a significant discount to the U.S. |
| **Global High Yield Taxable** | | ● | | | | Valuations are very extended and provide a poor risk/ return profile. Any additions to HY, therefore, should have a long-time horizon. Within HY, we prefer balanced exposure between floating rate loans and HY unsecured. |

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

## CIO EQUITY SECTOR VIEWS AS OF JANUARY 7, 2025

The CIO Equity sector view is developed by applying a multi-input process combining the CIO's factor views and fundamental bottom-up industry outlook with top-down macro-economic changes and trends. The factor approach emphasizes valuation and momentum as key inputs, with a fundamental overlay taking into consideration forward-looking views of growth, profits, policy, events and sentiment as well as inclusion of certain investment themes. BofA Global Research's sector strategy views are also captured as an input into the CIO process. Our sector views are developed with a 12- to 18-month outlook but are revisited monthly by the GWIM Investment Strategy Committee.

| Sector | CIO View | | | Comments |
|---|---|---|---|---|
| | Underweight | Neutral | Overweight | |
| Financials | | | ● | The positive outlook for the Financials sector is concurrent with the start of a Fed easing cycle. Perhaps counterintuitively, a lower Fed funds rate benefits deposit gatherers because of the immediate decline in interest expense paid on deposits. The decline in interest revenue from loans/securities is much more gradual, so net interest income has likely bottomed for this cycle. The risks associated with the regional banking troubles in March 2023 have faded and a pickup in regional bank mergers in recent months suggests confidence has been sufficiently restored to deploy capital. Funding pressure coupled with capital discipline has modestly tightened credit standards and slowed the pace of lending, but the start of Fed cuts would alleviate pressure on both fronts. A lower Fed target rate typically lowers interest rates across the curve (and throughout the U.S. financial system), which would have the effect of increasing bond prices and shrinking losses generated by higher rates. Shrinking unrealized losses in bond portfolios should accrete to equity holders in the form of a higher book value and increased capital flexibility for banks, insurance companies and asset managers. Capital return will likely remain the cornerstone of the investment case for most of the Financials sector. Lower interest rates should also improve credit quality (especially CRE) and facilitate workouts instead of charge-offs. Overall, the volatility of the Financials sector should improve with the recent addition of large e-payment card networks that have been stable earnings compounders historically (without taking credit risk). We also favor alternative asset managers with proven track records and billions in dry powder and that consistently draw fund inflows, and maintain management fee pricing power. Alts (especially PE) have demonstrated an ability to thrive in all kinds of economic environments, including recession. Overall, valuation is attractive and earnings driven momentum should continue to improve when rates move lower. **Risk Considerations: 1) a persistently inverted yield curve, 2) interest rate volatility, 3) a deep credit cycle for CRE, 4) lost market share to non-bank lenders.** |
| Consumer Discretionary | | | ● | With a resilient consumer, a solid job market, lower interest rates on the horizon and a better-than-expected economic backdrop, we are overweight Consumer Discretionary. Slightly lower energy costs, wage increases and a strong job market with only selective job cuts confined largely to the technology-related industries is helping to maintain solid consumer spending. Consumers remain resilient and are finding ways to alter their budgets to accommodate both experiences and necessities. Further, with inflation declining from its previous highs and interest rates also gradually moving lower, this is supporting consumer confidence. Consumer retail channels are shifting back to online spending as value-oriented consumers utilize alternative payment methods to supplement their spending and seek out bargains. More evidence of economic strength and a resilient consumer could help support relative earnings growth and relative valuation levels. Valuation for the sector is elevated with positive momentum. **Risk Considerations: 1) economic slowdown, 2) spikes in energy prices or interest rates, 3) geopolitical uncertainty.** |
| Utilities | | | ● | We favor exposure to Utilities on accelerating electricity demand forecasts driven by the AI boom which looks to be a positive long-term tailwind for the sector, catalyzing growing electricity demand for the first time since the early 2000s, and supporting even higher investment in power generation, transmission and distribution. Utilities historically provide reliable earnings and outperform in the late cycle and during economic growth slowdowns, especially regulated utilities that provide a defensive hedge to portfolios. Given the better demand outlook from AI and data centers, we see reason to view even this historically low-volatility sector in a more constructive light. Over the next decade, IRA legislation supports a strong runway for future renewable energy investments and projects, and we see long-term demand for renewables as sustainable under most policy backdrops. We view the need for increasing investment in electric infrastructure as structural and not dependent on any specific piece of legislation. We prefer Utilities with strong balance sheets, constructive regulatory mechanisms, and low-volatility business models. Unregulated Independent Power Producers (IPPs) are a small subsector that we currently favor given exposure to growth from rising AI and data center demand. Valuations based on forward price-earnings multiples are attractive compared to the broader S&P 500 index and momentum is strong. **Risk Considerations: 1) slower power demand growth than forecast, 2) greater regulatory scrutiny, 3) power outage events.** |
| Information Technology | | ● | | The Technology sector is neutral despite improvements in supply chains and AI-driven flows into mega-cap Technology stocks. However, margin risks remain for certain companies in the sector, and the potential remains for downward earnings revisions that are more likely to affect higher-beta, higher-valuation companies. Despite strong long-term Cloud and AI trends, software margins could continue to deteriorate, as Cloud consumption could potentially come under some pressure near term and is not immune to a macro slowdown. We suggest a neutral weight in IT, with a bias to larger and higher-quality companies with strong earnings growth, FCF and balance sheets. We continue to encourage investors to be careful about unprofitable, expensive, and long- duration IT companies. The pandemic accelerated the digital transitions for many industries, but, over the longer-term, we remain positive on the secular growth trends for Cloud computing, machine learning and AI, data centers, software, cybersecurity, and semiconductors. Valuations in the sector declined in 2022 but are still elevated after rising again in 2023 and 2024, especially after the rally in AI-related companies. Further, any additional moves higher in interest rates could pressure multiples for high-growth and high-valuation technology stocks with low to no profits; therefore, look for GARP (growth at a reasonable price) in software and semiconductors. The IT sector still generates significant FCF, dividend growth and remain long-term fundamental drivers for the sector. Technology is deflationary by nature; therefore, long-term investors should look to add to transformational and industry-leading businesses on market weakness. Valuations remain elevated and momentum is neutral. **Risk Considerations: 1) China exposure and trade wars, 2) supply chain constraints, 3) Generative AI monetization, 4) narrow breadth and premium valuations.** |

| Sector | CIO View | | | | | Comments |
|---|---|---|---|---|---|---|
| | Underweight | | Neutral | | Overweight | |
| **Communication Services** | | | ● | | | We are neutral on the Communication Services sector, as some of the largest companies in this sector provide high-quality fundamental characteristics and could be more attractive in a slow-growth economic environment. Despite our concern for ongoing regulatory oversight and the never-ending battle over content, management teams are now adjusting their business models to reduce costs and become more efficient. Ad spending is moving from e-commerce to travel and leisure, hence advertisers are having to shift their targeting. Retailers are suffering from rising costs and slowing sales, which could drive changes in advertising spend. We are constructive on the sector based on three key factors: 1) Valuation multiples were largely derisked in 2023; 2) Earnings estimates were reduced and are moving higher for the sector leaders; and 3) More importantly, broad cost-reduction plans could create potential earnings upside. Valuations are a little rich and momentum turned positive again. **Risk Considerations: 1) regulatory and anti-trust risks, 2) capital expenditures ramps for AI investments that limit EPS and FCF, 3) lower engagement pressuring growth.** |
| **Healthcare** | | | ● | ◄ | | As we enter 2025, we are lowering exposure in Healthcare on a confluence of macro, micro, and policy uncertainties that we believe reduce the probability of a sustained rally in the healthcare sector. These uncertainties could last throughout 2025, creating a lack of clarity on out-year earnings potential and, as a result, less new money entering the sector-near term. Also, some of the "pro-growth" policies from the incoming administration increases the probability of a more "pro-cyclical" trading environment which is not an ideal backdrop for Healthcare outperformance. As we look into the new year, we are focused on policy changes that could impact the Managed Care, Providers and Biopharma subsectors. Questions remain regarding the development of China's stimulus program and the level of biopharma funding that will materialize in 2025. M&A is a recurring talking point amongst investors moving into the new year as rates declined slowly over recent quarters, but we believe M&A activity may be slowed by policy concerns. As a result, in 2025, we emphasize greater exposure to high-quality companies with material catalysts. The medtech subsector is our strongest conviction, while distributors, diagnostics, vision and dental remain intriguing areas for investment. We find the large biopharma, diabetes and tools and equipment subsectors to be areas where stock selection will be most important in 2025. Looking out towards 2030, we continue to view the healthcare sector as one loaded with innovation and opportunity. Driving down costs, introducing drugs and equipment to battle previously unmet needs and indications, and the ability for AI and technology to improve operations in and out of the hospital are all opportunities that should drive greater efficiency in healthcare over the long term. Unfortunately, until we get through some of these macro and policy-related headwinds, it is difficult to forecast how quickly those innovations could make a difference to the sector. Valuation is fair and momentum is declining. **Risk Considerations: 1) repeal of the Affordable Care Act without another plan in place and uncertainty, 2) drug pricing negotiations broaden out from the current IRA structure.** |
| **Industrials** | | | ● | | | We are neutral on the Industrials sector after mixed Q3 earnings results, a lack of significant green shoots in the industrial economy outside of AI and electrification, and cautious second-half company guidance. Longer term there are multiple thematic drivers for Industrials over the next three to five years including improving outlooks for international defense budgets outside the U.S. as the global risk environment is elevated, underpinning favorable dynamics for defense companies. Recent safety and manufacturing issues in commercial aerospace weighed on the sector but longer-term aerospace should benefit from a multi-year backlog of commercial plane orders to build and deliver. Potential improvements in the global capital expenditures cycle, including the normalization and reshoring of supply chains and manufacturing, and investment in new equipment after years of focusing on productivity, and fiscal stimulus plans could support the construction, transportation, machinery, and freight and logistics industries longer term. However, weaker import/export demand from Europe and China could be a near-term drag on earnings growth for industrial conglomerates and transport stocks. Secular growth drivers like the evolution of AI and increased power demand support the longer-term view for electrical equipment and Industrials related to this trend. Valuation is slightly elevated, and momentum improved since the early fall. **Risk Considerations: 1) short-cycle recovery timing continues to be pushed back, 2) inflation resurgence drives up input costs, pressuring margins, 3) continued supply chain stress.** |
| **Real Estate** | | | ● | | | The decline in interest rates from 2023 peak levels reduces some but not all risks regarding refinancing and the cost of capital for RE projects. Recent increases in rates added pressure to the sector and remains a key risk as we enter 2025. Expectations of fewer but additional Fed rate cuts in addition to cautious positioning and sentiment in the RE sector could lead to increased Equity portfolio exposure to the sector, especially if rates decline. However, interest rates are still elevated compared to the zero-rate policy environment, therefore, increased interest expenses could still weigh on RE sector earnings in coming quarters. We would be more selective within the RE sector and prefer neutral sector exposure. There are mixed outlooks among its subsectors because of consumer and corporate changes like remote work, eCommerce, less business travel, etc., that are potential longer-term headwinds for CRE companies (e.g., office), mall operators and retail-related property owners as companies consolidate RE footprints. Furthermore, risks are rising for downward pressure on rental rates as lease contracts expire and new contracts are negotiated. Continue to emphasize longer-term secular trends in data centers, communication infrastructure (towers), storage and industrial RE. Valuation is neutral and momentum declined into year-end. **Risk Considerations: 1) spike in interest rates and borrowing costs, 2) declining demand for CRE in over supplied markets, 3) workout problems.** |
| **Energy** | | ● | | | | We remain concerned on the global oil supply and demand outlook for 2025. Despite tensions and conflicts in the Middle East, production has not been interrupted and therefore has capped oil price upside. Further, growing oil production from both OPEC+ producers and non-OPEC producers in Guyana, Gulf of Mexico, offshore Brazil and other regions could add to inventories in an environment that is already moving towards an oversupplied market. Combined with slower global demand, led by China, we see risks to energy company cash flows and earnings estimates in future quarters. OPEC+ indicating they could change the current energy policy by ending the production cuts in future quarters is a significant risk and would be an important change in current policy for energy markets. This dynamic has investor sentiment very cautious on the sector. Any potential oil price declines to lower ranges could weigh on energy stocks this year. Energy companies are still returning cash to shareholders through a combination of base dividends, increasingly less variable dividends, and stock buybacks. Longer term, secular headwinds still confront the sector, including the transition to clean energy, lower renewable energy costs, declining short-cycle inventories and sustainability-focused investors. Continue to emphasize companies that are low-cost producers with high FCF, balance sheet strength and low break-even oil prices. Energy stocks still provide attractive valuations and strong dividends with weaker momentum. **Risk Considerations: 1) lower oil and natural gas commodity prices, 2) slower global energy demand.** |

| Sector | CIO View (Underweight / Neutral / Overweight) | Comments |
|---|---|---|
| **Materials** | ● ⬤ ● ● ● | Pockets of slower global growth and weaker commodity prices factor into our continued cautious view on the Materials sector. We are seeing deceleration in the pricing cycle from higher pricing levels of recent years and some signs of oversupply in specific areas. Higher interest rates in the developed world and ongoing trials securing labor and materials are pushing some project timelines to the right, and, with the additional challenge of higher energy costs, we are seeing some formerly profitable projects being reconsidered. On the supply side, concerns remain about too much new capacity in the future for petrochemicals and commodity chemicals with questions regarding demand levels for 2025. Multiples could expand or contract dependent on pricing across the commodity complex. Downward pricing pressure 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 AI growth and power buildouts over the longer term; however, mixed data and the slower- than-expected growth and activity in China makes the risk-reward outlook less attractive with both inflation and pricing power moving lower. Earnings revision trends could be mixed going forward. As a result, the underlying sector valuation is neutral, but momentum declined into year-end. **Risk Considerations: 1) slower global economic growth, 2) weaker residential and non-residential construction, 3) oversupplied materials markets.** |
| **Consumer Staples** | ▶ ⬤ ● ● ● | We are reducing the magnitude of the underweight to the underperforming Consumer Staples sector. The directional change in our Consumer Staples sector view is meant to acknowledge the recent Q4 2024 underperformance versus the broader market and versus the Consumer Discretionary sector. The Consumer Staples sector encountered numerous headwinds beginning with the September 2024 Fed Policy shift, the presidential election outcome and ongoing sluggish fundamentals. On the fundamental side, a more discerning consumer continues to seek ways to optimize their discretionary spending budgets with new behaviors like product substitution and trade down. Increased sale of private label and store brands have pressured branded consumer product profitability. In addition, some product categories are experiencing further pressure from the increased usage of weight loss drugs. Adding to the negative investor sentiment is the perceived risk from the incoming administration's focus on government oversight of health and wellness trends. Recently, the recommendation to put health risk labels on alcoholic beverages has added to putting further pressure on the traditional consumer packaged goods companies. Global consumer packaged goods companies are responding to the headwinds that they can control, by altering their product mix and package sizes to include more better-for-you products, while sharpening their price points to remain relevant to a budget constrained consumer. Underlying fundamentals are beginning to stabilize, and traditional Staples companies are beneficiaries of the advantageous food-at-home versus food-away-from-home budget proposition. Food-at-home is more economical and allows consumers to stretch their meal budgets. In addition, the stronger multinational consumer packaged goods companies have embarked on sizable cost savings programs that are meant to act on those things in their control. An uptick in capital spending on AI initiatives is likely to drive future cost reductions in supply chain, factory floor automation and productivity, and diversify their global sourcing options. While investor sentiment remains subdued, underlying fundamentals are showing early signs of stabilization with lower break-even profitability along with easier revenue and earnings comparisons that could provide for better than feared earnings results in 2025. Valuation appears to have overreacted to the increase in both actual and perceived headwinds. Valuation measures such as relative dividend yield and enterprise value/sales are approaching multi-year lows. The sector valuation appears to be fair to undervalued, while momentum remains negative. Valuations are fair to undervalues, and momentum remains negative. **Risk Considerations: 1) soft demand across consumer-packaged goods, 2) consumer trade down and substitution, 3) ongoing growth in private label and store brands.** |

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 JANUARY 7, 2025

The following themes and subthemes encapsulate the Chief Investment Office's thinking on some of the most convincing undercurrents of future areas of growth around: Transformative Innovation, Resilient Infrastructure, Future Security and Changing Demographics. These themes carry long-term implications for economic growth, the cost of capital and global earnings. We'd consider exposure to these themes a key ingredient to investing.

| Level 1 | Level 2 |
|---|---|
| **Transformative Innovation**<br>• Generative AI<br>• Robotics/Automation<br>• Digitization | **Generative AI:** Power demand/generation, productivity wave<br>**Robotics/Automation:** Industrial/service robotics<br>**Digitization:** Cloud computing, data analytics, digital payments, internet of things, augmented reality and virtual reality, electrified transportation |
| **Resilient Infrastructure**<br>• Energy Addition<br>• Utility Infrastructure<br>• Supply Chain Reconfiguration | **Energy Addition:** Nuclear renaissance, solar, natural gas generation, hydrogen, battery storage<br>**Utility Infrastructure:** Data centers, grid (transmission/distribution), thermal management, water management, power generation<br>**Supply Chain Reconfiguration:** Onshoring/nearshoring buildout |
| **Future Security**<br>• Aerospace & Defense<br>• Cybersecurity<br>• Resource Protectionism | **Aerospace & Defense:** Remilitarization, space, drones<br>**Cybersecurity:** Network security, cloud evolution/security, endpoint security<br>**Resource Protectionism:** Food/agriculture/commodity scarcity (water), natural resources, metals/mining |
| **Changing Demographics**<br>• Healthcare Innovation<br>• Great Wealth Transfer<br>• Global Labor Force Distribution | **Healthcare Innovation:** Ageing, longevity, drug discovery, biotechnology (gene therapy, personalized medicine)<br>**Great Wealth Transfer:** Wealth creation, NextGen consumer/investor base<br>**Global Labor Force Distribution:** Immigration/migration, global fertility bust, automation "cobots" |

## 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** 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.

**MSCI All-Country World Index** is a market capitalization-weighted index that tracks the performance of large and mid-cap stocks in developed and emerging markets.

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

**MSCI Real Capital Analytics Commercial Property Price Index** is computed based on the resale prices of properties whose earlier sales prices and sales dates are known. The index represents the relative change in the price of property over time rather than its absolute price.

**Lincoln Senior Debt Index** is a quarterly index that tracks the fair market value of 1,600 middle market, direct lending credit investments every quarter across approximately 175+ fund clients in the U.S. and in Europe.

**Consumer Price Index** is a price index, the price of a weighted average market basket of consumer goods and services purchased by households.

**Euro Stoxx 600 Index** is a broad measure of the European equity market. With a fixed number of 600 components, the index provides extensive and diversified coverage across 17 countries and 11 industries within Europe's developed economies, representing nearly 90% of the underlying investable market.

**Large-cap Growth/Russell 1000 Growth Index** measures the performance of the large-cap growth segment of the US equity market. It includes companies with higher price-to-book ratios, higher sales per share growth, and higher forecasted growth. The index is reconstituted annually to ensure that the companies included reflect growth characteristics and that new and growing equities are included.

**Small-cap Value/Russell 2000 Value Index** is a market capitalization-weighted index that tracks the performance of around 2,000 small-cap US stocks. It's a key benchmark for the US small-cap market and is a subset of the Russell 3000 Index.

**Bloomberg U.S. Aggregate Bond Index** is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. Investors frequently use the index as a stand-in for measuring the performance of the US bond market.

## Important Disclosures

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

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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 and rebalancing do not ensure a profit or protect against loss in declining markets.

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. Bond portfolio laddering does not reduce market risk, and the principal and yield of investment securities will fluctuate with changes in market conditions. 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.

Investments in Infrastructure Assets will be subject to risks incidental to owning and operating infrastructure projects, including risks associated with the general economic climate, geographic or market concentration, government regulations and fluctuations in interest rates. The industries targeted for investment may be highly regulated by governmental agencies. Such regulations may impact an investor's ability to acquire, dispose of and/or manage investments.

**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.