S&P 500 Target Update

Don't worry, be happy

20 September 2023

Equity and Quant Strategy
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Raising 2023 year-end S&P 500 target to 4600; 4% upside

"Recession averted" says the consensus economist, but a fresh wave of bear narratives around equities have emerged (More bricks). The net message of our five target indicators is bullish, yielding a new 2023 year-end target of 4600, up from 4300.

Productivity, efficiency, less labor intensity

AI is part of this, as are automation, right-sizing labor, and wage inflation incentives after a decade of easy, financially-engineered earnings growth (Exhibit 22) Productivity would likely drive the equity risk premium (ERP) lower. Labor efficiency from the mid-80s to 2008 saw 15%/yr total returns, real rates averaged 3.4% (vs. today's 2%) and ERP fell. Old economy, inefficient co's (more prevalent in the equal weighted S&P 500) could benefit as much as Tech and growth, but have not priced this theme in as richly.

Duration risk? Stocks have options, bonds don't

Fixed income duration is fixed. But companies can lower equity duration in the face of higher rates, as META did in 1Q slashing costs and returning cash via a massive buyback. The saving grace of Tech could be a shift from growth to cash cow. (And the S&P 500 ex-top 7 has significantly lower duration risk.)

US manufacturing renaissance

Nearshoring, underspend, stimulus, and infrastructure needed to support new tech tools is bullish. More for cyclicals/manufacturing, more prevalent in the eq-wtd benchmark.

Likeliest direction of a surprise is still positive

Stocks discount expected growth but react to surprises. We swap our earnings revision ratio with a read on the likeliest direction of surprise using macro, BofA analyst and corporate guidance indicators (p. 14). Last year they suggested a miss, then a beat in 1Q23 and, although recently moderating, remain in neutral to positive territory.

Everyone still hates stocks (except the 7)

Sentiment is more bearish than bullish (Exhibit 27), our Sell-Side Indicator implies +15% over the next 12 months. S&P 500 consensus growth expectations are almost an all-time low, and ex-the Magnificent 7's 15% expectations, LTG is 5.7%, an all-time low (Exhibit 15). One in 5 funds have >40% AUM in TMT but are 16% u/w the avg stock.

Read my lips: equal-weighted over cap-weighted index

The eq-wtd S&P 500 has better visibility (lower EPS volatility, lower estimate dispersion) is cheaper and less crowded (Exhibit 3). The past nine "Recovery" cycles have seen the SPW almost always beat the SPX (Exhibit 5). Valuation implies 5ppt of excess returns for the equal weighted S&P 500 vs. cap weighted benchmark over the next decade (Exhibit 10). De-globalization poses risks to megas/MNCs not midcaps. Seasonality in 4Q is also favorable for the SPW vs. the SPX, see inside.

SPW = Equal-weighted S&P 500

SPX = Cap-weighted S&P 500

MNC = Multinational Corporation

Exhibit 1: Our new year-end target of 4600 is above consensus target of 4366

BofA vs. consensus S&P 500 year-end target (as of 9/18/23)

	2023 year-end target
BofA	**4600**
Avg.	4366
Median	4435
High	4900
Low	3700
Sample size	22

Source: Bloomberg, BofA US Equity & Quant Strategy

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Timestamp: 20 September 2023 01:07AM EDT

New S&P 500 target 4600 (from 4300)

4% upside by year end with a range of 4100-4700

We raise our S&P 500 2023 year-end target to 4600 (from 4300), with a range of 4100 (based on our most bearish target input, Fair Value) to 4700 (based on our most bullish model, our Sell Side Indicator). But our five market timing indicators and broader US equity strategy views support better returns from the equal-weighted S&P 500 than the cap-weighted index. For more details on our target models, see inside and S&P 500 Target Models.

> We have high conviction in the equal-weighted S&P 500 outperforming the cap-weighted index.

Exhibit 2: 2023 S&P 500 year-end forecast = 4600

S&P 500 2023 Target Models

Model	Category	Time Horizon	2023 Target	Current Weight in Forecast
BofA Fair Value Model	Fundamental/Valuation	Medium Term	4,108	15%
Sell Side Indicator	Sentiment	Medium Term	4,725	40%
Earnings Surprise Indicator	Fundamental/Sentiment	Short-term	4,640	15%
Long-term Valuation Model	Valuation	Long-term	4,572	15%
12-Month Price Momentum	Technical	Medium Term	4,623	15%
		Official S&P 500 Target	**4,600**	

Source: BofA US Equity & US Quant Strategy; Short-term = 1-3 months, medium-term = 1 year, and long-term = 5+ years. We calculate our price target based on S&P 500 price as of 8/31/23, and round to closest 50.

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Read my lips: SPW over SPX

Our highest conviction call is that of owning the equal-weighted S&P 500 (SPW) versus the cap-weighted index (SPX). The SPW has superior earnings visibility, lower valuations, less duration risk, and is even more unloved than equities overall (Exhibit 3). Our US Regime Indicator favors the equal-weighted benchmark over the cap-weighted benchmark, and de-globalization and nearshoring is more bullish for mid-cap cyclicals than large cap growth and multinationals.

> SPW = more visibility around earnings but higher equity risk premia, lower expectations (more likelihood to beat than miss), lower beta, lower valuations and less crowding risk.

Exhibit 3: Equal-weighted S&P 500: lower EPS volatility, less EPS estimate dispersion, cheaper valuations and less crowding risk

S&P 500 equal-weighted (SPW) index vs. cap-weighted (SPX) and Magnificent 7

	SPW	LT-avg.	SPX	LT-avg.	Mag. 7
1-yr beta	0.94	0.95	1.00	na	1.36
5-yr beta	0.92	0.95	1.00	na	1.21
chg.	0.02	na	0.00	na	0.15
Earnings coefficient of variation (3-yr)	12.7%	8.8%	16.9%	10.8%	30.8%
Earnings coefficient of variation (5-yr)	15.5%	13.3%	16.5%	15.1%	48.1%
EPS dispersion	4.0%	4.9%	7.1%	8.3%	10.3%
Fwd. EY	5.7%	6.6%	5.1%	6.6%	3.3%
Trail. EY	5.6%	6.0%	4.9%	5.7%	2.6%
ERP (fwd EY - real rates)	3.8%	4.4%	3.2%	4.4%	1.3%
ERP (trail EY - real rates)	3.7%	3.7%	3.0%	3.5%	0.6%
Positioning	0.84	0.86	na	na	1.05 (1.25 ex. AAPL & TSLA)

Source: FactSet, Bloomberg, BofA US Equity & Quant Strategy

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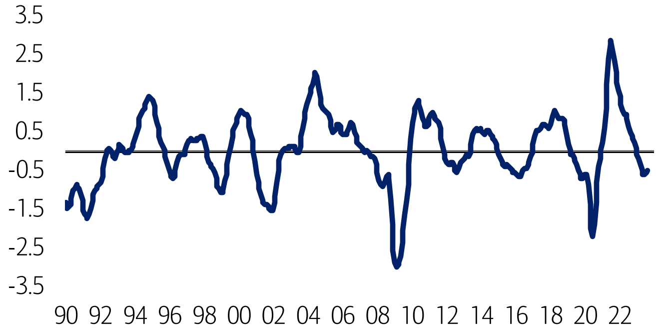
1) Macro cycle

> When macro improves, SPW leads SPX.

SPW has consistently outperformed SPX during "Recovery"

Our US Regime Indicator improved for the second straight month in August, officially entering the "Recovery" phase – see US Regime Indicator. During "Recovery" cycles, SPW consistently outperformed SPX, every time except in 2002 by 5.7ppt on average (Exhibit 5).

Exhibit 4: US Regime Indicator is officially in Recovery after two straight months of improvement
The US Regime indicator (Jan. 1990-August 2023)



Source: BofA US Equity & Quant Strategy, Refinitiv, ICE Data Indices, LLC, Institute for Supply Management, Bureau of Labor Statistics, Federal Reserve
Note: Phase 1 – Early Cycle; Phase 2 – Mid Cycle; Phase 3 – Late Cycle; Phase 4 – Recession
Disclaimer: The indicator identified as the US Regime Indicator above is intended to be an indicative metric only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise be relied upon by third parties for any other purpose, without the written consent of BofA Global Research. This indicator was not created to act as a benchmark.

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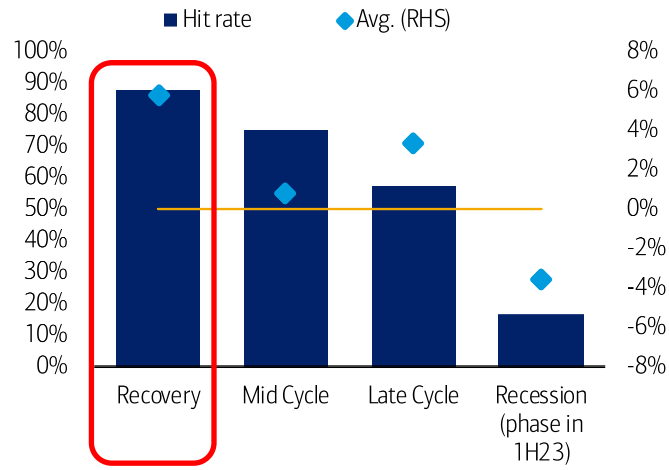
Exhibit 5: Recovery phase has historically been the strongest phase for the equal-weighted S&P 500 vs. the cap-weighted index
Relative performance of the equal-weighted S&P 500 vs. cap-weighted S&P 500 by macro regimes (1991-present)



Source: BofA US Equity & Quant Strategy, Refinitiv, ICE Data Indices, LLC, Institute for Supply Management, Bureau of Labor Statistics, Federal Reserve

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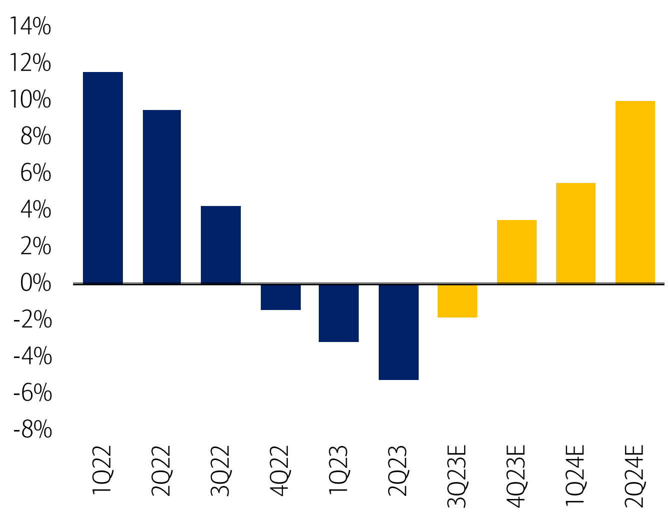
Profit upturn also favors Value (SPW) over Growth (SPX)

Consistent with our US Regime Indicator, we believe 2Q marked a trough in the profits cycle. Historically, the profits cycle mattered more than rates for Value vs. Growth. During periods of accelerating profits, Value has consistently outperformed Growth, which suggests Value-oriented SPW outperforming Growth-oriented SPX.

Exhibit 6: We expect 2Q to mark the trough in the profits cycle
S&P 500 quarterly EPS YoY (orange = BofA estimates)



Source: BofA US Equity & Quant Strategy, Haver Analytics

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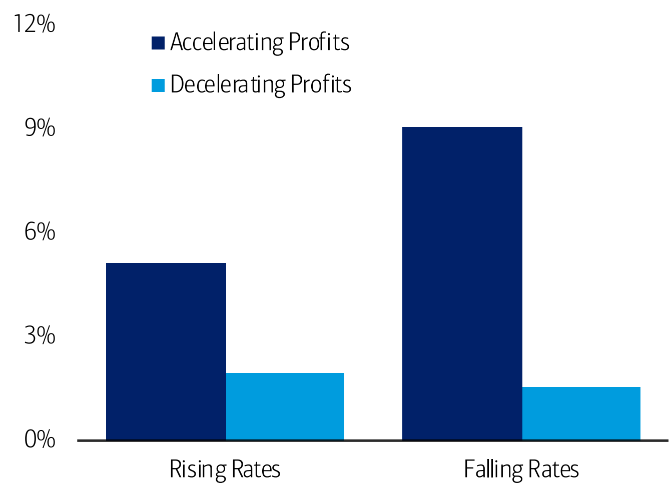
Exhibit 7: Profits cycle matters more than rates for Value vs. Growth
Value vs. Growth annualized quarterly performance during profit and rates cycles since 1926



Source: FactSet, BofA US Equity & US Quant Strategy

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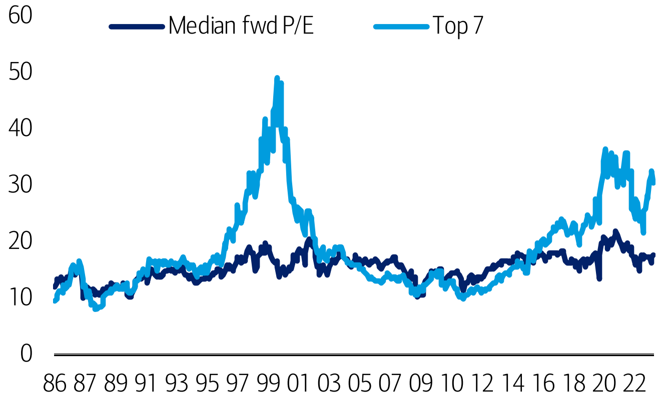
2) Valuations

The S&P 500 trades expensive on most valuation metrics we track (see Relative Value Cheat Sheet), but this is largely due to stretched valuations in mega cap Growth stocks. On an equal-weighted basis, the S&P 500 trades roughly in line with the historical average. The valuation gap between the top 7 stocks and SPW is at the highest level since the Tech Bubble, suggesting more upside in SPW than the cap-weighted index.

Exhibit 8: Equal-weighted S&P 500 trades in line with the historical average, both on fwd P/E...
S&P 500 median fwd P/E vs. top 7 P/E (1986-8/23)



Source: FactSet, BofA US Equity & Quant Strategy

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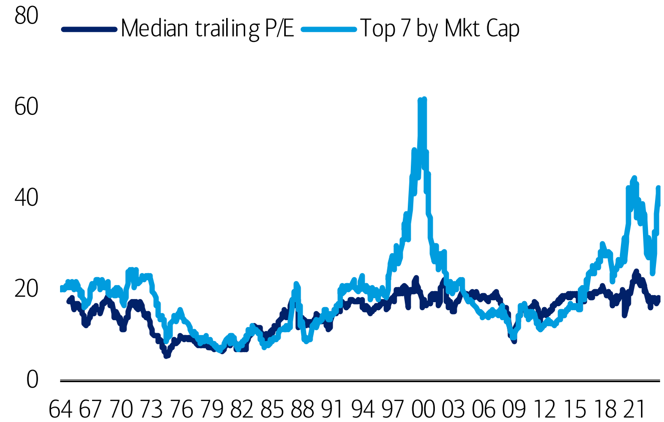
Exhibit 9: ...and on trailing P/E
S&P 500 median trailing P/E vs. top 7 P/E (1986-8/23)



Source: FactSet, BofA US Equity & Quant Strategy

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Additionally, based on our long-term valuation framework (one of our target models), the current normalized P/E for SPW (computed same way as cited in the #3: Long Term Valuation Model section) suggests +6% returns per annum for the equal-weighted index, vs. just +1% per annum for the cap-weighted index using an apples-to-apples time period of 1990-present (and +4% per annum for the cap-weighted index based on the longer data history used for our official Long-Term Valuation Model that feeds into our official S&P 500 target).

Based on a regression since 1990, current valuations suggest +6%/yr price returns over the next decade for SPW (vs. +1%/yr for SPX).

Exhibit 10: Valuations' predictive power on subsequent 10yr returns suggests better implied long-term annualized returns for equal-weighted than cap-weighted index
Forecasted annualized 10yr return for equal-weighted vs. cap-weighted S&P 500 based on comparable time history of normalized EPS and P/E since 1990

Equal-wtd. S&P 500 (data since 1990)		**Cap-wtd. S&P 500 (data since 1990)**	
R-squared	0.72	R-squared	0.83
Slope	(0.01)	Slope	(0.01)
Intercept	0.21	Intercept	0.23
Trailing Normalized EPS	275.50	Trailing Normalized EPS	207.04
Trailing Normalized PE	22.0	Trailing Normalized PE	21.8
Long Term Average PE	19.8	Long Term Average PE	17.4
Forecasted Annualized 10-yr Return	**6.2%**	**Forecasted Annualized 10-yr Return**	**1.1%**

Source: Haver Analytics, Bloomberg, FactSet, BofA US Equity & US Quant Strategy

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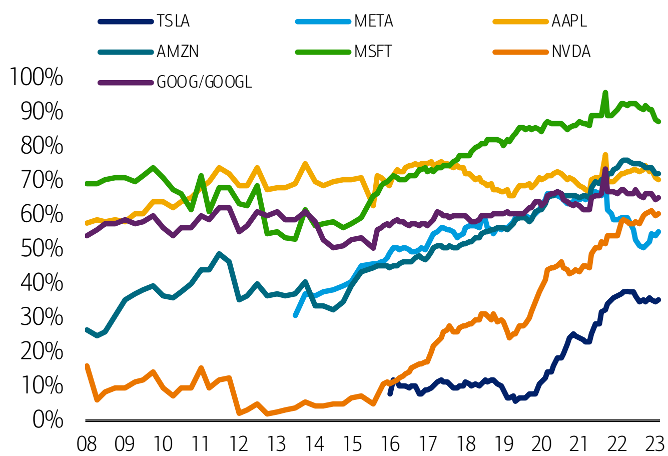
3) Positioning / sentiment

The S&P 500 is more top heavy than ever (Exhibit 13) and 1 in 5 funds has over 40% of AUM in the Magnificent 7 (vs. 12% last year). Of the seven stocks, only AAPL and TSLA are underweight by active long-only funds. On the other hand, long only funds are 16%

underweight the equal-weighted S&P 500, while crowding risk for Growth stocks started to rise recently.

> Who's left to buy the Magnificent 7? 1 in 5 funds has >40% of AUM in the top 7.

Exhibit 11: Critical mass: fewer funds left to buy biggest stocks
% of large cap long only active funds owning each ticker as of 7/31/2023



Source: FactSet Ownership, BofA US Equity & Quant Strategy

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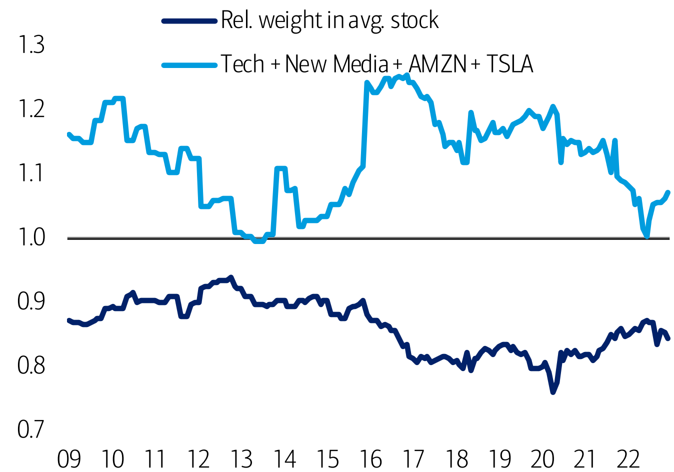
Exhibit 12: Active LOs underweight the eq-wtd S&P 500, while crowding risk for Growth stocks have increased
Long only funds' avg. relative weight for S&P 500 stocks vs. relative weight in Growth stocks (2009-8/23)



Source: FactSet Ownership, BofA US Equity & Quant Strategy

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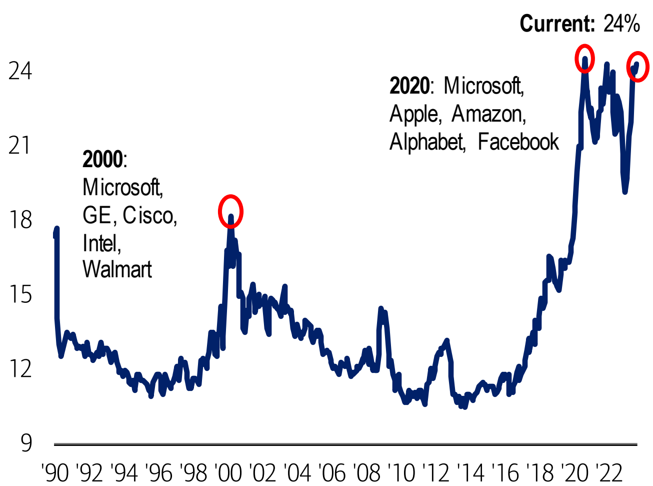
Exhibit 13: Concentration risk near record highs
Top 5 companies' weight in the S&P 500 (1990-8/23)



Source: Bloomberg, FactSet, BofA US Equity & Quant Strategy

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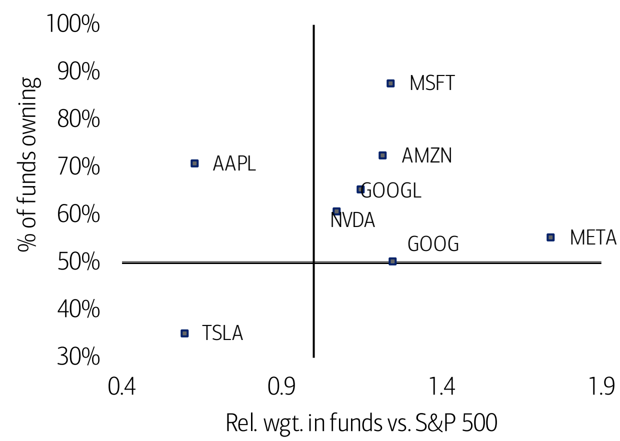
Exhibit 14: Just AAPL and TSLA are underweight by active funds
Large cap long only funds holdings in magnificent 7 (as of 7/31/2023)



Source: FactSet Ownership, BofA US Equity & Quant Strategy

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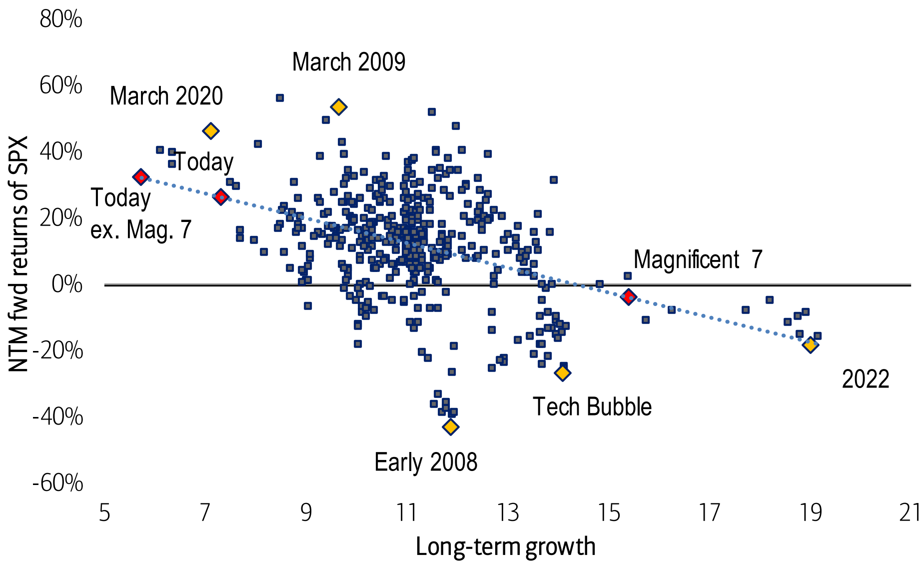
Another contrarian indicator suggests big gains, especially for SPW

The S&P 500 trades 3 standard deviations above the historical average on PE to growth, largely due to consensus long-term growth (LTG) expectations plummeting to near record lows of 7%. Historically, low LTG has been bullish for equities, with a strong inverse relationship between LTG and future S&P 500 returns. Today's LTG of 7% suggests 25% price returns over the next 12 months for the S&P 500, all else equal. Excluding Magnificent 7 (LTG: 15.4%), long-term growth expectations are even more dire, at just 5.7%, an all-time low.

Exhibit 15: Low long-term earnings growth expectations suggest outsized equity market returns
Long-term growth rates vs. forward 12-month returns



Source: BofA US Equity Strategy & Quantitative Strategy

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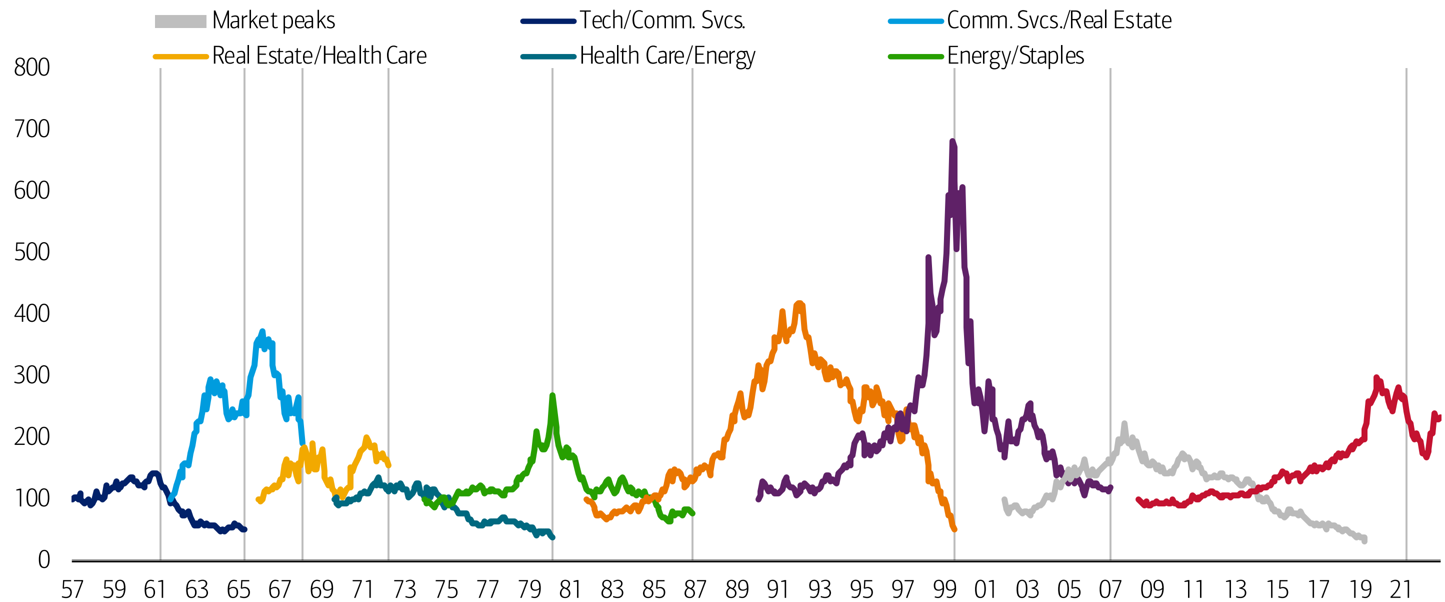
4) Secular forces at play

Bear markets have historically resulted in leadership changes, and we believe secular forces today are greater risks to the last decade's winner (i.e., Tech) than the old economy. Tech is at the center stage of US-China tensions and de-globalization is likely the biggest risk to the poster child of globalization, Tech. Tech has the highest foreign exposure of all sectors and its engrained supply chains in China and Taiwan pose a big risk. The old economy, especially domestic sectors, can ultimately benefit from re-shoring.

Exhibit 16: Bear markets typically bring changes in leadership
Relative performance of prior bull market leader vs. the next bull market leader (beginning of bull market = 100)



Source: BofA US Equity & Quant Strategy, FactSet *Cyclicals ex-Tech include Energy, Materials, Financials, Industrials.

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5) Duration risk

The S&P 500 trades with a record duration of 30+ years, as long duration sectors like Tech have grown to a much bigger weight (Tech: 15% in 2006 vs. 27% today). Every 10bp rise in real rates would translate into a 2% decline in the S&P 500, all else equal, with most acute pain in long duration sectors. Lower duration for the equal-weighted S&P 500 vs. the cap-weighted index suggests the impact from higher-for-longer environment should be mitigated.

But relative to bonds, equities win: they can lower duration risk. An example is META in 1Q 2023, which lowered its duration via cash return (a big share buyback) and layoffs, cost control and capacity reduction. Tech companies shifting focus to shareholder return, efficiency and right-sizing cost structure could be their path to outperformance from here.

Exhibit 17: The equal-weighted S&P 500 has less duration risk
Spread between the duration of equal-weighted S&P 500 and cap-weighted S&P 500 (2001-8/23)

Source: FactSet, BofA US Equity & Quant Strategy

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Exhibit 18: 10bp increase in real rates = 2% hit, all else equal
S&P 500 2023 fair value sensitivity to real risk-free rate and ERP assumptions (bold = current trading range)

Normalized Real Risk-Free Rate	Equity Risk Premium (ERP)								
	200	225	250	275	300	325	350	375	400
1.6%	5,991	5,602	5,261	4,958	4,689	4,447	4,229	4,031	3,851
1.7%	5,829	5,460	5,135	4,847	4,589	4,357	4,148	3,958	3,784
1.8%	5,676	5,326	5,016	4,740	4,493	4,271	4,070	3,886	3,719
1.9%	5,530	5,197	4,902	4,638	4,402	4,188	3,994	3,817	3,656
2.0%	5,392	5,075	4,793	4,541	**4,314**	4,108	3,922	3,751	3,595
2.1%	5,261	4,958	4,689	4,447	4,229	4,031	3,851	3,687	3,536
2.2%	5,135	4,847	4,589	4,357	4,148	3,958	3,784	3,625	3,479
2.3%	5,016	4,740	4,493	4,271	4,070	3,886	3,719	3,565	3,424
2.4%	4,902	4,638	4,402	4,188	3,994	3,817	3,656	3,507	3,370

Source: BofA US Equity & Quant Strategy

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*Seasonality in 4Q, especially for SPW

While the S&P 500 is -3% since the end of July, it is consistent with seasonal weakness in Aug-Sept., during which the index fell -0.7% on average since 1936. But heading into 4Q, seasonality is yet another tailwind for equities. 4Q has seasonally been the strongest quarter: +3.5% avg. returns (vs. +1.5% in other quarters) and 75% positive hit rate (vs. 61% in other quarters). It is an even bigger tailwind for SPW, which outperformed SPX by 50bps on average 55% of the time in 4Q (vs. -45bps & 36% hit rate in 3Q).

S&P 500 Target Models

#1: BofA Fair Value Model

Exhibit 19: S&P 500 2023 Fair Value = 4,108
BofA Fair Value Model (2023)

BofA Fair Value Model (2023)	
Normalized 2023 EPS	$202
Normalized 2024 EPS	$216
Nominal Long-Term Risk-Free Rate	4.50%
Assumed Long-Term Inflation	2.25%
Normalized Real Risk-Free Rate	2.25%
Equity Risk Premium	300bp
Fair Real Cost of Equity Capital (Ke)	5.25%
Fair Forward PE (1 ÷ Fair Ke)	19.0x
2023 Year-End Target (Fair PE × Normalized 2024 EPS)	**4,108**

Source: BofA US Equity & Quant Strategy

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S&P 500's fair value = 4,108 for 2023

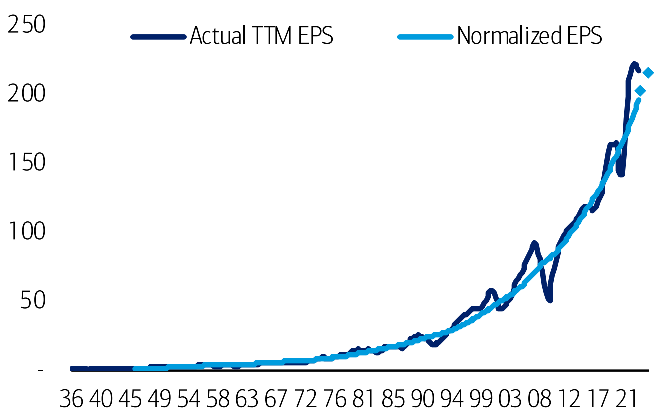
We make the following assumptions for our Fair Value Model based on the current market environment:

- **Normalized EPS:** Normalized 2024E EPS is $216 based on a long-run log-linear regression since 1936, incorporating cyclical and secular trends.
- **Real rates:** we use 2.25% normalized real risk-free rates, in line with the long-term average since 1970 and above the current real rate of 2.0%. We see upside risk to real rates.
- **ERP:** the S&P 500 ERP has been negatively correlated with real rates. The ERP averaged 540bps post-GFC, but a lower ERP of 300bp is justified in our view given (a) higher real rates, (b) increased earnings quality and (c) efficiency focus. Excluding the Tech Bubble, the ERP averaged 300bp between 1980 and GFC.

From financially-engineered growth to productivity-driven growth

2010s: Easy money, levered buybacks, globalization
2020s: Productivity gains, capex boom, re-shoring

Exhibit 20: Normalized earnings: suggests flat earnings growth through 2024
Trailing 12-mo. actual EPS* vs. normalized EPS (1936-4Q22; dots = 2023 and 2024 normalized EPS)



Source: BofA US Equity & Quant Strategy, Haver Analytics, FactSet. Pro-forma EPS used since 1988, Operating EPS used between 1977-1988, GAAP EPS (adjusted for write-offs) used from 1936-1977.

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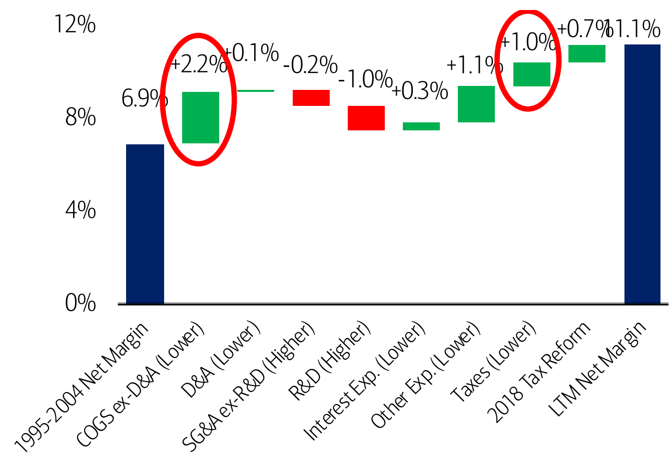
Exhibit 21: Globalization explains majority of margin expansion since 1995
LTM net margin (ex-Financials) expansion waterfall vs. 1995-2004 levels (factors related to globalization circled in red)



Source: BofA US Equity & Quant Strategy, FactSet

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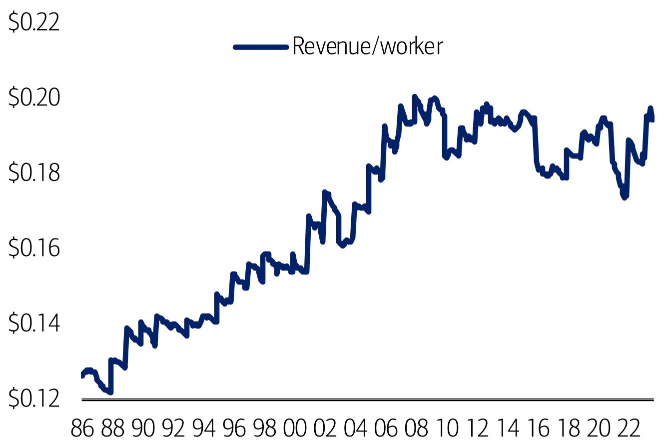
Exhibit 22: Labor efficiency improvements stalled post-GFC / ZIRP. What next?
S&P 500 inflation-adjusted $M revenue per year per worker (1986-8/23)



Source: FactSet, Bloomberg, BofA US Equity & Quant Strategy
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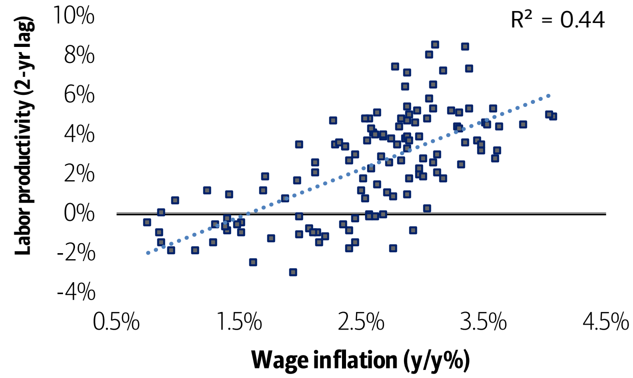
Exhibit 23: Inflation drives productivity capex
US Manufacturing wage inflation and labor productivity (y/y % changes)



Source: Bureau of Labor Statistics, BofA Global Research
Note: Quarterly data of US manufacturing labor productivity versus average hourly earnings of production & nonsupervisory employees
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Exhibit 24: High quality composition
S&P 500: % of B+ or better quality-rated stocks, 1990-8/23

Source: FactSet, BofA US Equity & US Quant Strategy
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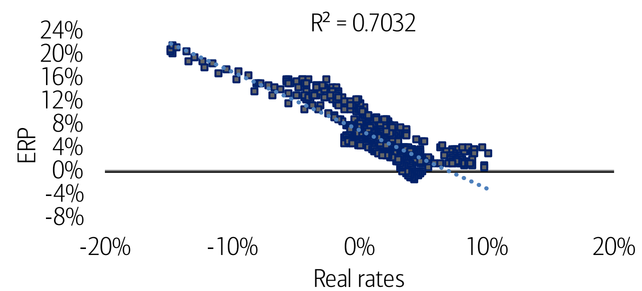
Exhibit 25: Higher real rates = lower ERP
Historical relationship between our normalized ERP vs. real rates (1945-8/23)



Source: BofA US Equity & Quant Strategy, Global Financial Data, Bloomberg. Note: See Methodology for details on calculations
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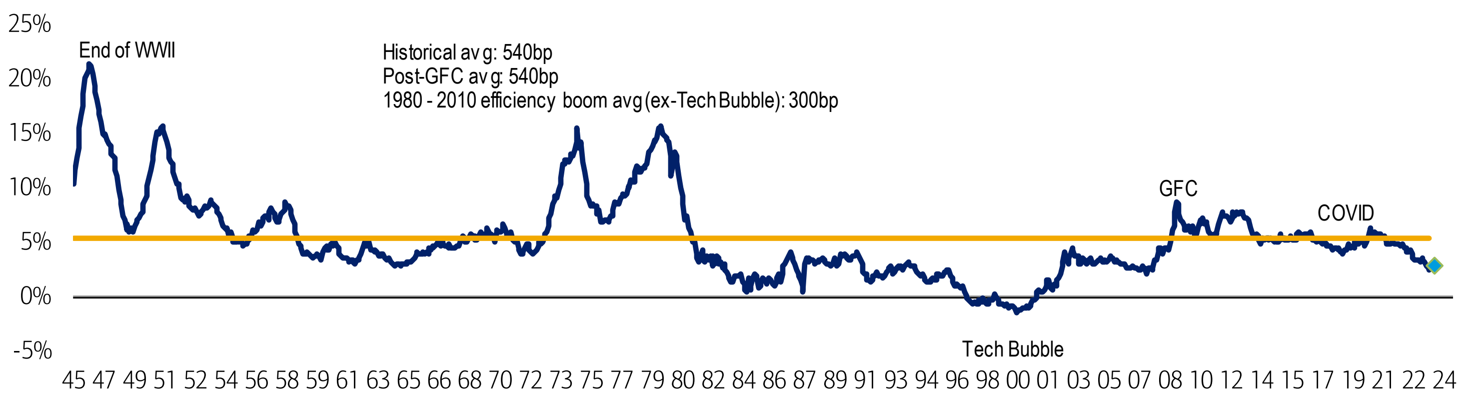
Exhibit 26: We expect ERP to normalize at levels lower than the post-Global Financial Crisis era's average of 540bp
Normalized equity risk premium (ERP) with BofA normalized ERP forecast (300bp), 1945-8/23



Source: BofA US Equity & Quant Strategy, Global Financial Data, Bloomberg
Note: Nominal ERP is calculated as the spread between the normalized earnings yield and real risk-free rate, where normalized EPS is based on a log linear regression of a blend of S&P 500 pro-forma EPS and operating EPS. The real rate is the difference between 1) 10-yr Tsy yield and 2) 10-yr breakeven, where prior to 1998, fwd 1-yr CPI was used as a proxy, which showed the strongest correlation to the 10-yr breakeven.
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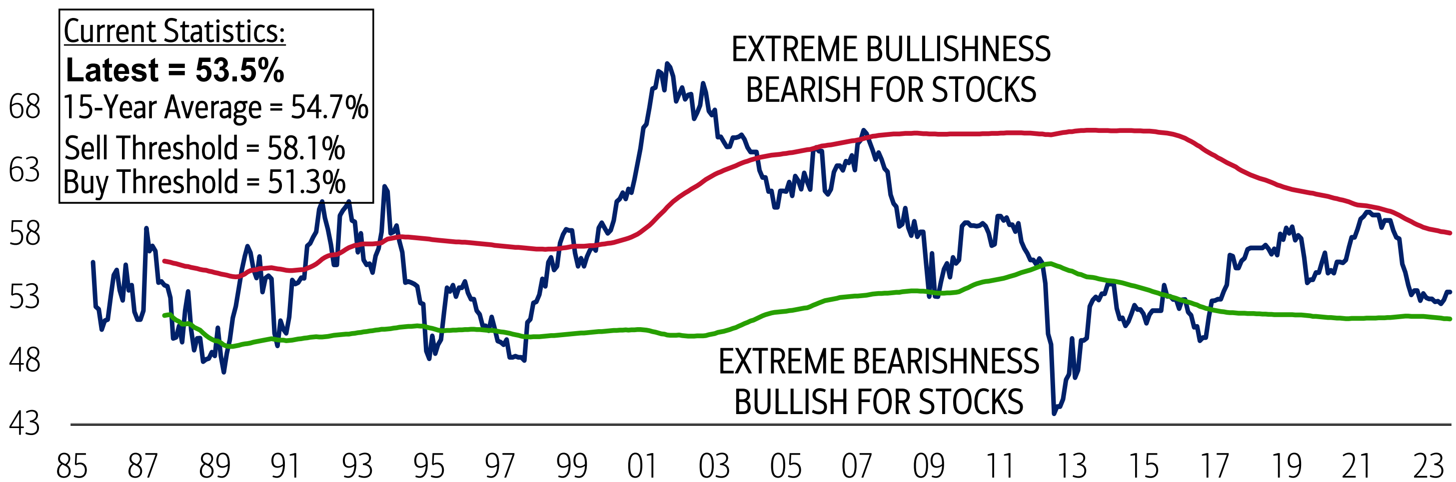
#2: Sell Side Indicator (SSI)

Still closer to "Buy" than "Sell": +15% over next 12mos (4725 by year-end)

The SSI is a contrarian sentiment indicator tracking US sell side strategists' average recommended allocation to stocks based on a monthly survey. It has been bullish when Wall Street strategists were bearish, and vice versa. The SSI was unchanged in August at 53.5% after two straight months of increase (see Sell Side Indicator). This level implies price returns of +15% over the next 12 months. Historically, when the indicator has been here or lower, 12m forward S&P 500 returns were positive 95% of the time (vs. 81% overall) and the median 12m return was 21%. *Caveat: the life of this indicator spans a period of higher equity returns than prior cycles (average S&P 500 12m fwd. price returns of 9.5% since Aug. 1985 (when SSI data begin) vs. 6.7% based on data from 1929 to 1985).*

Exhibit 27: Equity sentiment improved, but still closer to "Buy" than "Sell"
Sell Side Indicator, 8/1985-8/2023



Source: BofA US Equity & Quant Strategy Note: Buy and Sell signals are based on rolling 15-year +/- 1 standard deviation from the rolling 15-year mean. A reading above the red line indicates a Sell signal and a reading below the green line indicates a Buy signal

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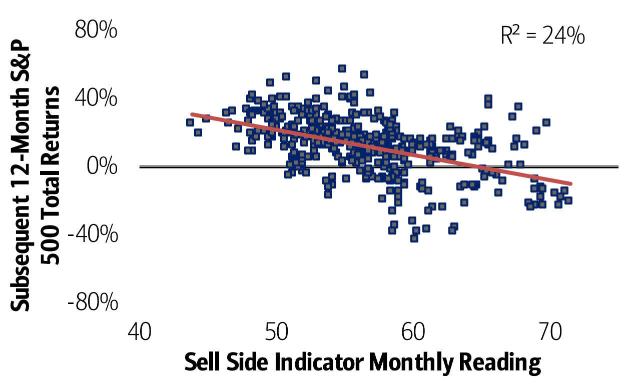
Exhibit 28: Sell Side Indicator has historically been a reliable contrarian indicator
Sell Side Indicator Monthly Readings & Subsequent 12-Month S&P 500 Total Return (8/85-8/23)



Source: BofA US Equity & Quant Strategy, Haver Analytics

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Exhibit 29: Sell Side Indicator has a higher R-squared than most other single factor market timing models
Predictive Power of Selected Indicators Forecasting 12-Month S&P 500 Returns (8/85-8/23)

Indicator	R2
Sell Side Indicator	24%
Sell Side Indicator at extremes (Buy or Sell)	34%
S&P 500 Dividend Yield	12%
Proforma PE	10%
Adj. Fed Model (EPS Yld - Real 10-Yr Tsy Yld)	4%
M1 Growth	3%
Fed Model (EPS Yield - 10-Yr Treasury)	1%
10-Yr Treasury Yield	0%
3-Mo T-Bill Rate	0%
GAAP PE	0%
M2 Growth	0%
Yield Curve (10-Yr - 3-Mo)	0%
BBB to Treasury Spread	0%

Source: BofA US Equity & Quant Strategy. Haver Analytics

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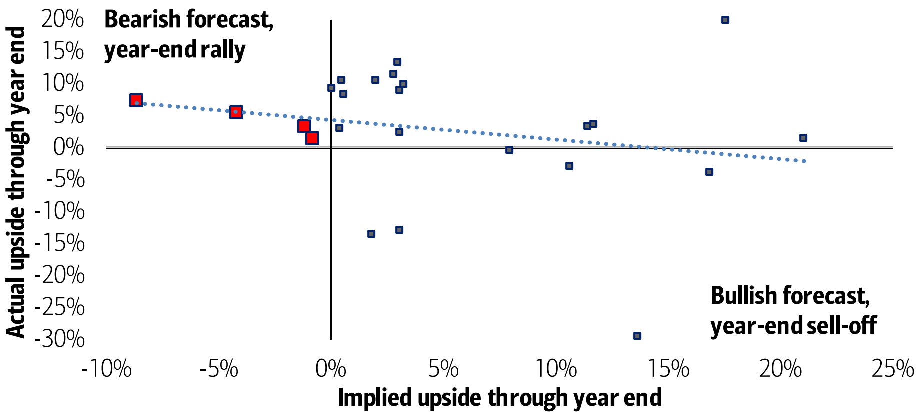
Strategists' S&P 500 targets suggest downside through year end

The avg. S&P 500 year-end target at the end of August typically implies gains of 5% through year end (based on data since 1999) but is currently suggesting 2% downside. In years when strategists expected the S&P to end the year lower, the S&P has ended the year higher 100% of the time, with stronger avg. returns than when strategists forecasted upside (+4.3% through year end vs. +2.5%).

Exhibit 30: Strategists' bearish forecasts make year-end rally more likely
Implied upside (downside) of sell side strategists year-end S&P 500 target as of August each year vs. actual S&P 500 upside (downside) through year end (1999-2022)



Source: Bloomberg, BofA US Equity & Quant Strategy

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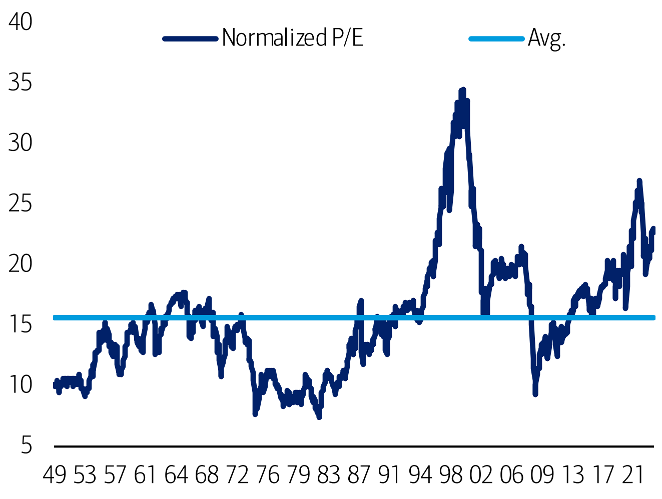
#3: Long Term Valuation Model

10-year return forecast = +4% annualized price returns (4572 by year-end)

Valuation may not be a catalyst, but has had strong predictive power over long-term returns. Today's multiple of 23x normalized earnings implies +4.3%/yr annualized returns over the next decade based on the historical relationship.

Exhibit 31: At 23x, the S&P trades 45% rich vs. the long-term avg.
S&P 500 Normalized P/E Ratio (1987-8/23)



Source: BofA US Equity & US Quant Strategy, FactSet, Haver Analytics

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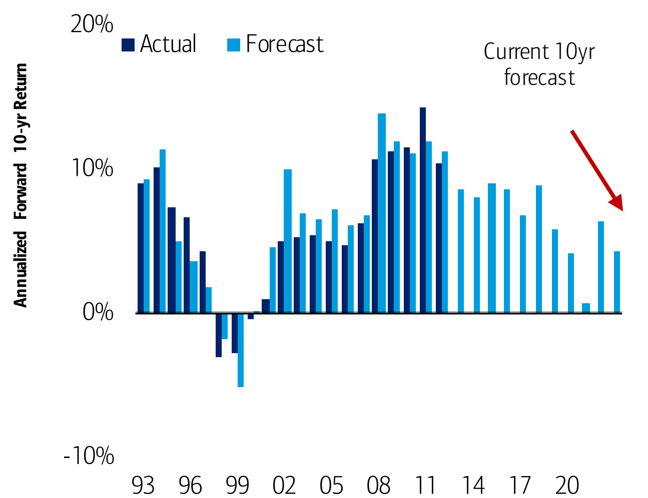
Exhibit 32: Valuation currently suggests 4% p.a. price returns over the next decade
S&P 500 annualized forward 10-yr return: actuals vs. model forecast (1993-present)



Source: FactSet, Haver, BofA US Equity & Quant Strategy

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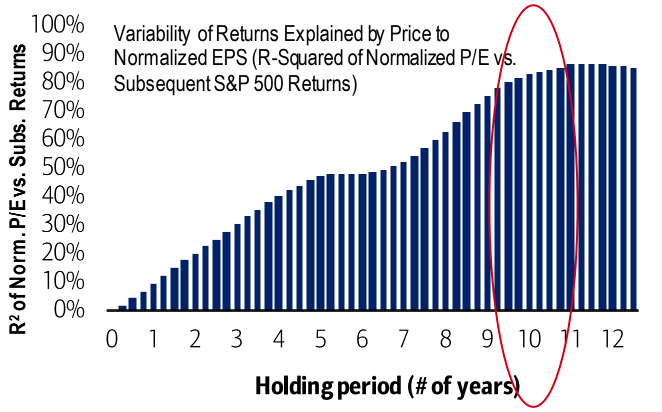
Exhibit 33: Valuation is almost all that matters for long-term stock returns
Price to normalized earnings predictive power on subsequent holding period returns (since 1987)



Source: BofA US Equity & US Quant Strategy, Haver Analytics, FactSet

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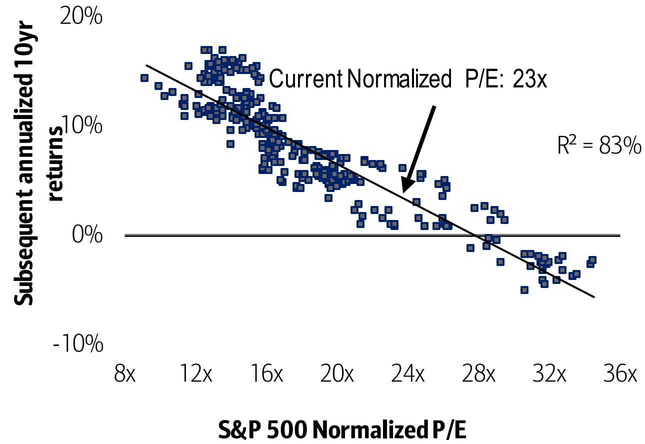
Exhibit 34: Valuations explained >80% of 10yr returns
S&P 500 normalized P/E vs. subsequent annualized returns (since 1987, as of 8/23)



Source: BofA US Equity & US Quant Strategy, Haver Analytics, FactSet

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#4: Earnings Surprise directional indicator

"Neutral" earnings surprise backdrop: S&P 500 at 4640 by 2023 year-end

Stocks discount expected growth but react to surprises. We thus replaced our trailing earnings revision ratio indicator (what happened in the recent past) with our outlook on surprise direction based on a set of leading indicators incorporating macroeconomic surprises, BofA analysts vs. consensus, and corporate guidance. See Exhibit 35 for the relevant inputs we are considering today.

Last year indicators were suggesting a miss, by the end of the year they were indicating a beat and today they remain neutral to positively skewed. While all three indicators remain above the historical average (or vs. consensus for BofA estimates), they are trending slightly weaker vs. a month ago. We thus consider ourselves in the "Neutral" phase of this indicator.

Exhibit 35: We see a "Neutral" earnings surprise backdrop based on leading indicators
BofA Earnings Surprise directional indicator

Indicators	Direction	Current	Historical avg.	z-score
Economic Surprise Index	Positive	0.4%	0.0%	1.0
Guidance ratio	Neutral	1.2	0.8	0.7
BofA analysts vs. consensus (2023 EPS)	Neutral	1.4%		
BofA Strategy view	**Neutral**			

Source: BofA US Equity & Quant Strategy, Bloomberg, FactSet
Note: BofA Strategy view is not based on quantitative metrics, but based on our discretionary view on what the leading indicators are suggesting
*Based on aggregate earnings amount, not average or median; BofA analyst forecasts account for ~90% of the S&P 500 stocks and ~95% of market cap. We use consensus estimates for stocks not covered by BofA analysts

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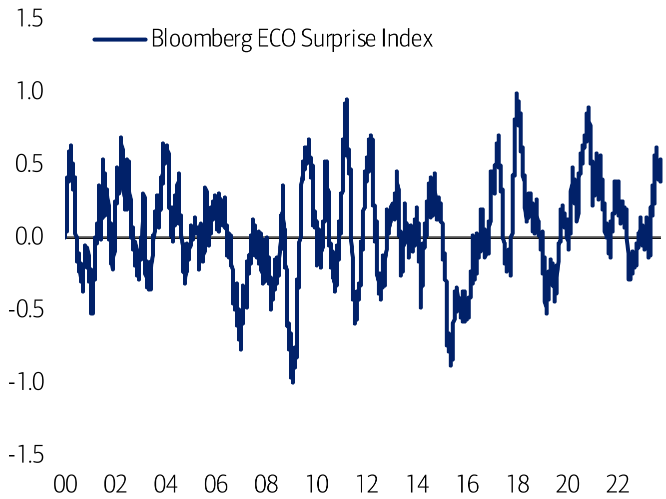
Exhibit 36: More positive surprises in economic data, but off the June peak

Bloomberg ECO Surprise Index (2000-present)



Source: Bloomberg

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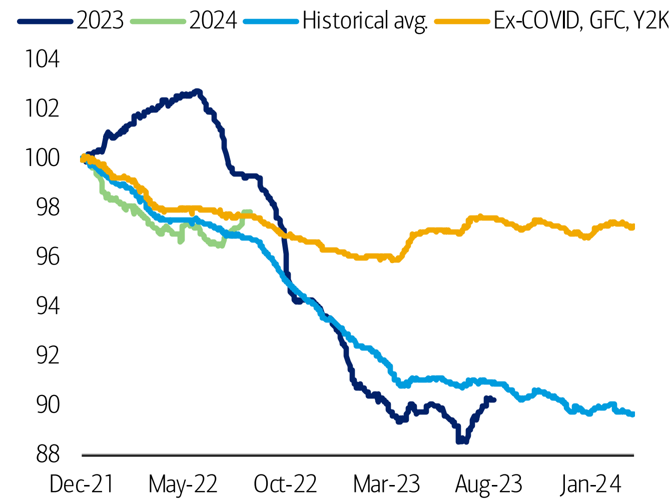
Exhibit 37: Consensus 2023-24 EPS are being revised higher

S&P 500 historical FY2 EPS revisions vs. 2023 consensus EPS (2023-24 as of 9/14/23)



Source: BofA US Equity & Quant Strategy, FactSet; Note: historical average based on 2001-2022

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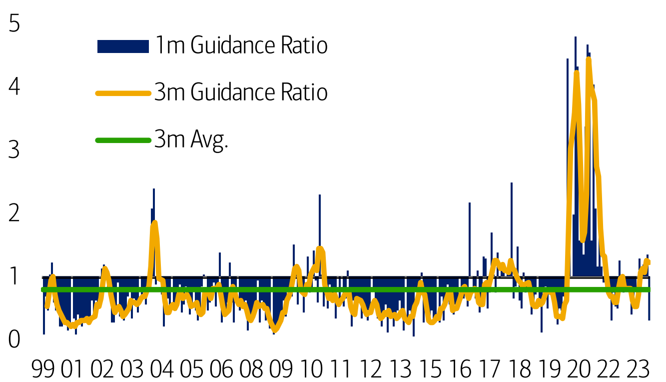
Exhibit 38: Our 3-mo. guidance ratio remains strong at 1.2x, but the 1-mo. ratio is trending weaker so far in September

S&P 500 Management Guidance Ratio (# Above vs. Below Consensus) – as of 9/15/23



Source: BofA US Equity and Quantitative Strategy

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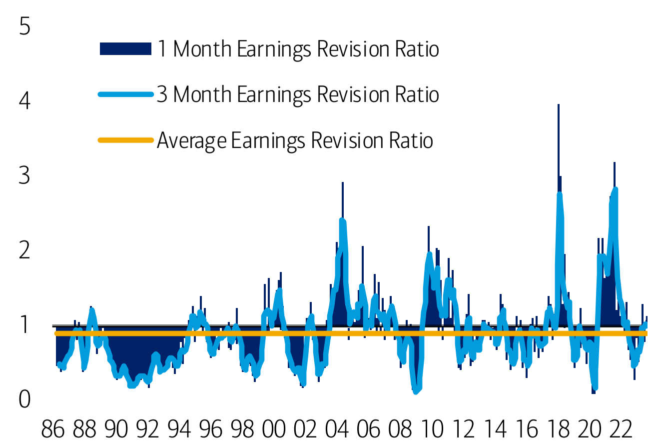
Exhibit 39: Our 3-mo. earnings revision ratio is above average at 1.0x vs. 0.9x historical average

S&P 500 earnings estimate revision ratio, 1/86-8/23



Source: BofA US Equity and Quant Strategy, I/B/E/S, FactSet

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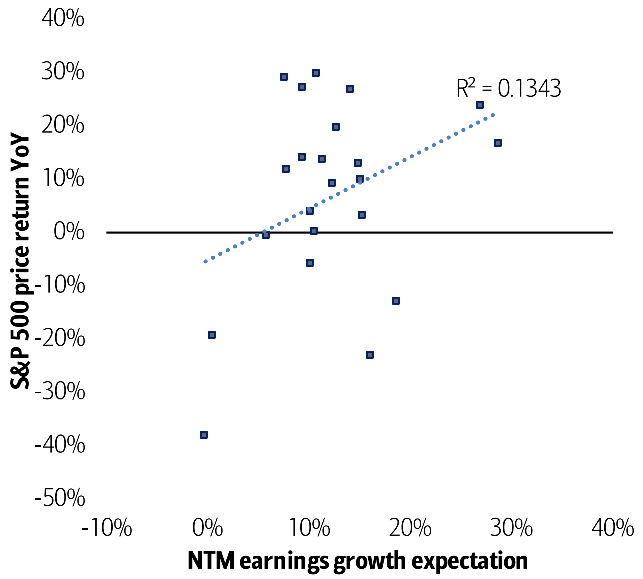
Returns are more correlated to growth surprise than growth forecast

S&P 500 returns have displayed predictable patterns based on earnings surprises relative to expectations, and in fact are more correlated with surprise than with actual or forecast earnings.

Exhibit 40: Returns are positively correlated with growth expectation...
S&P 500 annual price return vs. NTM earnings growth expectation (2001-22)



Source: BofA US Equity & Quant Strategy, FactSet

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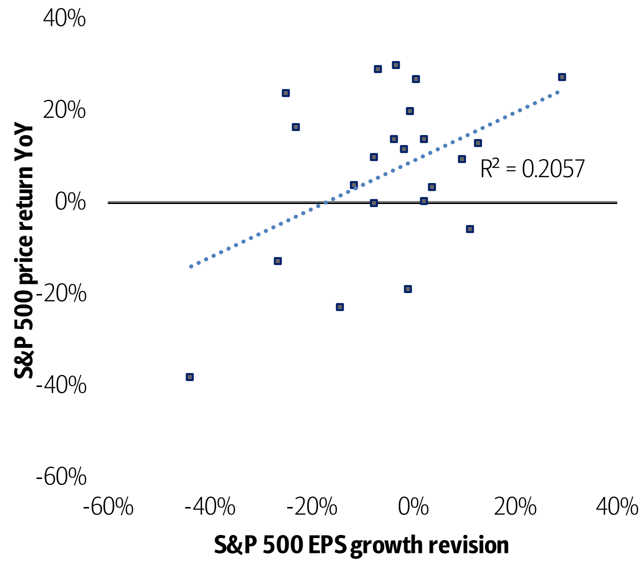
Exhibit 41: ...but are more correlated to growth surprises
S&P 500 annual price return vs. annual EPS growth surprise (2001-22)



Source: US Equity & Quant Strategy, FactSet

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Return distribution based on surprise classification

The distribution of 12-mo. S&P 500 price returns since 1928 suggests that returns have been less than +1% one third of the time, between 1-15% one third of the time and >15% one third of the time. The median annual return in each of these three ranges is presented in the table below. We use the median returns in each range as the three possible inputs into our S&P 500 target from our qualitative earnings surprise directional indicator, based on whether our read on potential earnings surprise is Negative, Neutral or Positive.

Exhibit 42: Range of 12-mo. S&P 500 price returns since 1928
Returns have been negative one-third of the time, >15% one-third of the time, and between 1-15% the remaining third of the time

	% of returns	Median 12m return in range	Classification
<1%	34%	(11%)	Negative
Between 1-15%	33%	9%	Neutral
>15%	34%	25%	Positive

Source: Bloomberg, BofA US Equity & US Quant Strategy

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#5: 12-month Price Momentum

Reversion to mean suggests 12m returns of +8% (4623 by year-end)

This framework is based on the notion that returns revert to "normal". The last 12 months' return was +14.0% as of August 31. This is 0.3 standard deviations above the historical average. This would imply a projected 12-month return of 7.9%, all else equal.

Exhibit 43: The last 12-mo. price return of +14% is 0.3 std. dev above average and implies a projected 12-month price return of 7.9%, all else equal.
Historical 12-month S&P 500 price return z-scores by range and average subsequent 12-month S&P 500 price returns, as of 8/23

	-2 or Less Std Dev Below Avg.	-1 to -2 Std Dev Below Avg.	-1 to 0 Std Dev Below Avg.	0 to +1 Std Dev Above Avg.	+1 to +2 Std Dev Above Avg/	+2 or More Std Dev Above Avg.
Average 12-Month Return	30.9%	10.4%	9.3%	7.9%	9.6%	-0.2%
Standard Deviation of 12m Returns	13.9%	21.0%	18.8%	14.0%	14.5%	16.5%
Probability of Negative Returns	0.0%	30.2%	27.7%	29.3%	23.2%	60.0%

Exhibit 43: The last 12-mo. price return of +14% is 0.3 std. dev above average and implies a projected 12-month price return of 7.9%, all else equal.
Historical 12-month S&P 500 price return z-scores by range and average subsequent 12-month S&P 500 price returns, as of 8/23

Percent of observations	0.7%	4.7%	34.7%	45.0%	7.5%	0.4%

Note: Based on S&P 500 return data since 1928, with cumulative average and z-scores beginning in 1933 when at least 5 years of data history is available

Source: FactSet, BofA US Equity & US Quant Strategy

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Methodology

Guidance Ratios

Earnings guidance: We track the number of instances of above- vs. below-consensus management guidance for earnings over the last three months for S&P 500 companies. If a company issues changes to its outlook more than once in a one-month period, we incorporate all instances of guidance into our aggregate number. The ratio also includes all instances of above- or below-consensus earnings guidance issued by a company (for example, if they issue both quarterly and annual guidance). The one-month and three-month revision ratios are calculated as they are for estimate revision ratios. The data source is Bloomberg. For companies that provide both GAAP and Operating guidance, or for REITs that provide both EPS and FFO guidance, we remove one data point if both data points provide the same guidance direction, otherwise both data points are used.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster[R1]
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

[R1] Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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