FIVE FAQs

# New year, new problems

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Equity and Quant Strategy
United States

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## Less fear, more greed but far from equity euphoria

Sentiment on equities has warmed since last year but is nowhere near euphoric levels witnessed at the end of prior bull markets. Our Sell Side Indicator is now halfway between negative and positive extremes in equity allocations. And only one (the last) of the five questions we address below addresses *upside* risk to stocks.

## Q: What do December trends say about US consumers?

A: BAC aggregated credit and debit card data showed holiday spend slowing in December after a strong November (see the report BofA on USA). Our economists still expect strong retail sales but believe that seasonal adjustments could obscure the underlying signal. Delinquencies are back to pre-COVID levels but are still well off prior recession levels, and deposits are higher than pre-COVID levels. The US consumer tends to spend until he loses his job. Here, encouragingly, real wage growth is positive, layoff mentions are 50% below 1Q23 levels, and the labor participation rate is near cycle lows. AI could take jobs but will likely create new ones.

## Q: What if China stimulus doesn't work?

A: Our economists expect China's real GDP growth to decelerate from 5.3% to 4.8% in 2024, where positives from stimulus are offset by the drag from property. But even a bigger deceleration would have minimal US impact - a 1ppt shock to China growth would likely translate to a 0.1ppt drag on US GDP (econ view). The US has weaned itself off China since 2018 - China's share of US imports has been almost halved from peak levels, and S&P 500's China sales exposure is <5ppt.

## Q: What does a weaker dollar mean for US equities?

A: Our FX strategists forecast another 3ppt of trade-weighted dollar depreciation in 2024. Our work suggests that every 10% drop should translate into a ~3% benefit to S&P 500 EPS via currency translation, all else equal. Energy and Materials have been the biggest beneficiaries, but US energy independence may have changed this relationship.

## Q: Growth *trounced* Value in 2023 – now what?

A: The Russell 1000 Growth index outperformed Value by a remarkable 33ppt in 2023. Historically, episodes of extreme Growth outperformance (>25%) have been followed by consistent and strong Value leadership over the next 3-, 6- and 12- months. Growth stocks are again crowded and carry excessively high premia relative to value cohorts.

## Q: Could the next Great Rotation be from cash to equities?

A: Based on our historical analysis, cash yields of +/- 5% mark the tipping point for higher or lower stock allocations. Our economists expect cash yields to drop below 5% in the very near future with the Fed's first rate cut slated for March. A large chunk of Baby Boomers' ~$80tn in net assets has shifted to cash-like vehicles that generate a 2%+ spread vs. long duration, low fixed rate liabilities (fixed mortgages) of ~3%. As that spread narrows, we could see retirees' cash shift to equity income funds.


**Refer to important disclosures on page 9 to 11.**
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Timestamp: 12 January 2024 03:46AM EST

## Q: What do December trends say about US consumers?

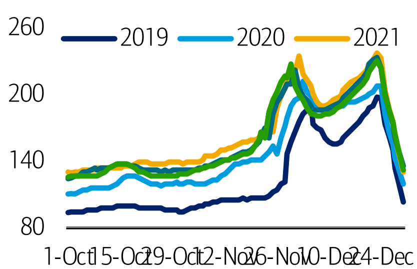
A: Spending on holiday items started out strong but tapered (+0.9% YoY in Nov. based on BAC card data, +0.2% YoY in the five weeks following Thanksgiving.) Our economists forecast above-consensus retail sales of +1.2% MoM in December (vs. +0.3% in November) but believe that seasonal adjustments could obscure the data (see BofA on USA). Rising delinquencies - levels breached pre-pandemic– sounds grim but delinquencies are far lower than prior decades, and deposits are still higher than 2019.

Watch jobs. The US consumer tends to spend until he loses his source of income. BofA expects a modest uptick in unemployment from 3.7% to 4.2% by year-end arguing that consumption could slow but not crash. The jobs backdrop looks healthy- layoff mentions by corporates have fallen 50% since 1Q 2023 and settled below long-term average levels. Layoffs have been prevalent in labor light industries (Tech, Financial Services) but the overall labor participation rate remains low after COVID's great resignation.

### Mixed holiday read: strong start, weak finish

**Exhibit 1: Holiday spending started strongly, then eased back in December**

Total card spending per household on holiday items (7-day moving average, average of last four weeks of August 2019=100)




**Source:** Bank of America Institute. Holiday items include all MCC codes for which spending in Nov.-Dec. is at least 20% of total annual spending in the category.

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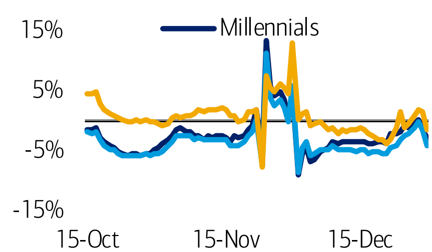
**Exhibit 2: Baby Boomers stronger holiday spenders compared to younger generations**

Credit and debit card spending per household on holiday items by generation (%YoY, 7-day moving average)




**Source:** Bank of America Institute. Holiday items include all MCC codes for which spending in Nov.-Dec. is at least 20% of total annual spending in the category.

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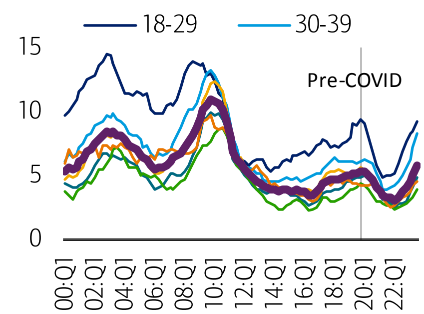
**Exhibit 3: Credit card delinquencies above pre-COVID, below prior recession peaks**

Transition into serious delinquency (90+) for credit cards by age




**Source:** New York Federal Reserve

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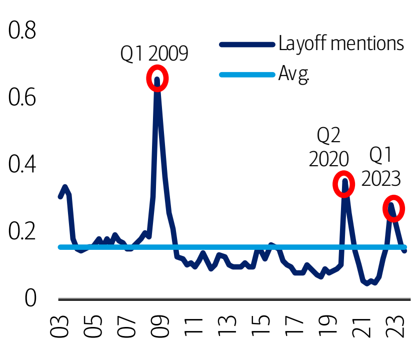
See Consumer Checkpoint for methodology, limitations, disclaimers related to Bank of America internal data.

### When does the US consumer stop spending? When he loses his job

**Exhibit 4: Mentions of "layoffs" in earnings transcripts are back to average levels**

Earnings transcript mentions of "layoffs" (as of 4Q23)




**Source:** FactSet, BofA Global Research

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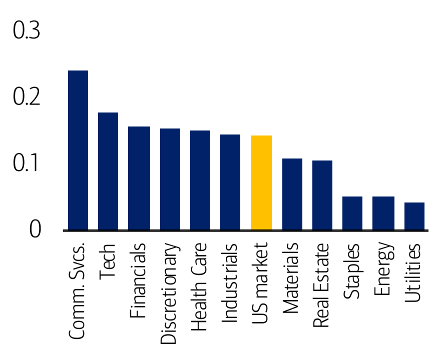
**Exhibit 5: Cuts acute at Silicon Valley & Wall Street (less labor intensive industries)**

Earnings transcript mentions of "layoffs" (as of 4Q23)




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

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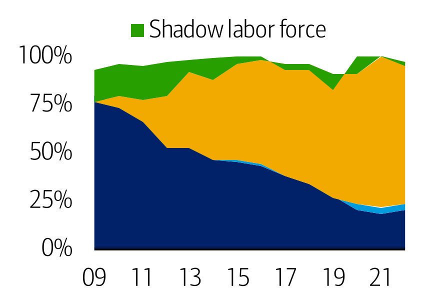
**Exhibit 6: Great resignation + re-showing has kept participation rate close to cycle lows**

% contribution to the total change in labor force participation since '98




**Source:** FRB Atlanta, BofA US Equity & Quant Strategy. Note: Disability/Illness and Family Responsibilities are not included.

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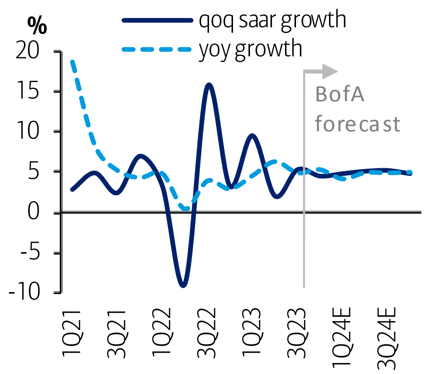
## Q: China growth: how bad, what's the impact?

A: Our economists expect China's real GDP growth to decelerate from 5.3% to 4.8% in 2024, with upside risk from stimulus and downside risk from property sector. Even if growth disappoints, our economists see minimal impact to the US, estimating a 1ppt shock to China growth would translate to a 0.1ppt drag on US GDP (econ view). Moreover, the US has been weaning itself off China since 2018. The S&P 500's direct China sales exposure flatlined in 2018 at less than 5ppt of total sales (despite China's economy now representing a bigger portion of the world economy), and China's share of US imports has dropped by 8ppt. Within the S&P 500, Tech and Materials have historically been most impacted by China's market performance.

### Upside risk from strong policy stimulus, downside risk from property

**Exhibit 7: BofA expects growth to stabilize**
China quarterly GDP growth




**Source:** NBS, BofA Global Research estimates
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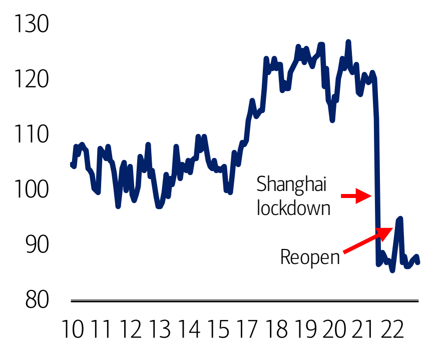
**Exhibit 8: Consumer confidence still well below pre-COVID levels**
China consumer confidence index




**Source:** Bloomberg
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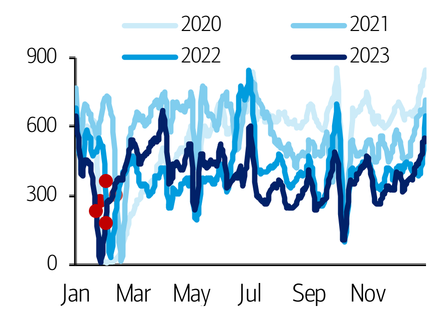
**Exhibit 9: China property not yet on firm footing**
Property transaction in 30 major cities: New home sales ('000 sqm, 7d avg)




**Source:** Wind, BofA Global Research. Note: Red dots indicate Lunar New Year (LNY) in each year, data as of Dec 31
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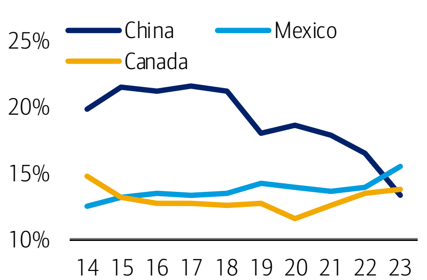
Econ view: Exports to China make up 0.6% of US GDP. The direct effect of a 1ppt shock to Chinese growth on US GDP would be less than 1bp. Accounting for negative effects on global growth and China-exposed stocks, we could see US growth being 0.1ppt weaker than the base case in 2024 and 2025.

### De-globalization is well underway

**Exhibit 10: China's share of US imports now < Mexico + Canada**
% of US imports of everything




**Source:** Panjiva
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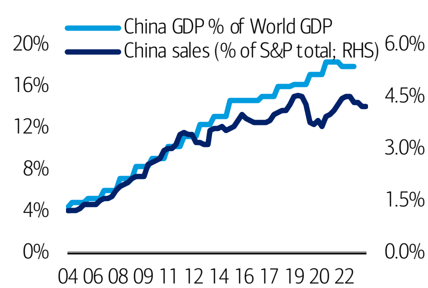
**Exhibit 11: China sales exposure flat since '18**
S&P 500's China sales exposure vs. China's GDP as % of world GDP




**Source:** BofA US Equity & Quant Strategy, FactSet, Bloomberg
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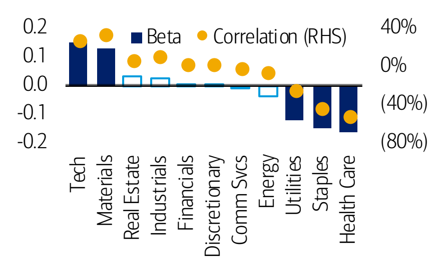
**Exhibit 12: Tech and Materials most impacted**
S&P 500 sectors' rel. perf. to MSCI China (May 1996-12/23)




**Source:** Bloomberg, FactSet, BofA US Equity & Quant Strategy
**Note:** Based on MSCI China index on a YoY basis; Empty bars indicate not statistically significant
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## Q: What does a weaker dollar mean for US equities?

A: The USD depreciated sharply in 4Q (DXY -5%) with expectations for Fed rate cuts bolstered by ongoing signs of disinflation (see World at a Glance). Our FX strategists forecast another 3% of trade-weighted dollar depreciation in 2024.

> Back of the envelope dollar math: every 10% drop in the trade-weighted USD should translate into about a 3% benefit to S&P 500 EPS via currency translation.

Historically, Energy and Materials have benefited most from a falling dollar but Energy may be less tethered – oil's inverse relationship to the USD broke down after the US began to grow energy independent, attributable in part to the fact that rising oil prices no longer contributed to a wider trade deficit (Exhibit 18).

**Exhibit 13: BofA expects weaker trade-weighted dollar**
USD forecast

| | Q124 | Q224 | Q324 | Q424 | Q125 | Q225 | Q325 | Q425 |
|---|---|---|---|---|---|---|---|---|
| EUR/USD | 1.07 | 1.1 | 1.15 | 1.15 | 1.16 | 1.17 | 1.18 | 1.2 |
| GBP/USD | 1.23 | 1.26 | 1.31 | 1.31 | 1.33 | 1.34 | 1.37 | 1.4 |
| AUD/USD | 0.66 | 0.68 | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 | 0.71 |
| USD/JPY | 145 | 143 | 142 | 142 | 140 | 138 | 136 | 136 |
| USD/CAD | 1.35 | 1.34 | 1.32 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 |
| USD/SEK | 10.93 | 10.36 | 9.74 | 9.65 | 9.57 | 9.4 | 9.24 | 9 |
| USD/CHF | 0.9 | 0.87 | 0.84 | 0.84 | 0.84 | 0.84 | 0.84 | 0.83 |
| DXY | 104.8 | 102.23 | 98.58 | 98.4 | 97.51 | 96.68 | 95.7 | 94.39 |

**Source:** BofA FX Research
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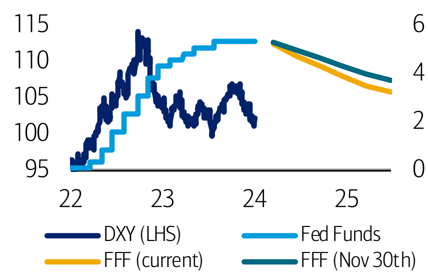
**Exhibit 14: USD depreciated amid repricing of Fed expectations**
DXY and Fed Funds Futures Curve (Nov 30 vs. current)




**Source:** New York Fed, Bloomberg and BofA Global Research
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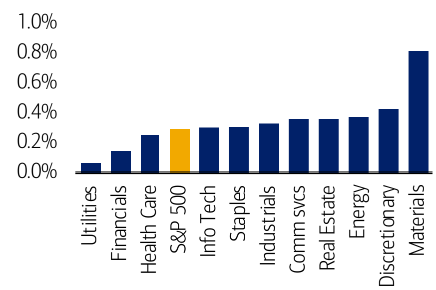
**Exhibit 15: 30bp benefit to S&P 500 sales**
Estimated FX impact to YoY sales growth in 4Q23 by sector




**Source:** FactSet, BofA US Equity & Quant Strategy
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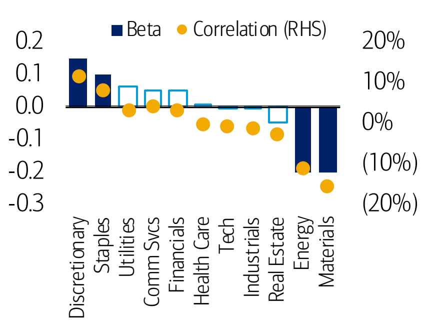
### Energy and USD decoupled

**Exhibit 16: Historically, Energy was one of the largest beneficiaries of a weaker dollar…**
S&P 500 sectors' rel. perf. to DXY (1973-12/23)




**Source:** Bloomberg, FactSet, BofA US Equity & Quant Strategy. Note: Empty bars indicate not statistically significant
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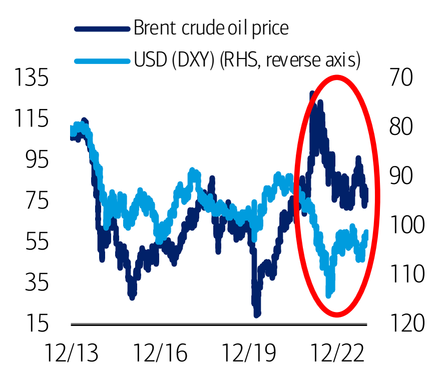
**Exhibit 17: …but oil prices and the dollar recently decoupled…**
Brent ($/bbl) vs. DXY (RHS; inverse)




**Source:** Bloomberg
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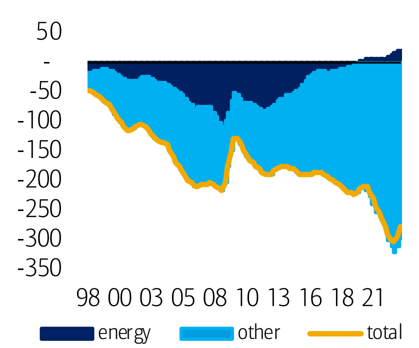
**Exhibit 18: …as the US became more energy independent**
US trade balance (quarterly, 4Q moving avg.; $bn)




**Source:** Bloomberg
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## Q: Growth trounced Value in 2023 – what next?

A: The Russell 1000 Growth index outperformed the Russell 1000 Value index by 33ppt in 2023. Historically, Russell Value led Russell Growth over the 3-, 6- and 12- subsequent months after episodes of Russell Growth extreme outperformance, with a very consistent hit rate. Periods which did not see a snap-back from Growth to Value were generally accompanied by negative profits growth. We already experienced a profits recession last year, and profits have re-accelerated since 2Q23. Other reasons for a snap-back in Value include crowded growth positioning, and excessively high premia for growth vs. value stocks.

**Exhibit 19: Russell 1000 Value usually "rips" after periods of extreme (25%+) underperformance**
Subsequent Russell 1000 Value index relative performance vs Russell 1000 Growth after outsized (25%+) outperformance over prior 12mth period

| | Next 3 months | Next 6 months | Next 12 months |
|---|---|---|---|
| **Rel. Ret:** | +3.9% | +10.4% | +16.5% |
| **Hit Rate (Value led):** | 63% | 79% | 74% |

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

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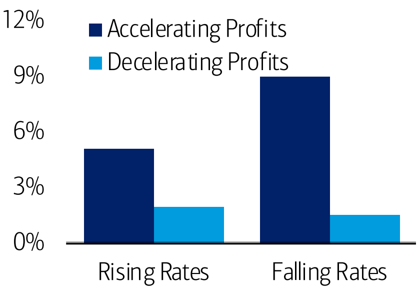
### Other reasons for a potential snap-back

**Exhibit 20: Value outperforms when profits accelerate (our base case)**
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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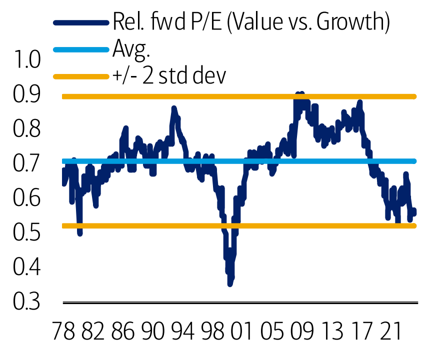
**Exhibit 21: Growth still expensive**
Relative forward P/E of Russell 1000 Growth vs Value style indices as of 12/23




**Source:** BofA US Equity and Quant Strategy, FactSet
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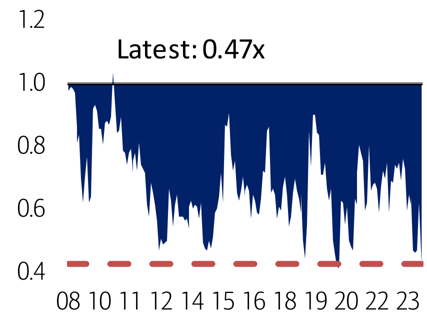
**Exhibit 22: Value is underweight vs. Growth**
Long only positioning in Value vs Growth proxied by Price to Earnings vs Long-Term Growth of S&P 500 (9/2008-12/2023)




**Source:** BofA US Equity & Quant Strategy, FactSet Ownership
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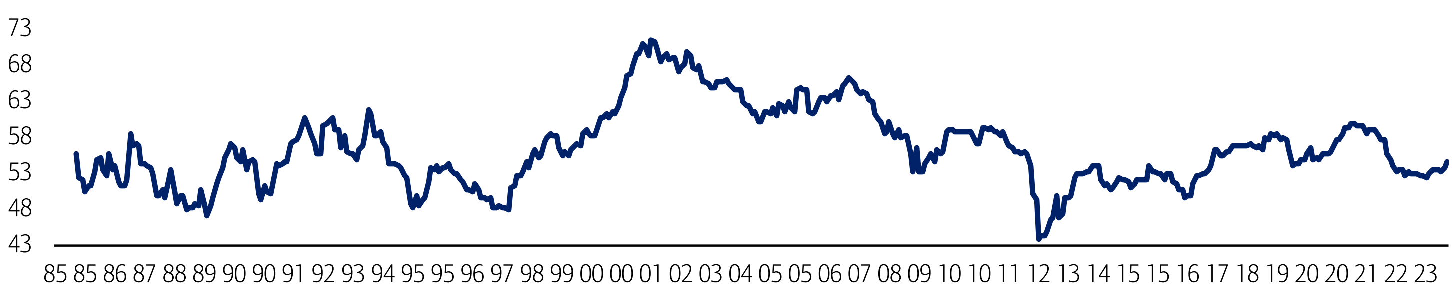
## Q: Could cash fuel the next great rotation into equities?

A: Following a year of investors bracing for a recession as the Fed hiked cash yields to 5%+, every type of US investor holds more cash and less equities. Expectations for a soft landing and Fed easing cycle have dominated the headlines, but cash levels have barely budged since mid-2023. We see some inklings of warming sentiment toward equities in our Sell Side Indicator and in BofA's Global Fund Manager Survey, but are far from levels of euphoria that would mark the end of a bull market.

**Exhibit 23: Wall Street is less bearish but far from euphoric on stocks**
Avg. recommended allocation to stocks by Wall Street strategists (2006-12/2023)




**Source:** BofA US Equity & Quant Strategy

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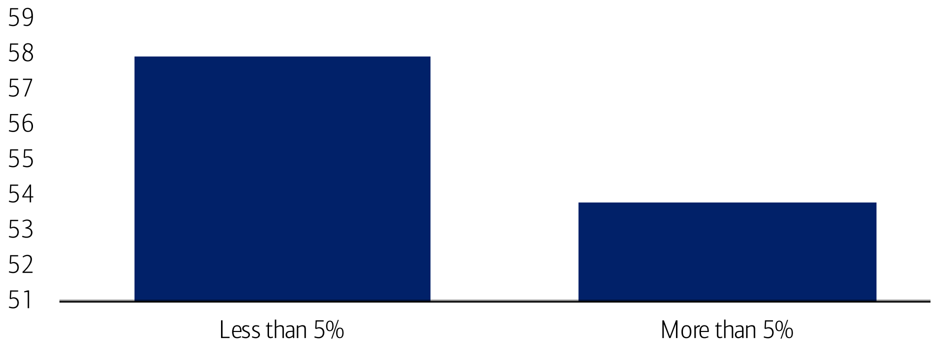
Our economists expect the Fed to begin cutting rates in March, and expects the Fed Funds target rate to fall to 4.25-4.50% by year-end, and to reach 3.25-3.50% in 2025. This bodes well for a rotation into equities. Based on two independent analyses, the tipping point in cash yields is about 5% for major changes in equity allocations.

**The 5% tipping point:** based on our Sell Side indicator data history as well as the RIC Report, investors allocate more toward equities when cash yields are below 5%, and vice versa.

**Sell Side Indicator:**

**Exhibit 24: 5% cash yield mark the tipping point for higher / lower equity allocations**
Sell side indicator bucketed by 3m US treasury yield (Aug 1985 to Dec 2023)




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

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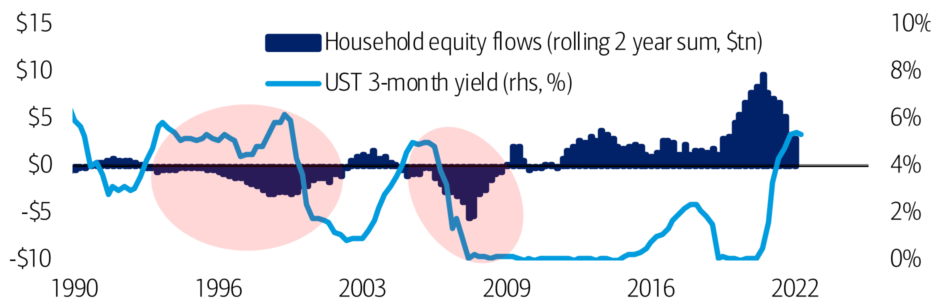
**RIC Report:**

**Exhibit 25: Households typically sell stocks once cash pays >4.5%**
3-month US treasury yield vs US household equity flows




**Source:** BofA Research Investment Committee, Haver, Federal Reserve FoF, Bloomberg. Note: Flow data through 3Q22. Household equity flows are based on buying/selling of single name equities and equity mutual fund shares.

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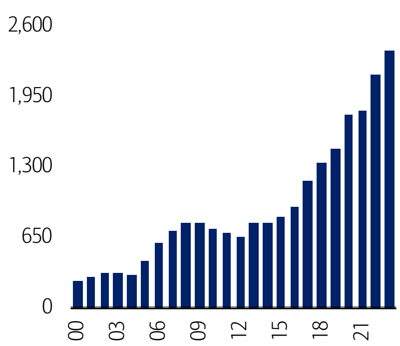
## Institutional and individual investors are sitting on elevated cash levels

**Exhibit 26: Private equity funds: record dry powder**
Private equities' total dry powder ($B) (2000-2023 as of 9/12/2023)




**Source:** Preqin, BofA Global Research
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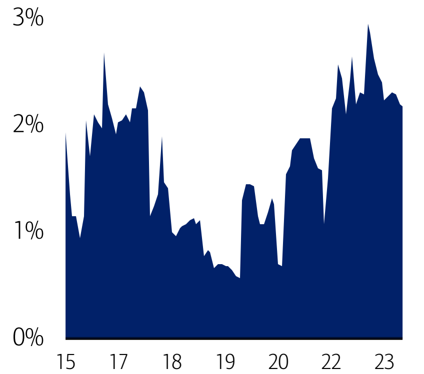
**Exhibit 27: Equity mutual funds: cash is 1 std dev above average**
US large cap equity mutual funds: Cash as a % of AUM




**Source:** FactSet Ownership, BofA US Equity & Quant Strategy
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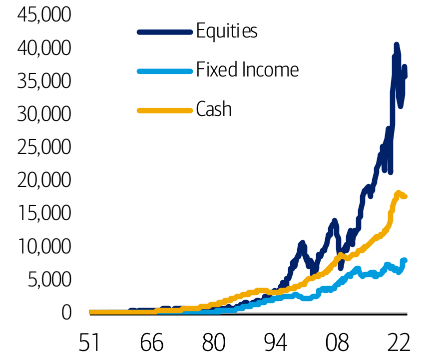
**Exhibit 28: Households have $18tn in cash, up from $13tn pre-COVID**
US household financial assets: equities, fixed income, cash




**Source:** BofA Research Investment Committee, Haver, Federal Reserve FoF
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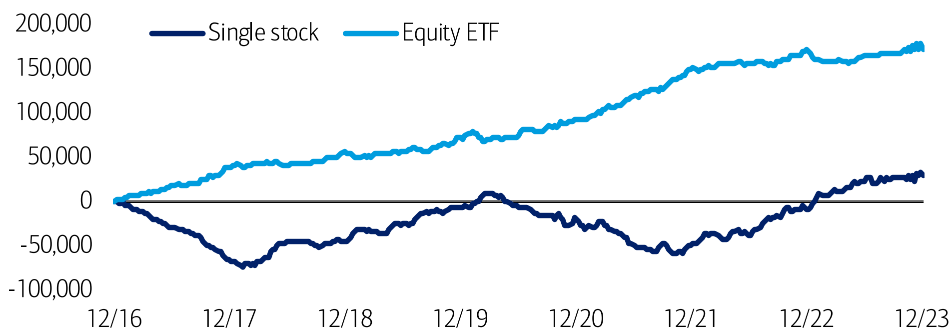
## Retail cash may be used to fund equities, but not necessarily via index funds

See BofA Client Flows

**Exhibit 29: ETFs inflows have slowed, single stock outflows have flipped to inflows in 2023**
Overall BofA client net buys (sales) of single stocks vs. equity ETFs, $ mn




**Source:** BofA Securities
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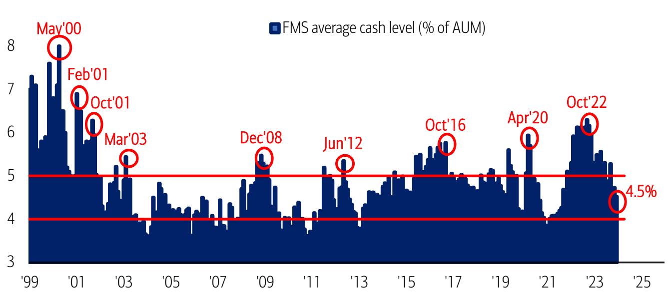
## Fund Manager Survey: investors say they are moving from cash to stocks

**Exhibit 30: BofA Global FMS Cash level dropped to 4.5% from 4.7%**
FMS average cash level % AUM




**Source:** BofA Global Fund Manager Survey
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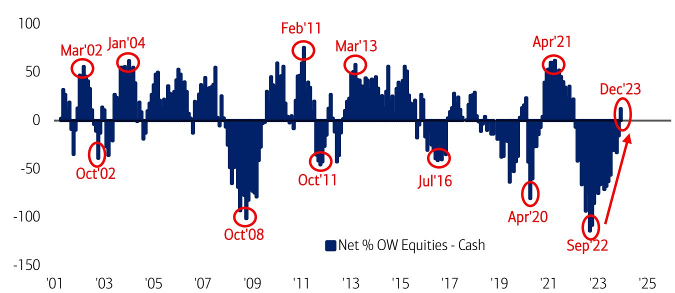
**Exhibit 31: Up in equities, down in cash**
Net % overweight equities – net % overweight cash




**Source:** BofA Global Fund Manager Survey
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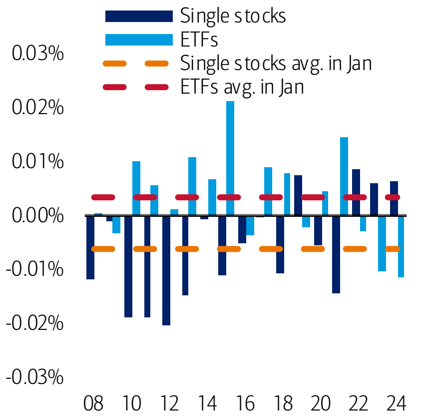
**Exhibit 32: Lately, retail clients have been purchasing more single stocks vs. ETFs in January despite historical trend (passive>active)**

Retail clients inflows/outflows in January (as a % of S&P 500 mkt cap)




**Source:** BofA Securities, Bloomberg

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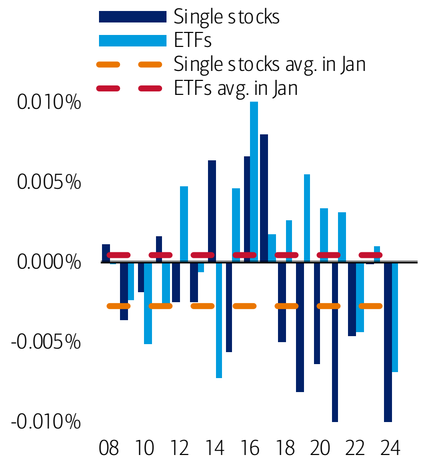
**Exhibit 33: Generally, large single stock selling from hedge fund clients**

Hedge fund clients inflows/outflows in January (as a % of S&P 500 mkt cap)




**Source:** BofA Securities, Bloomberg

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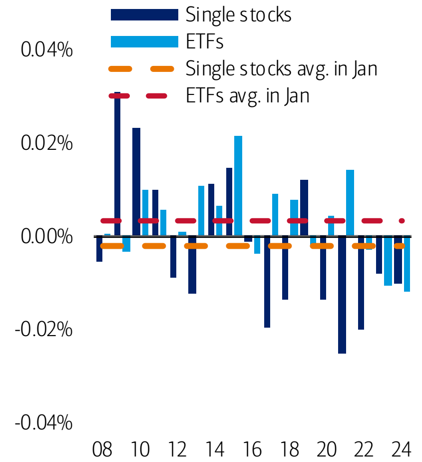
**Exhibit 34: Overall selling in Jan. from Institutional clients in recent years**

Institutional clients inflows/outflows in January (as a % of S&P 500 mkt cap)




**Source:** BofA Securities, Bloomberg

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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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