COMERICA WEALTH MANAGEMENT

Mid-Year Market Outlook

June 2022

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EXECUTIVE SUMMARY

The financial markets have struggled in their worst start to a year in decades. Of course, the combination of events that have weighed on the economy have pressured investor sentiment and stock prices. Surging inflation, the pivot in Fed policy, and historically pricey equity valuations were on the minds of investors as the year began, but the combination of COVID-19 lockdowns in China and Russia's invasion of Ukraine has escalated volatility further with investors becoming increasingly concerned about the possibility of global recession sometime within the next year.

POLICY - The tailwinds of fiscal and monetary policy have quickly turned to headwinds for the economy and the financial markets in 2022. Fiscal stimulus as a percentage of domestic output has plunged and the Federal Reserve is aggressively removing monetary support. Properly threading the needle on monetary policy will prove most important over the next year.

Economy - U.S. GDP sputtered to a decline of 1.5% in the first quarter, increasing fears that the economy was already in recession. Comerica's Economics Group projects GDP growth of 2.8% in 2022 and 1.7% in 2023, supported by slightly moderating price pressures and the unemployment rate holding below 4.0%. Full employment in the U.S. should prove a strong buffer against rising recessionary risks.

Fixed Income - The fixed income markets have had a turbulent first half of the year as inflation and the Federal Reserve's newfound resolve to fight it have caused bond yields to spike sharply higher. It appears the benchmark 10-year U.S. Treasury yield is forming a base in the 2.75% to 3.25% range. While the 40-year bull market in bonds may be over, the rapid adjustment in market interest rates to the Fed's policy pivot presents diversified portfolios with enhanced yield opportunities to help offset price pressures.

Equities - The equity markets have struggled for their worst start to a year in decades as investors reassess valuations given the risks of inflation, geopolitics, monetary policy, and the potential for recession. After a persistent march to new records last year, stocks have suffered severe technical damage that will take time to repair. We've identified three primary support levels and look for margins to gradually erode from record levels. Our below consensus profit forecasts suggest the S&P 500® Index will be fairly valued in the 4,000 to 4,250 range by yearend. We maintain our preference for value, quality (profitable) small caps, and cyclical sectors including Energy, Materials, Industrials, and Financials.

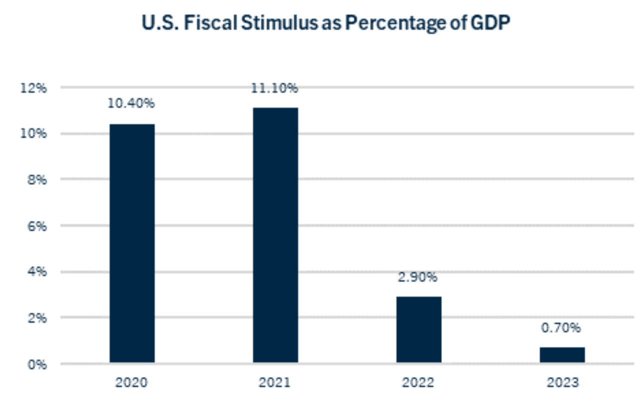
Global - Economic output and financial market performance remain constrained around the world as geopolitical tensions and inflationary pressures intensify. We maintain benchmark allocations for both Emerging and Developed markets, with a preference toward value and commodity exporters as eventual beneficiaries of cyclical recovery.

Currencies and Commodities - High inflation and slowing global growth have raised the risk of a global downturn, supporting demand for the U.S. dollar and pressuring commodity prices with the exception of energy. We look for these trends to persist until clarity emerges on global demand growth.

POLICY

The tailwinds of fiscal and monetary policy have quickly turned to headwinds for the economy and the financial markets in 2022.

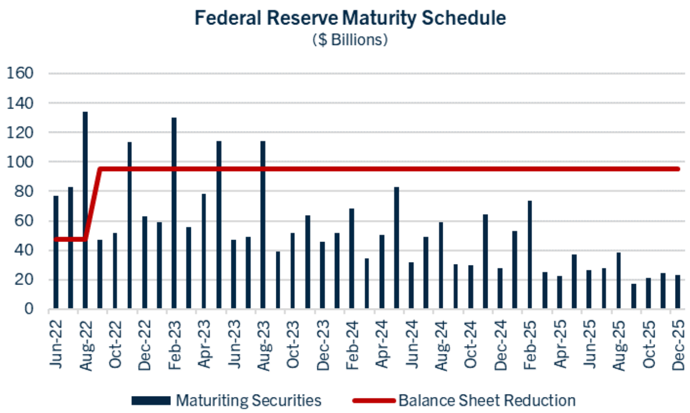
Fiscal stimulus as a percentage of economic output has declined from approximately 10.0% in each of the past two years to less than 3.0% currently. This factored into the weak GDP report for the first quarter. Moreover, political bickering has limited the prospects for new spending, though we suspect some degree of infrastructure outlays will be agreed over the next few months leading up to the midterm elections. **See Chart: Fiscal Stimulus as a Percentage of GDP.**



Source: Strategas Research Partners

The shift in monetary policy has had a larger impact on the economy and the financial markets, though, as the Federal Reserve has begun its interest rate tightening campaign. Fed Chair Jerome Powell has a tough balancing act ahead of him. If the Fed moves too slowly, it risks not tamping down inflation and having higher inflation expectations become embedded – making it more difficult to eliminate. Conversely, if the Fed raises rates too quickly, it risks tilting the economy into recession, with the associated job losses and other costs.

By signaling 50-basis point hikes at the next two meetings, the Fed can send a strong message about its commitment to fight inflation without sending the economy into a tailspin. This is because the maturity schedule for securities on the Fed balance sheet is elevated this summer, which will require proceeds of up to $150 billion to be reinvested, providing a near-term cushion for the economy and financial markets. **See Chart: Fed Balance Sheet Maturity Schedule.**



Source: Federal Reserve

Chair Powell has laid out specific plans to shrink the Fed's $8.9 trillion balance sheet. Over the next three months, the Fed will allow for a total of $47.5 billion in maturing U.S. Treasury and Mortgage-Backed Securities to roll off its balance sheet, followed by a doubling of that amount, to $95 billion per month, beginning in September.

The process of quantitative tightening (QT) will nonetheless take several years to fully unwind and return back to the $4 trillion, pre-pandemic level.

Properly threading the needle on monetary policy will prove most important over the next year.

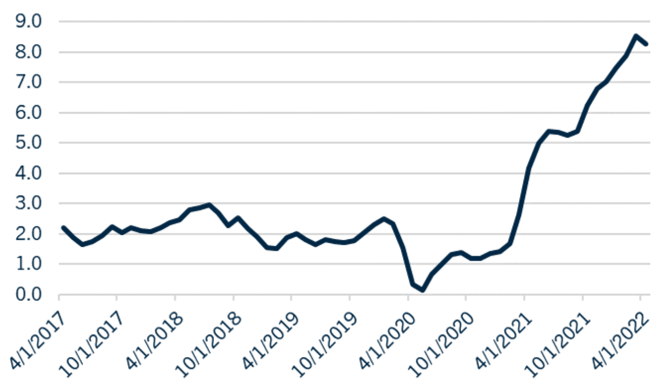
ECONOMY

U.S. GDP sputtered to a decline of 1.5% in the first quarter, increasing fears that the economy was already in recession.

Comerica Bank Chief Economist Bill Adams cited the reasons for weakness involved government spending, trade, and inventories. Strength was evident in personal consumption and business investment, though, and these trends were continuing in the current quarter. Indeed, reports on manufacturing, services, retail sales, and industrial production all indicated the economy was on pace for slower, but steady output gains, despite the many global risks. A doubling of the 30-year fixed mortgage rates, however, will likely take the speculative edge off the housing sector in the months ahead.

Inflation remains the biggest challenge to the U.S. economy. The Consumer Price Index climbed 8.3% on a year-over-year basis (YOY) in April, though the data slowed slightly from the previous month. We look for pricing pressures to moderate slightly though remain elevated, with CPI finishing 2022 in the range of 7.8% YOY growth. **See Chart: CPI.**

Consumer Price Index - YOY



Source: Bloomberg L.P.

Strong employment levels are resulting in upward pressure on wages, but incomes are unable to keep up with inflation. This presents a challenge for policymakers as job openings and quit rates also remain high.

The May Employment Report showed a gain of 390,000 jobs, ahead of previously lowered expectations but still consistent with the 400,000 monthly pace in payroll gains over the past year. The unemployment rate of 3.6% suggests a recession in the near-term is unlikely. **See Chart: Economic Forecasts.**

Economic Forecasts

	2021a	2022f	2023f
U.S. Real GDP	5.7	2.8	1.7
Consumer Price Index	4.7	7.8	4.5
Unemployment Rate	5.4	3.6	3.5
10-Year Treasury Note	1.44	2.70	2.64

Source: Comerica Bank — a = actual; f = forecast

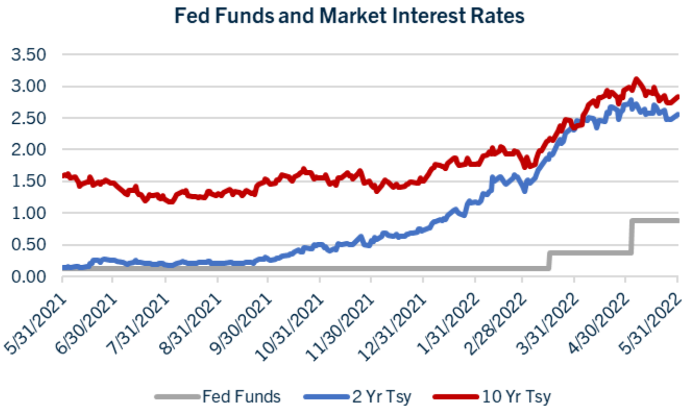
Of course, there are many reasons to expect an economic slowdown, or even recession next year, not the least of which is that fears of contraction can be self-fulfilling. A variety of global risks remain, including inflation and market interest rates, which can ultimately erode the current fundamental strengths in employment, consumption, and investment.

Comerica's Economics Group projects GDP growth of 2.8% in 2022 and 1.7% in 2023, supported by moderating price pressures and the unemployment rate holding below 4.0%.

FIXED INCOME

The fixed income markets have had a turbulent first half of the year as inflation and the Federal Reserve's newfound resolve to fight it have caused bond yields to spike sharply higher.

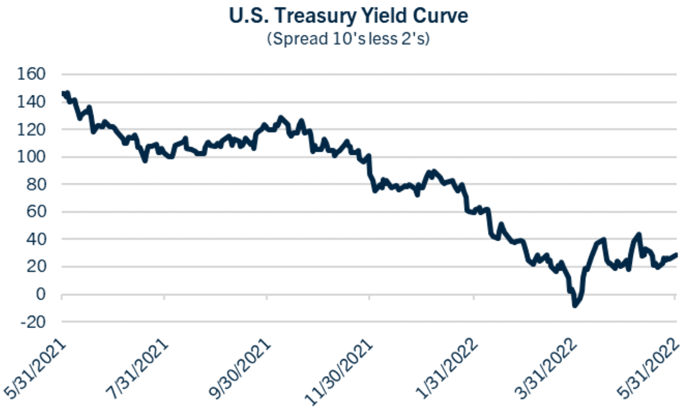
Although the Fed has only raised rates by 75 bps through early June, the bond market has been attentive to the projections and narrative shared by monetary policymakers and is expecting the fed funds rate to end the year near 3.0%. As a result, bond yields have moved more quickly than the fed funds rate, essentially doing the Fed's job for it. Leading the charge higher has been the 2-year Treasury note, which has jumped from ~0.75% at the start of the year to more than 2.75% currently. In addition, the yield on the benchmark 10-year Treasury note has doubled from ~1.50% to ~3.0% thus far in 2022. **See Chart: Fed Funds and Market Interest Rates.**



Source: Bloomberg L.P.

As a result, no corner of the bond market has been spared. Negative total returns have looked more like what investors fear from their equity portfolios than what they expect from fixed income. The broadest taxable index, the US Aggregate, is down more than 8.0% YTD while investment grade corporate bonds, with longer durations and buffeted by spread widening, are down almost 12.0% for the year. Corporate high yield, municipal bonds and mortgage-backed securities have also struggled with high single -digit percentage losses.

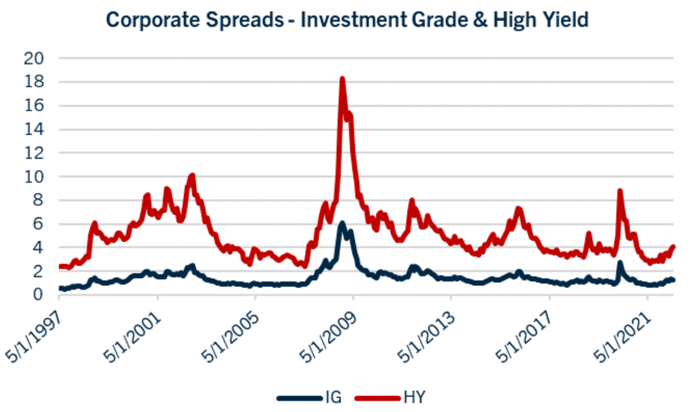
To be sure, this volatile ride was accompanied by a flattening-and for a short time inverted-U.S. Treasury yield curve. Though global challenges persist, and inflation remains at multi-decade highs, we suspect safe haven demand at the long end produced more bids than usual, first with concerns over the Omicron variant then followed by Russia's invasion of Ukraine. The recent curve steepening has also been an encouraging market signal. **See Chart: U.S. Treasury Yield Curve.**



Source: Bloomberg L.P.

It appears the 10-year Treasury yield is forming a base in the 2.75% to 3.25% range. The 40-year trend line of 3.25%, which represents resistance, recently put bond bulls in charge, while bond bears decided to bail around 2.75%. We suspect this range will persist in the months ahead as bonds appear to have responded to the Fed's messaging more quickly than stocks.

Another bond market signal suggesting a "better-than -feared" or an "already priced in" economic environment has been the relative performance of corporate spread sectors. While market interest rates have climbed given concerns about inflation and the degree to which Fed policy may overreach, the spreads for investment grade and high yield bonds relative to the benchmark 10-year Treasury remain well within their longer-term averages. **See Chart: IG and HY Spreads.**



Source: Bloomberg L.P.

As a result, we suspect there is reason to believe the worst of the bond market declines are behind us. We identify three factors potentially working in investors' favor. First, the bond market seems to have stabilized in May, with most sectors posting mildly positive returns. Second, the silver lining of declining bond prices is that it creates a more attractive yield landscape, which attracts new capital. For example, new investment in the corporate bond market earned ~2.0% yield at the beginning of the year; that figure is now greater than 4.0%. The change in the municipal landscape has been even more profound, with the Barclays Municipal Bond Index yield rising from ~1.0% to ~3.0%. This dynamic is present across the entire spectrum of fixed income. Third, even if there are further price declines from here, investors putting money to work at today's yields have a higher cushion - in the form of more coupon income - to help offset any price deterioration.

After the low yield landscape of the last couple of years, today's higher yield environment presents investors with more compelling choices for portfolio positioning. The most conservative fixed income investors can obtain yields in the 0.50% range in money market funds, which should continue to rise as the Fed pushes the fed funds rate higher in the months and quarters ahead. Those investors willing to accept some principal volatility might consider a shorter-term maturity strategy, where corporate investment grade bonds are producing yields over 3.0%. Another attractive opportunity for the amount of risk taken is in shorter-term municipal bond portfolios where yields more than 2.0%. Finally, for investors with a heartier risk/yield appetite, corporate high yield bonds now offer coupons in the 7.0% range while municipal high yield bonds offer up to 5.0% coupons.

While the 40-year bull market in bonds may be over, the rapid adjustment in market interest rates to the Fed's policy pivot presents diversified portfolios with enhanced yield opportunities to help offset price pressures.

EQUITIES

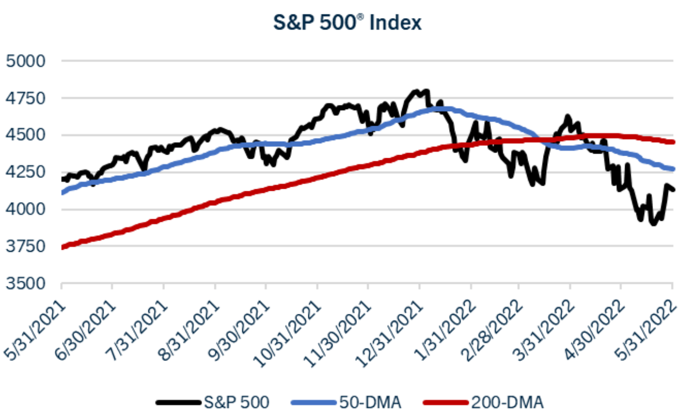
Performance

The equity markets have struggled for their worst start to a year in decades as investors reassess valuations given the risks of inflation, geopolitics, monetary policy and the potential for recession.

The S&P 500® Index is down approximately 15.0% YTD and weakness has been broad based, with Energy being the only sector that has experienced strong gains. Value has been down less than growth, and on an equal-weighted basis, the average stock is outperforming the Index. Defensive leadership indicates a recession is looming, yet we find this difficult to reconcile for 2022 given full employment in the U.S. Nonetheless, we've experienced wider than usual swings on a daily basis, with the competing forces of "buy the dip and sell the rip" occurring more frequently.

Technical Analysis

While we are strong advocates of fundamental analysis – focusing on earnings, economic activity, and interest rates – it is also important to respect market technicals – price and volume patterns – during periods of extreme volatility. Indeed, the equity market has suffered severe technical damage which will require a long time to repair. After achieving 70 records last year with barely more than a 5.0% pullback, the S&P 500® never established significant support levels, resulting in the downtrend where the Index has been trading below its 200-day moving average (DMA) for much of this year. **See Chart: S&P 500® Index.**



Source: Bloomberg L.P.

It is also important to recognize that while in downtrends, equities typically experience significant "bear market rallies" before a true bottom has been established. These countertrend rallies typically see gains of approximately 15.0% over a period of two months, before giving back their gains, exacerbating market volatility.

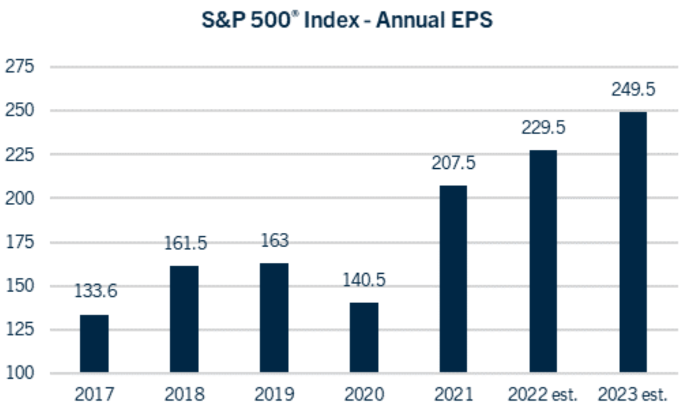
In attempting to find a potential bottom for the S&P 500® Index, we have focused on three key levels:

- The psychological 4,000 level was breached in early May. This was an important development not only because investors like big round numbers, but also because it represents the average drawdown (from the January 4th high of ~4,800) of 17.0% during midterm election years.
- The 3,850 range for the Index would represent a bear market, defined as a 20.0% decline from the early January highs. Its plausible that this level holds support given the slight moderation in inflation readings and market interest rates, yet concerns over recession, Fed policy, supply chains and the war in Ukraine may overwhelm sentiment in the weeks/months ahead.
- Should the bear market level fail to hold, we believe the 3,500 range provides solid support for the Index. This area represents the 50.0% retracement of the S&P 500®'s 2,600- point gain from the low of ~2,200 in March 2020 to the high of ~4,800 in January 2022. This range also represents the 200-*week* moving average for the Index, which proved to be reliable support during previous periods of extreme market weakness. Finally, at 3,500 investors would be paying a P/E ratio of approximately 15 times consensus Index earnings for this year, more in line with a bear market or recessionary multiple.

Once support has been established, stocks must then overcome resistance, which typically proves firm in downtrends. We view primary resistance for the S&P 500® in the 4,250 to 4,450 range, representative of the Index's 50- and 200-day moving averages (DMA).

Fundamental Analysis

We believe that equity investors will need to see a firming in fundamentals before successfully overcoming technical resistance. Fortunately, corporate earnings growth remains solid and despite the risks to margins, profits can still be discounted at rates below historical averages. While market interest rates have climbed this year, it should be noted that the benchmark 10-year Treasury yield of ~3.0% remains about one-half of its 50-year average, which is north of 6.0%. **See Chart: S&P 500® Index Earnings – Actual and Forecast.**



Source: FactSet

Indeed, a curious aspect of the market selloff in 2022 is that consensus earnings estimates have actually *risen* since the beginning of the year. The FactSet consensus earnings estimate for the S&P 500® has climbed to $230.00 in 2022 and $250.00 for 2023. This represents annual EPS growth of 10.0% and 9.0%, respectively. We continue to project operating EPS of $225.00 this year and are introducing an estimate of $237.50 for the Index in 2023.

Our profit forecasts remain below consensus estimates due to our concerns over inflation, geopolitics, interest rates, dollar strength, and the effect they will all have on margins and valuation.

Profit margins thus far remain resilient, hovering near record levels of 12.0% for companies in the S&P 500® Index. However, we look for increases in the costs for commodities and wages, to gradually erode margins in the coming quarters, limiting corporate profit growth.

While valuations have improved, from 21 times to 18 times our 2022 forecast, they still do not reflect levels associated with previous periods of high inflation. Of course, the market is counting on the Fed's ability to engineer a soft landing, but lockdowns in China and the war in Ukraine add complexities to already disrupted supply chains, as well as pressuring prices for food and energy.

Consequently, further volatility is likely as investors attempt to find an appropriate multiple given the levels of inflation and interest rates. We believe a P/E ratio of 17 times 2023 S&P EPS would have the Index fairly valued in the 4,000 to 4,250 range by the end of this year, reflecting the wide range of potential outcomes, including the possible testing of the 3,500 level (50.0% retracement) in the months ahead.

It is also important to remember that the equity markets act as a discounting mechanism for economic output, interest rates, and corporate profitability. History has shown that while investors price in worst case scenarios, the market can also price in recovery before the scenario has concluded. Midterm election years offer a telling example. Though the average drawdown for the S&P 500® is -17.0% in midterm years, the average recovery from the trough to the peak twelve months later is greater than 30.0%.

In addition, despite the climb in market interest rates, the equity risk premium - which measures the difference between the earnings yield on the S&P 500® and the yield on the 10-year Treasury note – continues to favor equities. Currently in the range of 300 basis points, history has shown forward twelve month returns for the Index averaging slightly above 10.0%.

In this volatile environment, we encourage investors to maintain their fully diversified, long-term asset allocation strategies. It is our view that successful long-term investing requires "time in" the market as opposed to "timing" the market. Adherence to strategic allocations with periodic tactical adjustments remains our preferred approach for portfolio management.

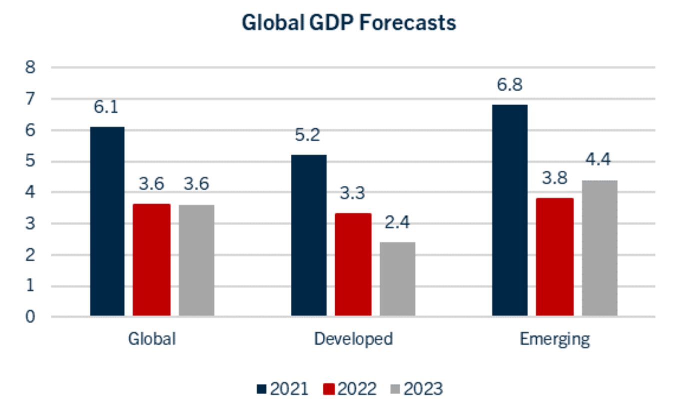
As such, we continue to favor value, quality (profitable) small caps, along with cyclical sectors including Energy, Materials, Industrials and Financials. We believe these categories within the equity market represent more reasonable valuation levels, and also include shareholder return potential through dividends and buybacks, as well as cyclical exposure once markets ultimately position for recovery.

GLOBAL

Economic output and financial market performance remain constrained around the world as geopolitical tensions and inflationary pressures intensify.

Russia's invasion of Ukraine has further pressured already escalating food and energy prices, while the Covid-19 lockdowns in China have dampened prospects for the incipient recovery in global supply chains. The recent reopening of Shanghai was well received by global investors, boosting the markets for emerging equities and copper.

Considering the disruptions to food and energy prices, as well as to global trade, though, the International Monetary Fund (IMF) recently reduced its 2022 forecast for global economic growth to 3.6%, down from 6.1% in 2021. **See Chart: IMF Global Economic Forecasts.**

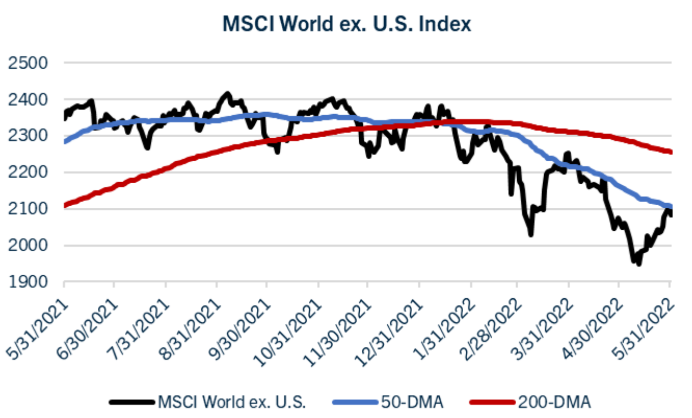


Source: International Monetary Fund

Developed Markets in Europe and Japan are confronting surging inflation, rising market interest rates, and disparate policy responses from leading central banks. Economic growth is moderating, weighing on financial market performance. The ECB recently announced plans to begin raising interest rates and end its bond buying program beginning this summer. Inflation pressures have increased beyond food and energy prices, and economic output is weakening. Monetary policymakers in Japan, however, remain committed to easy money policies as GDP fell by 1.0% in the first quarter. This stance has weighed on the yen, which is at its weakest level relative to the U.S. dollar in 20 years.

In the Emerging space, Beijing's regulatory crackdown on technology companies and property developers has collided with its zero-Covid policy, resulting in weaker than expected readings in manufacturing and consumption. The pandemic related lockdowns have weighed on output as Shanghai was closed for two months.

Though valuations have come in for both Emerging and Developed markets with the rise in market interest rates, each index is down approximately -13.0% YTD. The MSCI World ex. U.S. Index is attempting to rally, though, gathering momentum in recent weeks before running into resistance at its 50-day moving average. **See Chart: MSCI World ex. U.S. Index.**

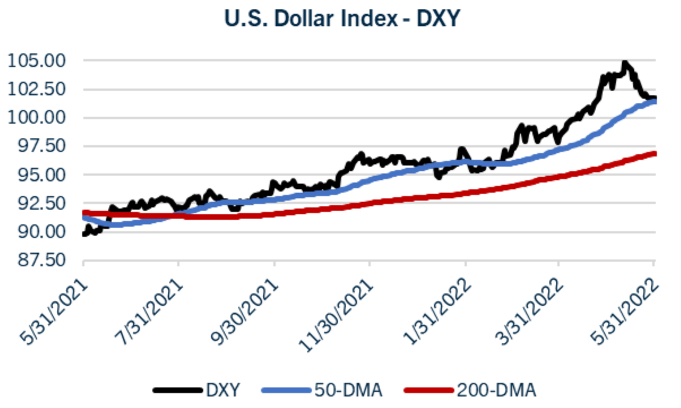


Source: Bloomberg L.P.

In this global environment, we maintain benchmark allocations for both Emerging and Developed markets, with a preference toward value and commodity exporters as eventual beneficiaries of cyclical recovery.

CURRENCIES AND COMMODITIES

High inflation and slowing global growth have raised the risk of a global downturn, which has supported demand for the U.S. dollar. **See Chart: U.S. Dollar Index (DXY).**



Source: Bloomberg L.P.

The greenback has once again proved its leadership and resilience during troubled times, despite growing concerns over the past decade relative to the growing influence of the Euro, Japanese Yen, and Chinese Yuan.

In addition, the U.S. dollar typically declines in the months following initial Fed rate hikes, yet the combination of surging inflation, disparate central bank policies, and intensifying geopolitical tensions had global investors bidding up the greenback to multiyear highs, before pausing slightly in early June.

The combination of a slowdown in global growth and dollar strength has weighed on commodity prices. Gold continues to struggle with its perception as a global inflation hedge, as investors are seeking higher yielding opportunities afforded elsewhere by rising market interest rates.

Copper is trying to regain momentum as Shanghai recently reopened and Chinese output growth resumes. Oil prices persist higher despite OPEC's production increase given concerns about reduced global supply and Europe's embargo on Russian energy imports.

We continue to view the U.S. dollar favorably and expect commodities to remain reliant on the outlook for global growth. Should the Ukraine situation worsen, gold may garner interest as a safe-haven/ store of value, but in a rising rate environment, global investors now have other options. In addition, copper may struggle until demand issues abate, but we look for oil strength to persist.

Be well and stay Safe!

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