U.S. Equities - Short-Term

- The S&P futures gained short-term upside momentum last Friday, but they are flashing a counter-trend signal today per the DeMARK Indicators® that mutes their MACD "buy" signal. The collective takeaway is neutral as the market continues to digest its gains through backing-and-filling. Short-term oversold conditions returned for the Russell 2000 Index last week, suggesting it will see relief from its underperformance.
- The financial sector is under pressure this morning on weakness in the brokers that helped a large hedge fund liquidate its positions on Friday. The stocks in question (e.g., GS, Nomura, Credit Suisse) appear poised for deeper pullbacks, but the broader financial sector appears to have limited downside after having become oversold from a short-perspective last week, now a source of bullish stochastic upturns.
- WTI crude oil prices are lifting off their 50-day MA after having become oversold from a short-term perspective. We expect a rebound to provide relief for the energy sector, which has seen a partial retracement of its February-March rally. XLE retreated ~13% from its intramonth high and now looks poised to rebound.

E-Mini S&P 500 Futures (ESA, 3948.50)
60-min. Bar Chart + 50-period MA + DeMARK Indicators®
Intraday Support: ~3932 | Intraday Resistance: ~3978-3979

U.S. Market Internals

		26-Mar	25-Mar	24-Mar	23-Mar	22-Mar
Price	S&P 500 Index (SPX)	3974.54	3909.52	3889.14	3910.52	3940.59
	SPX % Change	1.66%	0.52%	-0.55%	-0.76%	0.70%
Breadth	NYSE Advancers	3188	2592	1795	964	1905
	NYSE Decliners	971	1568	2397	3245	2231
	SPX % > 50-day MA	**83%**	76%	71%	71%	78%
	SPX % Oversold	6%	22%	19%	10%	7%
	SPX % Overbought	22%	14%	15%	20%	25%
	McClellan Oscillator	-6	-103	-169	-161	-70
Sentiment	CNN Fear and Greed Index	40	40	49	54	53
	AAII Bull-Bear Spread	**30.3**	**30.3**	**30.3**	**25.3**	**25.3**
	CBOE Volatility Index (VIX)	18.86	19.81	21.2	20.3	18.88
Leadership	NYSE New 52-Week Highs	118	31	28	26	58
	NYSE New 52-Week Lows	13	73	45	34	8
	NYSE NH – NL	105	-42	-17	-8	50
Volume	NYSE Volume (Billions)	3.39	3.33	3.10	3.25	2.87
	NYSE Up/Down Volume	2.3	3.3	-1.9	-5.3	-1.5

DeMARK Indicators®

Counter-Trend "Buy"/"Sell" Signals*:

Communication Services: None
Consumer Discretionary: **AZO**, **GPC**
Consumer Staples: SJM
Energy: EOG, WMB
Financials: BLK, HBAN, HIG, JPM, RF, RJF
Health Care: ANTM
Industrials: AOS, J, MAS
Materials: DOW, PPG
Real Estate: EQR, REG
Technology: ADP
Utilities: None

** Short-term counter-trend signals in the S&P 500 from the TD Sequential® and TD Combo® models; we **boldface** high-conviction signals per our methodology (none today).*

Since December 2020, institutions have been net sellers of equities, which we see as a contrarian positive indicator...

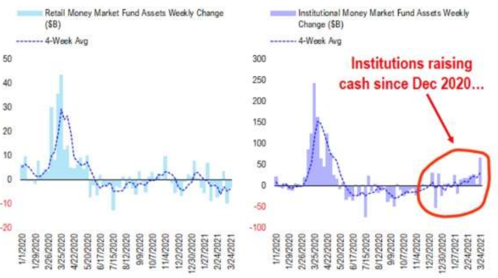
One of the most common questions asked of us, when we see our clients, is whether institutional investors are bullish. And my co-founder and John Bai, have been in consistent agreement -- institutional investors have been cautious since the start of 2021. Today, we present two pieces of empirical evidence of this:

- first, institutions have raised cash levels, +$128 billion since December 2020 and now the highest cash balances since June 2020
- second, tick data shows that stocks have been falling in the final hour of trading, the final hour is typically a measure of institutional activity

Thus, despite those widely cited surveys by BofA, etc, Fundstrat's observation from our clients has been of clients being quite cautious. And this is actually supported by the empirical data.

Institutions have been steadily raising cash since the start of the year...

Take a look at weekly change in money market cash balances, using data from ICI. The right chart is institutional money market cash. And as you can see, we have seen cash raised every week since December 2020.

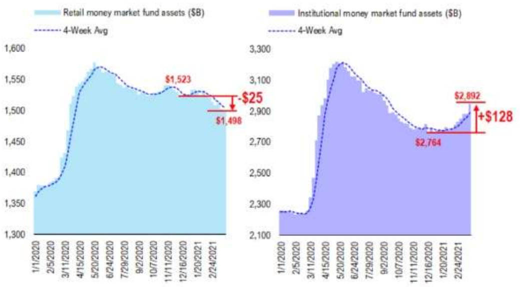


Source: Fundstrat, ICI

The total cash balances have increased a whopping $128 billion during that period of time. That has more than offset the $25 billion of decrease seen in retail money market balances. In other words, overall cash balances have been rising over the past 3 months.

- rising cash balances is not a sign of a bullish institutional investor
- cash balances are the highest since June 2020

This should be viewed as a source of firepower for future buying -- hence, cash on the sidelines could fuel further upside.



Source: Fundstrat, ICI

Stocks have been falling in the final hour of trading -- typically a sign institutions are sellers

Another sign of cautiousness of institutions is the selling seen in markets in the final hour. Typically, institutional investors execute the bulk of their trades in the final hour, along with derivatives, gamma hedging etc. Thus, the trading in that final hour is an insight into institutional activity versus retail.

- as this chart below (originally from Sentiment Trader) shows, since December, stocks have fallen in the final hour

- meaning, institutions are net sellers since December

Further lends credence to the empirical data of money market balances rising.

Source: twitter.com

Why are institutions net sellers? Hyper-growth stocks stopped working and perhaps institutions are reluctant to rotate into Epicenter...

The question that ultimately matters is why institutions are selling stocks here. We have a few thoughts on why:

- institutional investors see stocks as expensive
- institutional investors are worried about inflation and rising rates
- institutional investors are shedding their significant overweights in "stay at home stocks"
- institutional investors have been cautious since the January reddit massacre
- institutional investors are skeptical about the re-opening, hence, reluctant to own Epicenter
- institutional investors are still concerned about COVID-19 and want to see it recede further

Where the indicators stand

Breadth firms ahead of bullish April seasonality

Market Analysis

Bullish trading cycles but only SPX at weekly closing high

Rising 26 and 40-week moving averages (MAs) reflect bullish trading cycles on the S&P 500 (SPX), Russell 2000 (RTY), NASDAQ 100 (NDX) and MSCI Emerging Markets (EEM). Only the SPX and NDX closed higher last week, with an all-time weekly closing high on the SPX. Corrective phases in March have held important weekly chart supports at SPX 3723-3694, RTY: 2085-2060, NDX 12,440-12,200 and EEM 51.76-49.87. Neither the SPX nor the RTY has had a weekly close below its rising 13-week (quarterly MA) since October 2020. Both the NDX and EEM have closed below their 13-week MAs, but the rising 26-week MAs have held as these indices correct within bullish trends. EEM may be forming a bullish wedge after testing the prior high from 2018 as support.

NYSE breadth and volume improved late last week

The last ten sessions of March have bearish seasonality, and up until last Thursday and Friday (3/25-3/26), the second half of March had struggled in terms of price action, breadth and volume. Improving breadth on the NYSE in terms of advancing stocks and upside volume in those stocks confirmed a solid rally for the SPX off Thursday's low. Friday saw upside follow-through on solid breadth, but volume lagged breadth as selling pressure took hold of a select group of stocks. With three sessions left in March, moving above 50% on the 5-day MAs of the percentage of advancing NYSE stocks and the percentage of NYSE up volume would provide tactical support for the bulls.

Bullish breadth backdrop signals

The improvement in market breadth late last week is encouraging for the bulls, especially just prior to bullish seasonality in April. The SPX advance-decline line and the percentage of SPX stocks above 200-day MAs hit a new cycle highs last week. Positive market breadth is a solid backdrop signal and bullish leading indicator for the SPX.

Farrell Sentiment: Believers but not yet euphoric

Farrell Sentiment shows that individual investors finally became believers in the US equity market rally from the March 2020 low in 4Q 2020. However, belief does not equal euphoria. Last week's Farrell Sentiment level of 1.10 is below the peak bullishness levels of 1.34 in February 2018, 1.39 in January 2015 and 1.50 from January 2011. Similar to the net long position of institutional asset managers in S&P 500 e-mini futures, Farrell Sentiment has some room to run from belief to euphoria.

3/26 SectorPulse: Long S5RLST, S5CONS and S5ENRS

Each week, the Sector Pulse identifies up to three sector longs or up to three sector shorts. Since the XG Boost model's predicted probability is greater than 0.52 and there are no GFSI anomalies detected, the SectorPulse signal as of the March 26, 2021 weekly closing price is three longs: **Real Estate (S5RLST), Consumer Staples (S5CONS) and Energy (S5ENRS)**.

More indicators on the move inside this note

More indicators inside this note: Monthly MACD, cumulative net up volume, credit spreads, 14-day RSI on the SPX and margin debt.

Indicator checklist

Weight of the evidence remains bullish

The trend, breadth and volume indicator backdrop is bullish heading into positive April seasonality with additional support from benign credit spreads and financial conditions as well as from room to run on margin debt indicators. Sentiment shows tactical risk from the 3-month VIX vs VIX and put call ratios. An overbought 12-month margin debt z-score is more neutral than bearish. Daily Williams %R is overbought across daily, weekly and monthly timeframes, but persistent overboughts equal good overboughts.

Table 3: Indicator checklist: Trend, Breadth, Volume, Seasonality, Sentiment, Credit Markets, Price Momentum and Macro

The trend, breadth and volume indicator backdrop is bullish heading into positive April seasonality with additional support from benign credit spreads and financial conditions as well as from room to run on margin debt indicators. Sentiment shows tactical risk from the 3-month VIX vs VIX and put call ratios. An overbought 12-month margin debt z-score is more neutral than bearish. Daily Williams %R is overbought across daily, weekly and monthly timeframes, but persistent overboughts equal good overboughts.

Category	Indicator	Signal	Notes
Trend	S&P 500 trading cycle	Bullish	Rising 26 and 40-week MAs = bullish trading cycle. These MAs closed last week at 3701 and 3556, respectively.
	Golden Cross	Bullish	A Golden Cross (50-day MA above 200-day MA) in a recession is bullish.
	Monthly MACD	Bullish	July 2020 buy signal intact. Monthly MACD to new highs in early 2021. 12-month MA key support at 3445.
	Dow Theory	Bullish	New highs for the Dow Industrials and Transports on Friday (3/26) confirm the cyclical bull market from March 2020.
	Demark exhaustion signals	Triggered dips	Weekly 13 upside exhaustion signals on SPX (late Jan) and RTY (mid Feb). Mid-March daily 13 exhaustion on RTY.
Breadth	NYSE all issues A-D line	Bullish	Bullish trend intact with new highs in mid March.
	NYSE stocks A-D line	Bullish	Unlike early 2020, new all-time highs for this A-D line into mid March confirm the rally for US equities into March 2021.
	Most active A-D line	Weakening	Big drop in late March as breadth of the most heavily traded stocks has weakened – may be part of market rotation.
	S&P 500 A-D line	Bullish – new high	A new high last week is positive for market breadth and a potential leading indicator of new highs for the SPX.
	% SPX stocks > 10-day MAs	Firmed above 50%	After a bullish signal in early March, the % of SPX stock above 10-day MA dropped 31.7% before bouncing to 76.0%.
	% SPX stocks > 50-day MAs	Breakout	Stronger in late March than in mid February. Bullish March 9th breakout above YTD downtrend line intact.
	% SPX stocks > 200-day MAs	Bullish – new high	Improved on the SPX correction in late March. New highs on Friday (3/26). Overbought spikes above 90% are not bearish.
Volume	SPX cumulative net up volume	Confirmed rally	Below its 2020 peak, but tactical breakouts in early Feb and early Mar are positive. Probed to a new high in mid March.
	Cumulative volume other indices	Confirmed rally	Confirmed rallies on RTY and NYA into mid March and on NDX into mid Feb. Probed above 2020 peak on NYA.
	Volume Intensity Model (VIM)	Bullish	Bullish (VIM Accumulation above VIM Distribution) across the SPX, NASDAQ Comp, NYA and RTY.
	VIGOR	Rising / Bullish	Rising trends on VIGOR with new highs for NYSE, NASDAQ Comp and RTY, but no new high yet on the SPX.
Seasonality	S&P 500 seasonality	Bullish in April	2H March dip but seasonality shines in April. April is the second best month of the year for SPX seasonality.
	January / February Barometers	Bearish/Bullish	First five sessions up, but Jan closed lower - Chart Blast: Bearish January Barometer. Jan-Feb Barometer positive.
	Presidential Cycle	Bullish	Favorable Year 1 scenario for a Democrat Presidency.
	VIX seasonality	Risky in Feb/Mar	Feb/Mar can see bigger spikes in the VIX. Lower VIX spikes based on seasonality in April and May.
Sentiment	Farrell Sentiment	Not yet overbought	Refreshed bullish signal on move above 0.5 in early October. Not yet at overbought levels from 2018, 2015 and 2011.
	AAII Bulls	Risky above 50	Moved above 50 (overbought) in Nov (Quantifying Technicals) and last week. Recent overboughts: 1/18, 11/14 and 12/10.
	3-month VIX vs the VIX	Bearish divergence	Bearish signal on 2/18 confirmed 2H Feb risk. Bearish divergence (lower high) into weak 2H March seasonality.
	5-day put/call	Bearish	Bearish signal on move out of overbought.
	25-day put/call	Bearish	Bearish signal on move out of overbought.
	SPX futures positioning	Bullish: room to run	Large specs back to a net short. Asset managers have sold since late January – lows coincide with bullish SPX seasonality.
Credit markets	US high yield OAS	Bearish divergence	Benign levels but near prior cycle lows. A February to March bearish divergence (OAS lower highs vs SPX higher highs).
	LQD and HYG ETFs	Bearish breakdowns	After stalling on higher rates (bearish divergence), both LQD and HYG broke lower – a tactical risk for SPX.
	BAA vs US 10-year spread	Bullish	A narrowing spread with lower lows into late March confirm the SPX rally.
	Weekly HY vs IG ratio	Bullish	Tactically risky signals for LQD and HYG but HY continues to lead IG. This should persistent and is a bullish backdrop.
Price momentum	Daily Williams %R	Back to overbought	A move out of overbought coincided with weak 2H Mar seasonality. Back to overbought ahead of bullish April seasonality.
	Weekly Williams %R	Bullish	Brief probe out of overbought in January, but a generally persistent overbought since July favors a grind higher in the SPX.
	Monthly Williams %R	Bullish	Persistent overbought confirms bullish monthly MACD and favors a grind higher in the SPX.
Macro	Global A-D line (73 countries)	Bullish	Continued new highs into Mar after upside breakout is bullish for global equity market breadth in late 2020.
	Margin debt	Bullish	New highs since Nov 2020. Past new highs in Jan 2007, Jan 2013 and Jan 2017 saw continued upside for the S&P 500.
	Margin debt z-score	Less constructive	Risk: Back to overbought in December. Out of overbought in January. Last overbought preceded Sep-Oct 2020 correction.
	Margin debt 12-month ROC	Bullish	Bullish signal from July with room to run until peak levels seen in 2000 and 2007.
	FINRA free credit levels	Bullish	Even as margin debt has risen, FINRA free credit in accounts moved to the highest level since 2008 in Nov and Jan.
	ICI money fund cash levels	Bullish	Elevated at \$4.4tt and above the Financial Crisis Jan 2009 peak of \$3.9t - contrarian bullish. Has up ticked since mid Dec.
	Fed Financial Conditions	Stalled in late Feb	Bullish from April 2020 and continued to confirm the SPX rally into Feb 2021. However, lower since late February.
	Bloomberg Financial Conditions	Bullish	New high on financial conditions for the SPX rally from the March 2020 low.

Source: BofA Global Research, Bloomberg

Seasonality

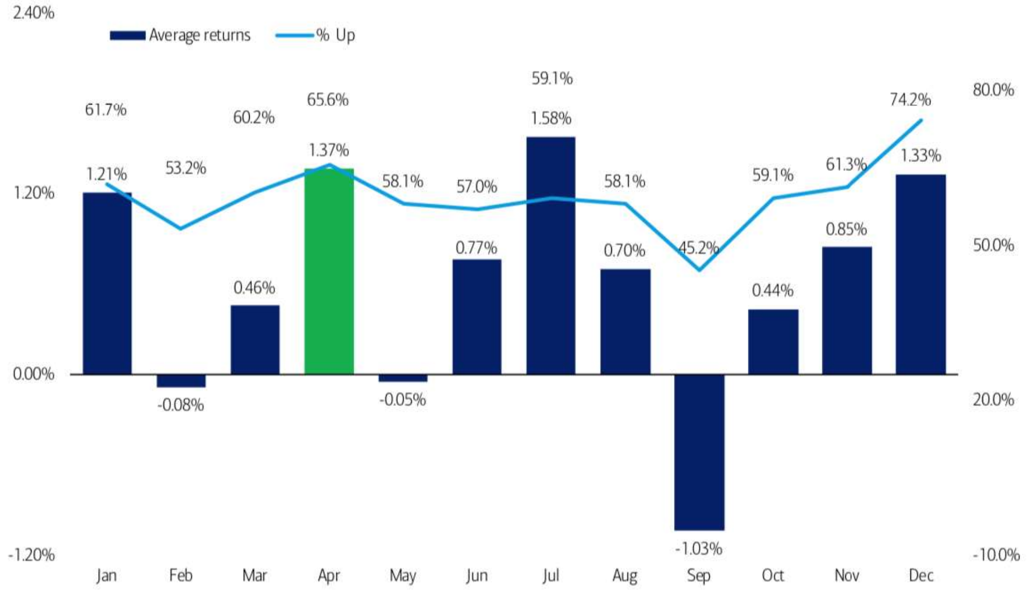
April = strongest month of best 6-month period of year

As we highlighted in [Market Analysis Comment: Elevated anxiety as seasonality shifts bullish in November: 02 November 2020](), November-April is the best 6-month period of the year for the SPX going back to 1928. February and March are the weakest two months of this period, but seasonality shines in April, which is the strongest month of the November-April period and is up 66% of the time with an average return of 1.37%.

Springtime for S&P 500 seasonality in April

Within the context of all 12 months of the year, April is the second best month behind July in terms of average return and the second best month behind December in terms of the percentage of time up, however, April ranks eighth in terms of its median return of 0.91%.

Chart 13: S&P 500 seasonality shows that April is a strong month going back to 1928.
April is the second best month behind July in terms of average return and the second best month behind December in terms of the percentage of time up.



Source: BofA Global Research, Bloomberg

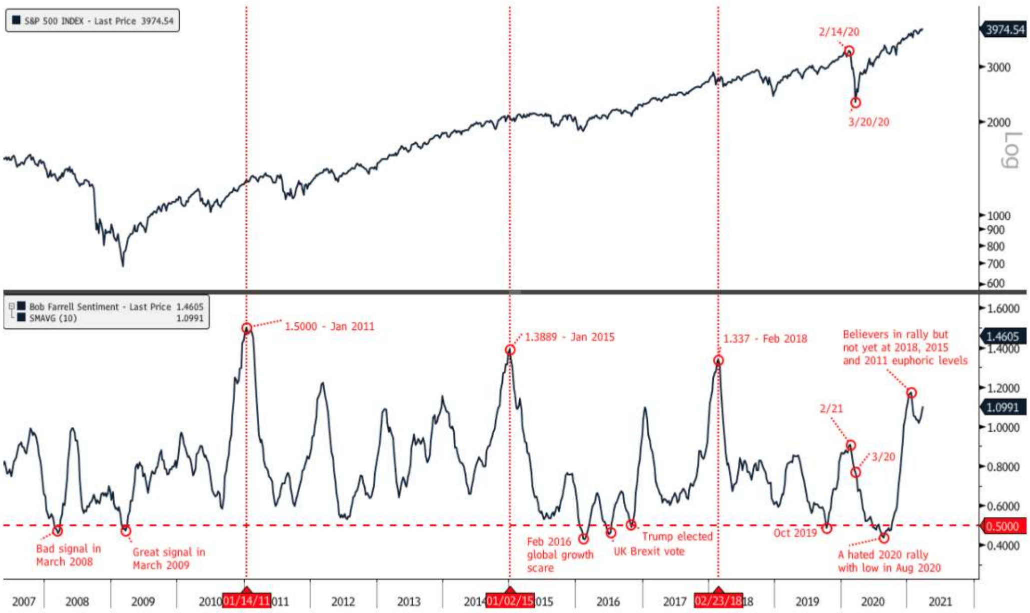
BofA GLOBAL RESEARCH

Sentiment

Farrell Sentiment: Believers but not yet euphoric

Farrell Sentiment shows that individual investors finally became believers in the US equity market rally from the March 2020 low in 4Q 2020. However, belief does not equal euphoria. Last week's Farrell Sentiment level of 1.10 is below the peak bullishness levels of 1.34 in February 2018, 1.39 in January 2015 and 1.50 from January 2011. Similar to the net long position of [institutional asset managers in S&P 500 e-mini futures](), Farrell Sentiment has some room to run from belief to euphoria.

Chart 14: S&P 500 (top) and Farrell Sentiment (bottom): Weekly chart
Belief does not equal euphoria: Farrell Sentiment remains below the peak bullishness levels of 1.34 in February 2018, 1.39 in January 2015 and 1.50 from January 2011.



Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Breadth

NYSE breadth and volume improved late last week

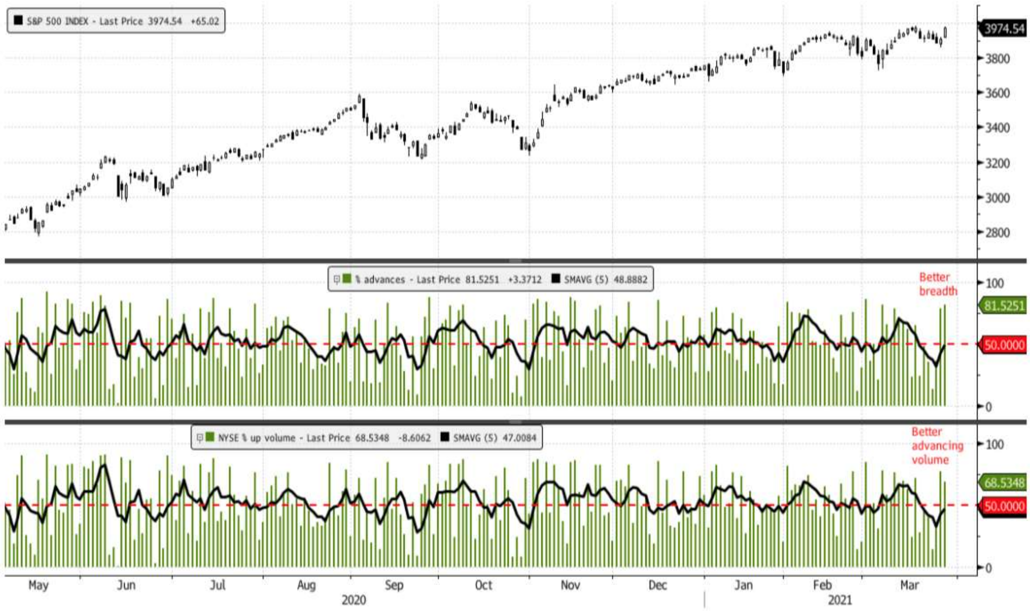
The last ten sessions of March have bearish seasonality, and up until last Thursday and Friday (3/25-3/26), the second half of March had struggled in terms of price action, breadth and volume. Improving breadth on the NYSE in terms of advancing stocks and upside volume in those stocks confirmed a solid rally for the SPX off Thursday's low. Friday saw upside follow-through on solid breadth, but volume lagged breadth as selling pressure took hold of a select group of stocks.

Encouraging for the bulls but more confirmation needed

The improvement in breadth late last week is encouraging for the bulls, especially just prior to bullish seasonality in April. With three sessions left in March, moving above 50% on the 5-day MAs of the percentage of advancing NYSE stocks and the percentage of NYSE up volume would provide much needed tactical confirmation for the bulls.

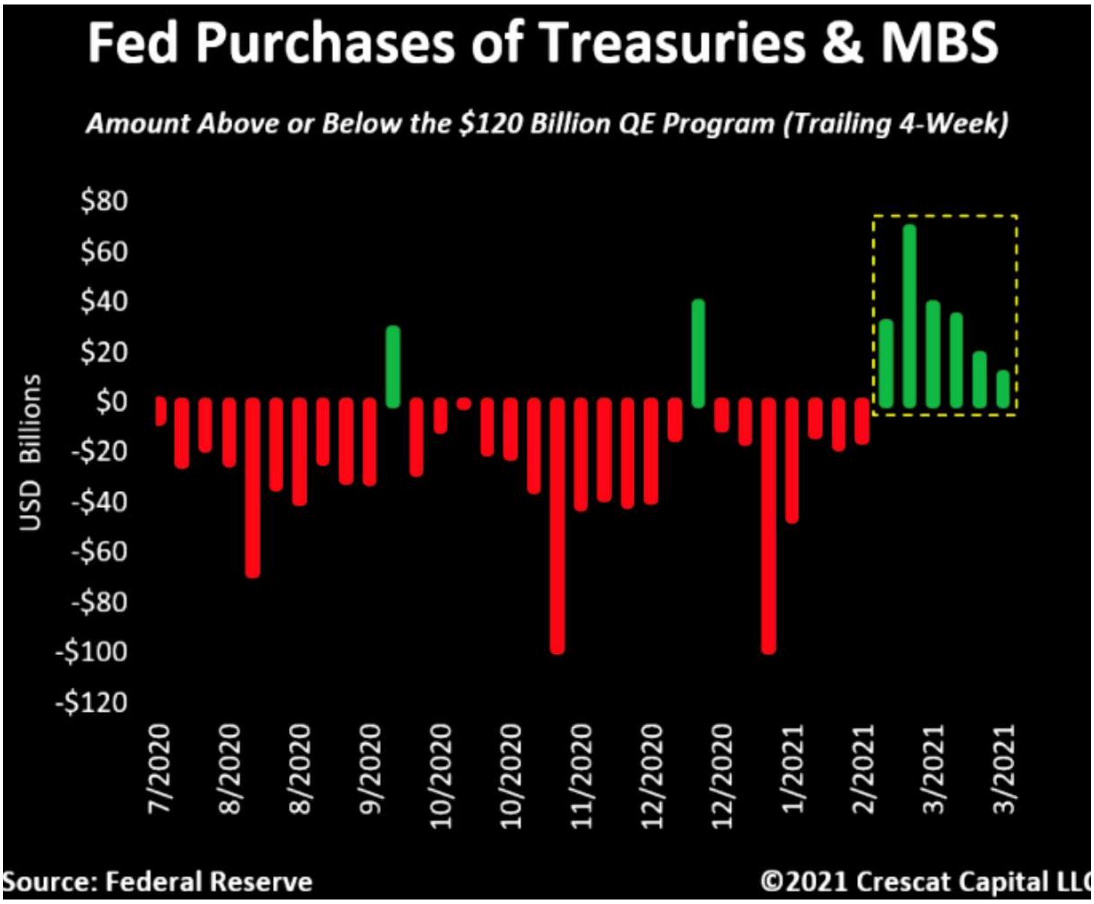
Chart 6: S&P 500 (top), percentage of up stocks on the NYSE (center) and the percentage of up volume in stocks on the NYSE (bottom): Daily chart.

The improvement in breadth late last week is encouraging for the bulls, especially just prior to positive S&P 500 seasonality in April. Moving above 50% on the 5-day MAs of the percentage of advancing NYSE stocks and the percentage of NYSE up volume would provide much needed tactical confirmation for the bulls.



Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH


Fed Purchases of Treasuries & MBS
Amount Above or Below the $120 Billion QE Program (Trailing 4-Week)
USD Billions
$80
$60
$40
$20
$0
-$20
-$40
-$60
-$80
-$100
-$120
7/2020
8/2020
8/2020
9/2020
10/2020
10/2020
11/2020
12/2020
12/2020
1/2021
2/2021
3/2021
3/2021
Source: Federal Reserve
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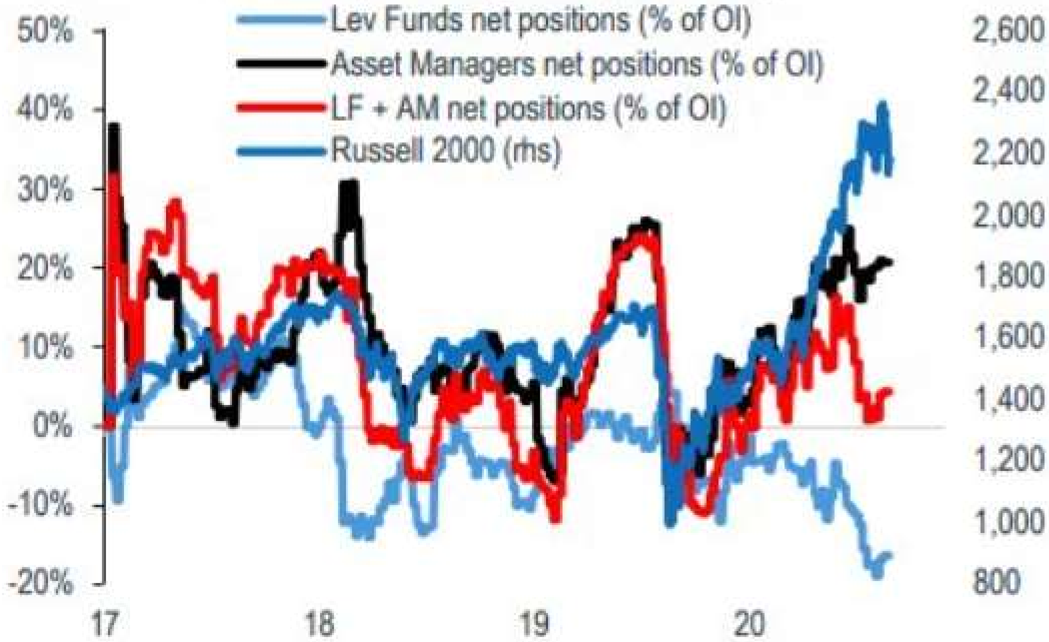
			% Change					Trading Range			
Tickers ↓	Name	Price	YTD	5-Day	50-DMA	Trend	Timing	Current	OS	50-DMA	OB
AMJ	MLP Index ETN	16.72	20.37	-0.54	4.61		Good	Neutral			
AMLP	MLP ETF	30.80	22.95	-0.16	5.81		Good	Neutral			
GDX	Gold Miners ETF	32.77	-9.02	-3.30	-2.66		Poor	Neutral			
GDXJ	Junior Gold Miners	45.93	-15.32	-5.44	-5.31		Neutral	Oversold			
IAI	US Brokers & Exchanges	92.96	17.17	-2.21	4.48		Good	Neutral			
IBB	Nasdaq Biotechnology	149.14	-1.47	-4.24	-6.71		Good	Oversold			
IGN	N. Amer. Tech-Media Network.	69.52	16.70	1.61	3.63		Neutral	Overbought			
IHF	US Healthcare Providers	252.54	7.79	1.03	3.72		Neutral	Overbought			
IHI	US Medical Devices ETF	330.24	0.90	2.05	-0.75		Good	Neutral			
IYC	US Consumer Services	74.82	6.25	-0.76	2.59		Neutral	Overbought			
IYG	US Financial Services	173.44	15.96	0.94	6.79		Neutral	Overbought			
IYK	US Consumer Goods ETF	175.57	1.55	1.01	0.35		Good	Neutral			
IYR	US Real Estate ETF	92.74	8.81	3.50	5.55		Poor	Extreme OB			
KCE	S&P Capital Markets ETF	84.32	12.41	-0.66	4.19		Neutral	Overbought			
KIE	S&P Insurance ETF	36.85	10.26	0.30	5.19		Neutral	Overbought			
KRE	S&P Regional Banking ETF	67.54	30.66	-2.40	7.43		Good	Neutral			
OIH	Oil Services ET	196.16	27.38	-1.01	2.93		Good	Neutral			
PBJ	Dynamic Food & Beverage	40.56	13.39	1.30	5.58		Neutral	Overbought			
PBS	Dynamic Media	50.31	9.32	-11.94	-4.80		Good	Neutral			
PEJ	Dynamic Leisure & Entert.	46.22	15.52	-12.38	-1.59		Good	Neutral			
PKB	Dynamic Building & Constr.	49.25	19.71	2.65	7.28		Neutral	Overbought			
PPA	Aerospace & Defense	71.89	6.13	0.56	4.10		Neutral	Overbought			
PPH	Pharmaceutical ETF	69.17	4.06	-0.32	0.22		Good	Neutral			
PSP	Global Listed Private Equity	14.57	8.73	0.28	2.34		Good	Neutral			
PXE	Dynamic Energy E&P	15.23	50.49	1.80	11.41		Good	Neutral			
RTH	Retail ETF	164.98	5.03	2.80	3.36		Neutral	Overbought			
SLX	Steel ETF	54.32	21.71	2.49	10.02		Neutral	Overbought			
SMH	Semiconductor ETF	241.64	10.63	3.41	1.47		Good	Neutral			
TAN	Solar ETF	88.02	-14.34	-1.74	-15.90		Good	Oversold			
VNQ	REIT ETF	92.84	9.95	3.19	5.49		Poor	Extreme OB			
XBI	S&P Biotech ETF	133.06	-5.46	-8.25	-12.07		Good	Oversold			
XES	S&P Oil & Gas Equip. & Svcs	54.72	23.61	-3.03	-0.47		Good	Neutral			
XHB	S&P Homebuilders ETF	70.84	23.11	4.24	10.77		Poor	Extreme OB			
XME	S&P Metals & Mining ETF	39.86	19.45	0.35	8.59		Neutral	Overbought			
XOP	S&P Oil & Gas E&P	83.32	43.06	-0.07	7.61		Good	Neutral			
XRT	S&P Retail ETF	88.75	38.22	-2.26	7.77		Neutral	Overbought			

Chart 7: Positioning by institutional investors in US Small Cap stocks does not look elevated

Russell 2000 versus CFTC positioning data by investor type



Source: J.P. Morgan

Chart 2: Higher rates have sunk those markets associated with innovation more than it has damaged the incumbents

Total equity call option buying on US exchanges (millions, right scale) versus prices of various indices and ETFs indexed to 100 in 2014 (left scale).

Source: J.P. Morgan

BofA GLOBAL RESEARCH

Airlines

Travel rebound is in full swing and so are the stocks; once again raising PO's

Price Objective Change

Travel rebound is in full swing and so are the stocks

The leisure travel recovery is in full swing with airline bookings seeing a more pronounced improvement since early February. The re-opening trade began in early November with the vaccine news and the stock moves have been powerful with US airline market caps 7% above pre-pandemic compared to 10% below for the rest of travel (Europe airlines, US hotels, cruise lines). With a strong recovery reflected in the stocks, the ability to meet or beat estimates will be important and support the "return to fundamentals" theme we outlined in our year ahead report. We will get the first glimpse over April earnings season, and we raise PO's (again) on robust bookings momentum and prefer leisure exposed airlines with good balance sheets: LUV, ALK and JBLU.

Pricing power is key to the stocks; raise PO's

We have heard investor arguments that airline stocks should re-rate because a new cycle is here. Our work shows there is no clear airline cycle over time that drives equity returns, but rather US airline stocks tend to trade on pricing power. With the strength in airline bookings, all of our airline price objectives are based on EV/EBITDAR multiples at the top end of historical ranges (legacy network carriers 6-7x and low cost/ultra-low cost carriers at 8-9x) on our 2022 earnings, which also implies valuations toward the high end of historical ranges on prior peak earnings (2019).

Prefer Buy-rated LUV, ALK, JBLU; DAL over AAL/UAL

We first upgraded leisure-oriented airlines in spring 2020, so our preferences for LUV and ALK remain as both are exposed to the leisure travel recovery while LUV has net cash on its balance sheet and ALK's net debt has not changed since pre-pandemic. We prefer JBLU over the ultra-low cost carriers given its largely leisure-oriented network from the northeast to Florida and Caribbean while trading at a 1x multiple discount to SAVE/ALGT (which remain Neutral-rated valuation after strong year to date returns). Among the US network carriers, we prefer DAL (Neutral-rated on valuation) over AAL/UAL (both Underperform-rated) given no equity dilution and focus on cutting costs from its network by eliminating fleet types..

BofA 2021 recovery forecasts in line with consensus

We currently forecast a 15% point sequential acceleration in revenue growth (relative to 2019) from 1Q to 2Q with industry revenues going from just 44% of 2019 levels in 1Q19 to 82% of pre-pandemic levels in 4Q21. These estimates are in line with the Street, and as long as there is no meaningful rise in virus cases from here that push the recovery further out, we believe these forecasts should now be the bogey going forward and will drive the stocks given valuations are at peak levels.

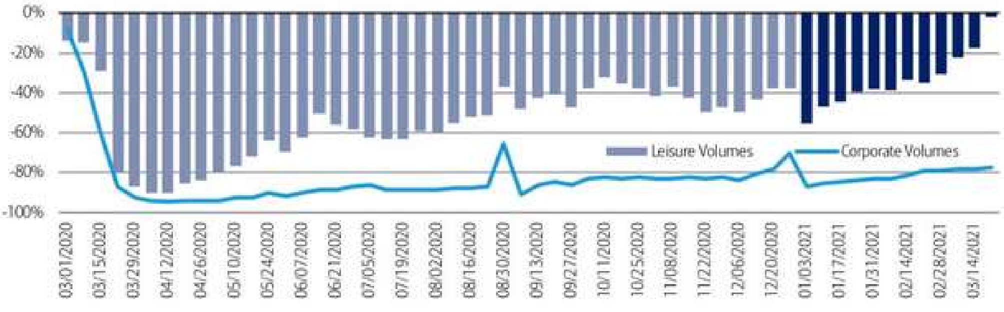
Capacity concerns remains the key risk

While international capacity has been rationalized with widebody fleets expected to be down -4.4% vs year end 2019, the narrowbody fleet (think domestic travel) will be about 3% higher than 2019 with double digit growth out of the ultra-low cost carriers. Meanwhile, looking at summer schedules, domestic capacity goes from -36% in January-March vs 2019 to up mid-single digits this summer. With corporate travel still weak, this could prove too much capacity to gain the pricing power needed at current valuations.

Travel rebound is in full swing

Despite some areas of Europe going under new lockdowns and the US CDC still advising against unnecessary travel, the recovery is in full swing with our airline bookings seeing a more pronounced improvement since early February led by leisure. Our leisure booking proxy is now just -2.1% from 2019 but corporate travel is still down -77.2%, leading overall bookings still -44.0% from 2019.

Exhibit 2: Corporate vs leisure domestic ticket volume growth vs 2019
Leisure continues to outperform corporate



Source: BofA Global Research, ARC

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It's been a strong run with outperformance since initial vaccine announcement
However, we feel like much of the good news is reflected in airlines. The re-opening trade has now lasted since early November when the vaccine was first announced and has been more powerful than we thought. From when the vaccine headlines first hit in early November, US airline stocks are up +76% compared to the cruise lines up +64%, and large hotel stocks up +53% compared to the S&P 500 up +13%. Year-to-date 2021, airlines are up nearly 3x as much as hotels and cruise lines.

Exhibit 3: US travel sector equity returns over course of pandemic
US airlines have outperformed other US travel sectors thus far in 2021 and since the first vaccine headlines surfaced in early November

	2021 YTD	2020	1/1/2020 - 2/19/2020	2/19/2020 - 3/23/2020	3/23/2020 - 6/15/2020	6/15/2020 - Vaccine	Vaccine - Today
DAL	18.5%	-31.2%	0.1%	-62.0%	37.1%	3.2%	51.7%
AAL	45.4%	-45.0%	-1.2%	-63.8%	62.9%	-62.4%	100.1%
UAL	31.4%	-50.9%	-9.8%	-66.9%	48.6%	-11.1%	63.9%
LUV	31.5%	-13.7%	5.8%	-40.9%	7.7%	10.1%	53.2%
ALK	31.4%	-23.2%	-3.8%	-63.1%	57.2%	1.3%	78.6%
JBLU	35.4%	-22.3%	11.2%	-67.0%	75.1%	2.8%	59.4%
SAVE	51.3%	-39.3%	2.1%	-76.1%	100.7%	-10.3%	109.1%
ALGT	32.4%	8.7%	-5.3%	-56.5%	59.3%	20.8%	81.5%
HA	51.2%	-39.6%	-8.8%	-67.2%	89.1%	-16.5%	93.2%
AC CN	16.4%	-53.1%	-6.6%	-72.0%	46.0%	-14.7%	67.6%
Airline Avg	***34.5%***	***-31.0%***	***-1.7%***	***-63.6%***	***58.4%***	***-7.7%***	***75.8%***
HLT	8.9%	0.3%	1.6%	-43.8%	22.3%	19.8%	30.5%
MAR	11.3%	-12.9%	-2.5%	-52.5%	29.5%	14.4%	41.3%
H	11.9%	-17.2%	0.3%	-47.2%	16.8%	1.6%	47.4%
IHG	5.9%	-5.2%	-4.7%	-53.6%	61.0%	12.8%	24.9%
HST	17.5%	-21.1%	-9.9%	-36.1%	16.6%	-15.8%	63.9%
PK	27.5%	-33.7%	-11.4%	-70.6%	71.4%	-10.8%	112.3%
Hotel Avg	***13.8%***	***-15.0%***	***-4.4%***	***-50.6%***	***36.3%***	***3.7%***	***53.4%***
CCL	20.3%	-57.4%	-14.7%	-72.3%	62.0%	-28.9%	88.6%
RCL	13.2%	-44.1%	-16.9%	-74.6%	115.8%	-3.7%	44.4%
NCLH	5.5%	-56.5%	-10.9%	-81.4%	106.7%	-15.1%	58.0%
Cruise Avg	***13.0%***	***-52.6%***	***-14.2%***	***-76.1%***	***94.8%***	***-15.9%***	***63.7%***
S&P 500	5.6%	16.3%	4.8%	-33.9%	37.1%	14.4%	13.1%

Source: BofA Global Research, Bloomberg

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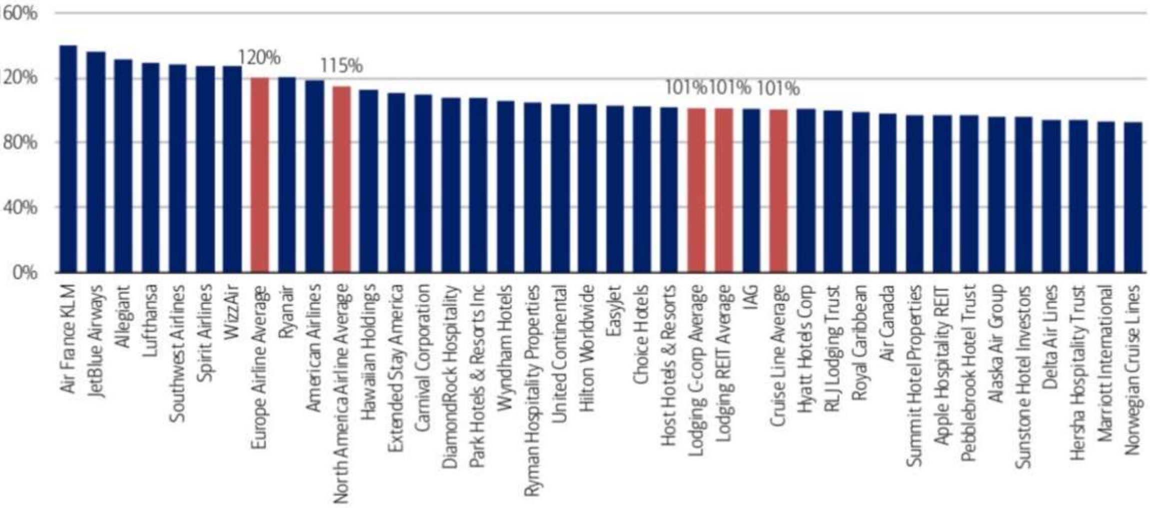
Travel stocks back to pre-COVID levels: airlines price in the most recovery

As we detail later in this report, the US airline industry has seen share counts rise +18% with net debt up +29% since the end of 2019. When we capture these new share counts, US airline market caps are 107% of pre-pandemic levels on average compared to 90% for the rest of travel (Europe airlines, US hotels, cruise lines). When we go a step further and add in new net debt balances, enterprise values across US airlines 120% of year end 2019 levels with US hotels back to pre-pandemic levels. This shows the market is pricing in more of a recovery in airlines relative to other forms of travel, so the ability to meet or beat estimates will grow in importance from here. We will get the first glimpse in April earnings season as airlines guide to 2Q revenue performance for the first time.

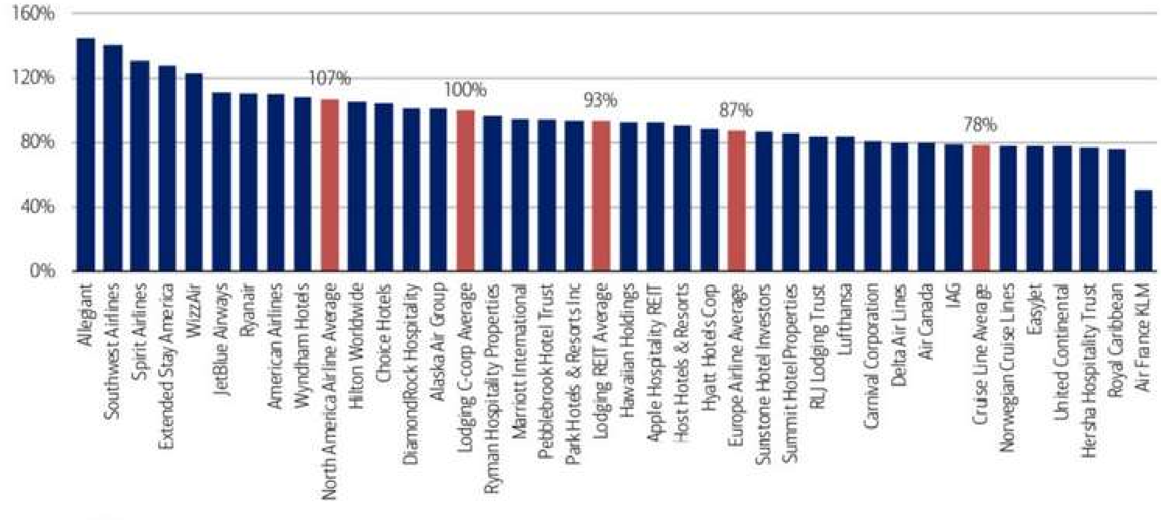
Exhibit 4: Enterprise values across travel stocks compared to year end 2019

Airline enterprise values are well ahead of pre-pandemic levels



Source: BofA Global Research

Exhibit 5: Market cap values across travel stocks compared to year end 2019
Airline market caps are well ahead of pre-pandemic levels



Source: BofA Global Research

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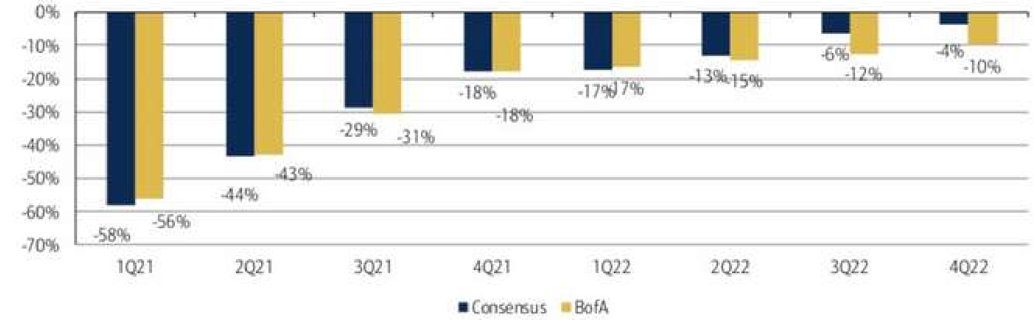
BofA 2021-2022 recovery forecasts align with consensus

We currently forecast an approximate 15% point sequential acceleration in revenue growth (relative to 2019) from 1Q to 2Q with this revenue growth improving to within about 20% of 2019 levels by the end of this year, which is similar to consensus. As long as there is no meaningful rise in virus cases from here that push the recovery further out, we believe these forecasts should now be the bogey going forward and will drive stock prices given valuations are now at the high end of historical ranges on prior peak earnings. In 2022, the BofA and the Street expect further recovery in quarterly revenue growth vs 2019 and expect airlines to get back close to pre-pandemic levels by end of 2022 as corporate and international begin to recover.

Exhibit 6: Revenue estimates vs 2019
BofA Estimates for a recovery are largely aligned with the Street



Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Price objective basis & risk

Alaska Air Group (ALK)

Our $78 price objective for ALK is based on 7.5x 2022E EBITDAR. Our target multiple is above ALK's historical average (5.0x) and at the high end of its historical trading range, which we believe is reasonable given its solid liquidity position relative to peers and still depressed 2022 earnings.

Upside risks to our price objective are a better pricing environment from a faster than expected economic recovery or lower competitive supply or a significant drop in fuel prices. Downside risks to our price objective are higher fuel prices, general economic weakness, unfavorable government regulation/taxes, safety concerns, integration issues, and terrorism/geopolitical events.

Allegiant Travel Company (ALGT)

For ALGT, our $260 PO is based on 9.0x 2022E EBITDAR. This is above ALGT's long-term average (6.6x) and at the high end of its historical trading range, which we believe is reasonable given ALGT's leisure exposure, monopolistic network, and liquidity runway.

Downside risks to our price objective are higher fuel prices, general economic weakness, government regulation/taxes, safety concerns and terrorism/geopolitical events.

American Airlines Group (AAL)

Our $6 PO is based on approximately 7x our 2022E EBITDAR. Our target multiple is in line with AAL's historical average, which we believe is reasonable given unknowns around a demand recovery and 2022 earnings uncertainty offset by the removal of any significant liquidity risk.

Upside risks to our price objective are better than expected pricing, a faster than expected resolution of labor contracts, and a stronger macro backdrop. Downside risks to our price objective are significant moves in fuel, general economic weakness, government regulation/taxes, safety concerns, and terrorism/geopolitical events.

Delta Air Lines (DAL)

Our $49 PO is based on 6.0x 2022E EBITDAR. Our target multiple is above DAL's historical average (4.4x) and at the high end of its historical trading range, which we believe is reasonable given uncertainty around 2022 earnings and the recovery in airline demand.

Upside risks to our price objective are better than expected pricing and a stronger macro backdrop. Downside risks to our price objective are higher fuel prices, general economic weakness, government regulation/taxes, safety concerns, a prolonged government shutdown and terrorism/geopolitical events.

Hawaiian Holdings (HA)

Our $18 PO is based on approximately 5.0x 2022E EBITDAR, which is above HA's long-term minimum EBITDAR multiple (3.0x). We believe this multiple is reasonable given HA's solid liquidity position offset by uncertainty around 2021-2022 earnings and the recovery in airline demand, ongoing quarantine measures, and likely elevated competition on its Hawaii routes once the outbreak subsides.

Downside risks to our price objective are an extension of quarantines, higher fuel prices, general economic weakness, government regulation/taxes, safety concerns and terrorism/geopolitical events.

Upside risks to our price objective are a better pricing environment from a faster-than-expected economic recovery or lower competitive supply, a significant drop in fuel prices, advancements in a virus vaccine and better cost controls.

JetBlue Airways (JBLU)
Our $22 PO is based on approximately 8.5x 2022E EBITDAR. Our target multiple is above JBLU's historical average (5.4x) and at the high end of its historical trading range, which we believe is reasonable given still depressed 2022 earnings and strong leisure-oriented markets.

Upside risks to our price objective are lower fuel prices, better than expected pricing, lower competitive supply, and general economic strength.

Downside risks to our price objective are higher fuel prices, general economic weakness, government regulation/taxes, safety concerns and terrorism/geopolitical events.

Mesa Air Group (MESA)
Our $15 price objective is based on approximately 4.5x calendar year 2022E EBITDAR, which is in line with its long term historical average. We believe this is an appropriate multiple as it balances MESA's historically lower multiple regional airline business vs mainline carriers with its investment in new aircraft technology. Downside risks to our price objective are difficulty attracting pilots over the long-term, operational disruptions, and a slower than expected travel recovery.

Southwest (LUV)
Our $68 PO is based on approximately 8.5x 2022E EBITDAR. Our target multiple is above LUV's long-term historical average of 5.5x and at the high end of its historical trading range, which we believe is reasonable given LUV's industry leading balance sheet and strong competitive position.

Downside risks to our price objective are higher fuel prices, general economic weakness, government regulation/taxes, safety concerns and terrorism/geopolitical events.

Spirit Airlines (SAVE)
Our $37 price objective is based on 9.0x 2022E EBITDAR. Our target multiple is above SAVE's historical average (5.9x) and at the high end of its historical range, which we believe is reasonable given SAVE's leisure footprint and still depressed 2022 earnings.

Upside risks to our price objective are a vaccination or advanced therapeutics, lower fuel prices, better than expected pricing, lower competitive supply, and general economic strength. Downside risks are economic weakness, government regulation and taxation, increased competition including the threat of new entrants, labor issues, safety concerns, terrorism and geopolitical events, changes in equity risk premiums, and overall stock market valuations.

United Airlines Holdings (UAL)
Our $43 PO is based on approximately 6.0x our 2022E EBITDAR. Our target multiple is at a premium to UAL's recent historical average (4.3x), which we believe is reasonable given unknowns about a recovery in travel demand offset by UAL's strong relative liquidity position.

Downside risks to our price objective are higher fuel prices, general economic weakness, government regulation/taxes, safety concerns, and terrorism/geopolitical events.

Upside risks are a faster than expected economic recovery, a stronger than expected pricing environment, or a better demand environment.

Conversations we are having with clients: Plunging 2020 profitability should rebound in 2021

One year ago this week, the WHO declared COVID-19 a pandemic and the equity market troughed. The S&P 500 has subsequently soared by 75% during the past 12 months. However, the decline in US case numbers stalled this week and new lockdown orders were implemented across Europe. In response, the recent trend of Value outperformance stalled. Signs of interest rate stabilization contributed to this dynamic, weighing on small-caps and rate-sensitive cyclical sectors.

The pandemic also drove a collapse in S&P 500 profitability in 2020. Return on equity (ROE) ended the year at 14.6%, the lowest level since 2016. Index-level LTM ROE dipped by 372 bp in 2020, falling most dramatically in 1H (Exhibit 1). Of the 5 DuPont factors we consider in our ROE calculation, evaporating margins were by far the most important driver of this contraction. EBIT margins dropped 262 bp from 15.6% in 4Q 2019 to 12.9%, the largest year/year drop since 2009. Margin pressure due to the pandemic accounted for 351 bps of the total decline in ROE contraction (Exhibit 2). Lower asset turnover also weighed on S&P 500 profitability and was responsible for another 214 bps of ROE decline. These factors outweighed the positive impulses of increased leverage, record-low taxes, and lower interest expense.

Trailing 4-quarter ROE fell year/year in 8 of the 11 sectors. Cyclical sectors drove index ROE lower. Industrials experienced the largest decline in ROE of any sector, decreasing by 16 pp from 4Q 2019 to 4Q 2020. Lower tax and increased leverage for the sector did little to offset the largest year/year decline in margins since at least 1975 (Exhibit 3). Other sectors with the biggest drops in ROE included Energy (-16 pp), Consumer Discretionary (-8 pp), and Financials (-4 pp). Today, ROE in all but one of these sectors sits within the bottom quartile relative to history, as their fundamentals deteriorated through the 2020 recession. The exception is Consumer Discretionary, which exhibits one of the widest ROE distributions of all 11 sectors and currently ranks in the 85th percentile despite the weakness in 2020. Notably, ROE in the Info Tech sector, the largest in the index, was flat year/year.

Sectors appear fairly valued relative to their profitably with three notable dislocations: Health Care, Staples, and Discretionary. Across 8 of 11 sectors, forward P/B valuations are tightly correlated to NTM ROE (Exhibit 4). Health Care and Consumer Staples are the only two sectors that trade at a discount to fair value based on forward profitability, suggesting opportunity for appreciation as fundamentals improve. Consumer Discretionary trades above its ROE-implied valuation, in part due to the high valuations and large weights of AMZN and TSLA in the sector (44% of market cap collectively).

Looking ahead, S&P 500 profitability should rebound in 2021, mostly driven by expanding profit margins. We expect S&P 500 margins will increase to 11.2% in 2021, which should support ROE expansion both at the index level and particularly for cyclical sectors that suffered most in 2020. Our economists recently upgraded their US GDP forecasts to 7% for 2021. The combination of their above-consensus expectations and company operating leverage drive our margins and EPS forecasts.

Three variables represent potential downside risks to the ROE outlook in 2021:

First, rising input costs could pressure profit margins. Our economists expect that core inflation will peak mid-year, but then settle near 2% and remain stable until rising to 2.1% in 2023. However, investors have recently expressed concern about supply chain bottlenecks and input cost pressures. The most recent US PMI data showed that manufacturing input prices surged to levels last seen as the economy exited the previous recession and that manufacturers' delivery speed was the lowest it has been since 2007. However, the survey's measure of output prices also surged. The ability of companies to pass through rising input costs to consumers will be a key determinant of the trajectory of S&P 500 profit margins. After sharply outperforming since early November, our basket of firms with low pricing power (ticker: GSXUSHGM) has underperformed stocks with high pricing power (GSXULVGM) in the last two weeks, likely reflecting investor concern about input cost pressures.

Second, greater interest expense due to rising rates would represent a downside risk to ROE. The nominal 10-year US Treasury yield has risen by 70 bp YTD to 1.6% as investors have pulled forward expected Fed tightening. The path of S&P 500 borrow costs (interest expense divided by assets) has closely tracked the path of interest rates. Our rates strategists expect nominal yields to end 2021 at 1.9%, still low by historical standards, but 28 bp above the current level. However, they estimate a plausible upside scenario could see yields climb to 2.25%-2.40%.

Finally, tax hikes could adversely affect S&P 500 ROE. Declining effective tax rates have been the second-largest contributor to ROE expansion during the last 45 years. In 2020, the median S&P 500 effective tax rate dipped to 18%, the lowest on record since 1975. President Biden has called for higher corporate taxes. As we discussed last week, Biden's proposal would lower S&P 500 EPS by 9% if enacted in full, but we expect a smaller version will likely pass in the end. Our political economists expect a tax bill will be written later this year, meaning higher tax rates will not take effect until 2022.

Investors looking to capitalize on the rebound in S&P 500 profitability in 2021 should consider the stocks in our ROE Growth basket, which we rebalance in this report. Our sector-neutral basket is comprised of the 50 stocks with the highest expected ROE growth in 2021 (ticker: GSTHGROE). The median stock in the basket is expected to expand ROE by 23% during the next 12 months (from 13% to 16%) compared with 2% increase for the median S&P 500 company. Stocks with highest expected ROE growth in 2021 are AXP, CMG, AIG, NUE, and HBAN (Exhibit 5).

Our ROE Growth basket has a Value tilt by construction, which is pronounced due to the pandemic recession. The 2020 recession weighed most heavily on stocks in the Value and Cyclical slices of the market. It is precisely these companies that will likely see their fundamentals rebound most in the coming year as we emerge from the recession. The median stock trades at a discount to the S&P 500 (P/B of 3.3x vs. 4.1x). The relative performance of GSTHGROE vs. the S&P 500 has closely tracked Value vs. Growth. The basket underperformed by 3 pp in 2020 (15% vs. 18%) but has outperformed by 5 pp YTD (9% vs. 4%) alongside the Value rally.