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Capital Market Outlook

April 8, 2019

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- **Macro Strategy**—Yield-curve inversions share both common and distinct features. They always reflect tightening financial conditions and slowing nominal growth. Their recession message, however, depends a lot on the underlying long-term inflation trend. The brief inversion in late March prolonged the expansion, in our view, because it reflected falling inflation pressures.

- **Global Market View**—An inverted yield curve, U.S.-Sino trade tensions, rising federal budget deficits and incessant political uncertainty at home or abroad—all of these factors are headwinds for equities in the near term. However, investors should not lose sight of what's right with America, as the U.S. economy remains one of the most resilient and dynamic in the world.

- **Thought of the Week**—Chinese equities have rallied thus far in 2019 as Beijing has implemented several fiscal and monetary policy stimulus measures. Investors have been anticipating better trading relationships between the world's two largest economies as well as a return to both stability and recovery for Chinese economic growth.

- **Portfolio Considerations**—We remain overweight equities and would be buyers on weakness—particularly in between earnings seasons. Within fixed income, we are overall neutral on credit and have a slight preference for short-dated investment grade corporates and municipals across the curve.

MACRO STRATEGY

Chief Investment Office Macro Strategy Team

GLOBAL MARKET VIEW

Joseph P. Quinlan
Head of CIO Market Strategy

Lauren J. Sanfilippo
Vice President and
Market Strategy Analyst

THOUGHT OF THE WEEK

Elizabeth Jacobi
Investment Analyst

Kishan Chhatwal
Assistant Vice President and
Investment Analyst

Data as of 4/8/2019 and subject to change.

MACRO STRATEGY

Anatomy of a Fed Policy Mistake: Part 2, Yield Curve Confirms Excessive Tightening

Chief Investment Office Macro Strategy Team

In our January 14, 2019 Capital Market Outlook "Anatomy of a Monetary Policy Mistake," we enumerated the evidence that the Federal Reserve (Fed) overtightened policy and thereby caused a significant global slowdown in 2018. The Fed's reversal since last year has provided additional evidence that its squeezing of financial conditions was the major factor behind weakening growth. More specifically, the sharp easing of financial conditions and strong rally in equity prices and other leading indicators, like housing activity, since the Fed's January pivot make it clear that the Fed overreacted to strong U.S. economic growth and took its eye off the inflation target, its only long-run objective.

The drop in inflation pressures as a result of last year's tightening has the silver lining that it has set the stage for an extended period of lower rates that will stretch out this record-setting expansion while inflation pressures take time to rebuild.

While the Fed has not cut rates, its shift in forward guidance for 2019 and 2020 from several rate hikes to possibly one, or even none, has caused a sharp drop in rates along the entire yield curve past six-month maturities. For example, 10-year Treasury rates have dropped about 75 basis points, causing mortgage rates to fall from almost 5% to just over 4%. This has spurred a surge in refinancing activity as well as a clear turn to the upside in housing data over the past three months. Ironically, these positive developments have been cast into doubt by the fact that the spread between the 10-year Treasury note yield and the 3-month Treasury bill rate, which has the best track record for predicting recessions, briefly turned negative during the last week of March, something that has often preceded recession.

On its way to inversion, the yield curve flattened throughout 2018 as a Fed on "automatic pilot" kept raising rates and shrinking base money with its quantitative tightening policy. That flattening has accurately predicted the significant slowing in U.S. economic activity that became apparent in late 2018. Ironically, the Fed has used that slowing in activity to justify its policy pivot without admitting responsibility for the slowdown. Basically, because of "data dependency," the Fed self-corrects its mistakes without ever having to admit them. This tendency of monetary policy to create a lot of business-cycle volatility is well documented in *A Monetary History of the United States, 1867–1960* by Milton Friedman and Anna J. Schwartz. Despite a long history of amplifying business cycles, the Fed has not found a way to completely avoid its policy mistakes even in a world of massive real-time information flows. That said, one reason that cycles have been less destructive and more muted since the 1940s is improved monetary policy. Because it was quickly recognized, last year's mistake was small in the historical scheme of things and had the positive side-effect of postponing an ultimate cycle-ending flare-up in inflation.

A different kind of inversion

Just as history rhymes rather than repeats, yield-curve inversions have distinct characteristics as well as the common feature of always indicating tightening financial conditions and slowing economic-growth momentum. While the focus is usually on their recession forecasting ability, not enough attention is paid to their inflation message. Last summer, inflation peaked and leading inflation indicators, such as those compiled by the Economic Cycle Research Institute rolled over, suggesting that the Fed was going to fall short of its target for the tenth straight year unless it stopped tightening policy. Nevertheless, it hiked rates two more times and kept shrinking the monetary base, exacerbating the deflationary shock that has become apparent across the world in slowing growth and falling inflation.

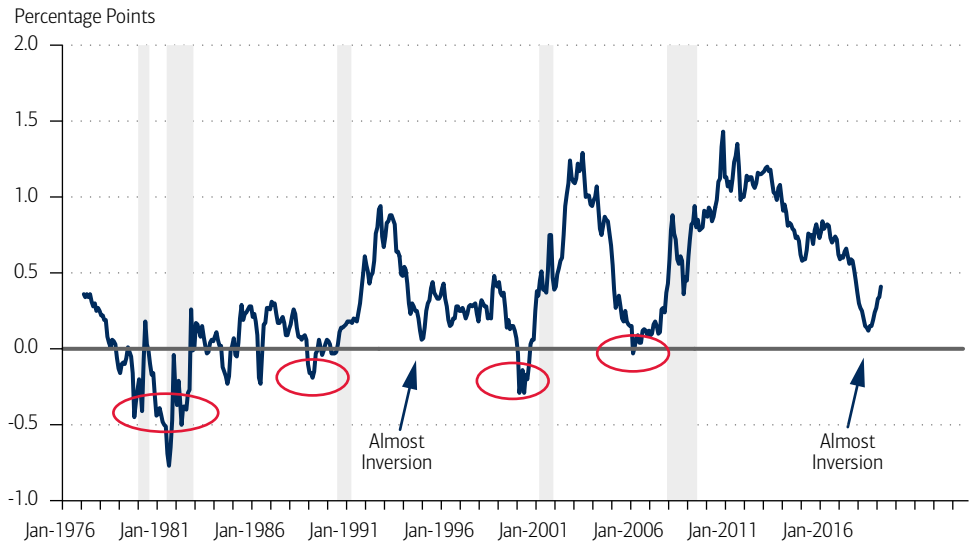
Inflation bore more of the tightening brunt than usual because U.S. growth was held up by the major supply-side policy boost from tax reform and deregulation. Capital spending increased as incentives for investment improved. Indeed, for the first time in ages, more direct investment came into the United States than went out. The important result was a sharp pickup in productivity, which is now running closer to a 2% growth rate than the sub-1% pace of the "secular stagnation" era. At the same time, as workers got bigger pay raises and paid lower tax rates, labor-force participation rose despite big demographic headwinds. The Fed underestimated these positive supply-side effects on potential growth, causing it to fall short of its inflation goal once again. The good news is policymakers are starting to incorporate evidence of a new higher potential growth rate into their operating procedure.

An inverted yield curve implies weaker nominal growth than a steeper curve. This does not mean it implies a recession. In the second half of the 19th century, a persistently inverted yield curve reflected persistent deflation in a strong real-growth environment. Last year's

flattening and the recent brief inversion reflect the weakening inflation component in addition to the weakening real-growth component of nominal gross domestic product (GDP). Both parts of nominal GDP were impacted by the Fed tightening. Fortunately, the relapse of inflation gives the Fed leeway to be accommodative for a couple of more years. As a result, the yield curve out to about five years has taken out the prospect of further rate hikes and begun to flirt with the possibility of easing.

Despite the drop in bond yields, the curve has begun to steepen beyond five-year maturities in recognition of the fact that accommodative policy over the next few years is likely to "seal the deal" for a 2% inflation rate. The risk of deflation is thus being taken out of the long end. As seen in Exhibit 1, the spread between the 10-year Treasury note and the 30-year Treasury bond has increased since the Fed flip. Furthermore, it never inverted as it did before past recessions. Instead, it remains unusually wide compared to past late-cycle inversion episodes and more closely resembles the 1995 mid-cycle near-inversion of long rates. This reflects the unusually long period of low rates that the market expects will be necessary to cement a reliable 2% inflation trend in a world where the Fed is fighting strong deflationary headwinds from demographics, technology and high debt levels. A friendlier Fed makes a prolonged expansion a good bet.

Exhibit 1: Spread Between 30-Year and 10-year Treasury Rates Not Signaling Recession.



Source: Haver Analytics. Data as of April 4, 2019.

Positive equity-market implications

A friendly Fed is bullish for the equity market. A March 26, 2019 study by Strategas looked at the 11 unique instances of 3-month to 10-Year inversions since the mid 1960s and, specifically, at how the S&P 500 performed in the next three, six and 12 months. They note that forward returns "are all over the place," with about as many positive as negative return results. They also note that "most of the negative +12-month forward returns were pre 1982, while the positive +12-month forward returns were post 1982," without speculating about the reasons for this.

One powerful reason for the positive post-1982 performance of equities after yield-curve inversions is the shift in the secular inflation trend post 1982. In a falling inflation environment, the Fed has more leeway to ease post inversions. This was not true pre 1982, when inflation was rising in each successive cycle. It is not a coincidence that Strategas found this sharp shift in equity performance post inversions after 1982. Given this historical pattern, it should not be surprising that we have been seeing unusually strong equity returns since the Fed pivot.

Finally, we would note that the depth and duration of inversions are also important considerations. The late-March inversion was very shallow and lasted just a couple of days. When historians look at it, an inversion is unlikely to appear in monthly average data. In our view, this "almost inversion" is most comparable to the "almost inversion" of 1995 (Exhibit 1), after the Fed had similarly raised rates over 200 basis points in a short period following the interest-rate cycle low point. GDP growth similarly slowed (from 5.4% in June 1994 to just 1.2% a year later). Long rates fell about 200 basis points as the Fed overtightened and the yield curve almost inverted. The end of the hikes and a cut in July 1995 helped boost the S&P 500 by 34% that year. Now, as then, the Fed has completed phase one of rate normalization and is likely to rest for a while. Risk assets are breathing a sigh of relief.

GLOBAL MARKET VIEW

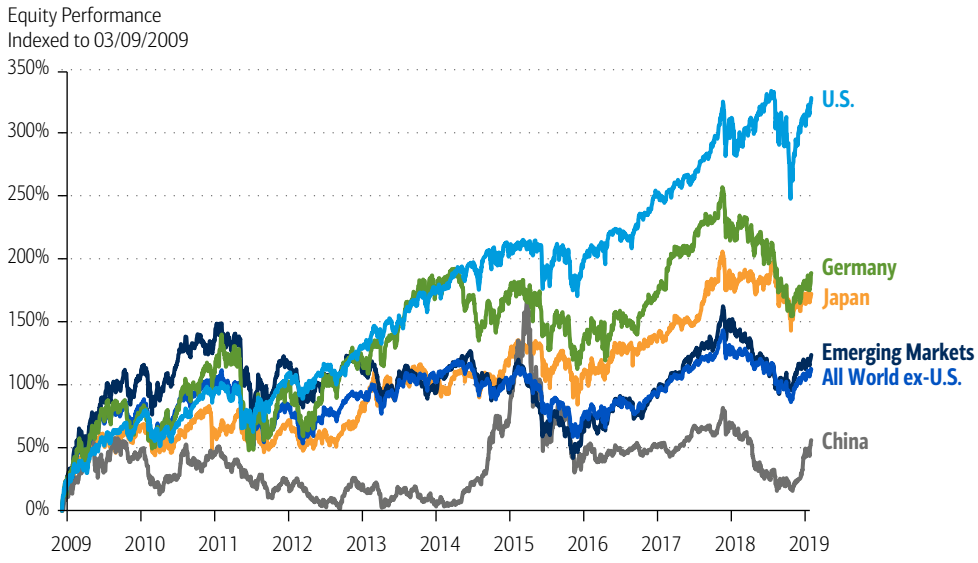
What's (Still) Right with America

Joseph P. Quinlan, Head of CIO Market Strategy

Lauren J. Sanfilippo, Vice President and Market Strategy Analyst

Roughly a decade ago, we published an out-of-consensus piece titled "What's Right with America." Then, we made the case that all was not lost in America—which was a hard sell in the face of soaring unemployment and a ballooning federal budget deficit, and against a backdrop of acute financial and political uncertainty, and incessant commentary that debt-laden America was economic toast. But with the S&P 500 up over 300% since the March 2009 lows, having outperformed most of the world's major indices, our bet on the American economy proved profitable (Exhibit 2).

Exhibit 2: The U.S. Outperforms the Rest of the World.



S&P 500 as U.S.; DAX Index as Germany; Nikkei Index as Japan; MSCI All World ex-U.S. as All World ex-U.S.; MSCI EM Index as Emerging Markets; Shanghai Composite Index as China. Data as of April 5, 2019.
Past performance is no guarantee of future results.

And ten years on, we are still of the same mindset—that the U.S. economy remains one of the most resilient and dynamic in the world, a fact investors should not forget amid the daily barrage of negative headlines. An inverted yield curve, U.S.-Sino trade tensions, rising federal budget deficits and incessant political uncertainty at home or abroad—all of these factors are headwinds for equities in the near term. However, investors should not lose sight with what's right with America.

First, America remains the largest and most productive economy in the world. With just 4.5% of the global population, the U.S. accounts for over 15% of global GDP on a

Purchasing Power Parity basis. In nominal dollars, the U.S. economy is over $7 trillion larger than China's. Never have so few people produced so much output. Since the crisis, U.S. output has increased by roughly $7 trillion; according to the latest figures from the Department of Commerce, total U.S. GDP was nearly $21 trillion in the fourth quarter of last year. *The bottom line: No other economy in the world comes close to the productive capacity of the United States.*

Second, contrary to popular lore, the U.S. remains a global manufacturing superpower. According to recent data from the United Nation's Development Organization, of the 22 manufacturing categories outlined by the U.N., the U.S. ranked first in terms of global share of output in 12 categories. The top ranking of the U.S. runs the gamut from paper products to motor vehicles to aircraft. And that's not all: The U.S. tallied second in six other categories. Combined, America ranked first and/or second in 18 out of the 22 sectors, underscoring the manufacturing breadth and competitiveness of American manufacturing. *The bottom line: America's manufacturing base is currently alive and extremely well.*

Third, the U.S. remains among the largest exporters of goods and services in the world. Currently, U.S. monthly goods and services exports are clipping along at $207 billion, a monthly tally only China comes close to. What the U.S. exports in a month is greater than what most countries export in a year. For full-year 2018, total exports (goods and services) topped $2.5 trillion, a 58% rise from the levels of 2009. Whether it's soybean or spacecraft, propane or plastics, accounting services or automobiles, the breadth of U.S. exports is virtually unparalleled. *The bottom line: Very few nations exhibit more export vigor than the United States.*

Fourth, the U.S. remains a magnet for foreign capital. Indeed, no country attracts as much overseas cash as the U.S. thanks to myriad attributes, including a vast and wealthy consumer market, a large skilled labor pool, a transparent rule of law, and more recently, cheap energy costs and low corporate taxes. The upshot, the U.S. remains a magnet for other peoples' money. Foreign holdings of U.S. securities (U.S. Treasuries, corporate bonds, government agencies and equities) totaled $17 trillion in the fourth quarter of 2018, up 73% from the fourth quarter of 2009. Meanwhile, over the 2000–'18 period, the United States attracted over 17% of total global foreign direct investment, light years ahead of second place China (8%). *The bottom line: Global demand for U.S. assets remains strong and robust, reflecting, in large part, America's economic strengths.*

Fifth, America remains the home to the world's top global brands. Despite intense global competition, America's global brand presence has become stronger over the past few years. Of the top 10 global brands in 2018, eight of 10 were American according to a report by BrandZ, which ranks the top 100 most valuable global brands. *The bottom line: Brands carry intangible value, with no country as brand savvy as America.*

Sixth, while China has made significant technological strides over the past decade, the U.S. remains the world's technology leader owing to the nation's risk-taking, not-afraid-to-fail entrepreneurial culture that underpins America's leadership in both technology and innovation. America is the largest market in the world for information technology (IT) spending on hardware, software and services, according to International Data Corporation estimates, and it remains the global leader in social media and content. The bottom line: America remains a global innovation giant, which is one reason why the NASDAQ has posted a return in excess of 500% since March 2009.[1]

Seventh, the top-ranked universities in the world are in the U.S.; indeed, 31% of the universities in the Quacquarelli Symonds World Rankings' top 100 universities for 2018 were located in America; five out of the top 10, and 11 out of the top 20, were American universities. *The bottom line: America remains a global leader in producing skilled/productive human capital.*

[1] Bloomberg as of March 2009.

Eighth, while the "Made in America" financial crisis was touted by many as the death knell of the U.S. dollar, nothing of the sort has occurred over the past few years. The greenback remains king for now—the world's unchallenged world reserve currency, accounting for 61.7% of global central bank reserves as of the fourth quarter of 2018, according to the International Monetary Fund. For second-place euro, the currency's share of central bank holdings plunged from 28.0% in mid-2009 to 20.7% in Q4 2018. *The bottom line: The global economy still pivots around the greenback, an "exorbitant privilege" the United States will continue to enjoy over the medium term.*

Ninth, the U.S. still ranks as one of the most competitive economies in the world. While America's competitiveness ranking slipped in the years following the financial crisis, the United States has found its way back into the global elite, ranking second in the latest competitiveness survey from the World Economic Forum. Only Switzerland ranked higher. *The bottom line: Competitiveness matters—it drives and dictates economic development, prosperity and ingenuity on a relative and absolute basis; the U.S. is positioned to remain among the world's most competitive economies.*

Finally, there have been a few surprises in the post-crisis period but none bigger and more significant than America's energy revolution. And what a revolution. In late 2018, the United States emerged as the largest oil producer in the world, out-producing even Saudi Arabia and Russia thanks to the spike in production as a result of horizontal drilling and hydraulic fracturing, or fracking. The latter has unlocked massive supplies trapped in shale formations in states including North Dakota, Oklahoma and Texas. The U.S. is also a leading producer of natural gas. *The bottom line: America is an energy giant, a dynamic that reflects the risk-taking entrepreneurial nature of the U.S. corporate sector and the technological prowess that sets the U.S. apart from the rest of the world.*

Investment summary

Betting against the U.S. corporate sector has been a losing proposition for nearly a decade. Distracted by divisive politics, the policy inertia of Congress and a 24/7 negative news cycle, many investors have been blinded to the underlying strengths and pillars of the U.S. economy, missing out on one of the greatest bull markets in history.

While we are not oblivious to the multiple challenges in front of America—a crumbling physical infrastructure, burdensome entitlement expenditures, the rising cost to service America's debt, an unwieldy healthcare system, anti-trade and immigration sentiment—America's multiple strengths give it ample opportunity/ammunition to address its weaknesses. The glass is half full, not empty. In the end, the bull rumbles on because there's still plenty right with America.

THOUGHT OF THE WEEK

Chinese Markets Optimistic on Growth-Stabilizing Policy Stimulus

Elizabeth Jacobi, Investment Analyst

Kishan Chhatwal, Assistant Vice President and Investment Analyst

Chinese equities have appreciated nearly 40% in 2019, far outpacing the 15% rise in the U.S.[2] Investors have been anticipating better trading relationships as well as a return to stability, and ultimately recovery, for China's economy.

The excessive deleveraging and financial reform programs implemented by Chinese authorities in 2017 led to a subsequent slowdown in economic activity, forcing them to reverse course to mitigate it. A flurry of fiscal and monetary stimulus measures

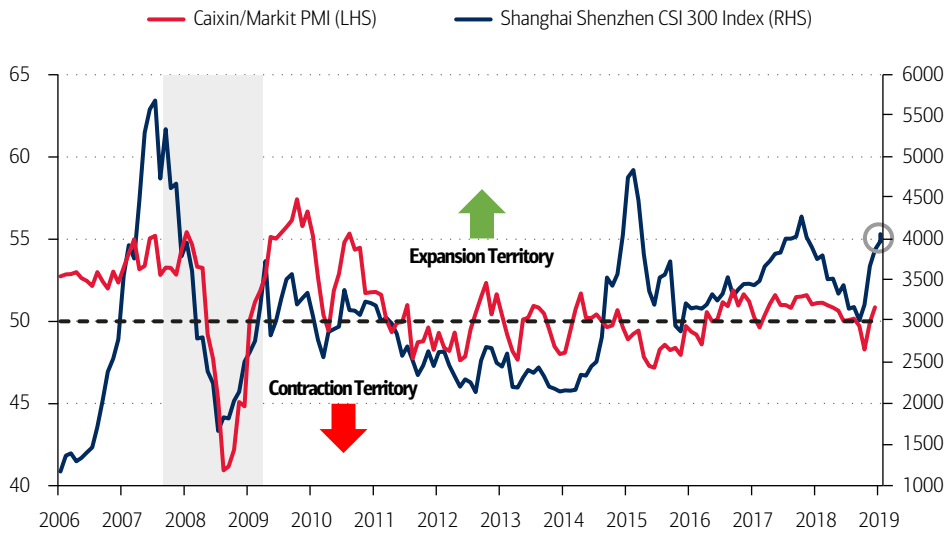
[2] Shanghai Shenzhen CSI 300 Index, S&P 500 Index. Data as of April 4, 2019.

have begun to signal an improvement in the broader economy. The recent rebound in industrial activity, as depicted by the Caixin/Markit Manufacturing PMI, saw the indicator increase to 50.8[3] in March following three months in contraction territory (Exhibit 3). Firms signaled higher output, optimism for production improved to a ten-month high, and employment at goods producers increased for the first time since 2013.

Since mid-2018, China has been implementing a combination of fiscal and monetary policy stimulus measures. In January, Beijing announced investments in rail infrastructure construction will increase 40% year-over-year in 2019.[4] Policymakers also lowered personal income taxes and import tariffs, increased rebates on research & development (R&D) spending, lifted Small and Medium Enterprise (SME) tax thresholds, and lowered social security contribution rates. The China Banking and Insurance Regulatory Commission encouraged lenders to increase loans to small businesses by 30% this year, allowing banks to tolerate a higher non-performing loan ratio for said borrowers in order to promote the private sector. The rate of the value-added tax will be further reduced for manufacturers, with the top rate being cut 300 basis points.

China's ultimate goal is to achieve more sustainable growth—more environmentally-friendly, less corruption, more consumer-driven, and in higher value-added industries. However, policymakers are conscious of preventing a significant slowdown and will look shift priorities to achieve an ongoing 6%-6.5% growth mandate. We currently see positive developments on the trade deal between the U.S. and Chinese officials over recent weeks and we remain optimistic that the two parties will come to a meaningful agreement resulting in a de-escalation of tensions and a possible removal of U.S. tariffs on Chinese goods.

Exhibit 3: Chinese Equities are Strongly Correlated to Industrial Activity.



Sources: Caixin/IHS Markit, Haver Analytics, Bloomberg, Chief Investment Office. Data as of April 4, 2019.
Past performance is no guarantee of future results.

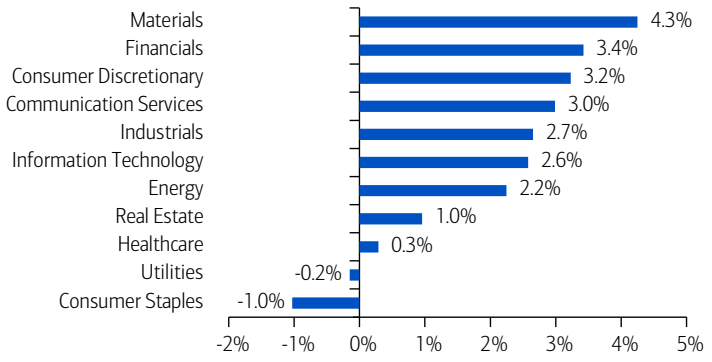
[3] Caixin/Markit Manufacturing PMI Index.
[4] China Plans 6,800 Km of New Rail Track in 2019 Amid Infrastructure Push, Reuters. January 2, 2019.

MARKETS IN REVIEW

Equities

		Total Return in USD (%)		
	Current	WTD	MTD	YTD
DJIA	26,424.99	2.0	2.1	14.0
NASDAQ	7,938.69	2.7	5.5	20.0
S&P 500	2,892.74	2.1	4.1	16.0
S&P 400 Mid Cap	1,948.91	2.8	2.2	17.7
Russell 2000	1,582.56	2.8	0.6	17.8
MSCI World	2,149.85	2.0	3.4	14.8
MSCI EAFE	1,911.40	2.0	2.6	12.2
MSCI Emerging Markets	1,085.14	2.6	3.4	12.7

S&P 500 Sector Returns



Fixed Income[1]

		Total Return in USD (%)		
	Current	WTD	MTD	YTD
Corporate & Government	2.94	-0.4	1.8	2.9
Agencies	2.56	-0.2	1.1	1.6
Municipals	2.38	-0.3	1.3	2.6
U.S. Investment Grade Credit	3.00	-0.3	1.6	2.6
International	3.67	-0.2	2.3	4.9
High Yield	6.25	0.5	1.4	7.8

	Current	Prior Week End	Prior Month End	2018 Year End
90 Day Yield	2.35	2.35	2.38	2.36
2 Year Yield	2.34	2.26	2.51	2.49
10 Year Yield	2.50	2.41	2.72	2.68
30 Year Yield	2.90	2.81	3.08	3.01

Commodities & Currencies

		Total Return in USD (%)		
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	172.59	1.6	1.4	8.1
WTI Crude $/Barrel[2]	63.08	4.9	10.2	38.9
Gold Spot $/Ounce[2]	1,291.75	0.0	-1.6	0.7

Currencies	Current	Prior Week End	Prior Month End	2018 Year End
EUR/USD	1.12	1.12	1.14	1.15
USD/JPY	111.73	110.86	111.39	109.69
USD/CNH	6.71	6.72	6.70	6.87

Source: Bloomberg, Factset.Total Returns from the period of 4/1/19 to 4/5/19. Bloomberg Barclays Indices.[1] Spot price returns.[2] All data as of the 4/5/19 close.
Past performance is no guarantee of future results. Please see the Index Definitions at the back of the document.

Asset Class Weightings (as of 3/6/19)

	Under-weight		Neutral		Over-weight
Global Equities	•	•	•	●	•
U.S. Large Cap Growth	•	•	•	●	•
U.S. Large Cap Value	•	•	•	●	•
U.S. Small Cap Growth	•	•	•	●	•
U.S. Small Cap Value	•	•	●	•	•
International Developed	•	●	•	•	•
Emerging Markets	•	•	•	●	•
Global Fixed Income	•	●	•	•	•
U.S. Governments	•	●	•	•	•
U.S. Mortgages	•	●	•	•	•
U.S. Corporates	•	•	●	•	•
High Yield	•	●	•	•	•
U.S. Investment Grade Tax Exempt	•	•	●	•	•
U.S. High Yield Tax Exempt	•	●	•	•	•
International Fixed Income	●	•	•	•	•
Alternative Investments*	see CIO Asset Class Views				
Hedge Funds					
Private Equity					
Real Assets					
Cash					

* Many products that pursue Alternative Investment strategies, specifically Private Equity and Hedge Funds, are available only to pre-qualified clients.

Economic and Market Forecasts (as of 4/8/19)

	Q3 2018A	Q4 2018A	Q1 2019A	Q2 2019E	2018A	2019E
Real global GDP (% y/y annualized)	–	–	–	–	3.8	3.3
Real U.S. GDP (% q/q annualized)	3.4	2.2	1.0*	2.5	2.9	2.2
CPI inflation (% y/y)	2.6	2.2	1.6*	1.9	2.4	1.8
Core CPI inflation (% y/y)	2.2	2.2	2.1*	2.2	2.1	2.2
Unemployment rate (%)	3.8	3.8	3.9	3.8	3.9	3.7
Fed funds rate, end period (%)	2.18	2.40	2.43	2.38	2.40	2.63
10-year Treasury, end period (%)	3.06	2.68	2.41	2.80	2.68	3.00
S&P 500 end period	2914	2507	2834	–	2507	2900
S&P earnings ($/share)	43	41	38*	42.5	161.5	168
Euro/U.S. dollar, end period	1.16	1.15	1.12	1.15	1.15	1.20
U.S. dollar/Japanese yen, end period	114	110	111	107	110	101
Oil ($/barrel, avg. of period, WTI**)	69	59	55	62	65	59

The forecasts in the table above are the base line view from BofAML Global Research team. The Global Wealth & Investment Management (GWIM) Investment Strategy Committee (ISC) may make adjustments to this view over the course of the year and can express upside/downside to these forecasts.

Past performance is no guarantee of future results. There can be no assurance that the forecasts will be achieved. Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment performance.

A = Actual. E/* = Estimate. S&P 500 represents a fair value estimate for 2019. **West Texas Intermediate

Sources: BofA Merrill Lynch Global Research; GWIM ISC as of April 8, 2019.

Index Definitions

Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Indexes are all based in dollars.

Index term	Definition
S&P 500 Index	includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market
Purchasing Managers' Index (PMI)	is an indicator of economic health for manufacturing and service sectors. EURO STOXX 50 is a stock index of Eurozone stocks designed by STOXX, an index provider owned by Deutsche Börse Group.
NKY Index	The Nikkei-225 Stock Average is a price-weighted average of 225 top-rated Japanese companies listed in the First Section of the Tokyo Stock Exchange.
SHCOMP Index	is a market composite made up of all the A-shares and B-shares that trade on the Shanghai Stock Exchange.
MXWDU Index	captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 24 Emerging Markets (EM) countries.
DAX Index	is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange.
MSCI EM	stands for Morgan Stanley Capital International (MSCI), and is an index used to measure equity market performance in global emerging markets.
Caixin/Markit Purchasing Manager Index	is a composite indicator designed to provide an overall view of activity in the manufacturing sector and acts as an leading indicator for the whole economy.
Shanghai Shenzhen CSI 300 Index	is a capitalization-weighted stock market index designed to replicate the performance of top 300 stocks traded in the Shanghai and Shenzhen stock exchanges.

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

All recommendations must be considered in the context of an individual investor's goals, time horizon, liquidity needs and risk tolerance. Not all recommendations will be suitable for all investors. Asset allocation, diversification and rebalancing do not ensure a profit or protect against loss in declining markets.

Investments have varying degrees of risk. Some of the risks involved with equity securities include the possibility that the value of the stocks may fluctuate in response to events specific to the companies or markets, as well as economic, political or social events in the U.S. or abroad. Small cap and mid cap companies pose special risks, including possible illiquidity and greater price volatility than funds consisting of larger, more established companies. Bonds are subject to interest rate, inflation and credit risks. Municipal securities can be significantly affected by political changes as well as uncertainties in the municipal market related to taxation, legislative changes, or the rights of municipal security holders. Income from investing in municipal bonds is generally exempt from Federal and state taxes for residents of the issuing state. While the interest income is tax-exempt, any capital gains distributed are taxable to the investor. Income for some investors may be subject to the Federal Alternative Minimum Tax. Investing in lower-grade debt securities ("junk" bonds) may be subject to greater market fluctuations and risk of loss of income and principal than securities in higher rated categories. Treasury bills are less volatile than longer-term fixed income securities and are guaranteed as to timely payment of principal and interest by the U.S. government. Mortgage-backed securities are subject to credit risk and the risk that the mortgages will be prepaid, so that portfolio management may be faced with replenishing the portfolio in a possibly disadvantageous interest rate environment. Investments in foreign securities (including ADRs) involve special risks, including foreign currency risk and the possibility of substantial volatility due to adverse political, economic or other developments. These risks are magnified for investments made in emerging markets. Investments in a certain industry or sector may pose additional risk due to lack of diversification and sector concentration. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates, and risk related to renting properties, such as rental defaults. There are special risks associated with an investment in commodities, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and the impact of adverse political or financial factors.

Nonfinancial assets, such as closely-held businesses, real estate, oil, gas and mineral properties, and timber, farm and ranch land, are complex in nature and involve risks including total loss of value. Special risk considerations include natural events (for example, earthquakes or fires), complex tax considerations, and lack of liquidity. Nonfinancial assets are not suitable for all investors.

Investments in tangible assets are highly volatile and are speculative. There are special risks associated with an investment in commodities, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes, and the impact of adverse political or financial factors.

Alternative investments such as derivatives, hedge funds, private equity funds, and funds of funds can result in higher return potential but also higher loss potential. Changes in economic conditions or other circumstances may adversely affect your investments. Before you invest in alternative investments, you should consider your overall financial situation, how much money you have to invest, your need for liquidity, and your tolerance for risk. Alternative investments are speculative and involve a high degree of risk. An investor could lose all or a substantial amount of his or her investment. There is no secondary market nor is one expected to develop and there may be restrictions on transferring fund investments. Alternative investments may be leveraged and performance may be volatile. Alternative investments have high fees and expenses that reduce returns and are generally subject to less regulation than the public markets. The information provided does not constitute an offer to purchase any security or investment or any other advice.