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Capital Market Outlook

April 15, 2019

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- **Macro Strategy**—The scope for "free money" is limited. The parameters that set the limits for fiscal and monetary expansion won't change through the alchemy of Modern Monetary Theory (MMT). The Federal Reserve (Fed) is already providing the money that is necessary to achieve its inflation target, and interest rates are the result of that liquidity provision given fiscal borrowing needs.

- **Global Market View**—With U.S. trade policy in focus, we think it's an opportune time to reflect on some of the important lessons learned from last year's trade wars. Here is what have we learned: Trade wars are not easy to win; come with costs; and are associated with unintended consequences. Global trade tensions remain a wildcard and headwind for global equities.

- **Thought of the Week**—Year-to-date, small-cap equities have outperformed their large-cap counterparts. We retain a preference for large-caps and remain cautious on small-cap equities for three primary reasons: 1) potentially higher volatility, 2) weaker fundamentals and 3) growth concerns.

- **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

Kathryn A. Cassavell
CFA®, Vice President and Market Strategy Analyst

THOUGHT OF THE WEEK

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Data as of 4/15/2019 and subject to change.

MACRO STRATEGY

Here We Go Again

Chief Investment Office Macro Strategy Team

For thousands of years across multiple cultures and continents, alchemists were engaged in seeking magical solutions to basic human wants and desires: achieving eternal life with special elixirs, for example, or more mundanely, making gold out of base metals and other cheaper materials. "Money for nothing" is a very strong human desire and, therefore, political force.

As the alchemists failed in their monetary quest, attention eventually turned to paper money, which was much easier to produce. The early 1700s, for example, saw John Law, a Scottish economist —during the formative years of central banking in France—

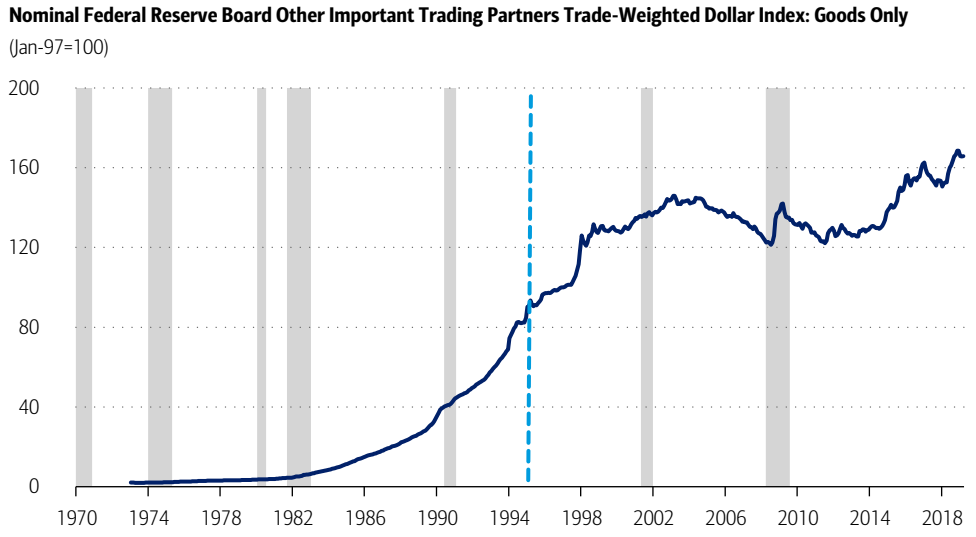
create the Mississippi Bubble in one of the early disastrous experiments with paper money. Three hundred years later, there is now a long history of experimentation with government backed or paper currencies, whose lessons are fairly straightforward: Looking across time and across countries, social and economic stability tends to be associated with monetary stability, and monetary stability tends to be associated with relatively low and stable inflation.

Furthermore, low and stable inflation tends to be associated with moderate growth in the money supply. Deflationary collapses are typically associated with big declines in money-supply growth, as we saw in the U.S. in the 1930s and Japan in the 1990s, while inflation, and especially hyperinflation, is always associated with rapid money-supply growth, as we have recently seen in Zimbabwe and Venezuela. This is true across countries and is aptly summarized by American economist Milton Friedman's famous adage "inflation is always and everywhere a monetary phenomenon."

One consequence of the critical role that the money supply plays for economic stability was a growing recognition after World War II, as fiat money replaced gold-backed money, that central banks needed independence from political influence to better control inflation. The result was a growing movement across the world to free monetary policy from political influence. This played a major part in ending the high 1970s inflation, and in restoring much lower global inflation rates thereafter.

As an illustration of the role that central-bank independence played, consider the value of the U.S. dollar against the currencies of its emerging market (EM) trading partners (Exhibit 1). A dollar converted to this basket of currencies in 1975 was worth less than a penny by 1995. Essentially, EM central banks were government tools that constantly inflated their money supplies, causing persistent high inflation that made their currencies worthless against major currencies, like the dollar, that were controlled by independent central banks.

Exhibit 1: Independent Central Banks Have Stabilized EM Currencies Against the Dollar Since About 1995.



Sources: Haver Analytics; Federal Reserve Board. Data as of April 10, 2019.

Notice that this changed after the mid 1990s, helping EM currencies hold their value against the dollar over the next 20 years and many more EM assets to achieve investment-grade status. This reflected a recognition that economic development is more sustainable in a stable monetary environment. Avoiding the periodic inflationary collapses of currencies that was typical of EMs like China, for example, in the earlier

period helped billions of people move out of subsistence poverty, the biggest, most widespread improvement in human living standards ever seen. The main point of this trip down economic memory lane is to provide a backdrop for judging MMT.

Why Now?

Before looking at the details of MMT, it is helpful to look at the forces or trends that have been propelling its newfound popularity. Two major factors appear to be behind the phenomenon. First, the evolution of monetary policy since the financial crisis, including zero and negative interest rates, as well as quantitative easing without the inflationary consequences that many critics had predicted, has emboldened a view that money and fiscal deficits can be expanded without consequence.

Second, the rise of socialism on the progressive left has made "pie in the sky" policies more popular in the U.S., particularly among millennials. Some surveys show that a majority of millennials favor socialism over capitalism despite the historical record, which shows no example of a persistently successful major socialist economy. If we exclude communist countries, the biggest population example of a socialist country today is Venezuela. Also, a few countries over the years have started out as democratic socialist but eventually became democratic and not socialist (e.g., Sweden) or non-democratic and socialist (Venezuela). Essentially, it appears that "democratic" and "socialist" are incompatible in the real world.

In any event, socialism is about putting control over resources and the means of production under collective, rather than individual, control. This "collective" impulse has extended to the monetary authority in the minds of several candidates for the Democratic nomination for president. As a result, some have endorsed MMT as part of a progressive platform.

What is MMT?

An overview of MMT on Wikipedia describes it as follows:

"MMT states that a government that can create its own money, such as the United States:

1. Cannot default on debt denominated in its own currency

2. Can pay for goods, services, and financial assets without the need to collect money in the form of taxes or debt issuance in advance of such purchases

3. Is limited in its money creation and purchases by inflation, which accelerates once the economic resources (i.e., labor and capital) of the economy are utilized at full employment.

4. Can control inflation by taxation and bond issuance, which remove excess money from circulation, although the political will to do so may not always exist;

5. Does not need to compete with the private sector for scarce savings by issuing bonds."

Taking the points in turn:

1. This is only true if the central bank prints enough money to finance fiscal profligacy without regard for inflation. If the central bank is independent and restrains the money supply to keep inflation in check, interest rates could skyrocket as the deficit soars and paying back the debt becomes impossible. When rates rise beyond a certain level, fears of credit defaults would escalate rates to depression-inducing high levels, as we saw in Greece, where the European Central Bank refused to accommodate adequate money-supply growth. Assertion 1 illustrates that MMT requires the central bank to be a tool

of fiscal policy and not an independent regulator of money to control inflation. This is what has caused hyperinflation in Venezuela and elsewhere.

2. Currently, the federal government is spending at the rate of roughly 20% of gross domestic product (GDP), approximately $4 trillion per year. The M2 money supply is about $15 trillion. If the government printed money to finance its current level of spending, the money supply would rise by about 25% a year instead of the roughly 5% pace in the current regime. This would be highly inflationary.

3. This point assumes inflation is caused by full employment rather than excessive money creation. However, there are countless examples of recession and high unemployment (underemployed resources) associated with high inflation because of excessive money growth (think Venezuela).

4. Taxation and bond issuance don't control inflation, money does. Hence, in this flawed view the government could borrow and raise taxes while printing more and more money, causing the kind of stagflation we saw in the 1970s.

5. This is true only as long as the government pays for deficits by printing money rather than borrowing or taxing.

The bottom line is that the scope for "free money" is limited. The parameters that set the limits for fiscal and monetary expansion won't change through the alchemy of MMT. The Fed is already providing the money that is necessary to achieve its inflation target, and interest rates are the result of that liquidity provision given fiscal borrowing needs. Shifting control of the money supply to politicians cannot change that constellation of money growth, interest rates and deficits unless the new monetary regime ignores the inflation target and prints more money. That's what usually happens when the monetary authority loses its independence in a society where people vote for more, more, more...

GLOBAL MARKET VIEW

Some Inconvenient Truths about Trade Wars

Kathryn A. Cassavell CFA®, Vice President and Market Strategy Analyst

Investor concerns about escalating U.S.-European Union (EU) trade tensions last week brought a brief halt to the U.S. equity rally, after President Trump threatened tariffs on $11 billion of EU imports. Prior to the announcement, the S&P 500 had posted eight straight days of gains on growing optimism about a U.S.-China trade deal. Yet while much of the benefits of a U.S.-China trade deal have been priced into markets, renewed U.S.-EU tensions and other trade conflicts (e.g., the U.S.-Mexico-Canada Agreement) may continue to weigh on markets.

With U.S. trade policy in focus, we think it's an opportune time to reflect on some of the important lessons learned from last year's trade wars. In the end, we continue to believe that a full blown U.S./EU trade war is avoidable; however, uncertainty surrounding U.S. trade policy can create unintended consequences that investors should be appropriately considering.

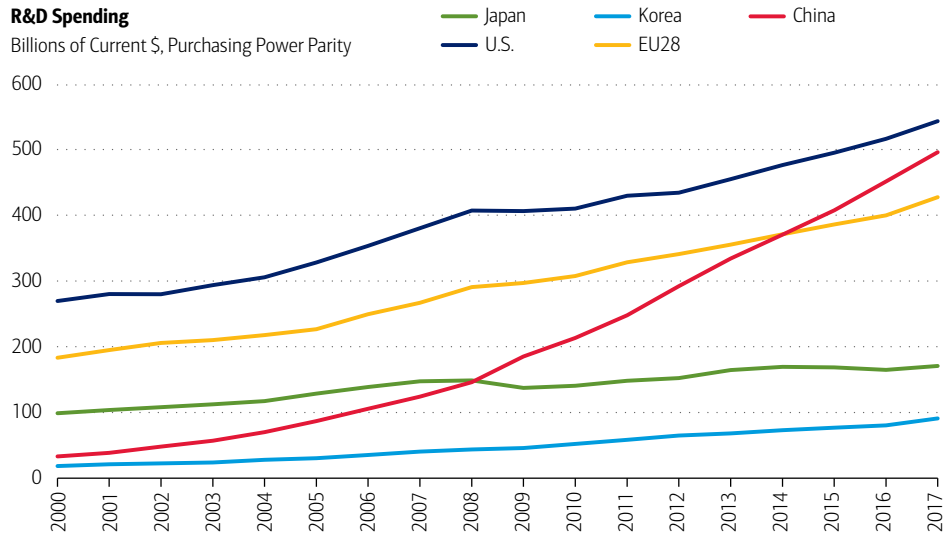
Three Truths about Trade Wars:

1. **Trade wars are not "easy to win".** Running large trade deficits doesn't automatically give the U.S. more ammunition in a trade war. There are several other ways for countries to retaliate besides raising tariffs (e.g., reduced market access for U.S. firms, boycott of U.S. products, etc.).

That said, the U.S.-China conflict goes far beyond trade. The U.S. administration's goals are much broader—focused on opening Chinese markets to foreign companies, preventing forced technology transfer, curbing state subsidies, and protecting intellectual property rights. America's pressure on China is not just about trade deficits; it's about the strategic rivalry over tech dominance in the 21st century. Though China may have dropped its "Made in China 2025" language, the goals remain in place: to move China up the value chain and develop a world-class technology sector, setting the global standards for the industries of the future.

By many measures, China is already on its way to becoming a technological superpower and is exerting its influence across the globe. At current growth rates, China is on track to overtake the U.S. in research and development spending by as early as 2020 (Exhibit 2). In terms of 5G infrastructure (R&D), Deloitte estimates that China has outspent the U.S. by $24 billion since 2015. In sum, trying to get China to change its industrial policies is not "easy" and is especially difficult without coordination among allies.

Exhibit 2: China's R&D Breakout.



Data as of March 2019. Source: Organisation for Economic Co-operation and Development.

2. **Trade wars are costly.** Though trade wars can potentially provide protection for certain industries, the overall economic effects tend to be skewed to the downside. Some of the direct costs of a trade war may include reduced exports, higher costs for consumers, and increased cost pressures for companies importing intermediate goods. Some examples include:

- U.S.-China trade war: The International Monetary Fund (IMF) estimates that an increase in tariffs of 25% on all goods traded between the two countries would decrease annual U.S. GDP growth by up to 0.6% and reduce China's growth by as much as 1.5%.

- Steel tariffs: Last year's steel tariffs created some 8,700 jobs and raised the pre-tax earnings of steel companies by $2.4 billion; however, costs for steel users rose by $5.6 billion. That's an extra $650,000 in costs per job created.[1]

- Reduced exports: U.S. exports to China fell sharply in the second half of 2018. The largest export declines came in the agriculture industry, as U.S. soybean exports to China were almost entirely replaced by exports from Brazil and Argentina.

[1] Peterson Institute for International Economics, "Steel Profits Gain, but Steel Users Pay Under Trump's Protectionism," December 20, 2018.

- Higher consumer prices: A 20% tariff on washing machines introduced in January 2018 was followed by a 18% increase in consumer prices (from February to June 2018).

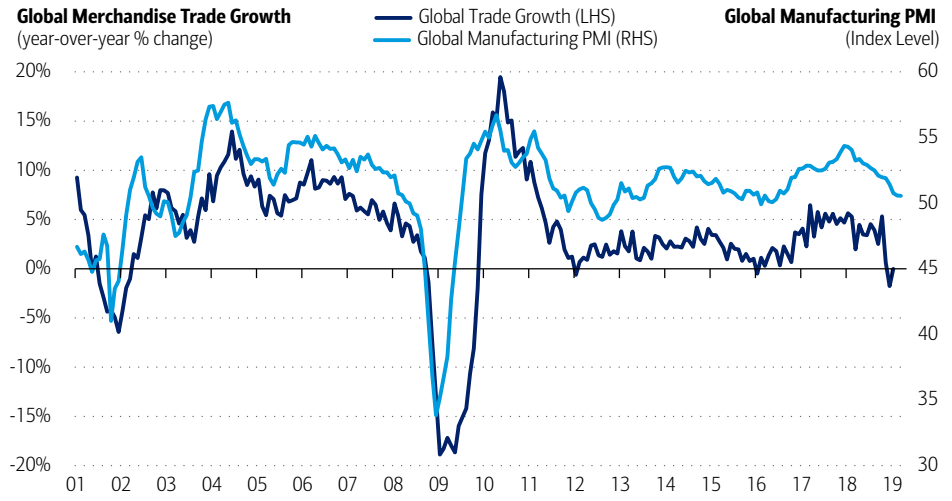
Foreign (Chinese) exporters could also bear some of the costs if tariffs cause them to reduce the price of their goods. However, a recent study by economists at the Fed, Princeton University and Columbia University on the impact of the 2018 tariffs found little evidence of this; instead they estimate that the full impact of the tariffs so far has fallen on domestic consumers.[2]

3. **Trade wars come with unintended consequences.** While the direct costs of tariffs appear to be more sector specific, trade wars also have many unintended consequences for the global economy.

First, trade wars pose a significant threat to business investment. Rising trade policy uncertainty can cause companies to scale back or postpone capital investment.

Second, softer growth in China can create ripple effects for the global economy. When demand from China slows, this puts downward pressure on global growth and tends to weaken export-driven economies such as the EU. As depicted in Exhibit 3, global trade and manufacturing growth significantly slowed by the end of last year but have since stabilized.

Exhibit 3: Global Trade and Manufacturing Growth Fall Amid Trade Wars.



Manufacturing PMI: greater than 50 indicates expansionary. Source: CPB World Trade Monitor; JPMorgan/IHS Markit/ Haver Analytics. Data as of March 2019.

Third, higher tariffs can cause unintended harm for foreign companies operating in China, since roughly 60% of China's exports to the U.S. are produced in foreign-owned (non-Chinese) factories.[3] Similarly, retaliatory tariffs imposed by China on the U.S. do not only impact American companies. Global companies with operations in the U.S. are also at risk. For example, BMW is the largest exporter of cars in the U.S., shipping over $8.4 billion of motor vehicles overseas from its Spartanburg, SC, factory, with nearly one-third of exports sent to China.

Another unintended consequence of trade wars: Pain in the financial markets can flow to the real economy through an erosion of consumer confidence. Or businesses could react to a prolonged stock price slump by cutting costs/headcount or holding back on investment.

[2] Mary Amiti, Stephen J. Redding, and David Weinstein, "The Impact of the 2018 Trade War on U.S. Prices and Welfare," March 1, 2019.

[3] Peterson Institute, "Trump Tariffs Primarily Hit Multinational Supply Chains," May 2018.

Finally, if trade protectionism persists, the costs for businesses to reorganize their global supply chains could be significant. Over the long run, greater barriers to trade and investment lead to a less efficient global trading system, reduced productivity and slower rates of global growth.

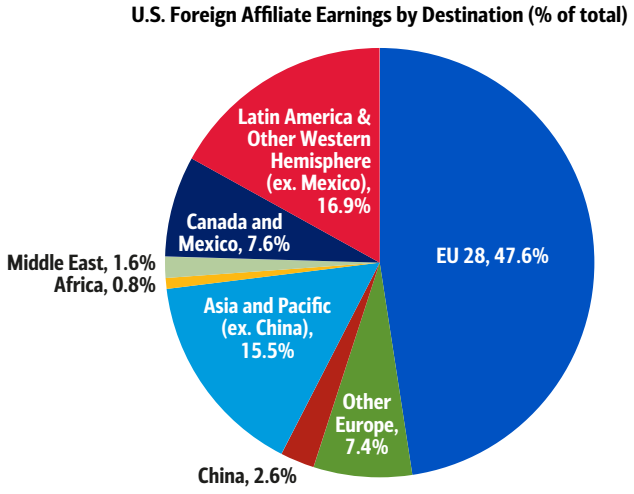
Investment Summary

The bottom line from all of the above: *Trade wars have real economic consequences.* Last year's trade tensions contributed to slower growth in China and a bear market in Chinese equities. Meanwhile, U.S. companies and consumers are hardly immune. The backdrop for U.S. earnings has deteriorated over the past year as companies have had to navigate multiple challenges—from higher tariffs to a slowdown in global growth, as well as Fed policy tightening.

In our view, a U.S./EU trade war would only make matters worse. While U.S. tariffs on $11 billion of EU goods are relatively small compared to the $250 billion of Chinese products targeted, they are significant in that they represent a break from the trade "truce" declared last summer and a growing divide between the world's two largest economies. Greater barriers to trade between the U.S. and Europe threaten to dismantle the largest commercial partnership in the world.

Exhibit 4 outlines just how important the European market is to the earnings of U.S. foreign affiliates. In 2018, the EU represented roughly half of U.S. foreign affiliate income, compared to just 3% for China. Given the outsized importance of the EU to Corporate America, investors should pay closer attention to the impact that escalating trade tensions between these two economies could have on markets. As we have written in the past, a transatlantic divide is the greatest geopolitical risk to the global capital markets, and investors should be pricing in the risks appropriately.

Exhibit 4: Passport to Profits



Source: Bureau of Economic Analysis. Data for 2018.

THOUGHT OF THE WEEK

Bigger is Better: A Preference for Large-Caps

Kishan Chhatwal, Assistant Vice President and Investment Analyst

Elizabeth Jacobi, Investment Analyst

Year-to-date, small-cap equities have outperformed their large-cap counterparts. We retain a preference for large-caps and remain cautious on small-cap equities for three primary reasons: 1) potentially higher volatility, 2) weaker fundamentals and 3) growth concerns.

I. Rising Volatility

Volatility, as represented by the Volatility (VIX) Index, has fallen over 60% since late December—despite no shortage of global uncertainty. However, volatility may be primed for a comeback and large-caps tend to outperform small-caps against that backdrop.

The VIX remains far from its historical average (20), and a flattening yield curve typically precedes greater volatility. According to BofA Merrill Lynch Global Research, the tightened spread between the 2- and 10-year Treasury yields suggests the VIX could double by 2021. Given the likelihood of episodic volatility, we recommend higher-quality exposure and favor large-cap over small-cap equities.

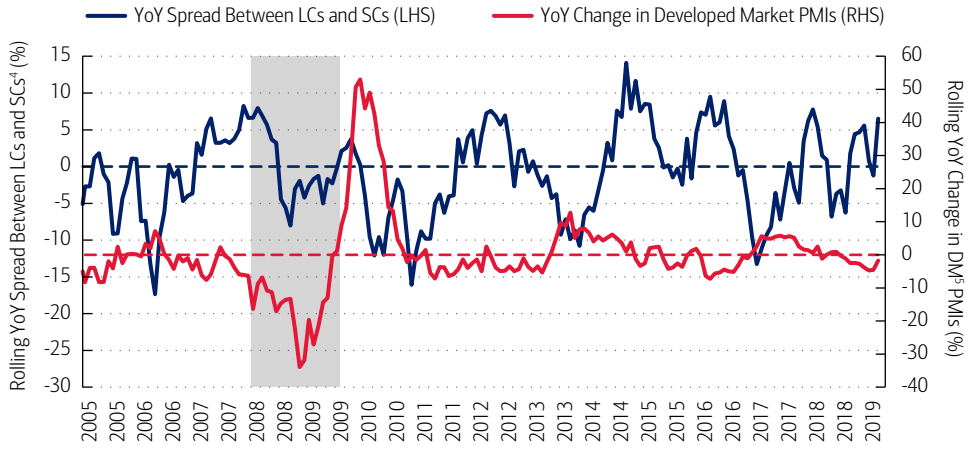
II. Weaker Fundamentals

On aggregate, small-cap companies historically have greater debt burdens, more exposure to rising rates, and poorer earnings prospects than large-caps. More than 50% of small-cap debentures are floating-rate compared to just over 25% for large-caps, according to FactSet Research Systems. Small-caps also couple historically high leverage with a weighted average maturity profile that's nearly double that of the S&P 500. Finally, their earnings growth is expected to be slower than large-caps. In fact, approximately 36% of small-cap companies are unprofitable, compared to just 11% for large-caps, according to Strategas Research Partners.

III. Global Growth Concerns

The International Monetary Fund (IMF) recently cut its outlook for global growth to the lowest level since the financial crisis, citing numerous uncertainties within certain developed markets (DMs). Contrary to popular belief, small caps can be hamstrung by international concerns as they often are the suppliers to globally integrated companies, especially within DMs, and thus smaller firms are generally more dependent on these revenue sources. Small-cap underperformance can often be cited as a leading indicator of a slowing economy. They historically have greater representation in sectors that are sensitive to changes in economic activity, demonstrate a high beta to DM growth, and tend to underperform in later stages of the economic cycle. While the recent shift in Fed policy may provide some near-term relief, broader risks remain. To the extent that developed economic activity continues to moderate, empirical data suggests large-cap equities may outperform (Exhibit 5).

Exhibit 5: Small Caps Tend to Underperform in a Slowing Economy.



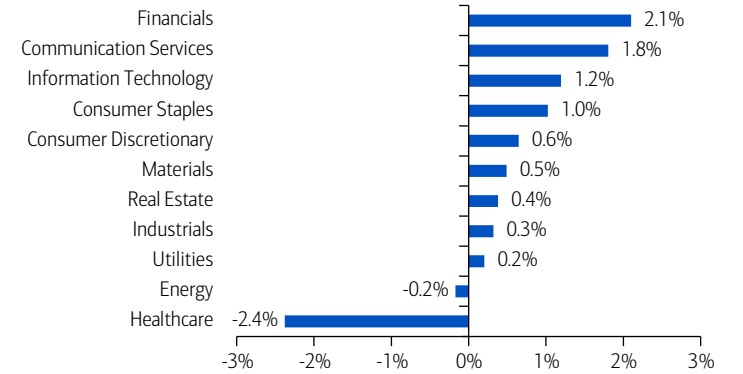
[4] Large Caps illustrated by the Russell 1000 Index, Small Caps by the Russell 2000 Index.
[5] Developed Market PMIs illustrated by the IHS Markit Global Composite Developed Market Purchasing Managers' Index
Source: IHS Markit/Haver Analytics, Bloomberg, Chief Investment Office. Data as of April 10, 2019. **Past performance is no guarantee of future results.**

MARKETS IN REVIEW

Equities

		Total Return in USD (%)		
	Current	WTD	MTD	YTD
DJIA	26,412.30	0.0	1.9	14.0
NASDAQ	7,984.16	0.6	3.3	20.7
S&P 500	2,907.41	0.6	2.7	16.7
S&P 400 Mid Cap	1,965.42	0.9	3.7	18.7
Russell 2000	1,584.80	0.2	3.0	18.0
MSCI World	2,159.39	0.5	2.5	15.3
MSCI EAFE	1,915.67	0.3	2.3	12.5
MSCI Emerging Markets	1,089.09	0.4	3.0	13.2

S&P 500 Sector Returns



Fixed Income[1]

		Total Return in USD (%)		
	Current	WTD	MTD	YTD
Corporate & Government	2.97	-0.1	-0.5	2.8
Agencies	2.61	-0.2	-0.4	1.4
Municipals	2.38	0.1	-0.2	2.7
U.S. Investment Grade Credit	3.03	-0.1	-0.4	2.5
International	3.67	0.2	0.0	5.1
High Yield	6.11	0.6	1.1	8.4

	Current	Prior Week End	Prior Month End	2018 Year End
90 Day Yield	2.36	2.36	2.35	2.36
2 Year Yield	2.39	2.34	2.26	2.49
10 Year Yield	2.57	2.50	2.41	2.68
30 Year Yield	2.98	2.90	2.81	3.01

Commodities & Currencies

		Total Return in USD (%)		
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	173.38	0.5	2.1	8.6
WTI Crude $/Barrel[2]	63.89	1.3	6.2	40.7
Gold Spot $/Ounce[2]	1,290.43	-0.1	-0.2	0.6

Currencies	Current	Prior Week End	Prior Month End	2018 Year End
EUR/USD	1.13	1.12	1.12	1.15
USD/JPY	112.02	111.73	110.86	109.69
USD/CNH	6.71	6.71	6.72	6.87

Source: Bloomberg, Factset.Total Returns from the period of 4/8/19 to 4/12/19. Bloomberg Barclays Indices.[1] Spot price returns.[2] All data as of the 4/12/19 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 4/12/19)

	Q3 2018A	Q4 2018A	Q1 2019A	Q2 2019E	2018A	2019E
Real global GDP (% y/y annualized)	–	–	–	–	3.6	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	2.0	2.4	1.9
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 12, 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.
CBOE Volatility Index	known by its ticker symbol VIX, is a popular measure of the stock market's expectation of volatility implied by S&P 500 index options.
Russell 1000	It represents the top companies by market capitalization. The Russell 1000 typically comprises approximately 90% of the total market capitalization of all listed U.S. stocks. It is considered a bellwether index for large-cap investing.
Russell 2000	Index is a small-cap stock market index of the bottom **2,000** stocks in the Russell 3000 Index. The **Russell 2000** is by far the most common benchmark for mutual funds that identify themselves as "small-cap", while the S&P 500 index is used primarily for large capitalization stocks.
IHS Markit Global Developed Market PMI	is based on monthly surveys of carefully selected companies representing major and developing economies worldwide.
Manufacturing Purchasing Managers' Index (PMI)	for a country, based on about 85% to 90% of the total **PMI** survey responses each month. Its purpose is to provide an accurate advance indication of the final **PMI** data.
Trade-Weighted US dollar index	also known as the broad index, is a measure of the value of the United States dollar relative to other world currencies.
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.