

# Capital Market Outlook

Chief Investment Office



The opinions are those of the author(s) and subject to change.

FEBRUARY 25, 2019

## IN THIS ISSUE

### MACRO STRATEGY

The Federal Reserve (Fed) is in the midst of a fundamental reevaluation of its operating procedures. In 2018, it overtightened because of some fundamental flaws in its conceptual framework of how monetary policy works. These errors are likely to be corrected in a new framework which should result in a more accommodative policy, stronger growth, and relative outperformance of assets that benefit from lower real rates and reflation.

### GLOBAL MARKET VIEW

The industrial revolution in robotics is just starting, portending more long-term upside for global robotic manufacturers. With the U.S. labor market at or near full employment; with the global pool of labor poised to tighten and shrink in the coming decades; and with the global shift toward de-globalization, nationalism, and anti-immigration policies gaining traction—all these factors should accelerate companies' adoption of automation and robotics.

### THOUGHT OF THE WEEK

There are four primary reasons for the sharp rebound in equities to start the year. However, we expect the general macro and market climate to remain fragile, so the next phase of market direction into the spring and summer is likely to be characterized by consolidation or back-and-fill direction.

### PORTFOLIO CONSIDERATIONS

We continue to emphasize a higher-quality portfolio positioning overall; in terms of asset allocation this is represented by higher U.S. and large capitalization exposure than our strategic allocations and higher-quality fixed income relative to high yield and emerging market debt.

## MACRO STRATEGY

### FIXING THE DAMAGE

#### Chief Investment Office Macro Strategy Team

The surge in equity prices so far in 2019 dates back to the January 4 about-face by Fed Chairman Powell at the American Economic Association (AEA) meeting, where he reversed his hawkish stance communicated after hiking rates at the December 18–19 Federal Open Market Committee (FOMC) meeting. At that time, the Fed chair was still signaling more rate hikes for 2019 and sustained Quantitative Easing (QT) on automatic pilot.

Just two weeks later, at the AEA meeting, a new dovish message was apparent. Signs that the economy was reacting negatively to what the Fed thought was a neutral policy were increasingly obvious in the worst December stock-market performance since 1931, crumbling consumer and business confidence, and the biggest monthly drop in retail sales since the financial crisis.

Data as of 02/25/2019 and subject to change.

Clearly, what the Fed thought was a “neutral” policy was in fact an overly tight posture that was risking an unnecessary recession.

The Fed's failure to hit its inflation target for the tenth straight year may be a key reason a recession caused by tight monetary policy is unnecessary. Inflation measured by the Fed's “core” Personal Consumption Expenditures (PCE) inflation objective peaked in July 2018 on a year-over-year basis at 2%, the target level. Two more rate hikes after that and continued shrinkage of the monetary base because of QT imparted a major deflationary shock that has caused excessive economic slowing and a substantial drop in longer-term interest rates around the world. Basically, the Fed prematurely declared “mission accomplished” and thwarted its own declared, long-term inflation objective.

Over the past decade, inflation has fallen short of the Fed's goal about 95% of the time. The average rate of U.S. “core” PCE inflation over the past decade is 1.55%. While the Fed

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has committed to making its 2% target “symmetric” its overtightening in 2018 caused it to fall short of that objective once again. A symmetric 2% target means that monetary policy should create inflation above 2% sufficient to offset the persistent shortfall of the past decade. Ex-New-York-Fed President Dudley in a February 15 Bloomberg interview said: *“I think the Fed is going to change that policy subtly over time. They are going to talk about ‘we want to hit 2% inflation on average.’ And that’s going to imply to people that if they miss on the low side for a while, that they’ll be willing to miss on the high side for a while.”*

This raises the obvious question—why have central banks consistently fallen short of their inflation objectives over the past decade despite unprecedented policy, like zero and negative interest rate targets and massive amounts of quantitative easing? Partly, the answer lies in the strength of the deflationary forces they are trying to counteract. Persistent long-term inflation and government intervention to prevent recessions and depressions have allowed debt to accumulate without the recurrent liquidation that was common before World War II. The global and U.S. economy are thus in a constant state of much higher leverage and indebtedness than was the case before.

High debt and leverage mean the economy is much more vulnerable to deflation as we have seen since the financial crisis. It requires lower interest rates to grow at its potential rate and service higher debt loads. In addition, accelerating technical progress has allowed economic growth with falling prices as the efficiencies from new technologies have made cheaper products possible. Also, fiscal drag has periodically counteracted stimulative monetary policy in both Europe and the U.S. since the financial crisis. Monetary expansion to counter the deflationary effect of high leverage, technical progress, and fiscal drag must necessarily be more aggressive to achieve a positive inflation target in a world that would otherwise be prone to deflation. Last year’s excessive tightening is just one more example of the central-bank tendency to overestimate the extent of accommodation in a world with deflationary tendencies. Feedback from the economy and the financial markets eventually told the Fed that it had tightened too much.

#### **DEVELOPING A BETTER APPROACH**

Fed vice chairman, Richard Clarida, acknowledged these problems in his *Monetary Policy Outlook for 2019* speech on January 10, 2019, less than a week after Chairman Powell’s crucial about-face at the AEA meeting. First, after stating that inflation was close to the 2% objective, Mr. Clarida admitted that *“that said and notwithstanding strong economic growth and the low unemployment rate, inflation has surprised to the downside recently and it is not yet clear that inflation has moved back to 2% on a*

*sustainable basis.”* He also cited some evidence that market-based measures of inflation expectations were falling below 2%.

Second, he acknowledged that strong growth need not be inflationary if it is accompanied by higher productivity, as seen in 2018. *“Not only has aggregate demand growth been robust, but so too has been the growth in realized aggregate supply. Over the first three quarters of 2018, hours worked in the nonfarm business sector were up 2.0% (at an annual rate), and productivity was up 1.8%. Realized productivity growth over the past eight quarters has averaged 1.3%, which is up from the 0.7% average recorded between 2011 and 2016. Strong growth supported by supply side gains in hours worked and productivity is not inflationary, as the experience of 2018 confirms.”*

Tax cuts and deregulation since 2016 have had the predicted impact on productivity that mainstream “secular stagnation” proponents continue to deny. The Fed and consensus economists continued to call for rate hikes over the course of 2018 despite the signs of breakout from “secular stagnation.” In essence, this is a self-fulfilling prophecy. As the economy grows faster than they think is sustainable and unemployment falls further below what they think it should be, they push interest rates higher, creating the slowdown they believe is necessary to avoid inflation. The flaw in this view, however, was revealed by the deflationary response of the economy to the over-tightening. Mr. Clarida’s open-mindedness and willingness to give growth a chance is a major positive for the 2019 economic and market outlook.

As a result of this major rethink in policy, the Fed is likely to remain accommodative until inflation averages sustainably above 2%, and we believe, the expansion should continue. Most investment strategists are positioning as if the U.S. is in the late-cycle stage of expansion. However, because monetary policy has been tighter than the Fed realized, signs of the overheating that typically accompany the late cycle are noticeably absent. The share of gross domestic product (GDP) comprised by discretionary cyclical expenditures, like autos, housing, and capital spending, remains well below late-cycle levels, indicating that there is still room to run in this cycle. The Fed’s recent shift to a more accommodative policy is being reflected in the stock market and rebounding confidence measures.

#### **THE END OF QUANTITATIVE TIGHTENING**

Aside from unnecessarily attacking a falling unemployment rate, we think the Fed’s other big mistake was QT. If your main goal is to achieve a higher inflation rate over time, the correct prescription would be to expand the monetary base, not shrink it. The Fed has belatedly recognized this. Governor Lael Brainard acknowledged it during a CNBC interview

on February 14, 2019: “So in my view that balance-sheet normalization process should come to an end later this year. But, you know, it’s important to remember we’ve already seen a very large amount of normalization taking place. Reserves are down 40% from their peak. They will be down more than 50% later in the year. So for me it seems that a balance-sheet normalization process has really done the work it was supposed to do.” According to the minutes from the January FOMC meeting, most members agree with this.

The Fed had originally forecast a much bigger program of QT, which it now appears ready to curtail much sooner than expected, leaving it with a much bigger balance sheet. Also, Mr. Clarida noted in his previously cited speech that: “Over the past seven years, FOMC participants have continually revised down their estimates of long run  $U^*$ <sup>1</sup> and  $r^*$ <sup>2</sup> as the unemployment rate fell and historically low policy rates did not trigger a surge in inflation and inflation expectations above target.”

<sup>1</sup>  $U^*$  is the unemployment rate associated with full employment in the economy

<sup>2</sup>  $r^*$  is the long-term equilibrium level of the federal funds rate

## CONSEQUENCES FOR MARKETS

The lessons of 2018 come at a time when monetary policy procedures are under a formal review process. The review will include the Fed’s monetary-policy strategy, policy tools, and communication practices. In his speech, Mr. Clarida has provided important insight into the policy shift we are seeing this year. For market participants it implies a much friendlier environment for risk assets. Allowing inflation to average about a half percentage point higher than the 1.55% of the past decade will require a substantial reflationary response in global asset markets. An extra percentage point of growth from the supply-side effects of stronger productivity would provide a further boost to nominal GDP growth.

The sub-four-percent average growth rate of nominal GDP during the decade up to 2017 was the lowest for such a sustained period since before World War II. A pickup to 5% or 5.5% nominal growth could end “secular stagnation” and make risk assets much more attractive. It would also make servicing a large debt load with faster growth possible. The Fed’s willingness to accommodate stronger growth is a key positive development that markets appear to be pricing in for 2019.

## GLOBAL MARKET VIEW

### THE PERFECT STORM ACCELERATING THE MARCH OF MACHINES

**Joseph P. Quinlan**, Head of CIO Market Strategy

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

Some refrains never go out of style. Case in point: the “machines are coming to take our jobs” lament has been around since the industrialization of weaving in the early 18th century. In the 19th century, Karl Marx wrote of machines being “superior competitors to workers,” while John Maynard Keynes warned in the 1930s of soaring unemployment thanks to advances in technology.

On it goes—today, there is no shortage of reports or sensationalized headlines speaking to the march of machines and the threat to the livelihood of workers. That the debate about technology-induced unemployment is centuries old speaks to the fact that the march of machines is unrelenting. A disruptive dynamic? For sure. As a recent report from the World Bank noted, “innovation and technological progress have caused disruption, but they have created more prosperity than they have destroyed.”<sup>3</sup> More work has been created by technological innovations over the centuries than destroyed as the report notes.

That said, there’s more to come, much more. The march of machines, notably robots, is accelerating thanks to a number of factors not likely to dissipate anytime soon.

<sup>3</sup> See “The Changing Nature of Work,” World Bank, 2019.

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### THE PERFECT STORM

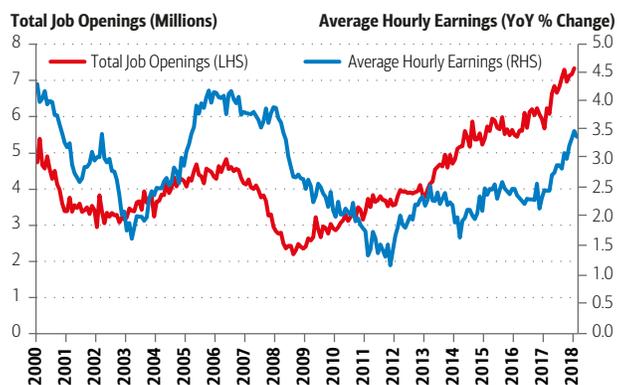
With the U.S. labor market at or near full employment; with the global pool of labor poised to tighten and shrink in the coming decades; and with the global shift toward de-globalization, nationalism, and anti-immigration policies gaining traction—against this backdrop, what’s not to like about robots?

What’s important for investors to realize is that the march of machines and artificial intelligence (AI)-led activities can’t come fast enough in the United States and other nations. In a world sprouting “help wanted” signs, companies either automate or die—it’s that simple. The upshot: the industrial revolution in robotics is just starting, portending more long-term upside for global robotic manufacturers.

### BUDDY CAN YOU SPARE A WORKER

Record job openings and a 4% unemployment rate in the U.S. point to one of the tightest labor markets America has seen in a half century. Since March of last year, the total number of job openings in the U.S. (currently 7.3 million) has exceeded the number of unemployed people, leading to intense competition for workers and putting upward pressure on wages (Exhibit 1). This labor shortage is occurring across the country, in all sectors and at all skill levels. In the manufacturing sector alone, there are 428,000 job openings, according to the latest data from the Bureau of Labor Statistics.

**Exhibit 1: U.S. Labor Market Dynamics.**



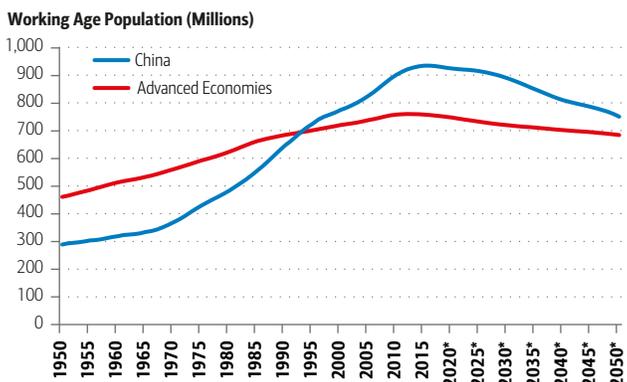
Total private average hourly earnings of production and non-supervisory employees. Source: Bureau of Labor Statistics. Data as of February 2019.

Potential consequences of this labor crisis include a slowdown in production, rising wages, compressed corporate margins and an overall loss in output for the U.S. economy. However, companies faced with wage pressures, and shrinking margins may consider alternative strategies to help improve productivity through investments in capex and automation.

**PEAK LABOR?**

The lack of workers is not just an American problem, it’s a global problem. In both the developed and developing nations, the next few decades are expected to see outright declines in the working-age population as a percentage of the total population. Note that after moving sharply higher over the latter part of the 20th century, and the first decade of this century, the working age population in China and advanced economies is set to slope lower in the coming decades (Exhibit 2).

**Exhibit 2: Major World Economies Have Reached Peak Labor.**



\*Estimate. Advanced economies include Europe, North America, Japan, Australia, and New Zealand. Working age population defined as population between the ages of 20 – 64. Source: United Nations. Data as of February 2019.

China’s working-age population peaked in 2016 and is projected to shrink by 10 million workers by the end of the decade, with more downside thereafter thanks to the demographic aftershocks of China’s “one-child” policy. In Eastern Europe, a region that

flooded the global labor markets with highly trained workers with the demise of the Soviet Union, the collapse in birth rates in the post-communist era is now reflected in shrinking labor forces across the region. In Russia, low birth rates, rising mortality among men below age 50 due to alcoholism, and a decline in the number of working-age females have all converged to stunt labor market growth in one of Europe’s largest economies. Japan, France, Germany and many other developed nations face similar problems.

One common denominator of these nations is the following: They are aging, growing older. What does that entail? More demand for robots. As *The Economist* recently noted, “aging and robots are more closely related than you might think.”<sup>4</sup> As the magazine cites, “between 1993 and 2014, the countries that invested the most in robotics were those that were aging the fastest.” With an aging and shrinking population base, firms are left no choice but to automate.

The upshot: an economic input that used to be abundant (labor) appears to be on course to become scarcer. The world is on the cusp of “Peak Labor,” with potentially profound implications for companies all over the world. To offset the one-two punch of a declining pool of labor and rising wages, firms will have no choice but to raise their capital/labor ratio—or boost capital to compensate for more expensive and scarce labor. As this happens, the premium on robotics and artificial intelligence will rise.

**THE IMPORTANCE OF IMMIGRANTS TO THE ECONOMY**

**Exhibit 3: The Heavy Lifting of Immigrants, 2017.**

Share of Foreign-Born Workers, (%)	
<b>U.S. Occupations</b>	17.1%
<b>High Skill:</b>	
Architecture and Engineering	18.5%
Computer and Mathematics	26.2%
Healthcare practitioners	15.0%
Life, Physical and Social Sciences	23.0%
<b>Low Skill:</b>	
Building and grounds cleaning/maintenance	37.4%
Construction and extraction	30.4%
Farming, fishing, and forestry	36.9%
Healthcare service workers	20.8%
Installation, maintenance and repair	15.4%
Personal care services	21.1%
Transportation and material moving occupations	20.6%

Percentage of U.S. workforce (out of 100 percent) in each occupation that is foreign born. Source: Bureau of Labor Statistics. Data as of May 17, 2018.

One of the defining features of the U.S. economy has been its ability to attract labor from overseas, which in turn expands the labor force and contributes to economic growth and innovation. As shown in Exhibit 3, approximately 17% of the total U.S. workforce in 2017 was foreign-born, or 26.3 million workers. This reliance on foreign labor spans various industries, from architecture and engineering (18.5% foreign-born workers) to farming (36.9%) and construction (30.4%). As anti-immigration policies threaten to cut

<sup>4</sup> See “Robots that look after Grandma,” *The Economist*, February 16, 2019.

off a key source of labor for U.S. firms, companies may consider alternative methods to help increase capacity to reach consumer demand—through investment in automation and robotics.

**INVESTMENT SUMMARY**

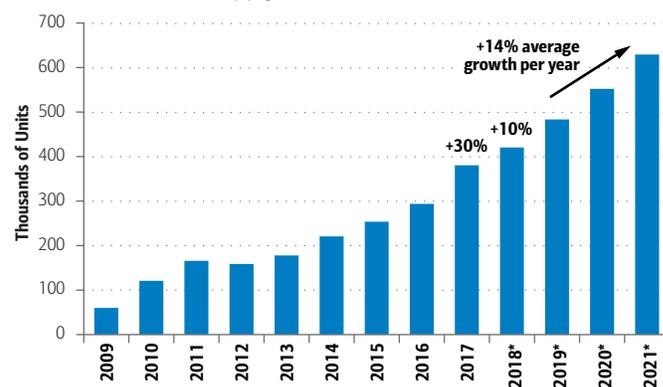
The shifting labor dynamics described above have put a greater corporate premium on automation and robotics. Other factors such as improvements in robotic capabilities, declining costs, and the expansion of automation into many different industries should lead to more demand for robotics in the coming years. Last year, the worldwide supply of industrial robots is estimated to have increased by 10% to a record high of 421,000 units, after climbing 30% in 2017 (Exhibit 4).

Robots are also extending their reach beyond the factory floor. Sales of professional service robots grew by 85% in 2017 to 109,500 units, installed across various industries from warehousing and logistics, to medical services, defense and agriculture.

China was the largest market for industrial robots, with sales in China triple that of the second largest market, Japan. Despite these large figures, China still has a relatively low number of installed robots compared to the country’s total workforce, pointing to significant upside for leading global robotics suppliers.

The growing importance of China as a buyer of industrial-use robotics makes the industry more vulnerable to economic weakness in China as we saw in 2018. Global trade concerns, growth fears, and a downturn in global purchasing managers’ indexes weighed on robotics manufacturers last year; however, the sector has recently seen a strong recovery. Because these stocks tend to be cyclical in nature, they can provide buying opportunities on any weakness in industrial activity. Investors with higher risk tolerance should be disciplined and patient when looking to build positions in this powerful secular investment theme.

**Exhibit 4: World Supply of Industrial Robots.**



\*Estimates for 2018-2021. Source: International Federation of Robotics. Data as of October 2018.

**THOUGHT OF THE WEEK**

**IS THERE ROOM FOR EQUITIES TO EXTEND THEIR RALLY?**

Chris Hyzy, Chief Investment Officer

Equity markets have rallied around 18% from their lows in late December and are up approximately 11% in the U.S. year-to-date. There are four primary reasons for the sharp rebound to start the year: Financial conditions have eased substantially as the Fed has shifted to a much more dovish tone on interest rates and the balance sheet; opportunities for a China and U.S. trade agreement have improved significantly since the fourth quarter of 2018; volatility has declined by more than 20% to start the year, which has stabilized sentiment; and oil prices have also stabilized, potentially helping underpin capital expenditure growth in the U.S. In our view, since earnings expectations have been re-set sharply lower, interest rates across the curve have fallen by close to 40 basis points, and although investor sentiment has improved, we have yet to experience a large wave of re-balancing back into equities. We believe there is room for equities to extend their rally.

At 2775 we are slightly above our first half fair value (2725) at a time when analysts are expecting negative growth in earnings for the first quarter and mid-single-digit growth thereafter. With a lower discount rate than when we started the year and reasonable full-year earnings growth for the

S&P 500 at 5%, we still expect 2900 to be reached prior to the close of this year as sentiment improves and the market multiple rises by 1 point at the same time that earnings creep higher over the last three quarters of the year.

However, we also expect the general macro and market climate to remain fragile given the cloud of geopolitical risk and the fact that the equity markets have front loaded a large portion of the expected yearly gains in just two months. Therefore, the next phase of market direction into the spring and summer is likely to be characterized by consolidation or back-and-fill direction until investors have a chance to examine the corporate earnings guidance for the second half of 2019 and full-year 2020. We remain overweight equities relative to fixed income and prefer U.S. large caps for core exposure and growth exposure via the emerging markets at this time.

**Exhibit 5: Year-to-date Performance.**

Indices	YTD Performance*
S&P 500 Index	11.3%
NASDAQ Composite Index	12.9%
Dow Jones Industrial Average	11.5%
MSCI Emerging Markets Index	10.8%

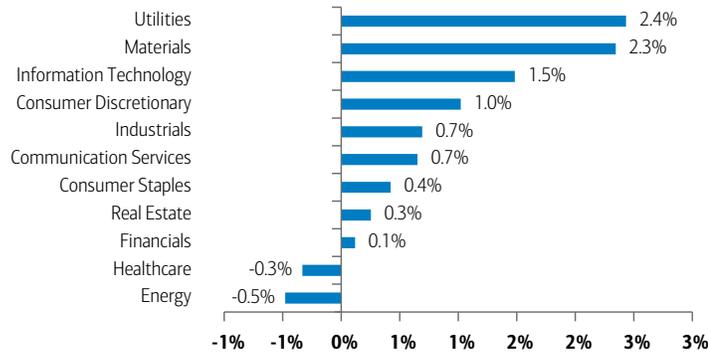
\*Price return. As of 02/22/2019 close. Source: Bloomberg. Data as of February 22, 2019. **Past performance is no guarantee of future results.** Performance would differ if a different time period was displayed. Short-term performance shown to illustrate more recent trend.

## MARKETS IN REVIEW

### Equities

	Current	Total Return in USD (%)		
		WTD	MTD	YTD
DJIA	26,031.81	0.6	4.4	12.0
NASDAQ	7,527.55	0.8	3.5	13.6
S&P 500	2,792.67	0.7	3.5	11.7
S&P 400 Mid Cap	1,933.72	1.1	5.5	16.5
Russell 2000	1,590.06	1.3	6.1	18.1
MSCI World	2,086.97	1.0	3.0	11.0
MSCI EAFE	1,869.15	1.6	2.2	8.9
MSCI Emerging Markets	1,058.65	2.8	0.9	9.8

### S&P 500 Sector Returns



### Fixed Income<sup>1</sup>

	Current	Total Return in USD (%)		
		WTD	MTD	YTD
Corporate & Government	3.11	0.1	0.1	1.3
Agencies	2.71	0.1	0.1	0.5
Municipals	2.54	0.2	0.5	1.2
U.S. Investment Grade Credit	3.17	0.1	0.1	1.2
International	3.90	0.0	0.3	2.7
High Yield	6.65	0.3	1.2	5.8

	Current	Prior Week End	Prior Month End	2018 Year End
90 Day Yield	2.38	2.37	2.35	2.36
2 Year Yield	2.50	2.52	2.46	2.49
10 Year Yield	2.65	2.66	2.63	2.69
30 Year Yield	3.02	2.99	3.00	3.02

### Commodities & Currencies

Commodities	Current	Total Return in USD (%)		
		WTD	MTD	YTD
Bloomberg Commodity	171.59	1.5	1.9	7.4
WTI Crude \$/Barrel <sup>2</sup>	57.26	3.0	6.5	26.1
Gold Spot \$/Ounce <sup>2</sup>	1,328.25	0.5	0.5	3.6

Currencies	Current	Prior Week End	Prior Month End	2018 Year End
EUR/USD	1.13	1.13	1.14	1.15
USD/JPY	110.69	110.47	108.89	109.69
USD/CNH	6.71	6.77	6.71	6.87

Source: Bloomberg, Factset. Total Returns from the period of 02/18/19 to 02/23/19. Bloomberg Barclays Indices.<sup>1</sup> Spot price returns.<sup>2</sup> All data as of the 02/23/19 close.

Past performance is no guarantee of future results.

### Asset Class Weightings (as of 01/08/19)

	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*			
Hedge Funds			
Private Equity			
Real Assets			
Cash			

### Economic and Market Forecasts (as of 02/22/19)

	Q2 2018A	Q3 2018A	Q4 2018A	Q1 2019E	2018A	2019E
Real global GDP (% y/y annualized)	-	-	-	-	3.8*	3.4
Real U.S. GDP (% q/q annualized)	4.2	3.4	1.5*	1.5	2.8*	2.2
CPI inflation (% y/y)	2.7	2.6	2.2	1.5	2.4	1.7
Core CPI inflation (% y/y)	2.2	2.2	2.2	2.2	2.1	2.3
Unemployment rate(%)	3.9	3.8	3.8	3.9	3.9	3.7
Fed funds rate, end period (%)	1.88	2.13	2.38	2.38	2.38	2.88
10-year Treasury, end period (%)	2.86	3.06	2.68	3.00	2.68	3.00
S&P 500, end period	2718	2914	2507	-	2507	2900
S&P earnings (\$/share)	41	43	40*	-	162*	170
U.S. dollar/euro, end period	1.17	1.16	1.15	1.16	1.15	1.25
Japanese yen/U.S. dollar, end period	111	114	110	106	110	101
Oil (\$/barrel, avg. of period, WTI**)	68	69	59	58	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 February 22, 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.**

**Dow Jones Industrial Average** is a price-weighted measure of 30 U.S. blue-chip U.S. companies. The index covers all industries except transportation and utilities.

**NASDAQ Composite Index** is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

**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.

**MSCI Emerging Markets Index** captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 832 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

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**Investing involves risk, including the possible loss of principal.** No investment program is risk-free, and a systematic investing plan does not ensure a profit or protect against a loss in declining markets. Any investment plan should be subject to periodic review for changes in your individual circumstances, including changes in market conditions and your financial ability to continue purchases.

Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment performance.

It is not possible to invest directly in an index.

Asset allocation, diversification, dollar cost averaging and rebalancing do not ensure a profit or protect against loss in declining markets.

**Past performance is no guarantee of future results.**

Stocks of small-cap companies pose special risks, including possible illiquidity and greater price volatility than stocks of larger, more established companies.

Companies may reduce or eliminate dividend payment to shareholders. Historically, dividends make up a large percentage of stocks' total return.

Investing in fixed-income securities may involve certain risks, including the credit quality of individual issuers, possible prepayments, market or economic developments and yields and shareprice fluctuations due to changes in interest rates. When interest rates go up, bond prices typically drop, and vice versa. 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 (AMT).

Investments focused in a certain industry may pose additional risks due to lack of diversification, industry volatility, economic turmoil, susceptibility to economic, political or regulatory risks and other sector concentration risks.

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 risks related to renting properties, such as rental defaults.

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. Always consult with your independent attorney, tax advisor, investment manager, and insurance agent for final recommendations and before changing or implementing any financial, tax, or estate planning strategy.

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 private equity 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.

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**The investments discussed have varying degrees of risk. Some of the risks involved with equities 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. Bonds are subject to interest rate, inflation and credit risks. Investments in high-yield bonds may be subject to greater market fluctuations and risk of loss of income and principal than securities in higher rated categories. Investments in foreign securities 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. 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 (AMT).**

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