

CHIEF INVESTMENT OFFICE

Capital Market Outlook

October 18, 2021

All data, projections and opinions are as of the date of this report and subject to change.

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Thought of the Week—Despite U.S. Equities trading near all-time highs, various market indicators and surveys suggest that sentiment is in neutral territory at best and thus remains a supporting factor for higher index levels.

Portfolio Considerations—The U.S. remains our preferred equity region relative to the rest of the world, with stronger balance sheets on aggregate, robust economic growth prospects, and strong earnings revisions. We prefer short duration relative to a stated Fixed Income benchmark that is aligned to investment goals.

MACRO STRATEGY

The Global Energy Crunch

Brian Daley, Managing Director and Head of CIO Equity Strategy

Secular transitions from the normal course of business to something new, innovative and disruptive are inherently volatile, and the current global energy transition is a complex and secular transition. This dynamic is evident in the recent spike in natural gas, liquefied natural gas (LNG), coal and retail fuel prices across the U.K., Europe and Asia. Traditionally, commodity prices are a function of supply and demand, and the current energy crunch is no different, with strong demand and tight global supplies driving energy prices higher.

Stronger-than-expected demand and increasing mobility coming out of the pandemic are drawing down oil and natural gas inventories to levels below their five-year averages at a time when inventories should be building during the “shoulder season”—a period of time between the summer driving season and before the winter heating season. Energy demand remains relatively inelastic in the short term, especially when supplies are tight and renewable power production is declining in specific regions.

On the supply side, the declines in capital investments in traditional hydrocarbon projects and slower production growth by both the U.S. energy industry and Organization of the Petroleum Exporting Countries (OPEC+) are resulting in tight supplies and higher prices.

MACRO STRATEGY

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GLOBAL MARKET VIEW

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Managing Director and Head of CIO Market Strategy

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THOUGHT OF THE WEEK

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Data as of 10/18/2021, and subject to change

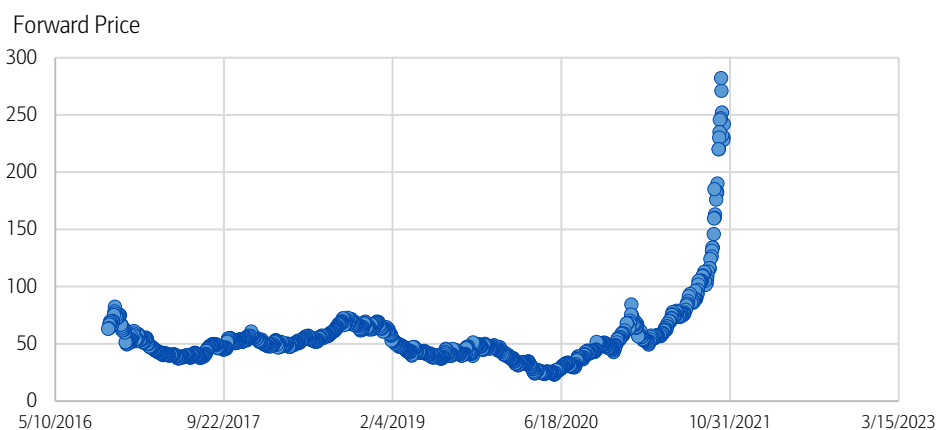
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New-found capital discipline by U.S. energy companies is reducing the amount of drilling for new oil and gas wells and lowering the amount of associated gas produced from oil wells. This is resulting in low inventories of key fuel sources for generating electric power and also creating a global race to secure important energy resources ahead of the winter heating season.

Further, the increasing mix of renewable power generation in electric grids around the world and sudden changes in weather patterns can potentially increase variability and inconsistency of power production. The U.K. and Europe are currently experiencing declining renewable power generation, as the winds died down in Europe, and they are relying too much and too quickly on renewable power without redundant traditional power sources and adequate storage. Declining renewable power generation combined with low inventories of natural gas is a key factor driving electricity prices to the highest levels in years. This is being felt the most acutely in the U.K., but also in Europe, Asia and the U.S., where consumers are seeing higher prices at the pump.

Exhibit 1: U.K. Baseload Electricity Forward Prices.



Source: Bloomberg. Data as of September 2021.

Winter Storm Brewing?

Global supplies and deliveries of available energy have not kept pace with improving global demand over recent months, and this could become an issue as we head into winter heating season in the Northern Hemisphere. Inventories are already low, and cold winter weather could exacerbate this issue and potentially result in significantly higher heating and electricity bills for consumers. The near-term direction of energy prices will be largely dependent on winter weather.

Disruptions and delays in the delivery of natural gas in pipelines from Russia and the Ukraine to Europe are a key reason natural gas inventories are low and power prices are high in Europe. In addition, U.S. LNG exports are very close to maximum capacity and cannot provide much relief, and some major LNG facilities around the world were offline for routine maintenance, reducing global LNG supplies. Furthermore, disruptions in coal shipments and declining capital investments in coal are driving increased oil and natural gas demand from China for power production and pushing LNG prices higher as China bids aggressively for available LNG cargoes. China's vice premier told Chinese state-owned energy companies to secure energy supplies "at all costs."

With natural gas prices in Europe trading more than six times higher than year-ago levels and coal prices up more than 100%, power producers in Europe and Asia may increase their demand for oil as a result of gas-to-oil switching and coal-to-oil switching in the near term. Saudi Aramco recently said the potential incremental oil demand from gas-to-oil switching by power producers could be 500,000 barrels per day of additional oil demand. At its last meeting, OPEC+ agreed to increase production by 400,000 barrels per day, but that will not go into effect until November and may result in additional inventory

drawdowns in October. Given this backdrop of below-average inventories and strong demand, energy prices could remain volatile and elevated in the near term, and dependent on winter weather conditions around the world.

Home Field Advantage—U.S.

Fortunately, the U.S. is in a stronger position than Europe and Asia in terms of energy supply, with a more balanced mix of renewables, legacy coal that is down to roughly 20% of U.S. power production, important nuclear base load power, and natural gas power production that can meet increasing electricity demand. Looking forward and over the longer term, there is currently an abundant supply of low-cost natural gas in the U.S. and other parts of the world that may be produced and brought to market at economical prices. The significant inventory of proved reserves for natural gas has the potential to keep longer-term natural gas and electricity prices at lower levels for global consumers while also continuing to replace and retire higher-emission coal- and oil-burning power plants with natural gas-fired power plants.

This combination of abundant natural gas and legacy nuclear resources is key for continued renewable and green energy growth and is set to increase as a percentage of the overall global energy mix. Natural gas and nuclear are two of the most consistent, lower-emission and large-scale power resources needed to replace higher-emission coal- and oil-burning power plants, deliver a smooth energy transition, and meet greater demand for power from electric vehicles and transportation, and the digitalization of the global economy.¹ A diversified mix of energy power sources will likely be necessary to move forward in the energy transition and to continue to make progress in reducing carbon footprints and greenhouse gas (GHG) emissions.

The current energy crunch indicates more sound and robust planning and policies are needed for implementing renewables for baseload power production, including critical redundant power capacity to back up intermittent renewable power sources. One problem Europe is facing is that some countries retired too many coal and nuclear plants too fast and replaced that retired power output with less consistent power sources, creating less stability and inconsistent power generation with higher electricity prices for consumers. Europe is now very dependent on Russia to supply it with increased supplies of natural gas for power generation and heating this winter.

Importantly, energy price spikes tend to hurt the lower-income and middle-income consumers, who spend a higher percentage of their income on electricity and heating, the most. If power production is not well balanced and electric grids do not have stability and reliability, spikes in power prices or power disruptions (blackouts) can potentially drive slower consumer spending and slower economic growth.

A refreshed look at energy policies to diversify and secure multiple energy resources for power production is prudent in the current environment. Furthermore, the recent spike in natural gas prices is a sign that policies developed for the energy transition need to take into account a longer timeline and consider greater back-up resources for renewable power production that provide flexibility and redundancy in electric grids around the world.

Further, major energy infrastructure investments are needed, including new and additional power transmission lines, existing grid upgrades and grid hardening, new micro grids, energy storage, increased cybersecurity investments, refitting older power plants with cleaner fuel sources, new energy transportation infrastructure for high-demand areas, and continued progress in building renewable power sources at scale. With thorough planning, smart energy policies, and energy infrastructure investments, we have the potential to reduce the risk of energy-related disruptions and make progress in decarbonizing the economy.

¹Chief Investment Office, *Capital Market Outlook*, June 14, 2021.

Portfolio Considerations

For investment and portfolio considerations, we remain overweight the Energy sector in equity portfolios, given that sentiment for the energy industry remains negative to neutral at best, with little conviction in the sector. In addition, positioning is still not crowded in energy stocks, free cash flows and returns of capital to shareholders are increasing, energy commodity prices are elevated, and relative valuations are attractive. We prefer U.S. energy companies over their international peers and would add energy exposure to portfolios that are underweight energy on pullbacks. This also aligns with our preference for U.S. Equities over International Developed and Emerging Market equities. Energy price uncertainty and volatility may be with us in the coming months on the back of the current energy crunch; however, there is no doubt the energy transition is in motion and will continue to make progress as more technology and innovation are applied to battery storage, carbon capture, renewable fuels and energy infrastructure, but the transition will not be a quick flip of the switch.

GLOBAL MARKET VIEW

Yes, The Robots Are Coming And Not A Minute Too Soon

Joseph P. Quinlan, Managing Director and Head of CIO Market Strategy

Lauren J. Sanfilippo, Vice President and Investment Strategist

A shrinking labor force, a bulging number of retirees, stagnant labor force participation rates among women, tighter immigration regulations, educational mismatches, coronavirus fears—a number of variables have converged to place unprecedented demand on labor not only in the U.S. but also around the world. According to the latest statistics from the Bureau of Labor, 10.4 million jobs in the U.S. were unfilled at the end of August, including a record number (870,000 openings) of job vacancies in manufacturing (Exhibit 2). The total figure for the month was down slightly from the prior month (11.1 million) but still well in excess of a year ago (6.5 million).

Exhibit 2: Job Openings In The Manufacturing Sector Near Multi-Decade Highs.



Source: U.S. Bureau of Labor Statistics. Data as of September 2021.

Globally it's no better. There were some 1.1 million job vacancies in the U.K. in September, a 20-year high. Roughly 800,000 jobs are unfilled in Germany, over 2 million in Japan, and 277,000 in France, all among other nations confronting an acute post-pandemic worker shortage that threatens to stifle future growth and corporate earnings. China? Its labor force has peaked, creating labor pains across the industrial base of the mainland. Not helping matters, more Chinese migrant workers are staying closer to home, shunning the big city factories for more rural employment. The same dynamic is playing out in Vietnam and other parts of Southeast Asia, creating supply chain bottlenecks for a host of U.S. firms.

In sum, rarely has the labor/work mismatch been as great as it is today. We are living through a global bull market for workers, which, among other things, refutes the common refrain that automation and the incessant march of machines (robots) is poised to replace

millions of jobs in the not-too-distant-future, leaving workers with less work, less income and less of a future. Nonsense. In his book, *The Exponential Age*, Azeem Azhar notes that “the notion of a jobless future—the “*robotocalypse*” of tabloid headlines—is overstated.”

The reality is that while some workers will lose their jobs due to automation—a churn in the global labor force that has been going on for decades—other jobs will be created as advanced robotics, machine learning and artificial intelligence (AI) goes mainstream. As the author suggests, and numerous empirical studies have concluded, “automation has the potential to create more work than it destroys. ...over time, automation will end up inventing whole new sectors of the economy—ones that we can now only imagine.” We concur and believe the great global labor shortage of 2021 portends robust capital expenditures (CapEx) on industrial and nonindustrial robots well into the future. To this point, according to Statista Research, the global market for robots is expected to grow at a compound annual growth rate of roughly 10% between 2020 and 2025.

Even before the pandemic, the demand for robots was accelerating in the face of a shrinking global labor force and tougher immigration rules and regulations. Per the latter, as Exhibit 3 makes clear, immigrants are hugely important to the overall health of the U.S. labor market, with immigrants making up roughly 17.5% of the U.S. civilian work force in 2020. That percentage is significant, and even higher in such sectors as Healthcare, Agriculture, Construction and Engineering. As we have long argued, America needs workers to pick apples (Agriculture) and work for Apple (Technology), and everything in between.

Exhibit 3: The Heavy Lifting Of Immigrants.

U.S. Share of Foreign-Born Workers (%)	
All Occupations	17.5%
Healthcare	
Home Health Aides	35.2%
Physicians	28.5%
Personal Care Aides	24.7%
Pharmacists	22.4%
Nursing Assistants	20.9%
Surgeons	18.9%
Registered Nurses	15.0%
Respiratory Therapists	13.1%
Miscellaneous	
Farming, fishing, and forestry	41.8%
Building and grounds cleaning/maintenance	36.9%
Construction and extraction	30.0%
Computer and mathematics	26.8%
Transportation and material moving occupations	20.6%
Architecture and engineering	19.6%
Installation, maintenance and repair	14.7%

Employed foreign-born persons 16 years and over. Sources: Bureau of Labor Statistics; National Foundation for American Policy. Data as of 2020.

That said, tougher immigration policies under the previous Trump administration, along with coronavirus-related travel restrictions, have sharply cut the number of immigrant workers in the U.S. over the past few years. Case in point: H1B visas for high-skilled foreign workers totaled just 125,000 in 2020, one of the lowest levels in years, and a 31% decline from the number of visas granted in 2016, when Trump assumed office.

Fewer immigrants augurs for more robots/automation across the U.S. industrial and service landscape. So does America’s rapidly aging labor force—a component of the labor market underappreciated by many investors. Here’s the inconvenient truth: America’s labor force is relatively old and aging, with the median age of a U.S. worker in 2020 standing at 42.5 (Exhibit 4). That’s 9 percentage points above the global average (39 years old); as older U.S. workers roll off the payrolls and retire, the available supply to backfill many of these occupations is increasingly scarce and slim, forcing firms, in many cases, to adopt and embrace automation-related solutions, aka, more spending on robotics and related activities.

Exhibit 4: America's Aging Workforce.

Occupation	Median Age
All Occupations	42.5
Management, business, and financial operations occupations	45.8
Architectural and engineering managers	49.1
Legal occupations	46.5
Elementary and middle school teachers	42.9
Healthcare practitioners and technical occupations	42.4
Dentists	48.4
Registered nurses	42.6
Healthcare support occupations	41
Home health aides	46.7
Personal care aides	46
Nursing assistants	39.5
Firefighters	39.5
Police officers	40.3
Janitors and building cleaners	48
Maids and housekeeping cleaners	46.5
Childcare workers	35.3
Office and administrative support occupations	42.9
Customer service representatives	34.8
Construction and extraction occupations	41.5
Driver/sales workers and truck drivers	46.5

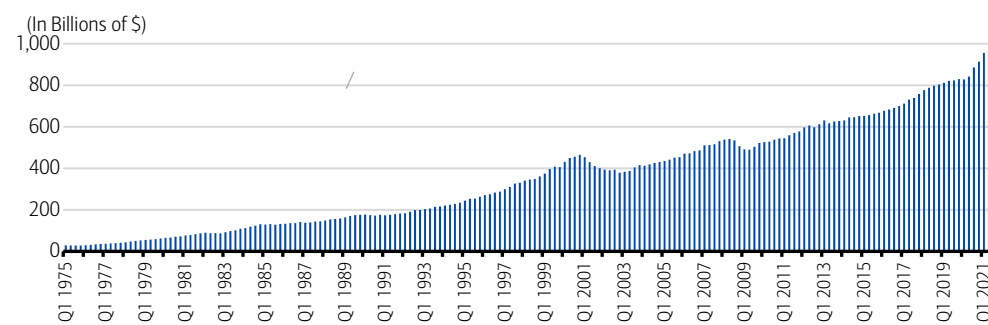
Note: Median age represents the midpoint in the age distribution such that half of workers are younger and half are older. Updated population controls are introduced annually with the release of January data. Source: Bureau of Labor Statistics. Data as of January 22, 2021.

Investment implications

While the debate over robots isn't likely to be settled anytime soon, what's important for investors to realize is the following: The march of machines can't come fast enough in the U.S. and other nations, given the soaring labor shortages and associated costs. Rarely talked about or remotely acknowledged, the U.S. and a handful of developed nations are confronting a labor crisis—a crisis of too few workers as opposed to too few jobs. As the crisis mounts, the aftereffects could include lost output, foregone demand, rising wage costs, and compressed margins—all of which, of course, are deleterious to corporate earnings.

Hence, the accelerating proliferation of robots, artificial intelligence and automation in general. Demand for robots (manufacturing and services) has been upward-sloping for years and has accelerated in the post-pandemic world. International Data Corporation (IDC) estimates digital transformation investment for corporations to grow at a 15.5% compound annual rate over a multiyear growth cycle, reaching \$6.8 trillion in 2023. To that point, the technology-led CapEx cycle is now up to 32% of total CapEx, reaching \$963 billion in Q2 of this year (Exhibit 5). Also to note, industrial equipment spending topped \$284 billion, a record high, and indicative of future spending on industrial robots.

Exhibit 5: Technology CapEx Tops \$960 Billion In Q2 2021.



Private fixed investment in information processing equipment and software. Source: Bureau of Economic Analysis. Data through Q2 2021.

We continue to favor automation companies across both the industrial and process automation spectrums. On the industrial side, this includes a wide range of global robotics companies, including industrial manufacturers and companies involved in vision and motion systems as well as other robotics parts and components. Beyond manufacturing,

we see investment opportunities in supply chain automation, where warehousing employment has failed to keep pace with the rapid rise of e-commerce. In the end, while robotics companies may be cyclical in nature, we believe the move toward automation is a strong secular theme with plenty of runway for future growth.

THOUGHT OF THE WEEK

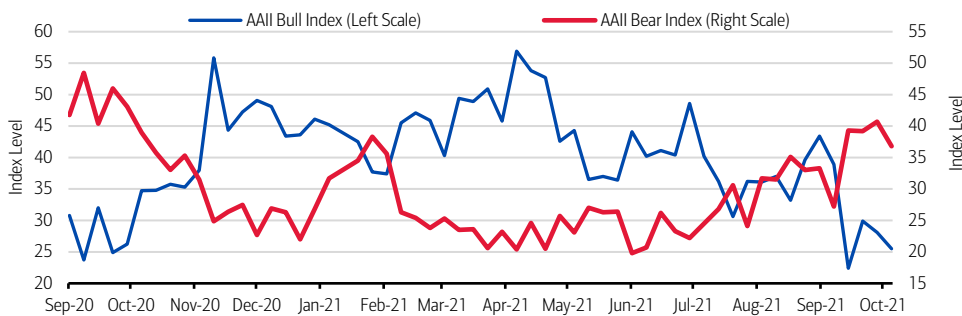
Stalling Sentiment Indicates Equity Upside

Emily Avioli, Assistant Vice President and Investment Strategist

U.S. Equities are currently trading near all-time highs, with recent headwinds around political showdowns in Washington, slightly higher interest rates, credit concerns in China, and higher energy prices creating a minor pull in the S&P 500 Index. Of note is that despite a robust 17% return year-to-date for the index investor sentiment has not reached euphoric levels, with various market indicators and surveys suggesting that sentiment is in neutral territory at best, and thus remains a supporting factor for higher index levels.

According to the American Association of Individual Investors (AAII) October 6 sentiment survey, around 37% of voters expressed a bearish sentiment on the stock market for the next six months, higher than the historical average of 31%. On the other hand, bullish investor sentiment has been below its historical average of 38% for four consecutive weekly readings (Exhibit 6).

Exhibit 6: Bearish Sentiment Has Overtaken Bullish Sentiment.



Source: Bloomberg. Data as of October 7, 2021.

The not-so-optimistic sentiment is confirmed by the BofA Global Research Bull & Bear Indicator, where the recent reading of 5.5 continues to inch closer to bearish territory.² Our September fund manager survey also shows declining bullishness on the economy and corporate profits—only 13% of fund managers expect that the global economy will improve, and 12% expect that global profits will improve, down from 91% and 89% in March 2021, respectively.

Market indicators tell a similar story. The Chicago Board Options Exchange (CBOE) Volatility Index (VIX), used as a gauge for investor uncertainty, remains in line with its long-term average. And the number of S&P 500 stocks trading above their 200-day moving average has fallen to roughly 55%, down from a year-to-date high of 87% in February 2021³, which could indicate room for further upside. Meanwhile, there are still record levels of cash on the sidelines—money market assets have a balance of roughly \$4.5 trillion, which is almost \$1 trillion more than 2019 levels, according to Bloomberg.

Fundamentals like corporate profits, stable credit markets, and accommodative monetary policy remain powerful supports for equities. A lack of euphoria among investors implies there could be further upside for stocks as the secular bull market moves forward. In our view, investors with cash on the sidelines may want to consider using a dollar-cost investing approach, especially on market weakness.

²October 7 2021. Indicator level of 0-2 = extreme bearish, 8-10 = extreme bullish.

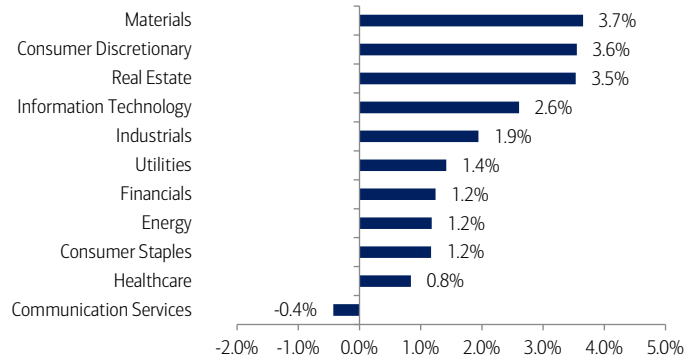
³Bloomberg Percentage of NYSE Stocks Closing Above 200 Day Moving Average, October 12 2021.

MARKETS IN REVIEW

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	35,294.76	1.6	4.3	17.0
NASDAQ	14,897.34	2.2	3.1	16.2
S&P 500	4,471.37	1.8	3.9	20.4
S&P 400 Mid Cap	2,748.28	2.2	4.1	20.3
Russell 2000	2,265.65	1.5	2.8	15.6
MSCI World	3,109.47	2.2	3.5	17.0
MSCI EAFE	2,324.50	2.4	1.9	10.4
MSCI Emerging Markets	1,283.67	2.1	2.5	1.2

S&P 500 Sector Returns



Fixed Income†

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	1.54	0.45	-0.16	-2.09
Agencies	0.95	-0.05	-0.31	-1.04
Municipals	1.15	0.06	-0.10	0.69
U.S. Investment Grade Credit	1.64	0.33	-0.17	-1.72
International	2.20	0.71	-0.06	-1.33
High Yield	4.16	0.15	-0.18	4.35
90 Day Yield	0.04	0.05	0.03	0.06
2 Year Yield	0.39	0.32	0.28	0.12
10 Year Yield	1.57	1.61	1.49	0.91
30 Year Yield	2.04	2.16	2.04	1.64

Commodities & Currencies

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Commodities				
Bloomberg Commodity	223.65	2.1	3.9	34.2
WTI Crude \$/Barrel††	82.28	3.7	9.7	69.6
Gold Spot \$/Ounce††	1767.62	0.6	0.6	-6.9

	Total Return in USD (%)			
	Current	Prior Week End	Prior Month End	2020 Year End
Currencies				
EUR/USD	1.16	1.16	1.16	1.22
USD/JPY	114.22	112.24	111.29	103.25
USD/CNH	6.43	6.45	6.45	6.50

Sources: Bloomberg, Factset. Total Returns from the period of 10/11/2021 to 10/15/2021. †Bloomberg Barclays Indices. ††Spot price returns. All data as of the 10/15/2021 close. Data would differ if a different time period was displayed. Short term performance shown to illustrate more recent trend. **Past performance is no guarantee of future results.**

Asset Class Weightings (as of 10/5/2021)

Asset Class	CIO View		
	Underweight	Neutral	Overweight
Equities	●	●	●
U.S. Large Cap	●	●	●
U.S. Mid Cap	●	●	●
U.S. Small Cap	●	●	●
International Developed	●	●	●
Emerging Markets	●	●	●
Fixed Income	●	●	●
U.S. Investment Grade Taxable	●	●	●
International	●	●	●
Global High Yield Taxable	●	●	●
U.S. Investment Grade Tax Exempt	●	●	●
U.S. High Yield Tax Exempt	●	●	●
Alternative Investment*			
Hedge Funds			
Private Equity			
Real Estate			
Tangible Assets / Commodities			
Cash			

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

CIO asset class views are relative to the CIO Strategic Asset Allocation (SAA) of a multi-asset portfolio.

Economic Forecasts (as of 10/15/2021)

	2020A	Q1 2021A	Q2 2021A	Q3 2021A	Q4 2021E	2021E
Real global GDP (% y/y annualized)	-3.1	-	-	-	-	5.9
Real U.S. GDP (% q/q annualized)	-3.4	6.3	6.7	4.5*	6.0	5.9
CPI inflation (% y/y)	1.2	1.9	4.8	5.3*	5.8	4.5
Core CPI inflation (% y/y)	1.7	1.4	3.7	4.1*	4.3	3.4
Unemployment rate (%)	8.1	6.2	5.9	5.1*	4.5	5.4
Fed funds rate, end period (%)	0.09	0.06	0.08	0.06	0.13	0.13

The forecasts in the table above are the base line view from BofA Global Research. 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. Historical data is sourced from Bloomberg, FactSet, and Haver Analytics.

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.

Sources: BofA Global Research; GWIM ISC as of October 15, 2021.

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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 U.S. dollars.

S&P 500 Index is a stock market index that measures the stock performance of 500 large companies listed on stock exchanges in the United States. It is one of the most commonly followed equity indices.

Index Investor Sentiment is a numerical guide to investor feeling toward the securities markets that is constructed to determine whether certain segments of the investment community are bullish or bearish.

Chicago Board of Options Exchange (CBOE) Volatility Index (VIX) is a real-time market index representing the market's expectations for volatility over the coming 30 days.

American Association of Individual Investors (AII) Bull Index is a sentiment indicator created using the famous AII sentiment survey which asks, every week, its members about their view on the direction of the stock market in the near term.

American Association of Individual Investors (AII) Bear Index shows the percentage of investors who are market bullish, bearish, or neutral on stocks.

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