

CHIEF INVESTMENT OFFICE

Capital Market Outlook

November 15, 2021

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

IN THIS ISSUE

Macro Strategy—After dipping a bit below 8% in Q3, according to the Bureau of Economic Analysis, nominal gross domestic product (GDP) growth has reaccelerated, supporting our view that it will continue to surprise to the upside in 2022 with an average of around 10%. This is likely to help sustain the double-digit corporate revenue growth and strong margins that are generating upside profit surprises in cyclical businesses.

Global Market View—Based on recent polling data, the Democrats confront a challenging political backdrop heading into 2022. A “red wave” can’t be ruled out in the midterm elections of 2022; but based on history, markets don’t mind a divided government. And backstopping Uncle Sam is considered the most resilient and dynamic economic entity in the world: the U.S. private sector.

Thought of the Week—One key reason we prefer U.S. Equities to Emerging Market (EM) Equities is because a fair amount of EM top talent is hunkered down in the U.S., creating shareholder value in the U.S. versus their home country. The upshot: advantage U.S. Equities versus many (not all) EMs.

Portfolio Considerations—Maintain an Equity overweight—a U.S. Equity bias relative to the rest of world—relative to Fixed Income overall. Within Fixed Income, we remain lower duration. This month, we are lowering our outlook within U.S. Equities for Large-cap Growth to neutral, in favor of both Large- and Small-cap Value. We are also raising Real Estate sector to neutral, and lowering Communication Services to a slight underweight.

MACRO STRATEGY

Back To the Races

Chief Investment Office, Macro Strategy Team

Our expectations for strong growth and higher-than-consensus expected inflation have been confirmed as the year progressed. Although Q3 real GDP growth decelerated to just 2% from a 6.7% annualized quarterly rate in Q2 (mainly because of microchip shortages, surging imports, and clogged U.S. distribution channels), domestic economic fundamentals and leading indicators suggest significant Q4 growth reacceleration. Indeed, excess household savings remain massive, wages are rising the most in decades, household interest expense as a share of income is still low compared to its historical average, and consumer spending on food and energy as a share of disposable income, though at a six-year high in Q3, is still slightly below its past 20-year average. With unemployment also

MACRO STRATEGY

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GLOBAL MARKET VIEW

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THOUGHT OF THE WEEK

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**Data as of 11/15/2021,
and subject to change**

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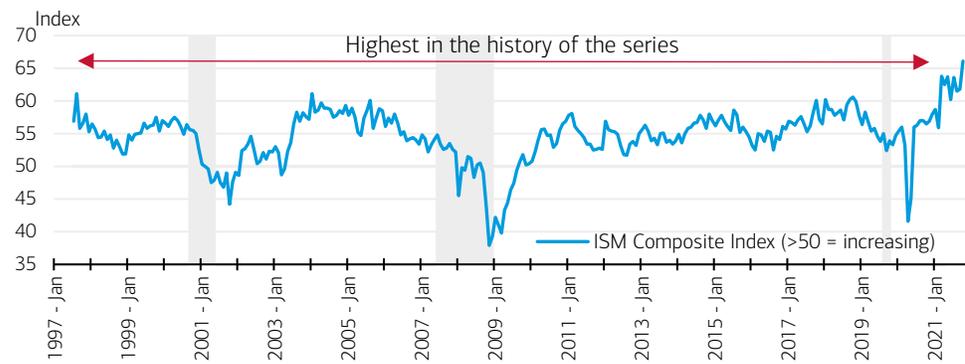
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down significantly this summer from 5.9% in June to 4.6% in October, consumer spending surprised to the upside in September, providing a high starting level for Q4 consumption.

Given this backdrop, it is not surprising that the Institute for Supply Management (ISM) manufacturing and services surveys remained extremely elevated through October, consistent with strong and broad-based expansion across industries in coming months. This includes the motor-vehicles industry, which, according to recent ISI Evercore Research reports, is scheduled to increase production in Q4 after shaving 2.4 percentage points off Q3 GDP growth due to global microchip shortages.

While the manufacturing ISM index remained at the top of its 40-year range, its services-sector counterpart spiked to a new record, as business activity and new orders rose to their highest level since the series began in 1997. As a result, after stalling at a very high level between March and September, the composite ISM index for manufacturing and services jumped to a new all-time high in October (Exhibit 1), pointing to strong economic growth into 2022. Following sharp upward revisions to its estimate as a result of the strong purchasing managers and employment data, the Atlanta Fed GDPNow forecasts 8.2% annualized quarterly real growth in Q4.

Exhibit 1: Growth Surging Again.

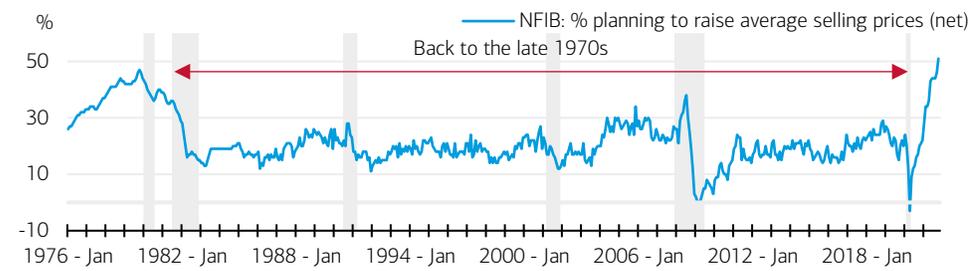


Gray shaded areas represent recession periods. Sources: ISM/Haver Analytics; CIO. Data as of November 9, 2021.

With growth reaccelerating, business pricing power exceptionally strong according to various surveys, and big Q3 earnings per share (EPS) upside surprises, led by the cyclical and Value areas of the Equity market, earnings estimates have been revised substantially higher, further boosting equity prices, another positive leading indicator of growth. In addition, the latest BofA Global Wave indicator corroborates our view of continued cyclical strength in the economy, as “the signal from the Global Wave remains positive for the fourteenth consecutive month, despite a sideways move in the data this month. A meaningful downward move is required to trigger a negative signal on the cycle...The signal... remains positive for equity markets, cyclical regions, cyclical sectors...”

In our view, a negative signal is unlikely anytime soon, with the strong cyclical expansion likely to continue since the Federal Reserve (Fed) has reiterated its plan to keep interest rates on hold for the foreseeable future. Given current guidance, as well as the leads and lags involved in the transmission of monetary policy to the economy, policy is on track to remain accommodative, and inflation high, for at least another year. Wages and salaries rose 10% year-over-year (YoY) in September, with a growing number of large companies announcing big raises, and the National Federation of Independent Business (NFIB) survey showing a surge in wage- and price-hiking plans to levels last seen at the peak of the double-digit inflation in the late 1970s and early 1980s (Exhibit 2). Accelerating wage and rent inflation support the view that inflation will likely be higher, not lower, next year.

Exhibit 2: Firms Planning to Raise Prices to Cover Soaring Costs.



Gray shaded areas represent recession periods. Sources: National Federation of Independent Business/Haver Analytics; CIO. Data as of November 9, 2021.

Real growth of 8%, or more, in Q4 would result in 2021 average real GDP growth of over 5%. Combined with inflation also running above 5%, nominal GDP growth would top 10% this year, in line with the mid-teens revenue growth reported by companies in their Q3 earnings reports. Margin performance varied quite a bit, however, as some companies were unable to pass on the big input-price increases, while others were. In particular, and as we expected, cyclical companies benefited from stronger operating leverage and better pricing power, resulting in faster earnings growth and bigger positive EPS surprises.

Continued real growth above 5% is not sustainable in an economy with potential GDP growth of around 3%, however. As the output gap has closed in 2021, the Congressional Budget Office is projecting the biggest excess of demand over potential GDP in 2022 since 1973 (exceeding the excess of 1978). That means double-digit nominal demand growth spurred by the most stimulative monetary and fiscal policies since World War II will continue to boost inflation in 2022. After two decades of nominal GDP growth of about 3% to 4%, the lowest since the 1930s, the highest nominal growth since the 1970s represents a sea change for investors, with the Fed's shift toward prioritizing maximum employment and allowing higher inflation a wild card in the policy outlook.

As inflation has soared further from the 2% target, the Fed has announced tapering its bond purchases in preparation for normalizing interest rates later in 2022. If inflation proves persistent, as we expect, forward guidance is likely to prepare the markets for rate hikes in the second half. Fed Chairman Powell did not dissuade this notion in his November 3 press conference. Indeed, he validated the market moves toward rate hikes in 2022 rather than supporting the previous Fed position that rate hikes would not come before 2023. Still, Powell did not dismiss the possibility that rate hikes might be delayed longer, which allowed the market to back off the more hawkish scenario and bonds to rally.

If inflation continues to surprise to the upside, the market and Fed hawks will eventually project a more aggressive rate-hike trajectory than currently incorporated in the yield curve. Mr. Powell's press conference served the purpose of slowing this process, as he did not want to get ahead of the market but rather continued to drag his feet on the need to address inflation. This gave the Equity market the green light to rally into year-end. It also gave the bond market room to continue digesting the big rise in long-term rates over the past year.

While nominal long rates have doubled off their lows, real rates have continued to fall, as the rise in inflation outpaces the rise in interest rates. Given the Fed's reluctance to remove accommodation, yields on Treasury Inflation Protected Securities (TIPS) have declined over the past month, with real yields on longer maturities dropping the most, almost 40 basis points as of November 10. Declining real yields reflect additional monetary ease, as zero rates and ongoing quantitative easing become less and less appropriate in an overheating economy. In other words, the current policy stance is feeding more, not less inflation, making it difficult to understand the consensus view that inflation is heading lower in 2022.

In any event, 2022 should be a transition year, as the Fed shifts from its current stance of feeding high inflation with double-digit money growth to trying to stop the wage-and

price spiral that has been set off by the most stimulative monetary-fiscal mix since the 1940s. Given the political difficulties of slowing demand in a midterm election year, we suspect the Fed will continue to resist raising interest rates enough to slow the boom. By then, the “transitory” inflation narrative is likely to prove even less credible than it has proven in 2021.

GLOBAL MARKET VIEW

What the Political Tea Leaves Portend for the Markets

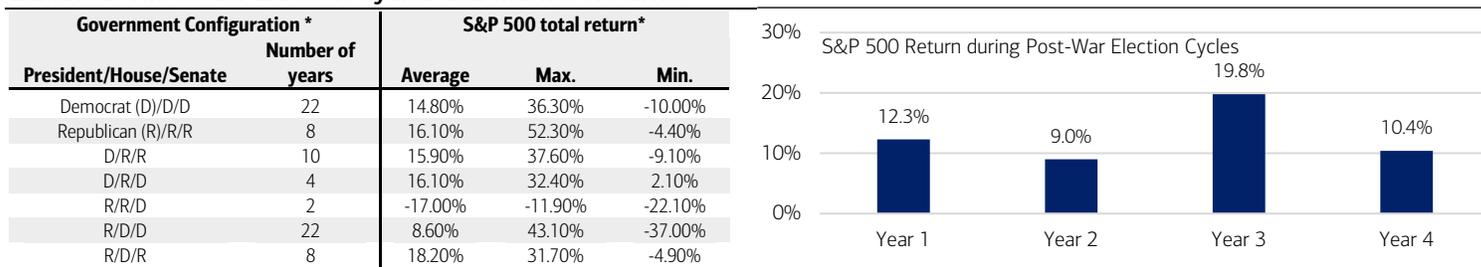
Joseph P. Quinlan, Managing Director and Head of CIO Market Strategy

Hayley Licata, Analyst

It’s not looking good for Democrats. One year out from the 2022 midterm election, the political landscape for Democrats, to say the least, looks rather challenging. In a recent USA TODAY/Suffolk University Poll, for instance, President Biden’s approval rating was just 38%. Vice President Kamal Harris’ approval was even worse—28%. Polling figures from Quinnipiac University and NBC News yield similar worrisome results for the White House, while a recent poll from Emerson College shows former President Donald Trump narrowly beating Biden in a hypothetical matchup.

The mood of voters is getting worse, not better. Fueling the angst of voters: slower growth and rising inflationary pressures on virtually everything (goods and services), with price hikes on cars, coffee and cosmetics akin to a tax on real incomes, notably among lower-income households. There’s nothing more politically harmful one year before an election than voter concerns of stagflation—weak growth-cum-rising prices. Per the latter, October’s consumer price index (CPI) YoY report came in at 6.2%, the biggest gain in consumer prices since 1990. Prices, not jobs, have moved to the political forefront. Even in good times, midterm elections are rarely pretty for the incumbent party, so as we head into 2022, the markets will start to discount the prospects of a reconfigured (divided) government—or perhaps the making of a “red wave.”

Exhibit 3: Historical Election Cycles and Market Returns.



*For election cycles from 1945 to 2020. D/D/R configuration has not occurred during the post-war period. Sources: Bloomberg; House.gov; Senate.gov; CIO. Data as of 2020. **Past performance is no guarantee of future results.**

Politics matter. Exhibit 3 depicts market returns against various configurations of the U.S. federal government since 1945. Before getting into the specifics, yes, long-term market returns reflect the fundamentals of real economic growth, corporate earnings and the cost of capital. But politics also matter—think government spending, taxes, deficits, wars, trade policies, regulatory statutes—all of these government-directed factors matter to the markets and can influence returns.

The markets don’t mind a divided government. Based on 75 years’ worth of history, split government, in general, is associated with healthy returns. That said, if the Republicans do take control of both the House and Senate in 2022, the market tea leaves are rather propitious, with average annual total returns of the S&P 500 under a Democratic White House and Republican-controlled Congress nearly 16%. A Democratic-controlled White House and Senate, along with Republican House, meanwhile, isn’t all that bad, with historical total returns of 16.1%. Interestingly, there has never been a Democratic-controlled White House and House, and Republican-run Senate over the post-war period.

Stock market returns in Year One of a presidential cycle have historically been strong. Exhibit 3 shows the average total returns of the S&P by election year. Year One is typically strong (12.3%), while gains in Year Two are moderate (9%) before accelerating in Year Three (19.8%). Returns in Year Four (10.4%) are typically half the prior year.

Above-average returns for Biden. With that as background, how do market returns in the first year of the Biden administration stack up relative to history? Answer: quite well. Indeed, year-to-date, S&P 500 total returns in excess of 26% are more than double the historic average; but this outperformance, of course, reflects many unique factors of the past two years, namely the massive U.S. fiscal and monetary stimulus to combat the depression-like effects of the coronavirus. To the latter point, America’s combined fiscal and monetary stimulus since the beginning of 2020 is in the neighborhood of \$13 trillion, with one more spending bill expected by year-end. That equates to roughly a staggering 60% of GDP.

Good not G.O.A.T (Greatest of all Time). Year One market returns under President Biden are impressive, but as Exhibit 4 illustrates, they are well off Truman’s first-year returns of 1945 (36.3%), and Year One returns of Clinton in 1997 (33.4%), Obama in 2013 (32.4%), Reagan in 1985 (31.7%), and Bush in 1989 (31.7%). In addition, Biden’s Year One stock market returns don’t resonate much on Main Street—or with the average voter.

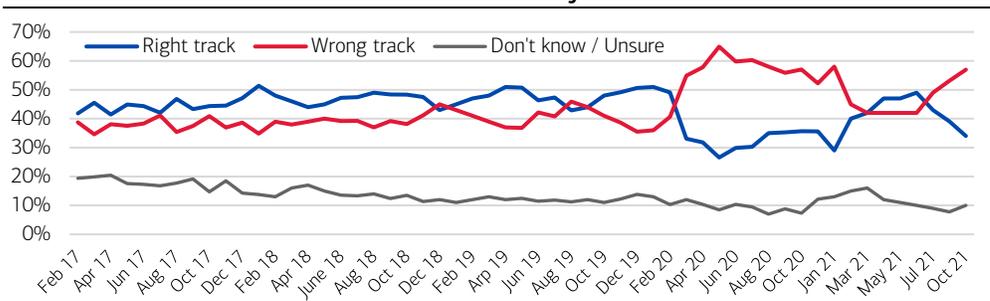
Exhibit 4: Best Year One Returns by President In Post-war Era.

Year	President	Party	House	Senate	S&P 500 Total Return
1945	Truman	D	D	D	36.30%
1997	Clinton	D	R	R	33.40%
2013	Obama	D	R	D	32.40%
1985	Reagan	R	D	R	31.70%
1989	Bush	R	D	D	31.70%
1961	Kennedy	D	D	D	26.90%
2021	Biden	D	D	D	26.60%
2009	Obama	D	D	D	26.50%
1949	Truman	D	D	D	23.60%
2017	Trump	R	R	R	21.80%
1965	Johnson	D	D	D	12.50%
1993	Clinton	D	D	D	10.10%
2005	Bush	R	R	R	4.90%
1953	Eisenhower	R	R	R	-0.90%
1981	Reagan	R	D	R	-4.90%
1977	Carter	D	D	D	-7.20%
1969	Nixon	R	D	D	-8.40%
1957	Eisenhower	R	D	D	-10.70%
2001	Bush	R	R	D	-11.90%
1973	Nixon	R	D	D	-14.70%

Sources: Bloomberg; House.gov; Senate.gov; Chief Investment Office. Data as of November 9, 2021. **Past performance is no guarantee of future results.**

More pain than gain. Notwithstanding an economy that is expected to expand by better than 5% this year, in spite of nearly 6 million new jobs being created in the U.S. in the year to October and an unemployment rate of 4.6%, and regardless of a 3.5% hike in average hourly earnings and household net worth at staggering levels (\$142 trillion)—despite all of the above, a growing majority of voters say the economy (57%) is on the wrong track, according to the latest figures from the Harris Poll (Exhibit 5). And with food and energy prices fueling the larger-than-expected jump in the October CPI, the “wrong track” mentality of the U.S. voter isn’t about to change anytime soon. All of this sets up more volatility and choppy capital markets next year courtesy of Washington.

Exhibit 5: American’s View on the U.S. Economy.



Sources: Harvard Center for American Political Studies/Harris Poll. Data as of October 2021.

Despite political uncertainty, there are plenty of reasons to remain optimistic about U.S.

Equities. As stated earlier, politics matter to the capital matters. But what matters more than the public sector is the private sector, or Corporate America, the most diverse and dynamic growth and wealth engine in the world. Thanks to the U.S. private sector, the U.S. economy remains one of the largest in the world, as well as a global leader in innovation/technology, manufacturing and services, all backstopped by world-class universities, the world's reserve currency, and a risk-taking ecosystem that continues to attract the best talent in the world. Heading into 2022, we maintain our U.S. Equity overweight relative to not only Fixed Income but also the rest of the world. We prefer Value and Growth, and continue to espouse exposure in economically sensitive sectors like Industrials, Materials, Energy, and Financials, and growthier sectors like Technology.

THOUGHT OF THE WEEK

EM: What If Elon Musk Launched Tesla in South Africa?

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Hayley Licata, Analyst

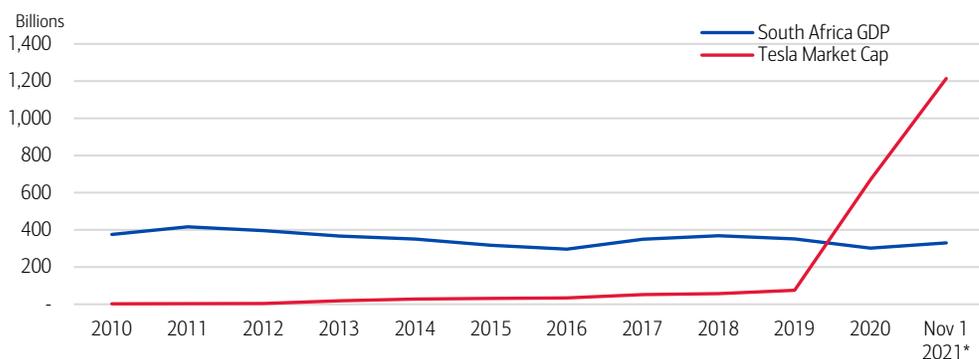
The CIO remains neutral on Emerging Market (EM) Equities, and believes cyclical and structural headwinds will weigh on the asset class again in 2022. Cyclical negatives: rising U.S. interests rates, moderating growth in China, and weaker fiscal support levels. Structural headwinds include inefficient labor markets, insufficient savings and underdeveloped capital markets, and a dearth of human talent/capital.

The latter is key because the best and brightest in many EMs—out of necessity or desire—end up in the U.S., home to the most entrepreneur-friendly, risk-taking ecosystem in the world. Hamdi Ulukaya (Chobani), Sergey Brin (Google/Alphabet), Jan Koum (WhatsApp), Mike Krieger (co-founder Instagram)—all of these immigrant risk-takers have plowed their entrepreneur energy into the U.S. over the past decades, boosting, in the process, America's long-run real growth and competitiveness.

Another case in point: Elon Musk (South Africa) and Tesla. Musk could never have launched Tesla in South Africa due to numerous constraints. But what if he had? Think of the positive knock-on effects to the local economy—jobs, income, capital flows, technology upgrades, tax revenues, etc. South Africa's economic fortunes would have risen along with Tesla, which now has a market cap (\$1 trillion+) more than three times the size of South Africa's economy (Exhibit 6). Tesla's market cap alone is nearly equivalent to the total market cap of the Johannesburg Stock Exchange.

Simply put, one reason we prefer U.S. Equities to EM Equities is because a fair amount of EM top talent is hunkered down in the U.S. These folks aren't creating shareholder value in their home countries; they're creating it here in the U.S. The upshot: advantage U.S. Equities versus many (not all) EM.

Exhibit 6: Changing Lanes: Tesla versus South Africa.



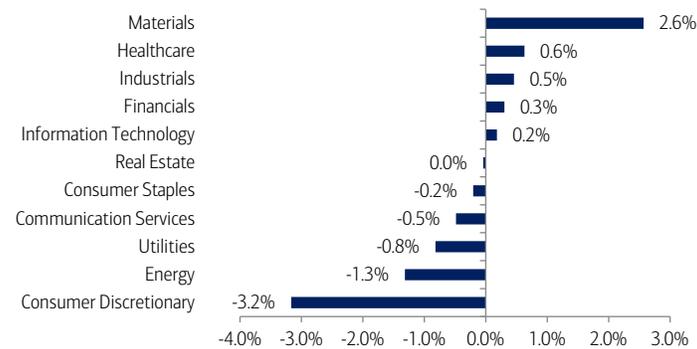
*South Africa 2021 GDP Estimate. Sources: Bloomberg; World Bank International Monetary Fund. Data as of October 2021.

MARKETS IN REVIEW

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	36,100.31	-0.6	0.9	19.8
NASDAQ	15,860.96	-0.7	2.4	23.7
S&P 500	4,682.85	-0.3	1.7	26.2
S&P 400 Mid Cap	2,902.19	-0.1	3.9	27.1
Russell 2000	2,411.78	-1.0	5.0	23.1
MSCI World	3,223.82	-0.2	1.6	21.3
MSCI EAFE	2,364.20	-0.3	1.3	12.4
MSCI Emerging Markets	1,285.48	1.7	1.7	1.4

S&P 500 Sector Returns



Fixed Income[†]

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	1.62	-0.81	-0.07	-1.95
Agencies	1.05	-0.55	-0.08	-1.23
Municipals	1.13	0.15	0.62	1.12
U.S. Investment Grade Credit	1.71	-0.75	-0.11	-1.69
International	2.26	-0.99	-0.10	-1.12
High Yield	4.23	-0.25	0.36	4.73
90 Day Yield	0.04	0.04	0.05	0.06
2 Year Yield	0.51	0.40	0.50	0.12
10 Year Yield	1.56	1.45	1.55	0.91
30 Year Yield	1.93	1.89	1.93	1.64

Commodities & Currencies

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Commodities				
Bloomberg Commodity	219.53	0.1	-0.5	31.7
WTI Crude \$/Barrel ^{††}	80.79	-0.6	-3.3	66.5
Gold Spot \$/Ounce ^{††}	1864.9	2.6	4.6	-1.8

	Total Return in USD (%)			
	Current	Prior Week End	Prior Month End	2020 Year End
Currencies				
EUR/USD	1.14	1.16	1.16	1.22
USD/JPY	113.89	113.41	113.95	103.25
USD/CNH	6.38	6.39	6.40	6.50

Sources: Bloomberg, Factset. Total Returns from the period of 11/8/2021 to 11/12/2021. [†]Bloomberg Barclays Indices. ^{††}Spot price returns. All data as of the 11/12/2021 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 11/11/2021)

Asset Class	CIO View		
	Underweight	Neutral	Overweight
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	●		

*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 11/12/2021)

	2020A	Q1 2021A	Q2 2021A	Q3 2021A	Q4 2021E	2021E
Real global GDP (% y/y annualized)	-3.1	-	-	-	-	5.8
Real U.S. GDP (% q/q annualized)	-3.4	6.3	6.7	2.0	6.0	5.6
CPI inflation (% y/y)	1.2	1.9	4.8	5.3	6.5	4.6
Core CPI inflation (% y/y)	1.7	1.4	3.7	4.1	4.9	3.5
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 November 12, 2021.

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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 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.

Institute for Supply Management (ISM) Manufacturing index measures the change in production levels across the U.S. economy from month to month.

Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

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

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