CHIEF INVESTMENT OFFICE

Capital Market Outlook

April 12, 2021

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

IN THIS ISSUE:

- Macro Strategy—Nimble supply management by the Organization of the Petroleum Exporting Countries and its allies (OPEC+) along with rapidly improving global manufacturing and trade, weather-related U.S. supply disruptions, and reflationary tailwinds have shifted oil prices into a higher $50 to $70 per barrel range this year, helping make energy stocks the best-performing sector in the S&P 500 index in the first quarter. A high correlation with inflation favors energy stocks as potential defense against the declining value of money.
- Global Market View—The geopolitics of U.S.-China relations, while thought to be pushed to the sidelines with the arrival of the Biden administration, remain key to market expectations and returns.
- Thought of the Week—America's exceptionalism can be seen in the longer-term outperformance of its equity market and manufacturing sector. While the latest U.S. fiscal stimulus argues for this trend to continue, uneven growth risks ultimately truncating the global economic recovery.
- Portfolio Considerations—We retain our positive view on Equities based upon favorable relative valuations and improving global growth. We prefer a diversified mix between Growth and Value with an overweight still to the U.S. overall. In Fixed Income we prefer shorter duration exposure with a focus on credit relative to government bonds—even though we expect municipal bonds to benefit significantly from the latest fiscal rescue plan.

MACRO STRATEGY

Chief Investment Office
Macro Strategy Team

GLOBAL MARKET VIEW

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

Lauren J. Sanfilippo
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THOUGHT OF THE WEEK

Rodrigo C. Serrano
Director and Senior Investment Strategist

Data as of 4/12/2021, and subject to change

MACRO STRATEGY

Reflation Tailwinds Also Give Boost To Oil Prices

Chief Investment Office, Macro Strategy Team

Massive supply cuts both in the U. S. and especially in the OPEC+, combined with a faster-than-expected rebound in economic activity and a weaker dollar over the past year, quickly pushed Brent oil prices back to pre-pandemic levels of around $70/barrel in mid-March. Crude oil prices should remain restrained by unusually elevated spare capacity and inventories as well as pressures to limit fossil fuel consumption, in contrast to copper, for example, which has already reached decade highs helped by strong demand and very low inventories.

Absent new policies aimed at limiting oil demand growth, the International Energy Agency (IEA) projects global oil demand to surge about 6% in 2021 and to exceed its 2019 level by 2022. Still, 2026 world oil consumption is estimated to be just 4% above the 2019 average as a result of substantial demand growth deceleration after 2022 as the world continues to transition away from fossil fuels. In fact, in its Market Report: Oil 2021 published in March 2021, the IEA suggests that new policies and regulations—such as encouraging permanently higher work from home, business travel cuts, higher fuel efficiency standards, stronger incentives for electric vehicle (EV) penetration to achieve 90 million EV cars by 2026 instead of the 60 million currently projected, and greater investment in renewables—could restrain demand even more over the next five years, to levels not far from 2019 and more in line with climate-change objectives.

Just as policymakers around the world are actively pushing the global economy away from fossil fuels, the world remains awash in crude oil following the pandemic shock to demand. Potential supply has accumulated in the form of massive idle production capacity and large global inventories (around a 20-year high, when adjusted for restrained coronavirus-related global demand), which will take a long time to be absorbed. This has forced OPEC and its allies to remain vigilant, with Saudi Arabia, for example, voluntarily cutting its output earlier this year by about 1 million barrels per day (mbd) to accommodate the return of Libyan oil to the market following a war-related production collapse in 2020. As we've discussed in past reports, and as this year's swings in OPEC+ supply targets show, this massive idle capacity can be brought back online at the slightest sign of upside price pressure. Notably, according to the IEA, Russia prefers a lower oil-price range of about $45 to $55 per barrel than OPEC does in order to keep U.S. production from increasing much. With Russia a member of OPEC+, it's not surprising that the cartel has just agreed to gradually add back about 2 mbd to supply by July (including unwinding the above-mentioned voluntary Saudi Arabia production cut this year) to keep prices in check as demand likely continues to grow with expanding vaccinations and presumably delay the ramp-up of U.S. supply.

Higher OPEC+ volumes still leave plenty of surplus capacity in OPEC, even excluding the estimated 1.7 mbd in Iranian oil capacity idled by U.S. sanctions, which could be brought to the market in relatively short order given Iran's recently signed energy-and-security pact with China, increased pressure to revoke U.S. sanctions on Iran, and a more receptive U.S. administration. In addition, assuming political stability, Libya has plans to add almost 1 mbd more to supply by 2026 than the IEA currently projects. Thus, even though the steep coronavirus-related loss of revenues of the past year has forced many oil-producing companies around the world to delay or cancel projects, there's potential for upside supply surprises ahead given otherwise abundant and inexpensive OPEC oil.

Overall, 2020 upstream investment was cut by a record 30% from 2019, with major oil companies also scaling back some of their most expensive oil projects as they plan for the transition to a low-carbon future, and 2021 investment is seen rising only marginally. According to the IEA, non-OPEC+ countries are now seen raising output by 4 mbd between 2020 and 2026 (40% of the global increase), three quarters of which is expected to come from the U.S. and Brazil.

Still, because of industry consolidation and a more conservative approach to investment, the U.S. is expected to see much more modest growth than was anticipated before the pandemic. The U.S. shale sector has been hit especially hard by the pandemic, causing numerous bankruptcies, mergers and acquisitions, and production cuts. Smaller producers are described as wary of the new administration's stance on fossil fuel, preferring not to reinvest as much as before but rather pay back debt or return cash to investors.

That said, according to the IEA's citing of a Dallas Fed energy survey, U.S. oil producers generally need a West Texas Intermediate (WTI) price of $45 to $50 per barrel to profitably drill a new well, with the best locations coming in below $30 per barrel, so sustained prices above $60 per barrel may result in more U.S. supply than currently expected, which would cap oil prices more firmly under $70 per barrel. In its April 2021 Short-Term Energy Outlook, the U.S. Energy Information Administration (EIA) estimates that U.S. domestic crude oil production averaged 11.1 mbd in January 2021—still 13% below the record 12.8 mbd produced before the pandemic, but 11% above the May 2020 pandemic—and will likely increase to 11.9 mbd in 2022, if WTI averages $55 per barrel.

With prices currently rebounding faster than expected to pre-pandemic levels, the rig count has been steadily rising, and drilling should continue to recover from its 2020 plunge, as it typically lags oil prices by about four months. Based on past experience, current oil prices are consistent with about double the current rig count, but drilling is likely going to undershoot given increased caution and investment discipline in the post-coronavirus world. Much higher drilling activity would be needed to offset declines at existing wells and bring production to pre-pandemic levels sooner than currently projected.

According to the IEA report, total U.S. oil supply (crude oil, natural gas liquids and biofuels) is projected to increase 10% to 18.2 mbd by 2026 (1.6 mbd more than in 2020) at current prices. A suspension of new lease approvals on federal land is not expected to have a material impact on output in the near and medium term, due to a substantial inventory of drilled but uncompleted wells and permits to sustain activity at current levels for some time. If a permanent freeze on new drilling permits and leasing on federal acreage is approved, production would be more likely to start declining in 2024.

Global upstream capital expenditure in 2020 fell to its lowest level since 2006 as operators spent one-third less than they planned to at the start of the year (U.S. companies accounted for more than half the decline), with 2021 expected to see only marginally higher spending. With U.S. producers less eager to ramp up production in light of ample OPEC+ excess capacity and growing pressure to shift the global economy away from fossil fuels, OPEC is in a good position to meet global demand growth. In fact, as global upstream investment lags, Saudi Arabia, Iraq, the United Arab Emirates (UAE) and Kuwait may have to substantially boost utilization rates to ensure the world is adequately supplied. More oil than currently assumed from Iran and Libya may ease the call on the rest of OPEC, but either way, increased dependence on the cartel creates security of supply risks and increases the risk premium on oil, adding upside pressure on oil prices.

The mean-reversion tendency of relative commodity prices also suggests that oil prices will likely drift higher in order to narrow their big gaps to other commodity prices. Hurt by massive oversupply, oil prices last year fell way below their long-term averages relative to copper, equity prices, money supply and nominal gross domestic product (GDP), for example, and thus had much ground to recuperate in order to narrow these gaps. The reflationary tailwinds typically boosting prices for commodities and nominal magnitudes, such as GDP, should continue to keep oil prices above levels otherwise suggested by massive supply-and-demand constraints.

All in all, despite a strong oil demand rebound in 2021-2022, inventories and idle production capacity remain massive. Also, global net capacity is seen increasing by about 4 mbd between 2019 and 2026, with upside potential surprises from Iran and Libya, even as demand is likely to be increasingly restrained by climate-change policies over the next five years. We expect oil prices to remain in a $50 to $70 per barrel range this year as the oil market is slowly rebalancing and reflation tailwinds also continue to shift oil prices higher in coming years. How fast the shift takes place depends in large part on how inflationary the current monetary and fiscal policy mix proves to be.

The Reprieve from Geopolitics Is Over

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

Lauren J. Sanfilippo, Vice President and Investment Strategist

At the beginning of the year, investors were expecting a geopolitical reprieve as the Biden administration settled into power. The market consensus—following four years of tumult around foreign trade and spiraling tensions with China—was that geopolitics as a lightning rod for market volatility and uncertainty was set to taper and that a post-Trump world would be defined more by diplomacy, multilateralism and cooperation versus late-night tweets, unilateralism and confrontation.

Reality, as is often the case, has turned out differently. It's not all quiet on the geopolitical front. Rather, it's messy—notably among the world's two largest economies, the U.S. and China. The U.S.-China strategic rivalry has only hardened since January, a development the markets have generally ignored.[1]

Last month's U.S.-China summit in Alaska was highly contentious (at least in public), and has been followed by a number of moves and countermoves that suggest U.S.-Sino relations have gone from bad to worse in a matter of months.

The Biden administration, for instance, has left the tough anti-China trade policies of his predecessor in place, and has not changed course on sending U.S. naval ships through the South China Sea, to the annoyance of Beijing. The administration has also elevated the Quad—an informal alliance of the U.S., Australia, Japan and India intended as a counterweight to China's forward positioning in Asia. Meanwhile, along with the U.K., the European Union and Canada, the U.S. has imposed sanctions on Chinese officials involved in setting policies in Xinjiang; what's more, the U.S. State Department, in its annual report on human rights, labeled Chinese policies in Xinjiang as "genocide," infuriating Beijing. The State Department has also floated the idea of the United States' boycotting the 2022 Winter Olympics in China. The latter is probably just talk, but it's done nothing to lower the geopolitical temperature between the two countries.

China's actions have not helped either. No longer content with Deng Xiaoping's—Chinese revolutionary and statesman—dictate that China should "hide your strength, bide your time," the current Chinese leadership is unapologetic about its actions in Hong Kong or its 25-year "strategic partnership" with Iran, which includes creating a Chinese-Iranian bank with the intent of undermining the U.S. dollar's world reserve currency status. Besides Iran, China has aligned itself with Russia, with the two parties recently agreeing to a space venture that envisions building a research station on the moon. The country has currently also stepped up its military presence in the South China Sea and taken to firing up nationalism among Chinese consumers to boycott certain foreign brands.

And then there is Taiwan, which has become one of the most important pieces of geography in the world. In early April, two days after China conducted simultaneous military exercises to the west and east of Taiwan, the U.S. State Department announced that America's "commitment to Taiwan is rock-solid,", a sentiment backed up by new and expanding military ties between the U.S. and Taiwan. The prospects for war are low, but the odds of a geopolitical misstep or mistake over Taiwan are rising. That Taiwan is a global manufacturing leader in semiconductors only raises the geopolitical stakes for the entire world.

What does all of the above mean for investors? Plenty.

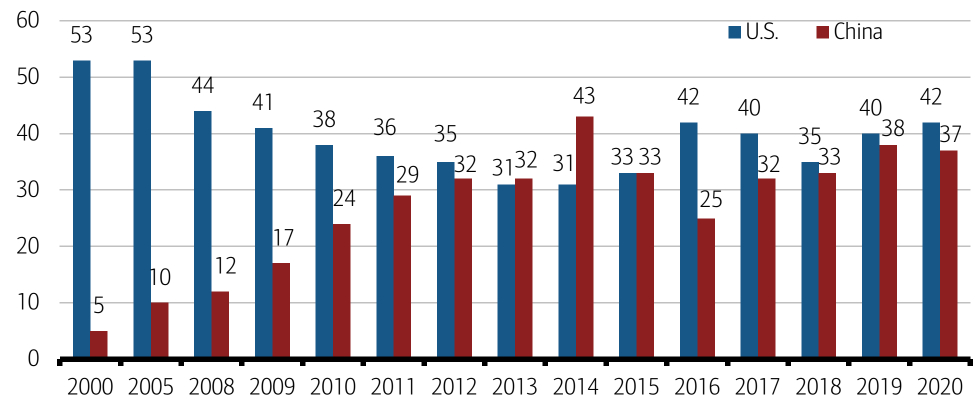
First, simmering bilateral frictions between the U.S. and China have the potential to increase near-term market volatility, as they did periodically during the Trump term. Geopolitics, in

[1] For more on this topic, see "The Great Rivalry: A New U.S.-China Cold War," August 2020.

other words, could emerge as a stiff headwind to our expectations of a market grinding higher this year.

Second, the more the U.S. and China spar over human rights, trade, technology and Taiwan, the greater the risk to global growth, notably global trade. As Exhibit 1 highlights, almost half the world counts either China or the U.S. as their number one export market. The more the elephants quarrel, the greater the risk to the rest of the world.

Exhibit 1: Trading Places? Countries with U.S. & China as Top Export Partner*.

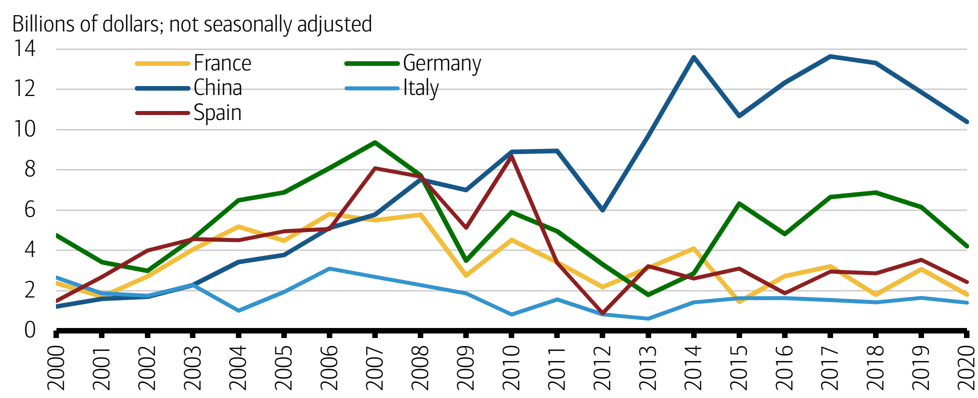


*Excludes Taiwan. Source: International Monetary Fund. Data as of April 8, 2021.

Third, and similar to the above, the geopolitics of the US and China reach far and wide—at risk is a world having to choose sides. Pro-U.S. or pro-China? This is a prospect that could greatly fragment the global economy and hamper the long-term growth of U.S. corporate earnings.

And speaking of earnings, the last point to consider is outlined in Exhibit 2. Not recognized by many U.S. investors, China has emerged as a significant source of earnings for many U.S. firms across multiple sectors over the past few decades. U.S. foreign affiliate income, a proxy for global earnings, totaled just $1.2 billion 2000, well before China's emerging middle class blossomed into one of the most powerful consuming cohorts in the world. However, by 2017, what U.S. affiliates operating in China earned ($13.6 billion) was 10 times larger than at the start of the decade, and well above the income earned in the wealthier/developed markets of Europe. U.S. affiliate income in China has trailed lowered over the past few years but still remains well above the levels of many other nations.

Exhibit 2: U.S. Affiliate Income Earned Abroad: By Country.



Source: Bureau of Economic Analysis (BEA). Data as of April 8, 2021.

In the end, the geopolitics of U.S.-China relations, while thought to be pushed to the sidelines with the arrival of the Biden administration, remain key to market expectations and returns.

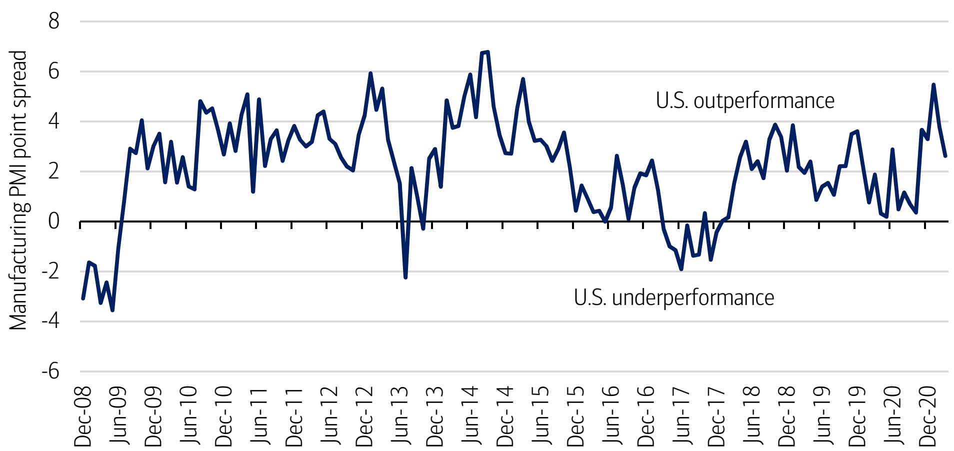
THOUGHT OF THE WEEK

American Exceptionalism, with a Caveat

Rodrigo C Serrano, Director and Senior Investment Strategist

Since the end of 2008, until April 9 of this year, the MSCI USA equity index has posted an annualized return of 13.7%.[2] It has outperformed both the Emerging Markets (7.4%) and International Developed Markets (5.3%) indices by more than 5% per annum. American exceptionalism can also be discerned in longer-term manufacturing trends. With the exception of the 2015 oil-price collapse, which dragged on U.S. capital expenditure, the U.S. Purchasing Managers' Index (PMI) has held a consistent point spread over the simple average of the corresponding indicators of 18 other major economies (Exhibit 3). Together, these top 19 economies represent just over 79% of global GDP.[3]

Exhibit 3: U.S. Manufacturing Had Consistently Outperformed That Of Other Major Economies Since 2008.



Notes: IHS Markit time series for Canada (Oct. 2010), France (Dec. 2012), Indonesia (Apr. 2011), and Mexico (Apr. 2011) are registered after Dec. 2008. For the U.S., ISM is replaced with the IHS Markit time series on Jun. 2012. Source: IHS Markit, Institute of Supply Management (ISM), Chief Investment Office. As of March 2021. Past performance is no guarantee of future results.

Recently, this outperformance has been supported by an aggressive fiscal and monetary response, among other factors. According to Cornerstone Macro Research, together, these policies have equated to 57.4% of U.S. GDP. Larger than those of China (18.4%) and the Eurozone (50.9%), they have also been implemented quicker compared to the latter, in our view. Totaling $1.9 trillion, the latest American fiscal stimulus is expected to boost 2021 U.S. real GDP to its fastest annual growth rate since 1983, at 6.4%, according to the International Monetary Fund (IMF). Demand spillover is expected to help advance global growth to 6.0%, its fastest pace on record since 1980.

However, we're monitoring whether too much American exceptionalism risks impeding inclusive growth, ultimately truncating the global recovery. Among risks cited by the IMF are rising U.S. interest rates. Combined with lagging vaccination drives and a higher dependency on tourism, a supported U.S. dollar and the risk of accelerated capital outflows may prove to be other obstacles to growth, particularly for emerging market economies. The IMF estimates that by 2024, the global economy will still be about 3% smaller compared to its pre-coronavirus trajectory. The recovery continues, but its synchrony is at risk, in our view.

[2] Price returns are used.

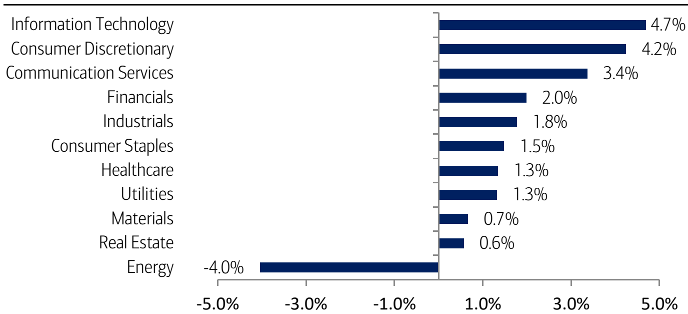
[3] The 18 countries are: China, Japan, Germany, India, the United Kingdom, France, Italy, Brazil, Canada, Russia, Korea, Spain, Australia, Mexico, Indonesia, Netherlands, Turkey and Switzerland. The nominal GDP share is calculated from World Bank data for 2019.

MARKETS IN REVIEW

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	33,800.60	2.0	2.5	11.0
NASDAQ	13,900.19	3.1	4.9	8.0
S&P 500	4,128.80	2.8	4.0	10.4
S&P 400 Mid Cap	2,670.52	0.9	2.4	16.2
Russell 2000	2,243.47	-0.5	1.0	13.9
MSCI World	2,910.10	2.4	3.5	8.6
MSCI EAFE	2,262.48	1.8	2.5	6.1
MSCI Emerging Markets	1,330.36	-0.6	1.1	3.4

S&P 500 Sector Returns



Fixed Income†

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	1.48	0.40	0.57	-3.73
Agencies	0.78	0.30	0.26	-1.33
Municipals	1.10	0.38	0.47	0.11
U.S. Investment Grade Credit	1.56	0.40	0.49	-2.90
International	2.21	0.42	0.77	-3.91
High Yield	4.02	0.53	0.71	1.57

	Current	Prior Week End	Prior Month End	2020 Year End
90 Day Yield	0.01	0.01	0.02	0.06
2 Year Yield	0.15	0.19	0.16	0.12
10 Year Yield	1.66	1.72	1.74	0.91
30 Year Yield	2.33	2.36	2.41	1.64

Commodities & Currencies

	Total Return in USD (%)			
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	179.41	0.2	0.7	7.7
WTI Crude $/Barrel††	59.32	-3.5	0.3	22.3
Gold Spot $/Ounce††	1743.88	0.9	2.1	-8.1

Currencies	Current	Prior Week End	Prior Month End	2020 Year End
EUR/USD	1.19	1.18	1.17	1.22
USD/JPY	109.67	110.69	110.72	103.25
USD/CNH	6.56	6.58	6.56	6.50

Sources: Bloomberg, Factset. Total Returns from the period of 4/5/2021 to 4/9/2021. †Bloomberg Barclays Indices. ††Spot price returns. All data as of the 4/9/2021 close.
Past performance is no guarantee of future results.

Asset Class Weightings (as of 4/6/2021)

	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					

*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 & Market Forecasts (as of 4/9/2021)

	Q4 2020A	2020A	Q1 2021A	Q2 2021E	Q3 2021E	Q4 2021E	2021E
Real global GDP (% y/y annualized)	-	-3.2	-	-	-	-	5.8
Real U.S. GDP (% q/q annualized)	4.1	-3.5	7.0*	10.0	9.0	5.0	7.0
CPI inflation (% y/y)	1.2	1.2	1.9*	3.4	2.9	2.8	2.7
Core CPI inflation (% y/y)	1.6	1.7	1.4*	2.2	1.9	2.2	1.9
Unemployment rate (%)	6.7	8.1	6.2	5.2	4.5	4.2	5.0
Fed funds rate, end period (%)	0.09	0.09	0.06	0.13	0.13	0.13	0.13
10-year Treasury, end period (%)	0.91	0.91	1.74	1.85	2.00	2.15	2.15
S&P 500 end period	3756	3756	3973	-	-	-	3800
S&P earnings ($/share)	42	140	42*	46	48	49	185
Euro/U.S. dollar, end period	1.22	1.22	1.17	1.18	1.16	1.15	1.15
U.S. dollar/Japanese yen, end period	103	103	111	104	105	106	106
Oil ($/barrel, avg. of period, WTI)**	44	40	58	64	60	58	60

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. S&P 500 represents the year-end target for 2021. **West Texas Intermediate.
Sources: BofA Global Research; GWIM ISC as of April 9, 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 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.

MSCI USA Equity Index is designed to measure the performance of the large and mid cap segments of the US market. With 620 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US.

Purchasing Managers' Index (PMI) is and economic indicator derived from monthly surveys of private sector companies.

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