

CHIEF INVESTMENT OFFICE

# Capital Market Outlook

June 14, 2021

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

## IN THIS ISSUE

- **Macro Strategy**—Nuclear energy stocks have been out of favor with green-energy investors for decades. As the global transportation fleet transitions to electric vehicles, this is changing. To reach net-zero carbon emission goals by 2050, nuclear energy is likely to play a prominent role. Investors are starting to recognize this, as related stocks have far outperformed those of other forms of green energy so far this year.
- **Global Market View**—The era of great power competition between the U.S. and China is in full bloom and will be a defining market/investment characteristic for the foreseeable future given the economic weight of both nations. Bilateral friction will likely be a frequent source of market volatility but also a catalyst for long-term investment opportunities in tech-related sectors like 5G, artificial intelligence, industrial robots, cloud computing, renewable energies and related activities.
- **Thought of the Week**—The Federal Reserve’s (Fed) wind-down of the Secondary Market Corporate Credit facility is not an issue for markets, in our opinion. Credit markets no longer need direct Fed intervention, and normalization is a good sign.
- **Portfolio Considerations**—We are monitoring the possibility of higher yields and higher levels of inflation, although we generally would expect an increase in price levels to favor Equities over Fixed Income. Consider rebalancing through the summer months if risk assets drift materially higher over and above target allocation levels.

## MACRO STRATEGY

**Chief Investment Office  
Macro Strategy Team**

## GLOBAL MARKET VIEW

**Joseph P. Quinlan**

Managing Director and Head of CIO  
Market Strategy

**Ehiwario Efeyini**

Director and Senior Market  
Strategy Analyst

## THOUGHT OF THE WEEK

**Matthew Diczok**

Managing Director and Head of CIO  
Fixed Income Strategy

**Data as of 6/14/2021,  
and subject to change**

## MACRO STRATEGY

### Nuclear Energy: The Ultimate Green Energy Play

*Chief Investment Office, Macro Strategy Team*

More and more regions in the U.S. and countries around the world are setting goals to eliminate fossil-fuel-powered vehicles over the next 10 or 15 years. As a result, electric vehicles (EV) are expected to become the primary mode of transportation after the 2020s. In the U.S., California, Washington state, and Massachusetts have set aggressive goals to achieve this milestone by 2035. Canada, India and China, for example, have also set constraints on the future use of fossil-fuel vehicles. Perhaps Norway is the most advanced in this regard. Electric vehicles there already comprise 60% of monthly sales, and the ultimate goal is to ban the sales of new fossil-fuel-based cars starting in 2025.

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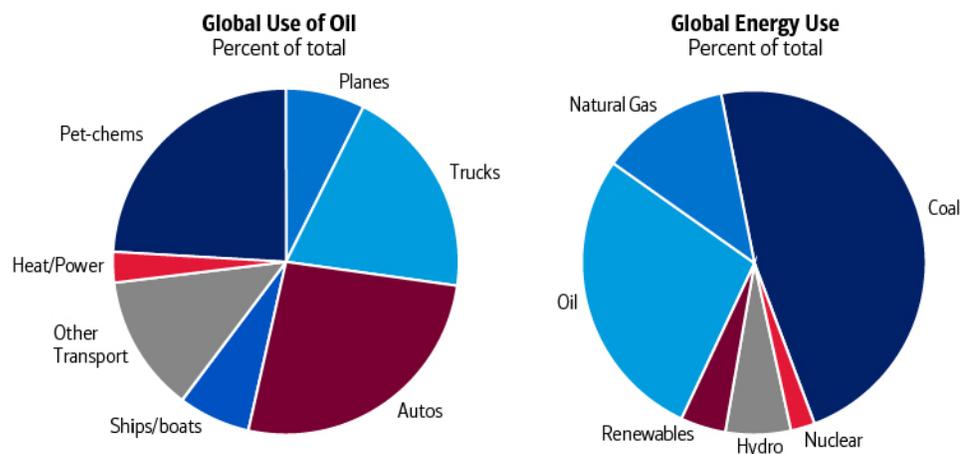
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One consequence of transitioning the transportation system from fossil-fuel to electric vehicles will be a massive shift away from petrol demand to electricity demand. This means fuel for electricity generation will also need to transition toward greener sources if the new EV transportation fleet is going to actually reduce CO2 emissions on the way to the net-zero goal by 2050. Exhibit 1 shows the current sources of global energy use, which are overwhelmingly comprised of fossil fuels. If most electricity remains generated by fossil fuels, then shifting the transportation fleet to electricity-based vehicles would do little to reduce carbon emissions. The electricity generation system will also need to transition to increasingly renewable green-energy sources.

**Exhibit 1: Most Electricity Is Still Generated By Fossil Fuels.**



Source: Cornerstone Analytics. Data as of June 4, 2021.

This is where nuclear energy excels. When all factors are considered, nuclear energy matches wind energy as the all-in lowest emitter of CO2 (Exhibit 2), with less than half the emissions rate of the most efficient solar sources and a slim fraction of the emissions rate of various fossil-fuel sources of electricity. The other major advantage of nuclear energy is its reliability compared to wind and solar power, which are subject to the vicissitudes of the weather (Exhibit 2). According to the U.S. Energy Department, “nuclear has the highest capacity factor of any energy source, producing reliable, carbon-free power more than 92% of the time in 2016. That’s nearly twice as reliable as coal (48%) or natural-gas (57%) plants and almost three times more than wind (35%) and solar (25%) plants.” Because of its much higher reliability factor, nuclear power plants produced 20% of the country’s electricity even though they accounted for only 9% of generation capacity in 2019, for example. This is important since problems with unreliable wind and solar power generation have played a role in multiple serious blackout incidences in recent years all around the world, with notable examples in Texas, California and Germany in the past few years.

**Exhibit 2: Nuclear Power More Reliable, With Lowest All-In Carbon Emissions Per Unit Of Electricity Generated.**

	Capacity Factor by Energy Source (%) 2019	CO2 Emissions Metric
Nuclear	93.5	12
Natural Gas	56.8	490
Coal	47.5	820
Hydropower	39.1	24
Wind	34.8	12
Solar	24.5	11

Source: U.S. Department of Energy. Data as of June 7, 2021.

One of the great ironies of the quest for clean energy generation is the prominent role environmentalists have played in preventing the transition to carbon-free nuclear energy. Starting with the Three-Mile Island disaster in 1979, followed by Chernobyl in 1986, and the more recent Fukushima incident in 2011, accidents at nuclear reactors have played a major role in causing countries to backtrack on plans to increasingly rely on nuclear energy for power generation. This is a good example of what historian Niall Ferguson discusses in his latest book, *Doom: The Politics of Catastrophe*. Basically, while science and technology are advancing at an accelerating pace, human nature remains relatively unchanged, which Professor Ferguson uses to explain why we are getting worse, not better, in handling disasters. He illustrates this point with the contrast between the contentious politics of the 2020 coronavirus pandemic and the much less contentious handling of the 1957-1958 Asian Flu pandemic, for example.

Similarly, the fear generated by the major nuclear accidents of the past four decades evolved into political obstacles to adopting what we now know would be a major solution on the road to net-zero CO2 by 2050. New technology has also been developed to ease worries about remaining issues, such as waste disposal, that have kept nuclear out of the mainstream of green energy. As a result, big investors like Bill Gates and Warren Buffett have embraced nuclear power as a means to a greener world future, with the U.S. Energy Department funding the first-ever nuclear reactor in Wyoming, partly financed by Mr. Gates. New, safer, smaller-scale nuclear reactors are in the early stages of implementation. Not surprisingly, given this new nuclear power potential, uranium prices and stocks have been riding the 2021 boom in commodities, far outperforming the S&P 500 so far this year. On the other hand, conventional green-energy stocks peaked late last year and are down sharply so far in 2021.

The stark contrast between the performance of popular green-energy stocks, like those of solar and wind companies, and that of unpopular nuclear-related stocks also illustrates the growth-to-value rotation driving 2021 equity-market performance. Solar stocks, for example, were favored by green investors in 2021, with the last gasp to record valuations after the new green-friendly administration was elected in November 2020. In retrospect, thanks to analysis by Empirical Research Partners, we now know that about a third of the big multiple expansion in long-duration growth stocks, such as those of traditional green-energy technology companies, reflected the big drop in long-term interest rates between March and December 2020. The sharp 2021 underperformance of these stocks, with lots of innovation promise but scant cash flows, reflects in part the revaluation of their long-duration cash flows to a doubling of long-term Treasury rates. In the meantime, in our view, uranium and other nuclear-related stocks are riding a cyclical and secular wave on the renewed promise of nuclear energy after four decades in the desert.

## GLOBAL MARKET VIEW

### Still Frosty: U.S.-China Relations and the Implications for U.S. Investors

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

*Ehiwario Efeiyini, Director and Senior Investment Strategy Analyst*

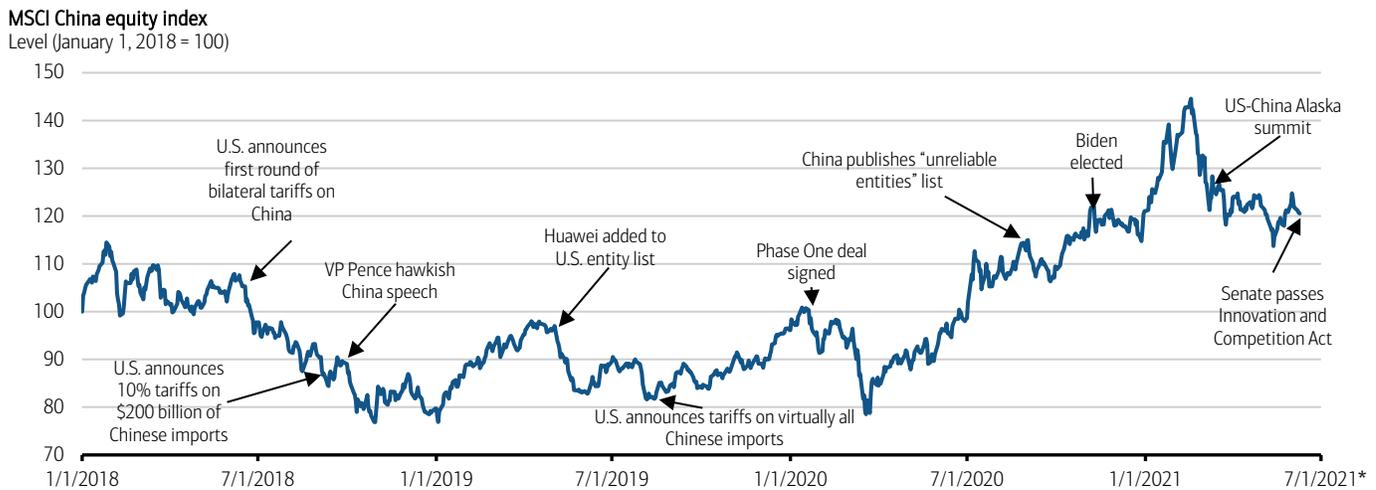
*"The period that was broadly described as engagement has come to an end,"*  
Kurt Campbell, U.S. Coordinator for Indo-Pacific Affairs, May 27, 2021.<sup>1</sup>

Notwithstanding the summer heat, and the fact that parts of the world are experiencing some of the hottest weather in history, bilateral relations between the U.S. and China remain frosty. A big chill remains despite market expectations that after four years of tumult and uncertainty under the Trump administration, the Biden White House would dial back the market-moving, anti-China rhetoric and policies of its predecessor. The latter

<sup>1</sup> "Biden's Asia Czar Says Era of Engagement with China Is Over," Bloomberg, May 27, 2021.

created an endless roller coaster ride for U.S. investors, notably those invested in the MSCI China Index (Exhibit 3).

### Exhibit 3: U.S.-China Trade, Investment and Technology Frictions Over Recent Years.



\*Estimate. Source: Bloomberg. Data as of June 9, 2021. Price index in local currency terms.

Thaw? Forget about it. There is no end in sight to the U.S.-Sino Cold War that erupted under the Trump administration. Indeed, President Biden has not only continued Trump's tough line on trade with China—leaving in place U.S. tariffs on Chinese goods and the "Phase One" trade deal—but also stepped up efforts to strategically counter China's rise with increased U.S. spending on 5G, semiconductors and other infrastructure-related spending. Supportive of the White House, the Senate passed the U.S. Innovation and Competition Act on June 8; the legislative package is designed to counter China's rising economic influence and is expected to be passed by the House and signed into law.

In other sensitive areas, the Biden administration has engaged and enhanced bilateral contacts with Taiwan and moved aggressively to stitch together a global coalition of like-minded democracies to help counter and restrain China's global ambitions. In addition to enlisting support from Europe, the administration has 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 United Kingdom, 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 U.S. State Department has also floated the idea of the U.S. 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 parties. Speaking to the stark reality of today, Biden's Asian Czar, Kurt Campbell, noted in late May that the era of engagement with China was basically over.

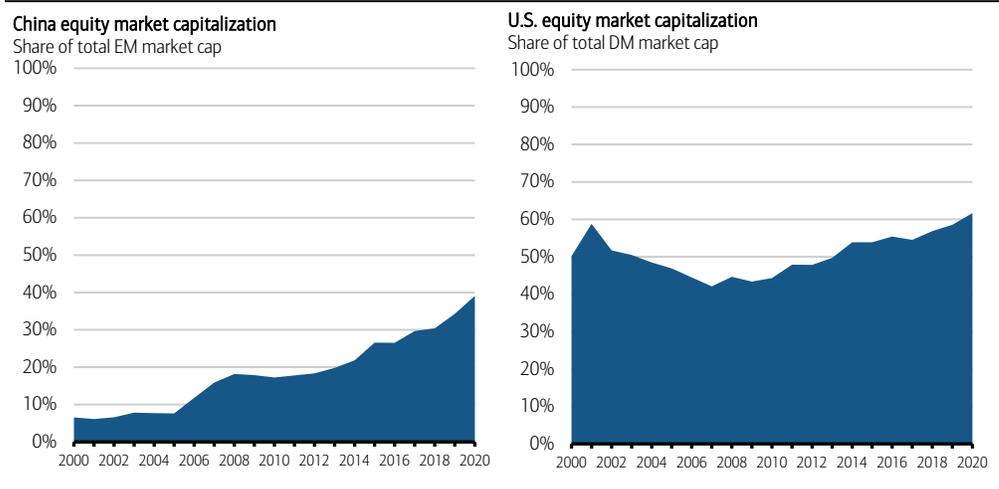
#### What does this mean for U.S. investors?

Just as we have seen over recent years, the new U.S. administration is likely to remain in periodic conflict with China as it looks to preserve its economic and national security interests in strategic areas such as intellectual property protection, supply chain resilience and data security. More bilateral frictions of the type seen under the previous administration clearly have the potential to increase market volatility as they did intermittently in 2018 and 2019.

Both the U.S. and China would potentially be at risk should any new restrictions on trade and technology be imposed. Tighter controls, for example, on U.S. semiconductor supplies or manufacturing equipment to China could curtail local Chinese production of consumer electronics and delay the rollout of next-generation 5G telecommunication networks on

the mainland. The same action could also potentially dent profits for U.S. leaders in the chip industry. And at the same time, potential retaliatory moves from China could risk lost access to the fast-growing Chinese market across a broader set of U.S. companies with China sales exposure. China and the U.S. have each seen their equity market size increase significantly over recent cycles, and each now dominates emerging market (EM) and developed market (DM) capitalization respectively (Exhibit 4). Any spillovers of this type from bilateral frictions between the two countries into their real economies will therefore remain a risk for investors exposed to global equities in either the developed or emerging worlds.

**Exhibit 4: China and the U.S. Dominate Market Capitalization In Emerging and Developed Equities.**



Source: MSCI. Data as of 2020. Based on MSCI equity indices.

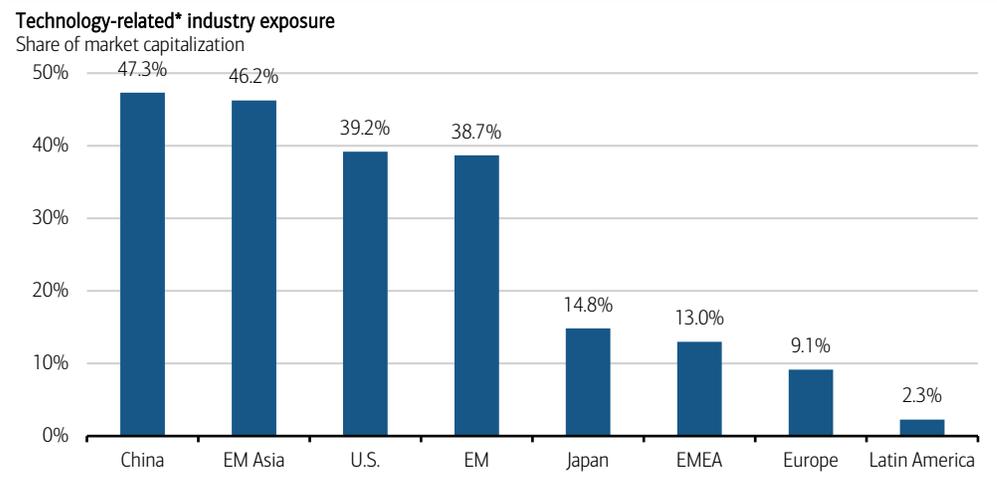
We nonetheless see continuing longer-term strength within technology-driven sectors in both markets. A post-pandemic global economy should see the shift toward automation and digitization in traditional activities such as media, retail and manufacturing continue to progress at an accelerated pace. And a prolonged period of competition for technological leadership between the world’s two largest economies is likely to pull forward investment in research and innovation through greater levels of sustained government support.

China will need to increase its spending within the key growth segments of the digital economy as it aims to move toward greater self-sufficiency in areas such as semiconductors and mobile operating systems. Indeed this has already been evident in the Chinese government’s prioritization of “new infrastructure” investment for the post-coronavirus recovery. Under this plan, China’s National Development and Reform Commission aims to spend a total of around \$1.4 trillion over the five years to 2025 across seven growth industries including the industrial internet, artificial intelligence and electric vehicles. Similarly, U.S. policy measures like the Innovation and Competition Act will aim to support technology investment domestically.

For investors, this could mean long-term growth opportunities across information technology software and services, chipmakers, semiconductor capital equipment and hardware applications such as networking equipment, cloud servers, electric vehicles and industrial robots. The growing geopolitical rivalry should also boost defense sector spending on advanced military hardware such as hypersonic missiles and anti-satellite weapons, as well as on enhanced cyber capability. Technology-related equity market segments have lagged the broad indexes so far in 2021, as investors have rotated away from growth sectors over the course of the year. But alongside ongoing growth in the global digital economy, these policy shifts reinforce our view that equity sectors most closely tied to these future trends should remain longer-term market leaders as we move further into the new decade.

Regionally, this should favor investor exposure to the U.S., China and emerging Asia more broadly given the large concentration of these markets in the most tech-focused areas across the Information Technology, Communication Services and Consumer Discretionary sectors (Exhibit 5).

### Exhibit 5: Technology-Linked Exposure In Major Regional Equity Markets.



Source: MSCI. Data as of 2020. \*Technology-related industries are information technology hardware, software and services, internet retail, interactive media. Exposures based on MSCI country indices. EMEA is Europe, Middle East and Africa.

China and the U.S., for example, have around 40% to 50% of their domestic market in information technology hardware, software and services, internet retail and interactive media. This stands well in excess of the 10% to 15% across these same segments in Europe and Japan. Though value-oriented regions have led the global equity rally over recent months, we would therefore expect the ongoing U.S.-China technology rivalry to further fuel longer-term strength in these growth markets of the future.

In the end, the era of great power competition between the U.S. and China is in full bloom, and will be a defining market/investment characteristic for the foreseeable future given the economic weight of both nations. Bilateral friction will be a frequent source of market volatility but also a catalyst for long-term investment opportunities in tech-related sectors like 5G, artificial intelligence, industrial robots, cloud computing, renewable energies and related activities.

#### THOUGHT OF THE WEEK

### Fed A Seller Of Corporate Paper—But Plenty Of Other Buyers

*Matthew Diczok, Managing Director and Head of CIO Fixed Income Strategy*

On June 2, 2021, the Fed announced its intention to sell down the corporate bond and exchange-traded funds (ETF) portfolio of the Secondary Market Corporate Credit Facility (SMCCF) back into the market.<sup>2</sup> The SMCCF was a Fed emergency lending facility initiated during the depths of the coronavirus crisis that intended to add liquidity to the U.S. corporate bond markets. It closed on December 31, 2020, and while it was not used in very large size, just the establishment of the SMCCF was key to keeping the fixed income markets functioning. It immediately helped stem the bank-run risk the corporate market upon announcement, from our perspective.

The Fed emphasized that sales from the SMCCF would be “gradual and orderly,” hoping to prevent any volatility in markets. Given the Fed’s inability to wind down other asset purchase programs successfully—the Fed’s shrinking balance sheet and tighter monetary

<sup>2</sup> [federalreserve.gov](https://www.federalreserve.gov) (“Federal Reserve Board announces plans to begin winding down the portfolio of the Secondary Market Corporate Credit Facility,” 2 June 2021.), [newyorkfed.org](https://www.newyorkfed.org).

policy helped slow the global economy in 2018—there was some skepticism in markets that this program could be successfully unwound with minimal market impact.

We are not skeptical. The size and scope of the SMCCF is not comparable to other programs, and we view the wind-down as a positive sign that credit markets—quite obviously, at this point—do not need any additional purchases or direct support from the Fed, in our opinion.

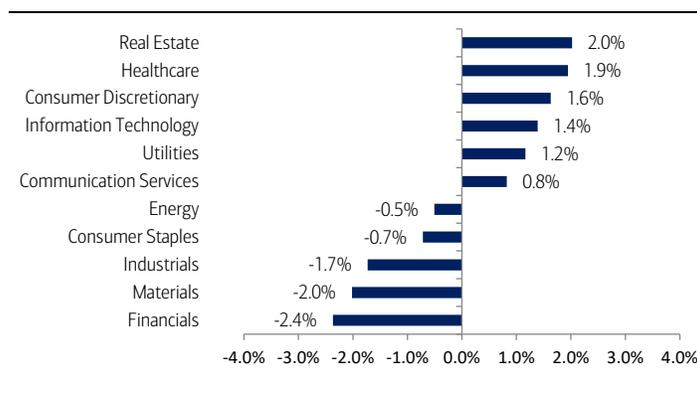
For context, within the SMCCF, the Fed owns approximately \$5 billion of corporate paper with less than five years to maturity in a market that trades more than five times that much (~\$27 billion) in a single trading day. The Fed's ETF holdings (<\$9 billion) are similarly *de minimis*. The size of the SMCCF is a drop in the bucket in both relative and absolute terms—for comparison, at its current pace, the Fed is buying \$1.4 trillion of Treasuries and mortgage-backed securities (MBS) annually. This wind-down is largely a non-issue, from our point of view. Spreads are not moving wider, and we do not expect them to based upon this program being sold down.

## MARKETS IN REVIEW

### Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	34,479.60	-0.8	-0.1	13.7
NASDAQ	14,069.42	1.9	2.4	9.5
S&P 500	4,247.44	0.4	1.1	13.8
S&P 400 Mid Cap	2,752.17	0.9	0.9	19.9
Russell 2000	2,335.81	2.2	3.0	18.7
MSCI World	3,012.67	0.5	1.3	12.8
MSCI EAFE	2,365.55	0.3	1.4	11.6
MSCI Emerging Markets	1,381.99	0.1	0.5	7.8

### S&P 500 Sector Returns



Sources: Bloomberg, Factset. Total Returns from the period of 6/7/2021 to 6/11/2021. <sup>1</sup>Bloomberg Barclays Indices. <sup>†</sup>Spot price returns. All data as of the 6/11/2021 close. **Past performance is no guarantee of future results.**

### Asset Class Weightings (as of 6/1/2021)

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.

### Fixed Income<sup>†</sup>

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	1.36	0.63	0.80	-2.17
Agencies	0.68	0.23	0.29	-0.62
Municipals	0.92	0.45	0.66	1.45
U.S. Investment Grade Credit	1.45	0.47	0.60	-1.71
International	2.04	0.87	1.10	-1.78
High Yield	3.88	0.50	0.78	3.04
	Current	WTD	MTD	YTD
90 Day Yield	0.02	0.01	0.00	0.06
2 Year Yield	0.15	0.14	0.14	0.12
10 Year Yield	1.45	1.55	1.59	0.91
30 Year Yield	2.14	2.23	2.28	1.64

### Commodities & Currencies

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Commodities				
Bloomberg Commodity	202.82	0.3	2.3	21.7
WTI Crude \$/Barrel <sup>††</sup>	70.91	1.9	6.9	46.1
Gold Spot \$/Ounce <sup>††</sup>	1877.53	-0.7	-1.5	-1.1
	Current	Prior Week End	Prior Month End	2020 Year End
Currencies				
EUR/USD	1.21	1.22	1.22	1.22
USD/JPY	109.66	109.52	109.58	103.25
USD/CNH	6.40	6.39	6.37	6.50

### Economic & Market Forecasts (as of 6/11/2021)

	Q4 2020A	2020A	Q1 2021A	Q2 2021E	Q3 2021E	Q4 2021E	2021E
Real global GDP (% y/y annualized)	-	-3.2	-	-	-	-	6.0
Real U.S. GDP (% q/q annualized)	4.3	-3.5	6.4	10.0	9.0	5.0	7.0
CPI inflation (% y/y)	1.2	1.2	1.9	4.7	4.7	4.5	3.9
Core CPI inflation (% y/y)	1.6	1.7	1.4	3.6	3.9	3.9	3.2
Unemployment rate (%)	6.7	8.1	6.2	5.8	4.9	4.2	5.3
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	1.44	1.65	1.90	1.90
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	107	110	113	113
Oil (\$/barrel, avg. of period, WTI <sup>**</sup> )	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.

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A = Actual. E\* = Estimate. S&P 500 represents the year-end target for 2021. <sup>\*\*</sup>West Texas Intermediate. Sources: BofA Global Research; GWIM ISC as of June 11, 2021.

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**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.

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