The Weekly Letter

JANUARY 31, 2017

GWIM Chief Investment Office

GWIM Investment Strategy Committee

Consumer, USA: The dominant role of consumers in the U.S. economy naturally leads to the question, "Is the consumer healthy?" While uncertainty swirls around the economy at present, notably around policy expectations, it's evident that the U.S. consumer generally is employed, wealthier and increasingly confident. What's more, these measures have evolved from indicators of potential strength to drivers of spending. If consumers continue to exercise their strength, there may be powerful implications for extension of the economic expansion.

Markets in Review: Last week equities rose, with the S&P 500 adding 1.0% and international equities, as represented by the MSCI EAFE Index, gaining 1.3%. Bonds were generally flat, with the 10-year Treasury yield at 2.48%, up from 2.47% on Friday of the prior week. Commodities overall, as measured by the Bloomberg Commodity Index, fell 0.4% with internal components mixed. WTI crude rose 1.4% to $53.20 per barrel, while gold fell by 1.6%, to $1,191.30 per ounce.

Looking Ahead: In the U.S., indicators of interest this week gauge the pace of home price appreciation and the strength of the manufacturing sector. In Europe, fourth-quarter real Gross Domestic Product is released.

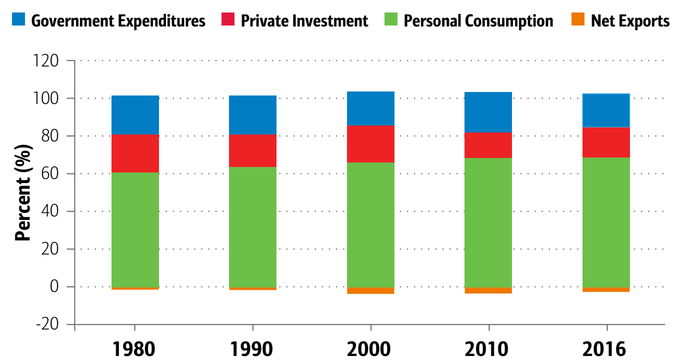
Consumer, USA

As sights are trained on the potential for faster U.S. economic growth, at the foundation of the calculus is the ever-important U.S. consumer.

The extent of the dependence of U.S. economic growth on consumers is difficult to overstate. Personal household consumption accounts for 68% of U.S. gross domestic product (GDP), a figure 10 percentage points above levels for other developed and developing countries.[1] U.S. annualized and seasonally adjusted personal consumption spending was $13 trillion in the fourth quarter of 2016, almost four times government expenditures for the period and twice as high as it was in 2000. Just to highlight its global significance, in 2015 U.S. consumer spending alone was nearly two-and-a-half times the combined GDP of India, Brazil and Mexico![2]

Such dominance naturally leads to the question, "Is the consumer healthy?" While uncertainty swirls around the economy at present, notably around policy expectations, it's evident that consumers are generally employed, wealthier and increasingly confident.

Exhibit 1: Personal consumption dominates U.S. GDP



Source: Chief Investment Office, Bloomberg, Bureau of Economic Analysis.

Nearing full employment

After having endured a harsh financial crisis, the U.S. private sector created over eight million jobs in the last decade. Private sector employment is near record highs, unemployment claims are at record lows, the unemployment rate stands at a nine-year low of 4.7%, and numerous companies can't source enough talent to fill available positions. Job openings were 3.7% of total jobs at year-end, the highest level since collection of the data began in December 2000. Green shoots of wage growth have finally emerged to further brighten an encouraging labor landscape.

[1] The World Bank, Household Final Consumption Expenditure (% of GDP).

[2] The World Bank, GDP Current US$.

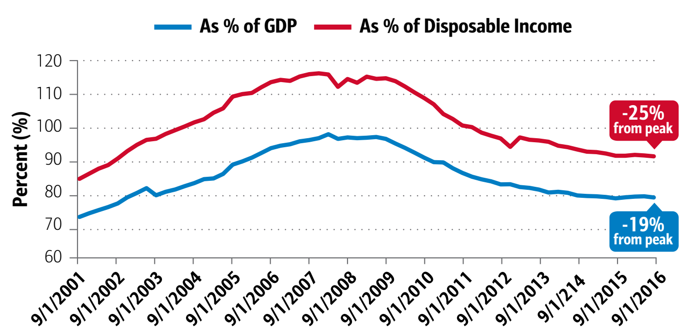
There are, however, aspects of the recovery likely to leave investors feeling less sanguine. Wage growth was stubbornly low until recently, and after accounting for inflation, real wages have been rather stagnant for the past decade. The recovery has also been uneven across regions, industries and levels of worker education. Texas, for example, has produced nearly 24% of the jobs added since 2007, according to the Bureau of Labor Statistics. Some of these variations reflect structural shifts in the economy.

Effectively wealthier

Since the financial crisis U.S. household net worth has been enhanced through strengthening of both sides of the balance sheet—appreciation of financial and real assets and reduction of liabilities.

Unprecedented levels of accommodative monetary policy that followed the financial crisis, including low interest rates and multiple rounds of quantitative easing, contributed to a reflation of risk assets across the globe. From 2009 through 2016, the S&P 500 produced total returns of 194%, the MSCI World ex-US Net Index gained 72%, the Merrill Lynch US Broad Market Bond Index rose 37% and the CoreLogic Case-Shiller National Home Price Index increased 20%. By encouraging the assumption of investment risk with their actions and policies, central banking authorities ended up rewarding asset owners.

Exhibit 2: Household debt is down from 2008



Source: Chief Investment Office, Bloomberg.

While the asset portion of the consumer balance sheet has reflated, the liability side of the ledger has shown considerable decline. According to Bloomberg, as of September 2016 household debt as a percentage of both GDP and disposable income had declined by about 20% from their highs in early 2008 to levels last seen in 2001 (see Exhibit 2). Combined with the drop in interest rates, deleveraging has made debt servicing a lot easier for households.

Accounting for both the steady escalation in asset values and lower relative debt levels, the Federal Reserve reports that Household and Nonprofit Net Worth has risen over 63% from recent lows in 2009. While budding inflation has the potential to erode some purchasing power, many consumers have good reason to feel a bolstered sense of financial empowerment.

Higher levels of confidence

Consumer confidence readings have touched levels not seen in more than a decade. The University of Michigan's Survey of Consumers produced a December sentiment reading of 98.2, marking a 13-year high. Likewise, the Conference Board's Consumer Confidence Index reached a 15-year high in December, propelled in part by a high degree of optimism among older consumers. While markets continue to digest elevated levels of uncertainty and to navigate periods of episodic volatility, the confidence exhibited by consumers seems to be escalating.

Extending the expansion

With consumers having experienced two cataclysmic market shocks over the span of two decades, some lasting effects might be expected. A March 2016 study from the management consulting firm McKinsey & Co. paints a picture of a U.S. consumer more apt to save additional earnings, shop across channels for discounts and abandon brand loyalty in some cases to trade down in price.[3] There also appear to be emerging shifts within patterns of expenditures; spending focused upon experiences has risen while outlays for clothing and certain other goods have decreased. A revival in consumer spending may portend outlays in some areas that have been neglected, including home and luxury goods.

To a large extent, consumers have proven their resilience. They have built upon momentum reflected in measures of their economic optimism, employment status and financial wealth. These measures have evolved from indicators of potential consumer strength to drivers of spending and commerce as optimism has developed into real growth. If consumers continue to exercise their strength, there may be powerful implications for extension of the economic expansion.

Portfolio Considerations: As we continue the transition from secular stagnation to fiscal reflation, the consumer will play an integral role in determining which areas of the economy most benefit from this regime change. On a secular basis, Millennials may support housing and related industries, and their experience-oriented spending could boost areas like travel & leisure. Baby Boomers should continue to drive spending on retirement-related goods and services as well as healthcare. E-commerce would get an extra lift from improving consumer spending as it continues to take share from traditional retailing.

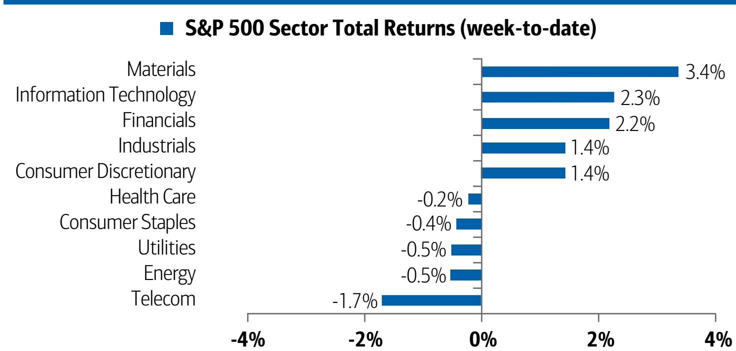
[3] McKinsey & Company, March 2016, "Savings, scrimping, and...splurging? New insights into consumer behavior."

Markets in Review

Trailing Economic Releases

- The U.S. Bureau of Economic Analysis reported that 4th-quarter real Gross Domestic Product (GDP) expanded at a seasonally adjusted annual rate of 1.9% versus the prior quarter. This was below the BofAML Global Research estimate of 2.5%. Personal consumption and investment both contributed 1.7% to the headline number. However, net exports subtracted 1.7%, on giveback after an unusually strong performance last quarter.
- The U.S. Census Bureau reported a 0.4% month-over-month (MoM) decline in Durable Goods Orders for December, below the BofAML Global Research forecast of 2.5% growth. However, a rise of 0.5% in the less volatile measure excluding transportation orders was in line with expectations.
- In the U.K, the Office for National Statistics reported that 4th-quarter real GDP expanded 0.6% on a quarter-over-quarter (QoQ) basis, better than the BofAML Global Research estimate of 0.5%. The data suggests that Brexit has not significantly affected economic performance thus far.

S&P 500 Sector Returns (as of last Friday's market close)



Equities

		Total Return in USD (%)		
	Level	WTD	MTD	YTD
DJIA	20,093.8	1.3	1.8	1.8
NASDAQ	5,660.8	1.9	5.2	5.2
S&P 500	2,294.7	1.0	2.6	2.6
S&P 400 Mid Cap	1,696.7	1.3	2.2	2.2
Russell 2000	1,370.7	1.4	1.0	1.0
MSCI World	1,803.4	1.2	3.0	3.0
MSCI EAFE	1,741.7	1.3	3.4	3.4
MSCI Emerging Mkts	915.9	2.5	6.2	6.2

Fixed Income

		Total Return in USD (%)		
	Yield (%)	WTD	MTD	YTD
ML US Broad Market	2.57	0.0	0.1	0.1
ML 10-Year US Treasury	2.48	0.0	-0.1	-0.1
ML US Muni Master	2.55	0.0	0.4	0.4
ML US IG Corp Master	3.36	0.1	0.3	0.3
ML US HY Corp Master	5.90	0.5	1.4	1.4

Commodities & Currencies

		Total Return in USD (%)		
	Level	WTD	MTD	YTD
Bloomberg Commodity	177.9	-0.4	0.6	0.6
WTI Crude $/Barrel[1]	53.2	1.4	-1.0	-1.0
Gold Spot $/Ounce[1]	1,191.3	-1.6	3.4	3.4
Level	Current	Prior Week End	Prior Month End	2016 Year End
EUR/USD	1.07	1.07	1.05	1.05
USD/JPY	115.10	114.62	116.96	116.96

Source: Bloomberg.[1] Spot price returns. All data as of last Friday's close.
Past performance is no guarantee of future results.

Looking Ahead

Upcoming Economic Releases

- On Tuesday, S&P Case-Shiller is set to release its home price index for November. BofAML Global Research expects year-over-year (YoY) growth of 5.4%. Rising home prices have historically been a tailwind for increased consumption.
- On Wednesday, the Institute for Supply Management reports its January Purchasing Managers Index. BofAML Global Research expects a reading of 55.0, signaling growth in the sector. Meeting this expectation would continue a trend of improvement seen since the first quarter of 2016.
- In the Eurozone on Tuesday, Eurostat is expected to release its preliminary 4th-quarter real GDP figure. BofAML Global Research expects the economy grew 0.4% QoQ. This would mark an acceleration from the prior quarter's advance of 0.3%. Rising growth may serve to reduce political risk as important elections approach in Germany, the Netherlands and France.

BofA Merrill Lynch Global Research Key Year-End Forecasts

S&P 500 Outlook	2017 E
Target	2,300
EPS	$129.00
Real Gross Domestic Product	**2016 E**
Global	3.4%
U.S.	2.1%
Euro Area	1.4%
Emerging Markets	4.6%
U.S. Interest Rates	**2016 E**
Fed Funds (eop)	0.88%
10-Year T-Note (eop)	2.85%
Commodities	**2016 E**
Gold ($/oz-period average)	$1,275
WTI Crude Oil ($/bbl-eop)	$59.00

All data as of last Friday's close.

CHIEF INVESTMENT OFFICE

Christopher Hyzy
Chief Investment Officer
Bank of America Global Wealth and Investment Management

Mary Ann Bartels
Head of Merrill Lynch Wealth Management Portfolio Strategy

Karin Kimbrough
Head of Investment Strategy
Merrill Lynch Wealth Management

Niladri Mukherjee
Director of Portfolio Strategy,
Private Banking & Investment Group (PBIG) and International

Tony Golden
Director

Emmanuel D. Hatzakis
Director

Marci McGregor
Director

Rodrigo C. Serrano
Vice President

John Veit
Vice President

The opinions expressed are those of the Global Wealth & Investment Management (GWIM) Chief Investment Office only and are subject to change. While some of the information included draws upon research published by BofA Merrill Lynch Global Research, this information is neither reviewed nor approved by BofA Merrill Lynch Global Research. This information and any discussion should not be construed as a personalized and individual recommendation, which should be based on your investment objectives, risk tolerance, and financial situation and needs. This information and any discussion also is not intended as a specific offer by Merrill Lynch, its affiliates, or any related entity to sell or provide, or a specific invitation for a consumer to apply for, any particular retail financial product or service. Investments and opinions are subject to change due to market conditions and the opinions and guidance may not be profitable or realized. Any information presented in connection with BofA Merrill Lynch Global Research is general in nature and is not intended to provide personal investment advice. The information does not take into account the specific investment objectives, financial situation and particular needs of any specific person who may receive it. Investors should understand that statements regarding future prospects may not be realized.

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

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

Neither Merrill Lynch nor any of its affiliates or financial advisors provide legal, tax or accounting advice. You should consult your legal and/or tax advisors before making any financial decisions. The investments discussed have varying degrees of risk. Some of the risks involved with equities include the possibility that the value of the stocks may fluctuate in response to events specific to the companies or markets, as well as economic, political or social events in the U.S. or abroad. Bonds are subject to interest rate, inflation and credit risks. Investments in high-yield bonds may be subject to greater market fluctuations and risk of loss of income and principal than securities in higher rated categories. Investments in foreign securities involve special risks, including foreign currency risk and the possibility of substantial volatility due to adverse political, economic or other developments. These risks are magnified for investments made in emerging markets. Investments in a certain industry or sector may pose additional risk due to lack of diversification and sector concentration. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates, and risk related to renting properties, such as rental defaults. There are special risks associated with an investment in commodities, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and the impact of adverse political or financial factors. Income from investing in municipal bonds is generally exempt from federal and state taxes for residents of the issuing state. While the interest income is tax exempt, any capital gains distributed are taxable to the investor. Income for some investors may be subject to the federal alternative minimum tax (AMT).

Past performance is no guarantee of future results.

ARGRKWP5

Merrill Lynch
Bank of America Corporation