Capital Market Outlook

Chief Investment Office

The opinions are those of the author(s) and subject to change.

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MACRO STRATEGY

The big surprise to the markets in 2018 has been the breakdown in synchronized global growth. Policy differences as well as relative vulnerability to the trade war seem to account for the widening differences in national growth rates and stock price performance.

GLOBAL MARKET VIEW

With the United States and China at loggerheads over trade, investors should be aware of the many economic ties binding the two countries. Looking beyond the trade balance, we explore some of the finer points of U.S.-Sino relations and the strategic but little understood competitive advantages for corporate America.

THOUGHT OF THE WEEK

The strength in U.S. equities this year has stood in sharp contrast with weakness in the rest of the world, particularly in emerging markets. How unusual is it for investors to see international markets falling alongside a resilient U.S.?

PORTFOLIO CONSIDERATIONS

U.S. equities remain the global frontrunners, helped by currently solid profit growth and rising economic activity. The rest of the world is playing catch-up. Many of these areas such as the emerging markets are at significant discounts, which is why we maintain a slight overweight.

MACRO STRATEGY

STOCK MARKET SAYS THE U.S. IS WINNING THE TRADE WAR

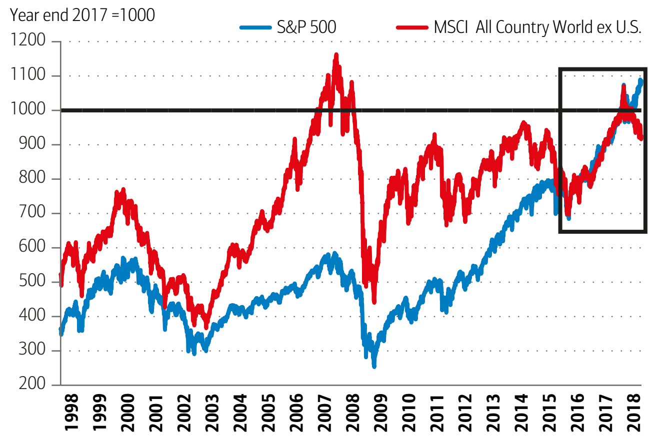
Chief Investment Office Macro Strategy Team

While the U.S. equity market has generally outperformed the rest of the world (ROW) since the 2008 financial crisis, it has surprised investors even more in 2018. Coming into the year, there was a general expectation that the synchronized global expansion that began in 2016 would continue. Under this assumption, most strategists expected markets outside the U.S. to continue their catch-up after a decade of underperformance.

The actuality turned out quite different. Since the spring, U.S. stocks have outperformed those in the rest of the world to a degree not seen since the 1990s (Exhibit 1).

Several factors are behind this big difference in performance between the U.S. market and the rest of the world. An examination of the factors suggests the U.S. could continue to do better for quite a while.

Exhibit 1: U.S. Equities Have Outperformed.



Source: Bloomberg. Data as of September 13, 2018.
Past performance is no guarantee of future results.

U.S. GROWTH DECOUPLES FROM THE ROW

A winter slowdown in Europe and the U.S. was regarded as temporary and due to special factors like severe weather. There was an expectation that come spring, more robust world growth would resume. Equity markets continued in lockstep as can be seen in the January-February market synchronization shown in Exhibit 1. The markets surged in January and began to correct in February. The U.S. and the ROW moved together until early spring.

In the spring, the U.S. economy resumed strong gross domestic product (GDP) growth which eventually topped 4%. In sharp contrast, the slowdown in Europe continued. Recent data show Eurozone GDP moderated a tad to just 1.5% in the second quarter. As recently as early 2017, Eurozone growth was matching or exceeding that in the U.S. and there was a general expectation it would continue around 2%, or so. Recent performance and leading indicators suggest it is heading toward 1% while the U.S. remains closer to 3%. The growth gap has swung sharply in favor of the U.S., helping to explain the stronger relative performance of U.S. equities.

POLICY DECOUPLED

A major reason for the widening growth gap between the U.S. and the ROW is a different policy mix. The U.S. expansion began before Europe's as monetary policy in the U.S. was quicker to adopt unconventional stimulus measures like zero interest rates and quantitative easing, which came much later in Europe. In addition, the European Central Bank (ECB) made a big mistake in 2011 when it prematurely raised rates and the Eurozone lapsed back into recession. More generally, political infighting continues to hamper Europe's response to the crisis and need for more comprehensive financial integration. Of course, political conflict also held back the U.S. expansion as fiscal policy was tightened prematurely in 2013.

For the first time in a decade, the U.S. is enjoying the fruits of both monetary and fiscal stimulus at the same time. Corporate and personal tax cuts have buoyed U.S. demand this year while government-spending increases have also boosted growth. This contrasts sharply with Europe where the conversation is still focused on containing spending and restrictive policies because of inter-country political squabbles, for example, between Italy and the European Union (EU) currently.

There are a host of other examples where Europe's political leadership has held back from pro-growth policies. As a result, country after country in the Eurozone is seeing a slow dissolving of the old political order in favor of more nationalistic, populist politicians. A lack of pro-growth policy and lingering problems from the financial crisis leave Europe's economy on much shakier ground and still stuck in the secular stagnation trap.

In addition to tax cuts and spending increases, deregulation and repatriation incentives have pushed business confidence sharply higher in the U.S. while the lowest unemployment rate in two decades according to the Bureau of Labor Statistics, has raised consumer confidence to levels only seen twice in the past fifty years (1969, 1999). The positive business and growth incentives have caused a surge in corporate profit growth in the U.S., which far outstrips that elsewhere helping to explain the significant outperformance of U.S. stocks.

MONETARY POLICY

Because the economy is much further advanced in its economic expansion and growing more strongly, monetary policy has moved further toward normalization in the U.S. than elsewhere in developed markets. Because the Federal Reserve (Fed) is being cautious and remains accommodative, rate hikes to date have not slowed U.S. growth.

Instead, the impact of higher U.S. rates and a shrinking Fed balance sheet is largely being felt in more vulnerable pockets of the world economy where companies in emerging markets, for example, borrowed dollars when rates where lower and now must refinance at higher rates. This has put a premium on dollar demand and caused emerging market (EM) currencies to falter. This is a potentially destabilizing feedback loop that could become contagious if it continues.

TRADE POLICY

While U.S. fiscal policy was expected to bolster growth in 2018, trade policy moved onto the front burner during the winter and became more of a focus for global markets. As it did, and as it became clear that China is the main country in U.S. crosshairs, its market began to suffer. It's the biggest emerging market and its technology companies are some of the biggest components of EM equity funds.

As Exhibit 1 illustrates, the sharp decoupling between U.S. and ROW equities began in May when China allowed its currency to depreciate sharply against the U.S. dollar (by about 10%). While the trade-weighted dollar has been stronger in 2018 by about 5%, most of that strength has been against the yuan and other emerging market currencies. It has remained fairly stable against major currencies like the yen and euro.

China is having a hard time figuring out how to respond to President Trump's trade demands. Currency depreciation helps buy them time as their economy slows down and their equity market sinks into bear territory. Ironically, the weaker Chinese currency, according to Haver Analytics, (it depreciated 10% in two months, compared to 10% in two years during the 2015-2016 bear market in EM) is a major restraint on U.S. inflation, helping to limit the Fed's need to tighten.

A falling yuan means weaker emerging market currencies and lower commodity prices as we have seen in recent months. This deflationary impulse generally hurts emerging markets because weaker currencies mean it's harder for them to buy commodities priced in dollars or to pay back loans denominated in dollars. Rather than a strong dollar, it's the deliberate devaluation of the yuan by Chinese authorities that is rippling through emerging and commodity markets, creating slower growth abroad.

The combination of a robust U.S. economy and a weaker Eurozone and emerging markets means that the U.S. will be better able to withstand any negative impact of a trade war. The Fed is moving into the phase of the business cycle when it normally worries about an overheating economy. To the extent negative trade war effects slow U.S. growth, they will substitute for the Fed's need to raise rates. Conversely, weakening growth in the ROW means they are more vulnerable to negative shocks than the U.S. This seems to be the message from the equity markets, which as an important leading indicator of economic activity seems to be saying that the U.S. is better positioned to withstand a growing trade conflict.

GLOBAL MARKET VIEW

U.S.-CHINA CHECKLIST: UNDERSTANDING SOME OF THE FINER POINTS OF U.S.-SINO TRADE

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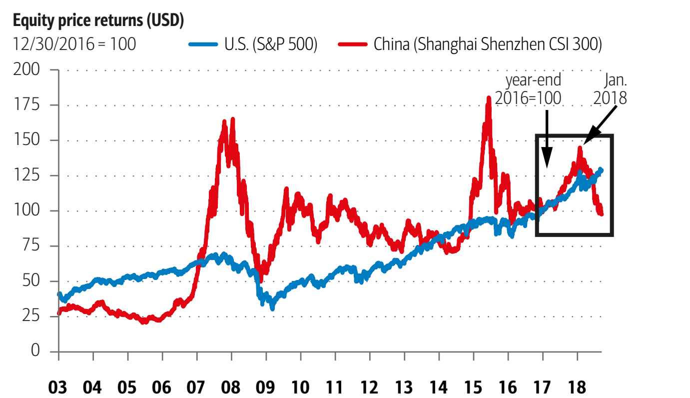
With the United States and China at loggerheads over trade, and with a recent report from AmCham China indicating that trade tensions are hurting the businesses of U.S. firms operating in China, we thought it would be an opportune time to shine additional light on some of the finer points of U.S.-Sino relations.[1]

Before delving into specifics, we continue to believe that U.S.-Sino trade tensions will remain a market irritant over the near term. On the plus side, a full blown trade "war" appears unlikely; however, some damage has already been done—bi-lateral trade tensions have contributed to softer growth in China this year and a bear market in Chinese equities. Thus far, most of the pain emanating from the trade spate has been borne by China, as exhibited by its weaker equity performance this year-to-date (Exhibit 2). But the U.S. is hardly immune, as the following makes clear.

Exhibit 2: U.S. Equities Power Ahead, While China Shares Slide.



Past performance is no guarantee of future results.
Source: Bloomberg. Data as of September 14, 2018.

Things for investors to consider:

One, U.S. investment in China is not as large as most think. China, so goes the consensus, has become the "factory to the world," leaving U.S. workers to flip hamburgers at low wages. Reality is quite different. U.S. foreign direct investment (FDI) into China has climbed during the past decade, but a little perspective is in order. The $79 billion the U.S. sank into China between 2000 and Q1 2018 equated to only 1.8% of total U.S. FDI flows to the world in the same period.[2] U.S. FDI to Ireland, a country slightly larger than West Virginia, was over five times that to China in the same period. On a historic cost basis, China accounts for only 1.8% of total U.S. foreign investment. Translation: China has not attracted as much U.S. investment, absolutely or relatively, as is popularly portrayed.

Two, when it comes to foreign investment, the United States enjoys a huge lead over China. It is no secret that Chinese investors are keen on increasing their direct investment position in corporate America. Next to America's massive trade deficit with the mainland, China's foreign investment in the United States has emerged as a key tension point between the two parties.

When it comes to FDI, however, America enjoys an overwhelming advantage—the U.S. corporate presence in China is orders of magnitude larger than China's presence in the United States. In 2017, U.S. foreign investment in China (on a historic cost basis) totaled $107.6 billion, while China's investment stake in the U.S. was just $39.5 billion—the latter

[1] Source: American Chamber of Commerce in China, "Impact of U.S. and Chinese Tariffs on American Companies in China," September 13, 2018.

[2] Source: Bureau of Economic Analysis. Data as of September 2018.

was a fraction (37%) of the former. In other words, setting aside trade for the moment, U.S. firms enjoy greater access to the Chinese market than their Chinese counterparts do to the United States. This investment gap represents a strategic but little understood competitive advantage for corporate America.

Three, consumers are what U.S. firms are really after in China. Contrary to popular opinion, access to the Chinese consumer—not workers—remains a key motivation for U.S. firms entering China. Keep in mind that China is not a unified market of 1.4 billion people, but a collection of markets with different dialects, varying levels of development and disparate per capita incomes. These variables, along with the brand sensitivity of Chinese consumers, intense foreign and local competition, and many other factors, dictate that American firms adapt to local tastes and operate on the ground. In China, customer proximity is key.

Accordingly, based on the latest figures provided by the Bureau of Economic Analysis (BEA), 83% of total sales by U.S. majority-owned foreign affiliates in China in 2016 (the last year of available data) went to the local market—substantially more than the global norm of 59%. Only 5.9% of U.S. foreign affiliate sales in China were for export to the U.S.

Fourth, what "Made in China" really means. The mainland has emerged as an exporting powerhouse, with "Made in China" the most ubiquitous signature in the world. That said, lost on many folks is that a great deal of what China exports to the United States and the world are goods from so-called "foreign-invested enterprises"—not Chinese companies, but subsidiaries of global multinationals.

The contribution of foreign-invested enterprises to China's export ascendancy is nothing short of staggering. From 1985 through 2017, aggregate exports of foreign-invested enterprises grew from about 1% of China's total exports to more than 40%. And the share of exports to the U.S. coming from foreign-invested enterprises in China is even larger, estimated to be 60%.[3] Because of this surge, "Made in China" does not mean what most people think. Thousands of low-cost Chinese firms are not flooding the U.S. market with goods, displacing U.S. workers in the process. Rather, foreign firms are increasingly leveraging low-cost China to their competitive advantage.

Take the iPhone, for example. While final assembly of the iPhone X by contract manufacturers occurs in China, the parts are sourced from a wide range of suppliers around the world. Touchscreens from Japan, memory chips from South Korea and Japan, and other components from the U.S., Europe and Taiwan make up the bulk of the component costs, while the final assembly done in China represents just 3% to 6% of the total manufacturing cost. With total materials costing $370 versus a $999 price tag for consumers, the bulk of the profits flow to Apple, yet the product—and many others like it—bear the familiar "Made in China" logo and shipments to U.S. consumers count as Chinese exports to America.[4]

Fifth, the U.S. trade deficit with China is a dangerous scorecard. Much has been made of China's trade surplus in goods with the U.S., which topped $375 billion in 2017. That's a large figure, to be sure, but it does not accurately reflect the true nature of bilateral commerce between the two nations. Local sales of goods and services by U.S. foreign affiliates operating in China are missing from the equation. These sales totaled $307 billion by our estimates—well above the U.S. exports of goods and services to China ($188 billion) in the same year. In 2017, U.S. goods exports were $130 billion. In terms of trade in services, the U.S. actually posted a trade surplus with China, with exports of $58 billion and imports of $17 billion, according to Bureau of Economic Analysis.

Against this backdrop, the trade figures alone—the favorite benchmark of global commerce—underreport and misrepresent the true balance of commerce between the U.S. and China. The primary means by which U.S. firms deliver goods and services to China is missing from the debate. China does sell more to the U.S., but not by the lopsided margin some might suppose.

Sixth, capital remains China's top export to the United States. While the mainland's exports to the United States run the gamut from Barbie dolls to footwear to computers, China's most important export to the United States may be capital. Or more to the point: U.S. dollars.

Lost on many legislators in Washington is this simple yet critical fact: China not only provides U.S. consumers with low-cost, high-quality goods, it also provides the capital to purchase such goods by recycling greenbacks earned from trade back into U.S. Treasuries and other dollar-denominated assets. China remains the largest holder of U.S. Treasury securities, holding some $1.2 trillion as of June 2018.[5] Should the United States opt to escalate its trade conflict with China, it may be cutting off a key source of foreign capital—something the world's largest debtor nation can hardly afford.

3 Peterson Institute for International Economics, "Trump Tariffs Primarily Hit Multinational Supply Chains, Harm U.S. Technology Competitiveness," May 2018. Data for 2014.

4 Source: IHS Markit. Data as of November 2017.

5 Source: U.S. Department of the Treasury.

Finally, the mainland remains an unlikely source of U.S. profits. The lopsided nature of U.S.-Sino trade gives the impression that all the benefits go to the Chinese. We believe that is simply not true. One of the best-kept secrets on Wall Street is that U.S. firms are making tidy sums of money in the Middle Kingdom.

Data on foreign affiliate income from the BEA corroborate these findings. U.S. foreign affiliate income in China rose from $1.2 billion in 2000 to $13.4 billion in 2017. Affiliate income jumped 11% from the year before. China is among the most profitable emerging markets in the world for U.S. companies. Add U.S. affiliate income earned in Hong Kong, and the total is double the earnings of U.S. affiliates in Germany and France, combined.

The bottom line: These many strategic linkages between the U.S. and China require close attention on the part of investors. While some may associate China's large and growing trade surplus in goods with the U.S. as a key competitive advantage for China, there are several other modes through which global companies reach consumers, including sales abroad by their foreign affiliates. What's more, U.S. multinationals' operations abroad are diverse, with China representing a small share of corporate America's outward direct investment. These factors underscore the dynamism and competitiveness of U.S. companies and may help explain the resilience of U.S. large cap stocks despite ratcheting trade tensions between the U.S. and China.

THOUGHT OF THE WEEK

IS IT UNUSUAL FOR U.S. EQUITY STRENGTH TO DEFY WEAKNESS ABROAD?

Ehiwario Efeyini, Senior Vice President and Senior Market Strategy Analyst

In a word, no. Emerging equities (in USD terms) crossed the -20% threshold into bear market territory this month, and since the launch of the MSCI EM index in 1988 we count five other periods of prolonged weakness for the asset class outside the three U.S. recessions of 1990, 2001 and 2008. In three of these five periods, U.S. markets rose. (Exhibit 3)

In 1994, accumulated Federal Reserve (Fed) interest rate hikes and a collapse in the Mexican peso led to extreme weakness across Latin America and emerging markets more broadly. But both U.S. and European markets were flat to higher. Developed markets also rallied through much of the 1997-1998 Asian crisis, even as currency pegs broke in Thailand, Korea, Indonesia, Malaysia and the Philippines. The U.S. would only sell off in the second half of '98 after Russia's default led to the collapse of systemically important U.S. hedge fund Long-Term Capital Management (LTCM). And U.S. markets also soared by 44% between 2012 and 2014, even as emerging markets suffered three rolling corrections on the back of falling commodity prices and the start of Fed tapering. Only on two other occasions did all three markets fall together. The euro crisis of 2011 caused a global selloff, primarily in Europe itself but also in the U.S. and emerging markets. While China's dwindling currency reserves and exchange rate shift were also major hurdles for developed market equities in 2015 (Exhibit 3).

We therefore should not be too surprised to see large falls in emerging markets next to a more resilient U.S. It has happened in the past. What has been more unusual this year

Exhibit 3: Rallying While EM Falls.
Six Major Drawdowns in Emerging Markets Outside U.S. Recessions Peak-to-Trough

EM drawdown period	Macro drivers	EM	U.S.	Europe
September 1994 – March 1995	Higher U.S. rates, Mexican peso crisis	-32.6%	2.5%	-0.8%
July 1997 – September 1998	Asian crisis, Russia default	-58.6%	8.0%	14.8%
May 2011 – October 2011	Euro crisis	-31.1%	-17.4%	-31.5%
March 2012 – December 2014	Commodity weakness, Fed tapering	-15.7%	44.0%	14.9%
April 2015 – January 2016	China reserve decline, exchange rate shift	-35.5%	-11.6%	-21.1%
January 2018 – present	Higher U.S. rates, dollar strength, trade policy	-21.2%	0.5%	-12.9%

Sources: Bloomberg, Chief Investment Office. Indices are MSCI Emerging Markets, MSCI Europe, S&P500. Price indices in USD terms.
Peak-to-trough dates are: 9/16/94 – 3/9/95, 7/9/97 – 9/10/98, 5/2/11 – 10/4/11, 3/2/12 – 12/16/14, 4/28/15 – 1/21/16, 1/26/18 – 9/11/18.
Past performance is no guarantee of future results. Data as of September 11, 2018.

is that Europe has weakened alongside emerging markets without the U.S. participating. Europe, of course, has its own internal challenges from sovereign stress in Italy, Brexit and higher (though still moderate) exposure to weakening EM assets in its largest sector, financials. But unlike the 2011 euro crisis, these so far appear localized and not systemic.

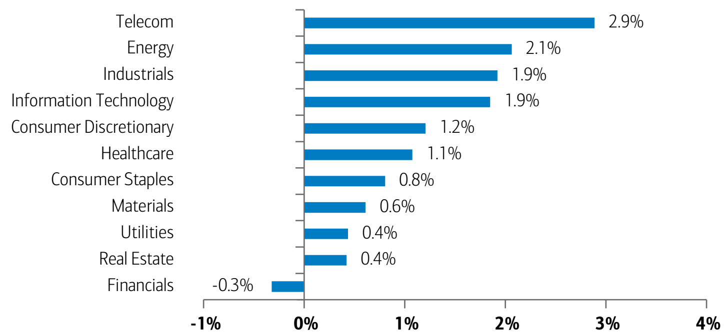
So looking back over the past 30 years, how could international weakness ultimately give way to a major U.S. selloff? This has typically required liquidity risk for the U.S. financial system (LTCM in 1998), or a systemic shock to a large economy (the Eurozone in '11, China in '15). Slower growth abroad and localized emerging market currency crises brought about by policy errors, higher U.S. rates and dollar strength have, on their own, not typically been enough.

MARKETS IN REVIEW

Equities

		Total Return in USD (%)		
	Current	WTD	MTD	YTD
DJIA	26,154.67	0.9	0.8	7.6
NASDAQ	8,010.04	1.4	-1.2	16.9
S&P 500	2,904.98	1.2	0.2	10.2
S&P 400 Mid Cap	2,046.56	1.0	0.2	8.9
Russell 2000	1,721.72	0.5	-1.0	13.1
MSCI World	2,166.59	1.4	-0.3	4.5
MSCI EAFE	1,939.02	1.8	-1.1	-3.4
MSCI Emerging Mkts	1,028.53	0.6	-2.5	-9.5

S&P 500 Sector Returns



Fixed Income[1]

		Total Return in USD (%)		
	Current	WTD	MTD	YTD
Corporate & Government	3.37	-0.1	-0.6	-1.8
Agencies	2.99	-0.2	-0.4	-0.5
Municipals	2.79	-0.2	-0.5	-0.2
U.S. Investment Grade Credit	3.42	-0.1	-0.6	-1.5
International	4.05	0.1	-0.4	-2.4
High Yield	6.22	0.5	0.3	2.3
	Current	Prior Week End	Prior Month End	2017 Year End
90 Day Yield	2.09	2.10	2.06	1.32
2 Year Yield	2.78	2.71	2.63	1.89
10 Year Yield	3.00	2.94	2.86	2.41
30 Year Yield	3.13	3.10	3.02	2.74

Commodities & Currencies

		Total Return in USD (%)		
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	170.50	-0.1	-1.4	-5.3
WTI Crude $/Barrel[2]	68.99	1.8	-1.2	14.2
Gold Spot $/Ounce[2]	1,193.50	-0.2	-0.7	-8.4
Currencies	Current	Prior Week End	Prior Month End	2017 Year End
EUR/USD	1.16	1.16	1.16	1.20
USD/JPY	112.06	110.99	111.03	112.69
USD/CNH	6.87	6.87	6.85	6.51

Source: Bloomberg, Factset. [1] Bloomberg Barclays Indices. [2] Spot price returns. All data as of the 9/14/18 close. **Past performance is no guarantee of future results.**

Asset Class Weightings (as of 7/11/18)

	Negative		Neutral		Positive
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	●				
Cash	We are neutral				

Economic and Market Forecasts (as of 9/14/18)

	Q1 2018A	Q2 2018A	Q3 2018E	2016A	2017A	2018E	2019E
Real global GDP (% y/y annualized)	–	–	–	3.1	3.8	3.8	3.8
Real U.S. GDP (% q/q annualized)	2.2	4.2	3.4	1.6	2.2	2.9	2.7
CPI inflation (% y/y)	2.3	2.6	2.6	1.3	2.1	2.5	2.1
Core CPI inflation (% y/y)	1.9	2.2	2.3	2.2	1.8	2.2	2.4
Unemployment rate(%)	4.1	3.9	3.8	4.9	4.4	3.9	3.4
Fed funds rate, end period (%)	1.63	1.88	2.13	0.63	1.38	2.38	3.13
10-year Treasury, end period (%)	2.74	2.86	3.15	2.44	2.41	3.25	3.35**
S&P 500, end period	2641	2718	–	2239	2674	3000	–
S&P earnings ($/share)	37	40*	40	118	132	159	170
U.S. dollar/euro, end period	1.23	1.17	1.12	1.05	1.20	1.14	1.20
Japanese yen/U.S. dollar, end period	106	111	114	117	113	112	105
Oil ($/barrel), end period	65	74	62	54	60	63	69[1]

Figures represent economic and market data and forecasts provided by BofA Merrill Lynch Global Research. **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 / *Estimate for Q2 2018 / **Estimate for Q2 2019.

[1] Forecast represents a period average

Sources: BofA Merrill Lynch Global Research; Global Wealth & Investment Management Investment Strategy Committee.

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.

MSCI All Country World is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. The MSCI ACWI is maintained by Morgan Stanley Capital International (MSCI), and is comprised of stocks from both developed and emerging markets.

The Standard & Poor's 500 (S&P 500) is an American stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500 index components and their weightings are determined by S&P Dow Jones Indices.

MSCI Emerging Markets Index captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 832 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

IMPORTANT DISCLOSURES

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Investing involves risk, including the possible loss of principal. 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.

Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment performance.

It is not possible to invest directly in an index.

Asset allocation, diversification, dollar cost averaging and rebalancing do not ensure a profit or protect against loss in declining markets. Dollar cost averaging involves continual investment in securities regardless of fluctuating price levels; you should consider your willingness to continue purchasing during periods of high or low price levels.

Past performance is no guarantee of future results.

Investing in fixed-income securities may involve certain risks, including the credit quality of individual issuers, possible prepayments, market or economic developments and yields and share price fluctuations due to changes in interest rates. When interest rates go up, bond prices typically drop, and vice versa. 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).

Investments focused in a certain industry may pose additional risks due to lack of diversification, industry volatility, economic turmoil, susceptibility to economic, political or regulatory risks and other sector concentration risks.

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 risks related to renting properties, such as rental defaults.

Nonfinancial assets, such as closely-held businesses, real estate, oil, gas and mineral properties, and timber, farm and ranch land, are complex in nature and involve risks including total loss of value. Special risk considerations include natural events (for example, earthquakes or fires), complex tax considerations, and lack of liquidity. Nonfinancial assets are not suitable for all investors. Always consult with your independent attorney, tax advisor, investment manager, and insurance agent for final recommendations and before changing or implementing any financial, tax, or estate planning strategy.

Investments in tangible assets are highly volatile and are speculative. 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.

Alternative Investments such as private equity funds, can result in higher return potential but also higher loss potential. Changes in economic conditions or other circumstances may adversely affect your investments. Before you invest in alternative investments, you should consider your overall financial situation, how much money you have to invest, your need for liquidity, and your tolerance for risk.

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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).

Investing directly in Master Limited Partnerships (MLP's), foreign equities, commodities or other investment strategies discussed here, may not be available to, or appropriate for, Merrill Edge clients. However, these investments may exist as part of an underlying investment strategy within exchange-traded funds (ETF's) and mutual funds, which are available to Merrill Edge clients.

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