

Capital Market Outlook

Chief Investment Office



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DECEMBER 10, 2018

IN THIS ISSUE

MACRO STRATEGY

U.S. growth has surprised the consensus to the upside in 2018, while inflation rolled over on the back of persistent Federal Reserve (Fed) tightening. This “Goldilocks” scenario sets the stage for another year of economic growth in 2019, when the current expansion would become the longest in U.S. history.

GLOBAL MARKET VIEW

From agriculture to aerospace, life sciences to logistics, energy to entertainment, think of the U.S. economy as a hydra-headed superpower with the wherewithal to withstand various headwinds (trade tensions, stronger dollar, rising interest rates, etc.) like no other economy. The markets have not come around to recognizing America’s underlying strengths amid a whirl of challenges.

THOUGHT OF THE WEEK

The mild inversion in the belly of the yield curve is yet another sign telling the Fed that it may be closer to a neutral policy stance than it thinks. The Fed should listen; recent disinflation provides a good excuse to pause and help extend the recovery.

PORTFOLIO CONSIDERATIONS

We continue to maintain our favorable view on equities and would continue to have a higher allocation in shorter-dated fixed income (inclusive of cash) relative to longer duration. Within equities, we maintain our higher-quality bias with a preference for the U.S., and we are still neutral on commodities and non-U.S. developed markets, given Europe’s political and economic headwinds.

MACRO STRATEGY

GOLDILOCKS LIKELY TO EXTEND INTO 2019

Chief Investment Office Macro Strategy Team

Our view of a “Goldilocks” economy this year, characterized by strengthening but not overheating growth and inflation, has been validated. As past correlations indicated, surging consumer and business sentiment to almost 20-year highs were followed by a meaningful acceleration in real gross domestic product (GDP) growth to just above 3%, led by sizzling real consumer-spending growth averaging around 4% in the summer and fall. While housing has suffered stronger-than-expected headwinds from rising interest rates, real business investment growth accelerated to an average of around 7%, helped by surging revenues and earnings as well as favorable lending conditions.

Indeed, although the trade-weighted dollar index strengthened more than expected, restraining commodity prices as well as

global trade and manufacturing activity, global growth has remained firm. This, combined with a slight inflation pickup, has helped boost S&P 500 revenues by about 9% through the third quarter. With cost increases generally lagging the surge in revenues, margins increased and profits accelerated. Pre-tax GDP-based profits rose 8% in the first three quarters of 2018 from the same period last year, while after-tax profits expanded 17%. In this context, it’s not surprising that employment growth kept surprising the consensus to the upside and average hourly earnings growth accelerated to 3.2% by November, in line with our view of an acceleration to 3.5% growth in 2019.

Inflation has remained tame, however, and to quote our September 4, 2018 Capital Market Outlook (CMO) Fed Closer to Neutral Than it Thinks, “Conditions for excessive Fed tightening and further yield-curve flattening or inversion are not in place yet. The economic growth outlook and aggregate wage growth remain consistent with a low probability of recession and benign

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Data as of 12/10/2018 and subject to change.



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credit conditions into late 2020.” Basically, we believe that the likelihood of a prolonged “Goldilocks” expansion increased, as the lagged effects of cumulative rate hikes to date take steam out of the economy, reducing the risk of overheating and the need for more Fed restraint ahead.

That said, the “theoretical” probability of recession can differ from the “observed” probability if the Fed over tightens. Indeed, despite uncertainty about the precise neutral rate at this stage of the expansion and the Fed apparently still looking for it, there are increased signs that we are already close to neutral. The yield-curve spread has declined further below average, volatility has increased to its long-term average from subdued early-year levels, and the dollar has strengthened, tempering inflation pressures. Home-buying conditions have deteriorated, another indication that the Fed is already taking steam out of the economy.

While consumer fundamentals remain extremely solid and strong confidence levels indicate 3% GDP growth will continue into 2019, the correlation between real consumer spending and home-buying sentiment doesn’t suggest an exuberant consumer-sector ahead. If past correlations are any indication, housing affordability, homebuilding and home sales may have weakened enough to prevent overheating in consumer spending despite possible bouts of strength spurred by better-than-expected 2019 real personal income in light of lower gasoline prices, tax cuts and sustained strong employment.

With a long lag, housing-related softness also tends to restrain small businesses’ sales and earnings, as well as the share of businesses raising worker compensation. The surge in the latter over the past year got markets worried about runaway wage growth and inflation, so its recent rollover should help defuse such fears ahead. Notwithstanding leading signals for strong employment over the next few months, in our view a peak in small businesses’ hiring plans is likely as 2019 progresses. In other words, shorter-lead signals suggest strong and possibly accelerating employment growth through spring 2019, but longer-term downside pressures from cumulative Fed hikes to date are also poised to kick in, likely tempering employment growth to some extent. As a result, we do not exclude the possibility for the unemployment rate to bottom sooner than generally anticipated. A “not too hot, not too cold” economic environment, headwinds from increased mortgage rates and softening housing activity, as well as increased uncertainty about the economic outlook, are good reasons to reconsider further hikes in our view, and increasingly in the markets’ view.

Although prudent for the Fed to step off the brakes for a while, mixed signals from Fed officials about the path of monetary policy

have heightened fears of a policy mistake, causing financial-market trepidations in recent months. As long as the yield-curve spread was above or closer to its long-term average, we have viewed prior equity-market setbacks as temporary. The recent decline in the spread between the 10-year Treasury and the Fed Funds rate is worrisome, however, since it indicates a broadening view that the Fed is stepping into unnecessarily restrictive territory.

With deflationary pressures still blowing around the world, risking a more serious global growth and inflation downturn would be a grave Fed mistake, in our view, that should be avoided at all costs. Given the risks involved, we expect a more pro-reflationary effort from the Fed to prevail. This implies little additional yield-curve flattening and a peak in the dollar sometime soon—which we assume in our outlook because of our expectations for an imminent Fed pause as well as lagged downside effects from the rising trade deficit.

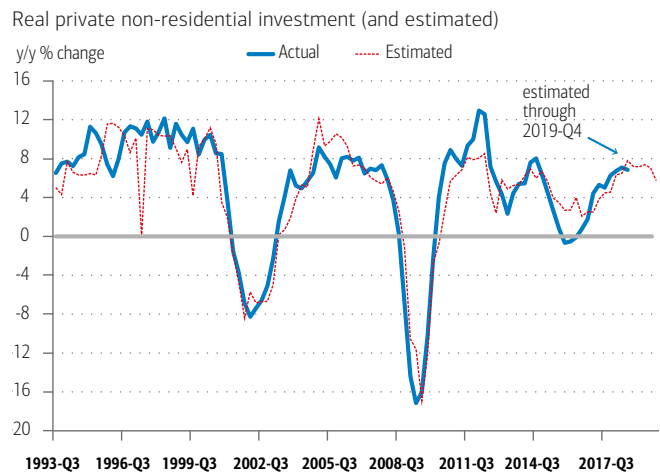
A peak in the dollar would help soften a likely rollover in the manufacturing Institute for Supply Management (ISM) index from its surprisingly strong levels as 2019 progresses, though the impact of tax cuts and deregulation on business sentiment remain underappreciated, keeping risks to this important sentiment indicator to the upside. Given typical correlations, modest softening of the manufacturing ISM index would limit the downside pressure on the earnings revisions ratio and profits growth, as well as on year-to-year equity returns.

Additional Fed hikes and a stronger dollar would endanger our outlook for solid manufacturing activity as well as our expectations for 2019 pre-tax GDP profits growth of about 7% and S&P 500 revenue growth of around 7%. Revenue growth tends to be inversely correlated with credit spreads, so weaker revenues than we assume would worsen credit conditions. Such a combination would pose downside risks to our otherwise firm 7% estimate increase in 2019 real business investment. Basically, a Fed pause is needed soon to assure a milder manufacturing, business investment and revenues growth mini-cycle slowdown compared to those in 2011–2012 and 2014–2016.

The ongoing plunge in manufacturing sentiment, weak credit growth and lower-than-expected Eurozone inflation suggest that the European Central Bank (ECB) has also misjudged the bloc’s growth capacity, likely causing it to postpone the planned start of its rate-hike cycle to prevent a new bout of deflationary pressures. Lower oil prices and some stabilization expected in China should help the global manufacturing slowdown avoid a more serious setback, but downside risks from Europe combined with an overly aggressive Fed would have strong negative impacts on global growth and profits, in our view.

Encouragingly, the yield-curve spread is still at levels consistent with a low probability of recession through early 2020, and there's still time for the Fed to prevent an increase in the probability of recession occurring later in 2020. Swap spreads, which tend to increase substantially before a recession, remain much below average and inconsistent with late-cycle conditions. This tells us that despite current market anxiety, an inflation surge and a Fed-induced recession are unlikely before late 2020, and that our positive outlook for investment, spending, inflation and profits is more likely to play out than not.

Exhibit 1: Investment-led Productivity Rebound Helping Keep Inflation in Check.



Sources: Bureau of Economic Analysis/Haver Analytics, Chief Investment Office
Data as of December 6, 2018.

GLOBAL MARKET VIEW

THE AMERICAN ECONOMY—A HYDRA-HEADED JUGGERNAUT

Joseph P. Quinlan, Head of CIO Market Strategy

Kathryn A. Cassavell, CFA®, Vice President and Market Strategy Analyst

With credit-sensitive sectors like automobiles and housing exhibiting signs of weakness, investors' fears of an impending U.S. recession or earnings swoon are mounting. Compounding matters: simmering U.S.-Sino trade tensions, which have combined with concerns over the future path of interest rates to make for very choppy and volatile capital markets as investors try to discern the economic road ahead.

We have spent plenty of time of late discussing with clients where the U.S. economy is in the cycle. Mid-cycle or late-cycle—no one really knows, but our bias is toward the former. We are more certain of the following: At roughly \$21 trillion, the largest economy ever assembled, the U.S. economy doesn't beat to a single tune. No one sector dictates the pace of growth, drives employment or determines earnings growth.¹

Yes, many sectors/industries are interconnected, with multiplier or knock-on effects. But more broadly speaking, the sophistication and diversification of the U.S. economy is unparalleled. No economy in the world has the range and breadth of capabilities as the United States. From agriculture to aerospace, life sciences to logistics, energy to entertainment, think of the U.S. economy as a hydra-headed superpower with the wherewithal to withstand various headwinds (trade tensions, stronger dollar, rising interest rates, etc.) like no other economy.

¹ Bureau of Economic Analysis. As of 2018.

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This doesn't mean the U.S. economy is recession-proof—far from it. It does mean, however, that investors shouldn't equate weakness in one or two sectors—even housing and autos—with the end of the economic expansion. This thinking is seeping into the psychology of the markets, which we believe is premature and misguided.

Case in point: the U.S. manufacturing sector. While many investors are under the assumption that the U.S. is not in the business of making “stuff” and that America's manufacturing capacity has either been allowed to atrophy or be shipped to low-cost locales like China and Mexico, nothing could be further from the truth.

Simply put, America is a manufacturing superpower. Exhibit 2 highlights America's global share and rankings based on 22 different manufacturing categories, ranging from food and beverages to basic metals to motor vehicles. The numbers come from the United Nations and are based on 2016 data, the last year of available data.²

² United Nations Industrial Development Organization, International Yearbook of Industrial Statistics, 2018.

Exhibit 2: Made in the U.S.: America's Dominating Presence in Global Manufacturing.

PRODUCT DIVISION	2000		2010		2015		2016	
	(% GLOBAL SHARE)	RANK	(% GLOBAL SHARE)	RANK	(% GLOBAL SHARE)	RANK	(% GLOBAL SHARE)	RANK
1 Food products	15.0	2	19.7	1	17.6	1	17.8	1
2 Beverages	15.0	2	16.2	1	16.0	1	15.9	1
3 Textiles	12.2	2	8.4	2	7.1	2	7.1	2
4 Apparel	15.2	2	3.5	9	2.5	10	2.2	10
5 Leather	9.0	3	2.9	7	2.1	9	2.0	8
6 Wood products (ex. furniture)	31.6	1	16.3	1	16.7	2	17.1	2
7 Paper products	25.1	1	23.9	1	22.0	1	21.3	1
8 Printing and reproduction of recorded media	26.9	1	22.7	1	22.9	1	22.4	1
9 Refined petroleum products	10.8	2	18.9	1	18.7	1	17.8	1
10 Chemical products	22.2	1	22.9	1	19.6	2	18.5	2
11 Pharmaceuticals	N/A	--	26.4	1	20.8	1	20.5	1
12 Rubber and plastic products	22.7	1	17.7	1	17.9	1	17.3	1
13 Other mineral products	12.6	2	10.3	2	10.1	2	9.9	2
14 Basic metals	13.9	2	10.8	2	8.9	2	8.7	2
15 Fabricated metal products (ex. machinery)	22.7	1	20.2	1	20.3	1	18.8	1
16 Computer, electronic and optical products	N/A	--	21.1	1	22.9	2	21.7	2
17 Electrical equipment	20.3	2	11.4	4	11.0	4	11.0	4
18 Machinery and equipment	20.7	2	16.6	1	16.2	2	15.1	3
19 Motor vehicles, trailers and semi-trailers	22.9	2	14.0	2	16.8	1	16.7	1
20 Other transport equipment	30.6	1	39.4	1	41.0	1	40.3	1
21 Furniture	20.6	2	21.2	1	21.8	1	21.5	1
22 Other manufacturing	20.6	2	38.3	1	33.9	1	32.7	1

N/A categories not applicable to year 2000. Source: United Nations Industrial Development Organization. Data as of 2018.

Here are some stunning takeaways:

- First, of the 22 categories outlined, the United States ranked first in 12 categories, or more than half of the total. The top ranking of the U.S. runs the gamut from paper products to motor vehicles to aircraft (other transport equipment).
- Second, the U.S. ranked first and/or second in 18 out of the 22 categories, underscoring the manufacturing breadth and competitiveness of American manufacturing. In only four sectors—apparel, leather, electrical equipment, and other machinery and equipment—did the U.S. fail to make the top two.
- Third, while America's global share in some sectors has declined since the start of the century, the U.S.'s share has increased in others, including food, beverages, refined petroleum products, other transport equipment and furniture.
- Fourth, between 2010 and 2016, America's global manufacturing share actually edged higher in a number of sectors, including wood products (ex. furniture), computer and electronics, motor vehicles, other transport equipment, and furniture.
- Fifth and finally, the future of U.S. manufacturing remains relatively bright—notwithstanding the constant drumbeat of negativity from the popular media. Indeed, America's global manufacturing competitiveness continues to improve: According to Deloitte's 2016 Global Manufacturing Competitiveness Index, America's ranking has improved from fourth in 2010 to third in 2013 to second in 2016. By 2020, global CEOs expect the U.S. to retain the top spot from China.³

Beyond various manufacturing activities, think agriculture and energy—two sectors where, again, the U.S. ranks as global powerhouses. Hardly on the screens of most Americans, the U.S. agricultural sector is among the most abundant, varied and tech-driven in the world. No country in the world produces as much food as efficiently as the United States.

Then there is energy, with the fracking revolution over the past decade triggering nothing less than an energy renaissance in the United States. To wit, the U.S. is now the world's largest crude oil producer in the world, topping Russia and Saudi Arabia for the title earlier this year.⁴ In August 2018, U.S. crude oil production topped 11 million barrels per day (b/d) for the first time in history; that's a far cry from the less than 4 million b/d production levels in mid-2008. In addition, last week the U.S. became a net exporter of crude oil and petroleum products for the first time on record, according to U.S. Energy Department data going back to 1973.

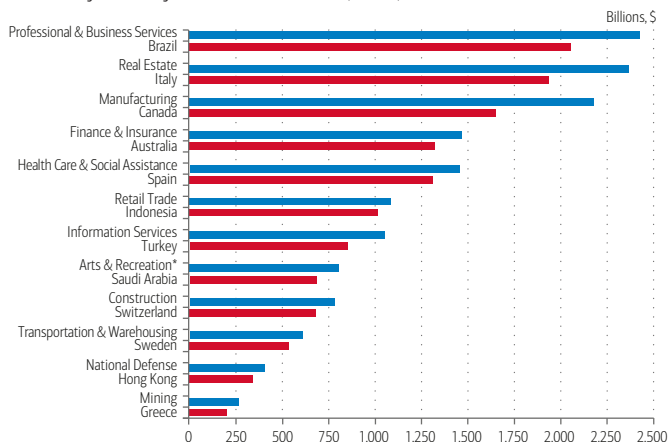
Finally, there are services—yet another dynamic, multi-sector component of the U.S. economy. Think professional and business services, with output totaling nearly \$2.5 trillion in 2017, more output than the entire economy of Brazil (Exhibit 3). And that's just for starters. Finance, real estate, health care, retail, information services, arts and entertainment, transportation—many of these activities produce more annual output than most countries. Such is the dynamic characteristic and range of U.S. services—on a global basis.

³ Deloitte, 2016 Global Manufacturing Competitiveness Index, September 2017.

⁴ U.S. Energy Information Administration. Data as of 2018.

Exhibit 3: Relative Size and Strength of U.S. Industries.

U.S. GDP by Industry vs. Countries' GDP (2017)



*Includes accommodation and food services.
Sources: Bureau of Economic Analysis; World Bank.
Data as of November 2018.

So what does all of the above mean for investors?

It means the following: Because of America's hydra-headed economy, we believe the economy is relatively well-positioned to withstand and move forward next year in the face of mounting headwinds related to trade, a flattening yield curve, soggy growth in Europe and other concerns. The markets have not come around to recognizing America's underlying strengths amid a whirl of challenges. Given the competitive composition of the U.S. economy, we believe the bull market rumbles on, with equity returns in 2019 expected to track earnings growth of 5%-6%.

Investors are hung up on where the U.S. economy is in the cycle. That's important for sure. But even of greater importance is the diversity of U.S. output.

THOUGHT OF THE WEEK

THE YIELD CURVE IS TALKING—IS THE FED LISTENING?

Matthew Diczok, Managing Director and CIO Fixed Income Strategist

The yield curve came back into focus this week as two-year and three-year Treasury rates edged higher than five-year Treasury rates for the first time since 2007. A very slight inversion in this part of the curve would not be particularly important in isolation. However, in the context of other indicators—slowing global growth, weaker inflation, softness in the housing market—it adds another data point to the story that we have written about: The Fed may be closer to the neutral fed funds rate than it realizes. A pause in the rate hike cycle is warranted to allow the Fed time to better gauge the effects of recent monetary policy on the real economy.

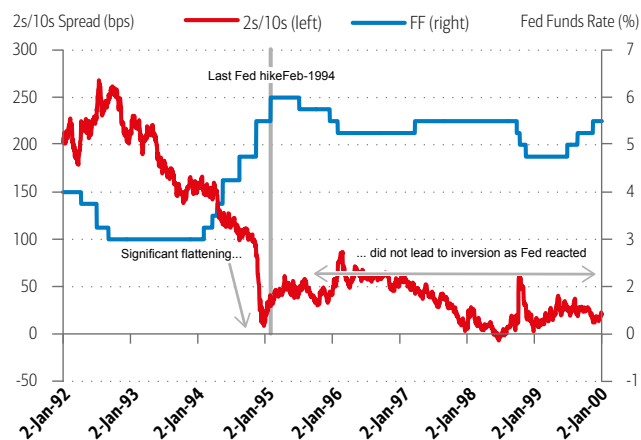
As the yield curve moves exacerbate markets' nervousness, it is important to keep perspective. Significant flattening does not automatically mean that an inversion—and eventually a recession—will follow, provided that the Fed heeds the signals that the market is sending. Even a very aggressive flattening of the curve can be managed by the Fed pausing or—if necessary—cutting rates in order to prolong an expansion.

This was precisely the case in the 1990s. The Fed raised rates 300 basis points (bps) in seven hikes from February 1994 to February 1995. This aggressive hike campaign—doubling the fed funds rate from 3% to 6% in one year—caused a significant sell-off in short-term Treasury yields, similar to what we've witnessed over the last year. This flattened the 2s/10s curve from 100 bps to nothing in less than two months.

Anyone looking simply at the pace and trajectory of the flattening at that time would have taken inversion as a given. Charts are not destiny, however; the Fed's reaction is the key factor. The Fed heeded the message that the yield curve—amongst other indicators—was sending in 1995 and paused, ultimately easing later that year. This prevented any inversion and kept the 2s/10s curve mostly range bound between 0 bps and 50 bps—where it stayed for the rest of the decade. This helped extend the economic expansion that had started in 1991 and lasted until 2001.

Bottom line: The Fed still has both the time and the tools necessary to extend the current expansion. Recent disinflation and market volatility provide a good excuse to pause, and the Fed should listen.

Exhibit 4: Mid-course Policy Correction Prevented Inversion in 1995.



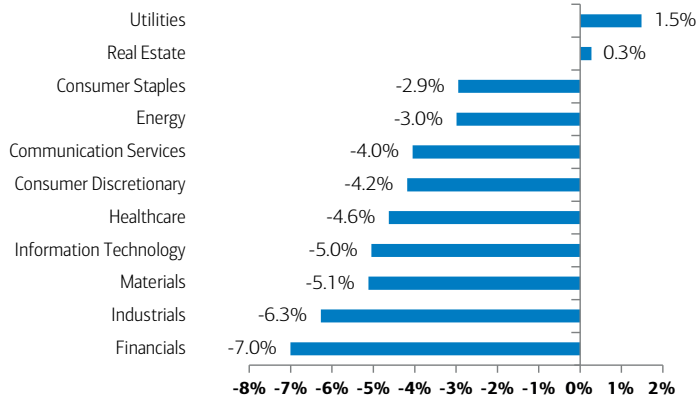
Sources: Bloomberg; Chief Investment Office.
Data as of December 4, 2018.

MARKETS IN REVIEW

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	24,388.95	-4.4	-4.4	0.9
NASDAQ	6,969.25	-4.9	-4.9	2.0
S&P 500	2,633.08	-4.6	-4.6	0.3
S&P 400 Mid Cap	1,780.94	-5.2	-5.2	-4.9
Russell 2000	1,448.09	-5.5	-5.5	-4.6
MSCI World	1,965.24	-3.7	-3.7	-4.9
MSCI EAFE	1,768.48	-2.3	-2.3	-11.4
MSCI Emerging Markets	981.37	-1.3	-1.3	-13.4

S&P 500 Sector Returns



Source: Bloomberg, Factset. Total Returns from the period of 12/03/18 to 12/07/18. Bloomberg Barclays Indices.¹ Spot price returns.² All data as of the 12/07/18 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		

Fixed Income¹

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	3.40	0.9	0.9	-1.4
Agencies	2.93	0.6	0.6	0.5
Municipals	2.75	0.7	0.7	0.8
U.S. Investment Grade Credit	3.44	0.9	0.9	-1.0
International	4.30	0.8	0.8	-3.2
High Yield	7.32	-0.1	-0.1	-0.1

	Current	Prior Week End	Prior Month End	2017 Year End
90 Day Yield	2.34	2.32	2.32	1.32
2 Year Yield	2.71	2.79	2.79	1.89
10 Year Yield	2.85	2.99	2.99	2.41
30 Year Yield	3.14	3.29	3.29	2.74

Commodities & Currencies

Commodities	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Bloomberg Commodity	173.54	1.2	1.2	-3.6
WTI Crude \$/Barrel ²	52.61	3.3	3.3	-12.9
Gold Spot \$/Ounce ²	1,248.35	2.1	2.1	-4.2

Currencies	Current	Prior Week End	Prior Month End	2017 Year End
EUR/USD	1.14	1.13	1.13	1.20
USD/JPY	112.69	113.57	113.57	112.69
USD/CNH	6.89	6.95	6.95	6.51

Economic and Market Forecasts (as of 12/07/18)

	Q1 2018A	Q2 2018A	Q3 2018A	2019E
Real global GDP (% y/y annualized)	-	-	-	3.6
Real U.S. GDP (% q/q annualized)	2.2	4.2	3.5	2.7
CPI inflation (% y/y)	2.2	2.7	2.6	1.6
Core CPI inflation (% y/y)	1.9	2.2	2.2	2.3
Unemployment rate(%)	4.1	3.9	3.8	3.4
Fed funds rate, end period (%)	1.63	1.88	2.13	3.38
10-year Treasury, end period (%)	2.74	2.86	3.06	3.25
S&P 500, end period	2641	2718	2914	2900
S&P earnings (\$/share)	37	41	41*	170
U.S. dollar/euro, end period	1.23	1.17	1.16	1.25
Japanese yen/U.S. dollar, end period	106	111	114	105
Oil (\$/barrel), end period	65	74	73	59 ¹

The forecasts in the table above are the base line view from BofAML Research team. The GWIM may make adjustments to this view over the course of the year.

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 a fair value estimate for 2019. / *Estimate for Q3 2018

¹ Forecast represents a period average

Sources: BofA Merrill Lynch Global Research; Global Wealth & Investment Management (GWIM) 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.

Dow Jones Industrial Average is a price-weighted measure of 30 U.S. blue-chip U.S. companies. The index covers all industries except transportation and utilities.

NASDAQ Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

S&P 500 Index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.

Institute for Supply Management (ISM) is based on surveys of more than 300 manufacturing firms by the Institute for Supply Management (ISM). The ISM Manufacturing Index monitors employment, production, inventories, new orders and supplier deliveries.

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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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