Capital Market Outlook

Chief Investment Office

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MACRO STRATEGY

As we gear up for the holiday season, corporate earnings were once again considered the gift that kept on giving, gauged by third-quarter (Q3) S&P 500 earnings per share (EPS) growth tracking 27% year-over-year (YoY), surpassing even the lofty pace of recent quarters. The results are seemingly more impressive as we unwrap their contents further and examine forward guidance and company management commentary.

GLOBAL MARKET VIEW

One can't help but walk away from Europe worried and concerned. The continent is long on bickering and skepticism and short on unity and solidarity — all of which is threatening the European Union's (EU's) fragile cyclical economic expansion and the global earnings of U.S. multinationals. As Europe's woes accumulate and reach a tipping point, the aftershocks will be felt far and wide.

NOVEMBER GAINS EVAPORATE

Recent equity market weakness has gathered steam again as concerns over economic growth for 2019 continue. Higher short-term interest rates, a widening in credit spreads, and continued trade and tariff sparring between the U.S. and China have all weighed on equity prices in the past week. The high growth, more richly valued areas of the market have declined the most which is exacerbating the weakness in the broader indices. Given the spate of news in the very short-term, we expect uncertainty to remain elevated as we head into December.

In order for investors to turn more positive on the growth prospects for 2019, we believe two specific events need to happen. First, the Federal Reserve (Fed) needs to signal that they have become more dovish as global growth slows down. The Fed doesn't necessarily need to actually pause right away, in our view. However, an adjustment to the communication on downgrading the number of Fed interest rate hikes for 2019 is important. Second, a China – U.S. trade agreement is also imperative. We recognize that a long-term deal is unrealistic but even a short-term "bridge" agreement on tariffs and trade would significantly help investor sentiment around the turn of the year. Caution is warranted, and, yes, economic and earnings growth are slowing, but we do not expect an economic hard landing next year. Once we get through this second phase of weakness, we expect improved investor sentiment and equity returns for 2019 to match the level of corporate earnings growth around 6% for the full year at this point.

MACRO STRATEGY

EARNINGS SEASON: UNWRAPPING THE GIFTS OF Q3

Nick Giorgi, CFA, Vice President, Investment Strategist

As we gear up for the holiday season, corporate earnings were once again considered the gift that kept on giving, gauged by Q3 S&P 500 EPS growth tracking 27% YoY. The results are more impressive as we unwrap their contents further, currently illustrating solid revenue gains, cost containment and sustainability. Forward guidance has also been firm with company management commentary generally reinforcing positive

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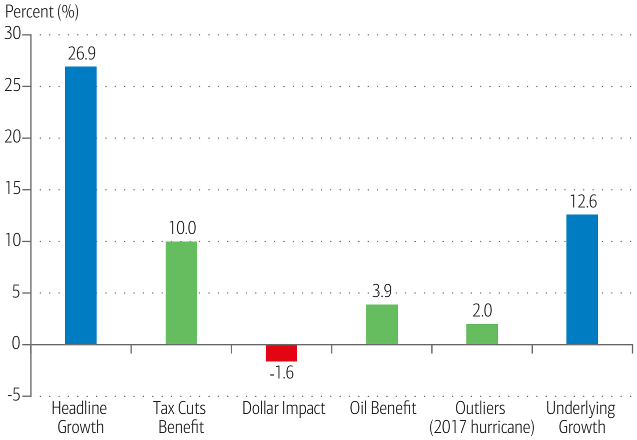
momentum moving forward. While it will be difficult to maintain such a torrid pace of growth, we expect earnings to continue their ascent through future quarters.

This year has succeeded a strong 2017, with companies generating profits at an even more impressive clip. Whereas last year represented the first in which the S&P 500 produced double-digit profit growth since 2011; this year's earnings are tracking at a rate only matched or surpassed during two years since 1990[1]. The Q3 results have been broad, with nine of eleven sectors having contributed double-digit expansion. On a micro level, Information Technology, Communication Services and Utilities have led with the highest proportion of "beats," while Real Estate and Energy have lagged.

As we dig deeper into company releases, the sustainability and quality of corporate earnings appears solid. While more variable or transitory effects like tax reform have helped to boost earnings, the underlying growth rate remains impressive even when these items are stripped away (Exhibit 1). Sales growth for the S&P 500, a pure measure of customer demand less affected by accounting measures, has advanced 8.5% YoY, slightly off from the pace of Q2, although an estimated 1% was sheared off by currency effects, according to BofA Merrill Lynch (BofAML) Global Research. Energy and Real Estate logged the greatest proportion of positive revenue surprises while Utilities were more challenged. Small caps have also enjoyed a strong earnings season, albeit at a slightly weaker and narrower pace than large caps. Of companies having reported, just 30% have beaten both profit and sales expectations. The relative strength for large cap earnings keeps us more favorable on them.

Exhibit 1: Earnings are Robust Even Without Transitory Effects in Q3.



Sources: Federal Reserve; Haver Analytics; FactSet; Bloomberg; Deutsche Bank. Data as of November 2018

NOTES ON GUIDANCE

As we look ahead to 2019 and beyond, we look to commentary from management teams for any clues on the outlook for margins, capital spending and profits. Large cap managements' guidance has come in stronger than its historical average. Capital expenditures (capex) growth in Q3 has decelerated but remains solid, tracking 14%, while capex guidance has weakened, perhaps reflecting lower oil prices and uncertainty surrounding trade. We expect capex for S&P 500 companies to moderate but remain solid over coming quarters, consistent with strong readings on capex intentions from the recent Duke CFO Global Business Outlook survey and the National Federation of Independent Business. While the topic of tariffs has become increasingly prevalent on earnings calls, only about 9% of reporting S&P 500 companies have mentioned a major negative impact so far, with Industrials making up the largest share, according to BofAML Global Research.

Small cap guidance has been relatively weak, with a number of management teams issuing weaker-than-expected outlooks. Despite lower international exposure among small caps from a final demand perspective, smaller companies might have less flexibility in their supply chains suggesting they could face margin pressures from higher input costs if tariffs spread. Small caps also tend to come under pressure from higher rates and diminished momentum in the Manufacturing sector; risks that warrant close attention as the cycle matures.

Despite concern over rising input costs and rates, corporate profitability has continued to improve for Q3, with net profit margins rising to 12% so far versus 11% in Q2. Management teams are beginning to mention margin pressure from higher wages, ranging from restaurant workers to truck drivers. With 7 million job openings and a shortage of skilled workers, we expect companies to leverage automation to supplement their workforces; another tailwind for productivity growth. For instance, a major consumer products company announced plans on its earnings call to leverage digitization/automation to increase productivity amid labor shortages to protect margins. The topic of rising rates is coming up as well, with management teams from a number of industries mentioning plans to refinance and pay down debt. Despite high leverage among S&P 500 companies, interest coverage remains stable at 7.1 times versus its longer-term average of 5.6 times according to FactSet Research Systems, but we expect more companies to fortify their balance sheets as we get later in the cycle.

At the sector level, we monitor the Industrials sector for any early signals of decelerating global demand and margin pressures, and the Consumer sectors for insight on the health

[1] 1994 (42%), 2010 (38%); Bloomberg, November 2018.

of the consumer. Headline earnings per share data have been better than expected for most Industrial companies so far for Q3, but with many companies reporting weaker-than-expected core operating earnings. Revenue growth has decelerated across a number of companies due to slower demand in Europe and Asia, while margins were affected by tariffs, and higher wages, transportation and raw material costs. At the industry level, certain end markets such as housing and autos have been weak, while commercial aerospace has been relatively strong.

In the Consumer sector, commentary has been positive across the food/beverage, apparel and restaurant industries with management teams noting solid organic growth and resilient margins, with many companies raising prices to offset higher costs. With current low unemployment, rising wages and strong consumer confidence, the setup for consumer spending over the holidays and into next year seems to be as strong as ever. Tax refunds in the first half of 2019 (which are estimated to rise $85B[2]) should provide an additional boost to spending on discretionary items as well. Impacts from tariffs and higher input costs have been most pronounced in the appliance and home improvement industries, where some companies noted margin pressure from higher raw material costs, and expectations that tariff costs would rise further next year. We believe margins in industries like furniture and appliances could be disproportionately impacted as they tend to exhibit relatively high price elasticity, suggesting they may struggle to pass higher costs onto customers. We also feel consumer durables in general could face headwinds from rising rates as consumer financing becomes more expensive.

While lower corporate taxes have helped earnings growth this year, we believe the main driver has been strong nominal growth in the economy and rising productivity, which has enabled companies to manage wage pressures more effectively. Going forward, we expect earnings growth to moderate to around 6% – 7% for the S&P 500, consistent with our expected nominal gross domestic product growth of around 5%, and supported by buybacks and fairly stable profit margins. However, we continue to monitor developments on trade/tariffs with China and rising rates and wages, which could hurt companies' bottom lines.

[2] Cornerstone Macro, November 2018.

GLOBAL MARKET VIEW

NEARING A TIPPING POINT IN EUROPE

Joseph P. Quinlan, Head of CIO Market Strategy

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

Rarely has Europe seemed so dysfunctional and discombobulated — with significant implications for corporate America. After three trips to the continent in the past two months, one can't help but walk away worried that the EU is at a tipping point. The continent is long on bickering and skepticism and short on unity and solidarity, all of which is threatening the EU's fragile cyclical economic expansion and the fundamental underpins of the Union.

The woes are multiplying: The United Kingdom's departure from the EU; the bitter divide between Brussels and Italy over the latter's budget deficit; rising political populism along the periphery (Poland and Hungary); the currency crisis in Turkey; the refugee crisis emanating from the Middle East and Africa; the divide between the wealthy north and the stagnant south; the political departure of Angela Merkel—all of these variables have converged to leave Europe confused and confounded, and confronting multiple crises.

And 2019 doesn't look any better — at least in the near term. The United Kingdom is scheduled to depart the EU on March 29, 2019 without any clear road map or exit ramp at this juncture. Meanwhile, with populism gaining strength across the region, the European Parliamentary elections are scheduled for May. At stake are numerous key positions that drive Europe, including new presidents of the European Commission, the European Council and the European Central Bank. The fundamental unity of Europe will be at risk if nationalist candidates/parties fare well in the Parliamentary elections, a prospect that is expected to weigh heavily on investor confidence over the near term. Risks around Brexit and the Parliamentary elections are expected to weigh on both the pound and the euro over the near term, contributing to U.S. dollar strength.

Compounding matters, amid all the political strife, economic growth across Europe has decelerated. Eurozone gross domestic product (GDP) growth in Q3 came in lower than expected by analysts, slowing to 0.2% over the quarter (Exhibit 2). Manufacturing Purchasing Managers Index (PMIs) in Europe have also witnessed a sharp slowdown since peaking at the end of last year. This pullback is in stark contrast to the economic environment in 2017, when annual GDP growth in the Eurozone eclipsed that of the U.S. (2.4% vs. 2.2%).

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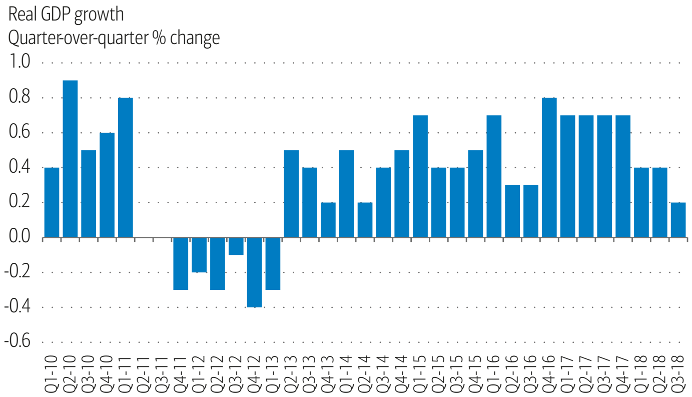
Exhibit 2: Growth in the Eurozone Slows in Q3.



Sources: Eurostat; Haver Analytics. Data as of November 2018.

Additionally, data released last week showed the German economy (the largest in the EU according to Eurostat) contracted in Q3 for the first time since 2015 amid weakness in the auto industry and a slowdown in China. While much of the weakness in the auto sector was cited as temporary, owing to manufacturers' delays in meeting the EU's new emissions standards, a more protracted U.S.-China trade war could have more lasting effects on capital goods producers in the export-dependent region. EU exports of goods and services make up 45% of GDP, while exports from China and the U.S. are a much smaller share (20% of GDP and 12% of GDP, respectively).

All of the above wouldn't be of consequence if Europe didn't matter to the health of the global economy. The fact is, however, it does. Only the U.S. economy, for instance, is larger than the EU: $20.5 trillion nominal U.S. dollars vs. $18.8 trillion, according to International Monetary Fund estimates for 2018. In the same year, the EU economy was some 39% larger than China's. Not only is the EU large, its 500 million consumers rank among the wealthiest in the world, with the EU home to nine of the top 20 nations ranked by per-capita income. Wealth is correlated with highly skilled labor, innovation, a world-class R&D infrastructure and importantly, strong levels of private consumption. In 2016, the EU accounted for 21% of global personal consumption, a slightly lower share than that of the U.S. (29%) but well above that of China (10%) and India (3%).

Today, the U.S. and Europe remain the bedrock of the global economy. Yes, the economic progress of China, India and others has been impressive over the past decade, but the success of each party is due in part to the global economic architect/framework created, supported and funded by the U.S. and Europe. From this lens, it is clear, and there is no doubt, that the future of the EU remains critical to the long-term health of the global economy.

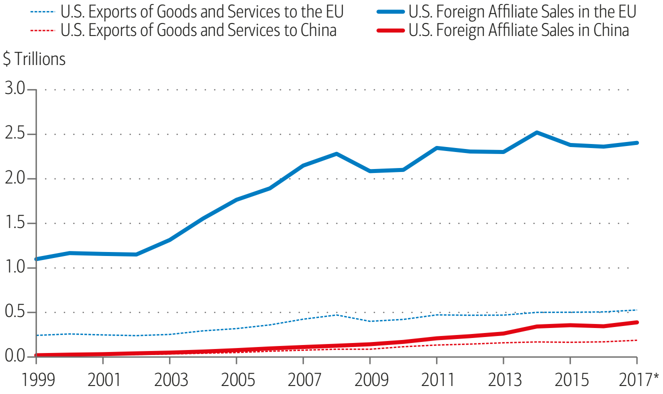
THE STAKES FOR CORPORATE AMERICA ARE HUGE

The EU has been a long-time pillar of America's global economic infrastructure and a key hub for the global competitiveness of U.S. companies. Wealthy consumers, respect for the rule of law, the ease of doing business and credible institutions—all of these factors, and more, have long made the EU a more attractive place to do business for American firms.

U.S. companies are bound to the European continent primarily through the activities of their foreign affiliates (Exhibit 3). In 2017, we estimate that sales delivered through U.S. affiliates in the EU were roughly $2.4 trillion, compared to U.S. exports of goods and services of $500 billion.

Also evident from Exhibit 3 is the fact that Europe remains, by far, the most important market for U.S. multinational companies. While much attention has been given to the rise of the middle class consumer in China and associated market opportunities (represented by the rising red line in Exhibit 3), there is still a long way to go before China catches up to the EU in terms of foreign affiliate sales. Currently, the EU accounts for 41% of U.S. foreign affiliate sales, a share larger than that of the entire Asia Pacific region (27%).

Exhibit 3: How Business Is Done: U.S. Foreign Affiliate Sales vs. Exports.



*Estimates for foreign affiliate sales for 2017.
Non-bank majority owned affiliates: 1999-2008. All majority owned affiliates: 2009-2017.
Source: Bureau of Economic Analysis.
Data as of November 2018.

Meanwhile, the more profitable U.S. affiliates are in Europe, the more earnings are available to the parent firm to hire and invest at home, dole out higher wages to U.S. workers, and/or increase dividends to U.S. shareholders. In other words, U.S. corporate success in Europe is hugely important to the overall and long-term success of many U.S. multinationals and, by extension, the U.S. economy. The more successful U.S. affiliates are in reaching new consumers in Europe and leveraging the continent's resources, the better off are the foreign affiliates, U.S. parent companies, U.S. workers, shareholders and local communities.

In other words, America's transatlantic partnership with Europe yields significant dividends. With nearly 60% of U.S. global foreign affiliate income (a proxy for global earnings) coming courtesy of Europe, no region of the world has as outsized an influence on the economic success or failure of U.S. firms as Europe. And while last year's positive economic environment led to record profits for U.S. foreign affiliates in Europe, rising investment uncertainty and structural challenges in Europe suggest a more precarious operating environment for U.S. firms doing business in the EU.

INVESTMENT SUMMARY

In the end, Europe's woes are global in nature. What happens in Europe, in other words, doesn't stay in Europe. Notably in the cross hairs: U.S. multinationals that have long counted on Europe to drive the bulk of their non-U.S. earnings growth. Decelerating growth in Europe, along with a stronger U.S. dollar versus the euro, threatens to undermine U.S. global earnings heading into next year. The euro is currently trading near a 17-month low against the dollar, as markets weigh the volatile backdrop in Europe against robust economic growth in the U.S.

With U.S.-China tensions at a hard boil, and with many emerging markets struggling in the face of rising U.S. interest rates and elevated oil prices, the last thing the world economy needs right now is a significant economic downdraft from Europe. That leaves the U.S. economy as the *last man standing* — which is bullish for U.S. assets on a comparative basis—but as Europe's woes accumulate and reach a tipping point, the aftershocks will be felt far and wide.

THOUGHT OF THE WEEK

HIGHER RATE REGIME MORE FAVORABLE FOR ACTIVE MANAGEMENT

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

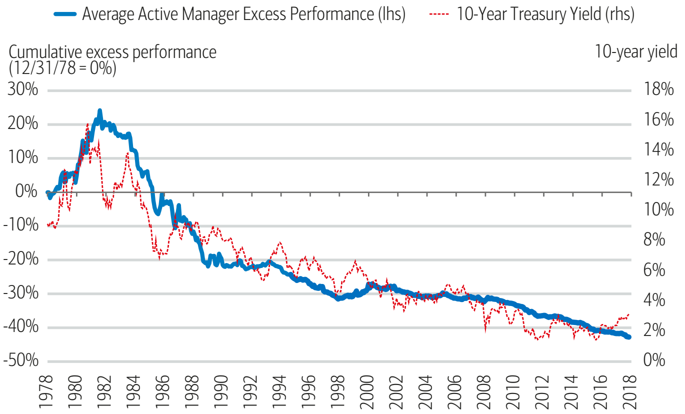
The rise of index-based investing has been nothing short of stunning. In just five years, the amount invested in exchange-traded funds and products globally has more than doubled, with assets under management topping $5 trillion this year.[3] The share of U.S. equity funds allocated to passive investments has grown from just above 20% in 2009 to 42% in 2018 according to BofAML Global Research. With over 3.7 million indices globally[4], the options for passive investing have never been greater.

However, a turning point for active management may be on the horizon.

Historically low interest rates, high correlations across and within asset classes, and low volatility have all made for a challenging environment for active managers in recent years. But as the Federal Reserve (Fed) retreats from easy monetary policy, and as interest rates in the U.S. continue to rise from historic lows, we believe volatility should pick up, which could be positive for active managers.

As shown in Exhibit 4, active manager performance over the past four decades has been strongly correlated with the 10-year treasury yield. During the rising rate regime of the 1970s and early 1980s, actively managed funds outperformed their benchmark, though they lost some of their competitive edge once rates descended to ultra-low levels. Now, with stock correlations low by historical standards and with the recent Fed interest rate hikes, active managers with more flexibility to adjust allocations across sectors and companies could benefit. In the end, amid the many shifting cross-currents of a rising rate environment, the tide is tilting more favorably towards active versus passive managers.

Exhibit 4: Cumulative Active Manager Excess Performance.



Note: Average of large cap U.S. active manager excess returns vs. benchmark, cumulative returns starting in 1978.
Sources: Chief Investment Office, Morningstar, Bloomberg, Nomura.
Data as of November 2018.
Past performance is no guarantee of future results.

[3] Financial Times, "Passive funds hit new highs on wave of investor approval," September 9, 2018.

[4] Index Industry Association. Data as of 2018.

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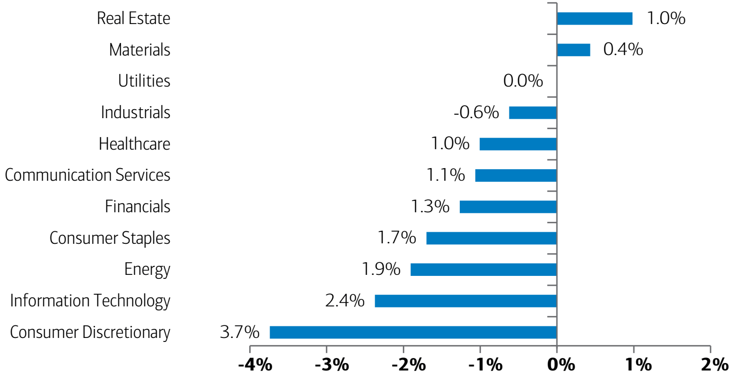
MARKETS IN REVIEW

Equities

		Total Return in USD (%)		
	Current	WTD	MTD	YTD
DJIA	25,413.22	-2.1	1.4	4.9
NASDAQ	7,247.87	-2.1	-0.7	6.0
S&P 500	2,736.27	-1.5	1.1	4.1
S&P 400 Mid Cap	1,865.40	-0.9	2.3	-0.5
Russell 2000	1,527.53	-1.4	1.2	0.5
MSCI World	2,031.76	-1.5	0.6	-1.7
MSCI EAFE	1,812.84	-1.4	0.0	-9.3
MSCI Emerging Markets	986.30	1.0	3.2	-13.0

S&P 500 Sector Returns[1]



Fixed Income[2]

		Total Return in USD (%)		
	Current	WTD	MTD	YTD
Corporate & Government	3.50	0.3	0.4	-2.3
Agencies	3.06	0.5	0.4	-0.3
Municipals	2.99	0.4	0.3	-0.7
U.S. Investment Grade Credit	3.55	0.5	0.4	-2.0
International	4.30	-0.2	0.1	-3.7
High Yield	7.19	-1.3	-1.0	-0.1
	Current	Prior Week End	Prior Month End	2017 Year End
90 Day Yield	2.29	2.28	2.24	1.32
2 Year Yield	2.80	2.93	2.87	1.89
10 Year Yield	3.06	3.18	3.14	2.41
30 Year Yield	3.32	3.39	3.39	2.74

Commodities & Currencies

		Total Return in USD (%)		
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	174.18	1.3	1.0	-3.2
WTI Crude $/Barrel1	56.46	-6.2	-13.6	-6.6
Gold Spot $/Ounce1	1,221.50	1.0	0.6	-6.3
Currencies	Current	Prior Week End	Prior Month End	2017 Year End
EUR/USD	1.14	1.13	1.13	1.20
USD/JPY	112.83	113.83	112.94	112.69
USD/CNH	6.92	6.95	6.97	6.51

Source: Bloomberg, Factset.[1] Total Returns from the period of 11/13/18 to 11/17/18. [2] Bloomberg Barclays Indices. [3] Spot price returns. All data as of the 11/9/18 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 11/16/18)

	Q1 2018A	Q2 2018A	Q3 2018A	2016A	2017A	2018E	2019E
Real global GDP (% y/y annualized)	–	–	–	3.1	3.8	3.8	3.6
Real U.S. GDP (% q/q annualized)	2.2	4.2	3.5	1.6	2.2	2.9	2.7
CPI inflation (% y/y)	2.2	2.7	2.6	1.3	2.1	2.4	1.9
Core CPI inflation (% y/y)	1.9	2.2	2.2	2.2	1.8	2.1	2.3
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	3.38
10-year Treasury, end period (%)	2.74	2.86	3.06	2.44	2.41	3.25	3.35**
S&P 500, end period	2641	2718	2914	2239	2674	3000	
S&P earnings ($/share)	37	41	41*	118	132	162	172
U.S. dollar/euro, end period	1.23	1.17	1.16	1.05	1.20	1.18	1.25
Japanese yen/U.S. dollar, end period	106	111	114	117	113	115	105
Oil ($/barrel), end period	65	74	73	54	60	63	71[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.

A=Actual / E=Estimate / *Estimate for Q3 2018 / **Estimate for Q3 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.

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.

Purchasing Managers Index (PMI) is an indicator of economic health for manufacturing and service sectors. The purpose of the PMI is to provide information about current business conditions to company decision makers, analysts and purchasing managers.

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).

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