Capital Market Outlook

Chief Investment Office

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OCTOBER 9, 2018

IN THIS ISSUE

MACRO STRATEGY

At their September Federal Open Market Committee (FOMC) meeting, the Federal Reserve (Fed) policymakers acknowledged that U.S. economic growth is stronger than they expected. At the same time, they remain confident that inflation is not a threat. We expect upside growth surprises to persist as the structural improvements in the tax and regulatory space provide much needed "nutrition" for economic growth long after the temporary "sugar-high" from increased government spending has faded.

THOUGHT OF THE WEEK

At September's end, the Italian coalition government put forth a budget proposal targeting a deficit of 2.4%. The proposal was met with skepticism by Eurozone officials and induced a capital markets sell-off across Italian assets.

GLOBAL MARKET VIEW

Slower global growth, a stronger U.S. dollar, and a world increasingly disenchanted and disillusioned with America could weigh on U.S. foreign profits over the near term. Not yet detected by the markets, the world is souring on a more protectionist and antagonistic America, a trend that could potentially undermine global demand for U.S. goods and services.

PORTFOLIO CONSIDERATIONS

U.S. equities remain the global frontrunners, helped by 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 (EM), are at significant discounts, which is why we maintain a slight overweight.

MACRO STRATEGY

FED UPGRADES U.S. GROWTH OUTLOOK

Chief Investment Office Macro Strategy Team

Our early-year expectations of a likely peak in global manufacturing and trade growth appear to be validated by recent data. The slowdown in growth momentum has been mild, however, as our expectations for upside risks to both U.S. sentiment and "hard" data have also materialized, helping support both global purchasing managers' surveys and actual activity. Although the moderation in global manufacturing sentiment this year occurred from a relatively strong position and has been mild, the divergence across countries and regions has been significant. U.S. manufacturing sentiment has continued to surge, while Eurozone sentiment has dropped sharply from its elevated early-year levels.

Despite much optimism about a continuation of the above-trend, synchronized global growth pace of 2017, weakening current conditions and leading indicators have caused rapidly dimming Eurozone growth expectations for 2018 and 2019. French industrial production and confidence levels have notably deteriorated, while German 2018 growth forecasts have been substantially revised lower in recent weeks. Overall, a squeeze on real incomes from higher oil prices and rebounding inflation, along with some tightening of financing conditions related to Italian political risks, a bigger exposure of Europe to Turkey, diminishing pent-up investment demand after a few years of moderately above-trend growth, and insufficient structural reform to boost the bloc's potential growth help explain expectations for further slowdown, possibly to just about 1% year-over-year during the next 12 months.

Because they never increased much during this cycle, the rollover in EM surveys has been less striking, but

Data as of 10/9/2018 and subject to change.

they are approaching the 50 mark separating expansion from contraction. With EM leading sentiment indicators deteriorating and growth likely to remain under downside pressure from rising Fed interest rates, rising oil prices and increasing China trade-war fears, downside risks to growth have increased, in our view. As is typical with slowing global growth and trade momentum, metals prices have also softened this year and the dollar has appreciated.

Still, EM and global growth should benefit from the unequivocal boom occurring in the U.S., where economic indicators have continued to surprise to the upside, and growth estimates continue to be revised up. Most recently, for example, the Fed boosted its 2018 real gross domestic product (GDP) growth expectations from 2.8% in June to 3.1% at the September 25–26 FOMC meeting. This will help mitigate softening conditions in the Eurozone, keeping global growth from weakening too much from its approximate 3.8% pace in 2017–2018 (which was slightly above the estimated 3.5% average of the past 20 years). In other words, thanks to the U.S. economic boom, indicators suggest global growth should continue to chug along at a relatively healthy pace next year, albeit with risks to the downside coming from overseas.

Indeed, notwithstanding anticipated noise in economic data due to the effects of Hurricane Florence, we believe that strong fundamentals are likely to keep U.S. economic data on a trend consistent with a "Goldilocks" economy in coming quarters. U.S. growth expectations have been raised by strengthening consumer spending prospects as a result of stronger employment and income growth than previously expected, massive upside revisions to the personal saving rate, as well as surging consumer confidence in present conditions and expectations, both currently at their highest levels in 20 years. Importantly, leading indicators for employment have strengthened anew in light of surging purchasing managers' employment expectations through September at both the manufacturing and service-sector level. The Conference Board's leading economic index has also remained solid, consistent with firm economic growth into 2019. Overall, leading indicators for U.S. growth continue to signal a pickup in GDP growth from 2.9% year-over-year in the second quarter of 2018 to between 3% and 3.5% through early 2019.

The surge in business optimism over the past two years has been accompanied not only by expanding payrolls but also by a reacceleration in business investment. Real non-residential business investment increased 8.7% at an annualized rate in the second quarter following a whopping 11.5% gain in the first quarter. This was the strongest first-half investment growth pace in six years. With currently robust revenue growth, surging profits, a growing shortage of workers, and increasing capacity utilization rates in the economy, we believe the appetite for capital investments should remain healthy.

The National Federation of Independent Business (NFIB) small business optimism index reached a record in August, led by a surge in hiring intentions, "off-the-charts" enthusiasm about business expansion conditions as well as record earnings-trends perceptions. The NFIB noted that business is booming. According to the NFIB president, "*As the tax and regulatory landscape changed, so did small business expectations and plans… We're now seeing the tangible results of those plans as small businesses report historically high, some record breaking, levels of increased sales, investment, earnings, and hiring.*" This is consistent with a strong outlook for small business hiring, sales and capital expansion, with real capital expenditures (capex) likely to remain strong this year and next. The significant change in business-sector sentiment is consistent with more upside surprises to real business investment growth expectations—which is generally assumed at around 4% to 6% year-over-year by mid-2019, but in our view is likely to be closer to 8%. Thus, we believe risks to U.S. growth remaining to the upside notwithstanding quarterly volatility.

With output growth expectations increasing and the labor market tightening, it should not be surprising that leading indicators for hourly wage growth are also pointing to substantial acceleration in coming quarters. However, a cyclical productivity pickup is likely to become more evident, and inflation expectations remain well anchored in light of the Fed's express, unequivocal commitment to price stability, as underscored by Chairman Jerome Powell in his speech to the National Association for Business Economics on October 2, 2018. As a result, in spite of a likely cyclical acceleration in wage growth, we believe that conditions are not in place for upside inflation surprises.

Favorable signals from the yield curve support this view. The yield curve suggests a low probability of recession over the next 12 months. The spread between the 10-year Treasury yield and the fed-funds rate has remained consistent with just about a 15% probability of recession through late 2019, and leading signals from moderate wage growth suggest that the curve should not flatten more over the next year. In other words, absent a Fed mistake in the form of excessive and premature restraint in coming months or an exogenous shock, leading yield-curve fundamentals should keep it relatively steep around current levels, consistent with a low probability of recession through late 2020.

That said, policy has started to create some headwinds to U.S. and global growth in the form of a strong dollar and a substantial increase in interest rates which have capped auto sales and housing, for example. That policy has become less accommodative is also evident in the fact that the yield curve has flattened, with the spread between the 10-year Treasury and fed funds rate (or alternatively the three-month yield) now below average levels. Fed officials have noted the yield curve as an important indicator to watch for signs of overtightening, and the narrowing of the curve has no doubt been a signal that the Fed may be approaching such territory. This, and the shift of the real fed funds rate into positive territory, has no doubt contributed to the Fed's acknowledgement that it has started to move beyond accommodation and elimination of its "policy remains accommodative" phrase from the post-Federal Open Market Committee (FOMC) September 26 statement.

The sharp rise in longer-term interest rates since the September meeting is an indication that the market is comfortable that the Fed's gradual rate-hiking trajectory will not derail a strengthening economic expansion. Real interest rates are normalizing after a decade of "secular stagnation." This is a good sign that the Fed and consensus economists are likely to continue being surprised by the strength of U.S. GDP growth.

GLOBAL MARKET VIEW

U.S. FOREIGN PROFITS LOOK STURDY—AT LEAST FOR NOW

Joseph P. Quinlan, Head of CIO Market Strategy

First the good news: Gross corporate profits from the rest of the world (ROW) hit a record high of $820 billion (seasonally adjusted annual rate) in the second quarter of this year, a figure up modestly from the prior quarter but some 14% higher than the same period a year ago. Meanwhile, foreign affiliate income, a narrower metric of U.S. global earnings, also posted strong results in the second quarter, rising 10.6% from the same period a year ago and by over 11% in the first half of the year.

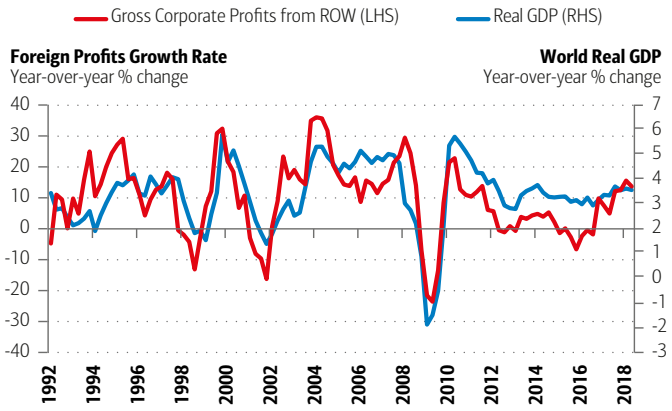
Both figures come courtesy of the Bureau of Economic Analysis and underscore the twin tailwinds of solid global growth and a softer U.S. dollar on U.S. foreign profits.

As Exhibit 1 highlights, foreign profit growth of U.S. firms closely tracks real global GDP, with the upturn in global demand since 2016 boosting U.S. foreign profits. Ditto for the weaker U.S. dollar, which was posting negative year-over-year growth rates through Q2 of this year (Exhibit 2).

Meanwhile, besides the one-two punch of strong global demand and a competitive currency, other variables have underpinned solid foreign profit growth over the past few quarters, including corporate America's global brand leadership; broad global footprint via foreign direct investment; and "best-in-class" technological capabilities. Against this backdrop it is little wonder ROW gross corporate profits have marched steadily higher over the past few years, rising 24% between the start of 2016 and mid-2018.

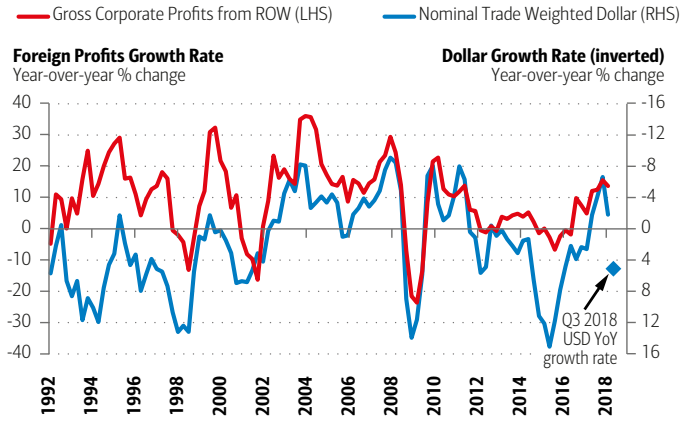
Now the less encouraging news: The global backdrop for U.S. earnings has deteriorated over the past few months and could

Exhibit 1: Corporate Profits Sensitive to Global Growth.



Gross corporate profits receipts from rest of world measured before tax with inventory valuation and capital consumption adjustments, seasonally adjusted annualized rate. Sources: Bureau of Economic Analysis; International Monetary Fund; Haver Analytics. Data as of Q2 2018.

Exhibit 2: Foreign Corporate Profits Benefited from a Weakening Dollar.



Gross corporate profits receipts from rest of world measured before tax with inventory valuation and capital consumption adjustments, seasonally adjusted annualized rate. Sources: Bureau of Economic Analysis; Federal Reserve; Haver Analytics. Profits data as of Q2 2018. Trade weighted dollar data as of Q3 2018.

amount to a noticeable headwind to third-quarter earnings and beyond. The tide has shifted in two important respects. One, the synchronized global expansion evident at the beginning of the year has fizzled and become more desynchronized owing to stronger-than-expected growth in the U.S., China's economic slowdown, and trade and currency shocks in a number of EMs (Turkey, South Africa and Argentina). Growth in the Eurozone has also lost steam over the past six months, leaving the U.S. the locomotive of the global economy.

And because it's America leading the way, the greenback has come back into favor with investors, with the trade-weighted dollar up 5% in Q3 from the same period a year ago. A stronger dollar represents a mild negative for third-quarter earnings but there is more to consider.

SOURING ON AMERICA

In addition to the above, and just as important to future earnings, in our opinion, is the simmering political bad blood between the United States and its major trading partners, and the attendant rise in anti-American sentiment around the world. Not yet detected by the markets, the world is souring on a more protectionist, belligerent and antagonist America, a trend that could potentially undermine global demand for a host of U.S. goods and services in the years ahead.

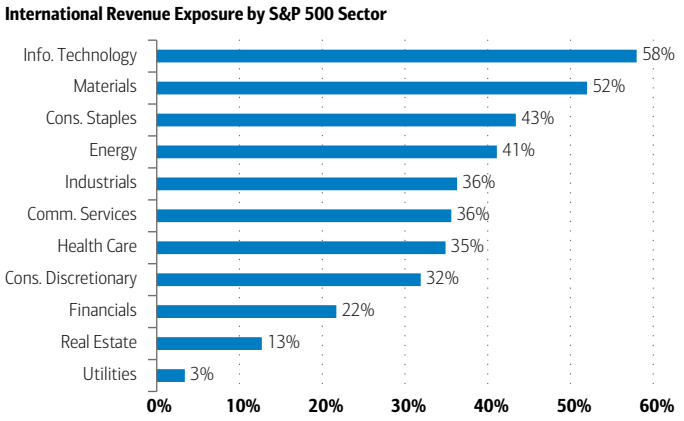
According to a new 25-nation Pew Research Center survey[1], America's global image has plunged in the past two years, notably in key foreign markets like Mexico, Canada, France and Germany.

According to that report, "President Trump's international image remains poor, while ratings for the United States are much lower than during Barack Obama's presidency," with a median of only 27% of those surveyed saying they have confidence in President Trump to do the right thing in world affairs. Some 70% lack confidence in him. Slightly more encouraging, of those polled, a median of 50% have a favorable opinion of the U.S., while 43% offer an unfavorable rating. In general, however, favorable views of the U.S. remain at historic lows in many countries—a worrisome backdrop for any U.S. company/sector dependent on foreign sales/earnings to drive growth (Exhibit 3 highlights the sectoral foreign exposure of the S&P 500).

This is not to suggest that there is a one-to-one correlation between what foreigners think of Washington and their desire for American goods and services. Commerce can certainly trump diplomacy—but the latter still matters.

[1] Pew Research Center, Trump's International Ratings Remain Low, Especially Among Key Allies, October 1, 2018.

Exhibit 3: Technology and Materials Sectors Most Exposed to Foreign Markets.



Source: FactSet. Data as of October 2018.

Take for example China's recent seven-day Golden Week, a time when some 7 million Chinese travel overseas. Last year, the United States ranked as the fifth most popular destination among Chinese consumers, although America dropped to 11th this year according to Ctrip, a popular Chinese booking agency.[2] According to the company, Chinese travelers place a great deal of weight on the current state of foreign relations when deciding where to travel, and not unexpectedly, given tense U.S.-Sino relations, many Chinese tourists have opted to bypass the U.S.

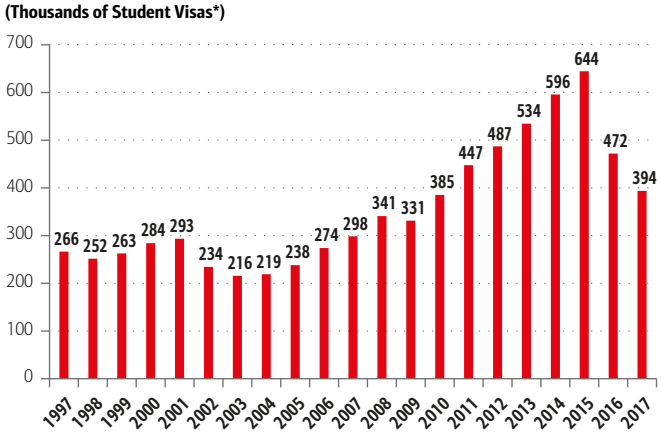
According to the data source ForwardKeys, Chinese outbound bookings to the U.S. are down roughly 10% year-to-date, which means billions of lost revenue for a variety of U.S. service providers in the U.S. (think transportation, retail, travel and leisure, etc.). No foreign visitors spend as much in the U.S. as the Chinese, with U.S. travel export receipts from China totaling nearly $31 billion in 2016, the last year of available data. That figure is up nearly *10 times* from the levels of a decade ago (or $3.5 billion in 2006). Incidentally, the U.S. enjoys a massive trade surplus with China in travel services, with the surplus hitting a record $26.2 billion in 2016.

Another potential sign of trouble ahead: the decline in the number of visas issued to foreign students wishing to study in America. In the year ended September 30, 2017, the State Department issued nearly 400,000 student visas, a 17% decline from the prior fiscal year and down nearly 40% below the 2015 peak (see Exhibit 4). Big drops were reported among Indian and Chinese students, with tougher immigration rules and regulations one key reason cited for the drop.[3]

[2] See "China's 7m Golden Week shoppers head to Japan, Thailand and Korea," Nikkei Asian Review, September 29, 2018.

[3] See "Visas Issued to Foreign Students Fall, Partly due to Trump Immigration Policy", WSJ, March 11, 2018.

Exhibit 4: U.S. State Department Visas Issued.



*F-1 Visas only.
Source: U.S. State Department. Data as of September 30, 2017.

Long-term, the decline in the number of foreign students in U.S. universities represents a double-edged sword. The U.S. is not only losing a source of demand (students are consumers) but also a future source of supply (or potential workers upon graduation).

THE BOTTOM LINE

Earning expectations for the third quarter are relatively buoyant (in excess of 20% year-over-year) and basically already priced into U.S. equities. Not yet fully discounted are the growing headwinds to foreign profits, notably slower global growth, a stronger U.S. dollar, and a world increasingly disenchanted and disillusioned with America, with the latter a potential long-term catalyst for lost demand for U.S. goods and services.

THOUGHT OF THE WEEK

MAMMA MIA: A SPICY REACTION TO ITALY'S BUDGET PROPOSAL

Nick Giorgi, CFA®, Investment Strategist

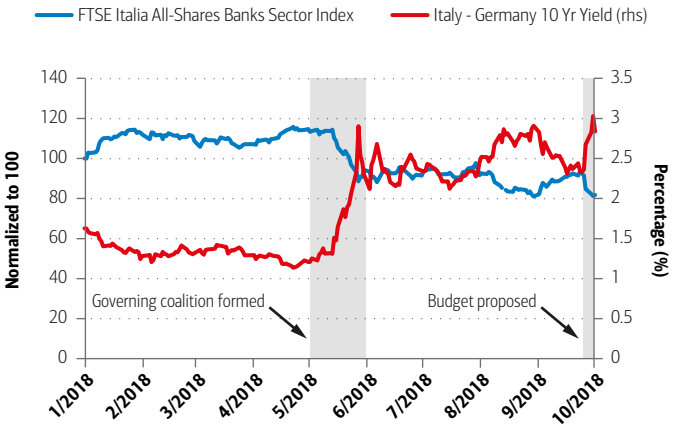
At September's end, the Italian coalition government put forth a budget proposal targeting a deficit of 2.4% of GDP, with little more detail. This represented a departure from a path by which Italy was expected to flatten their fiscal deficit in the near future to help dampen the Eurozone's second-highest debt burden, at approximately 130% of gross domestic product. The proposal was met with the gnashing of teeth in Brussels, while the capital markets reconciled their concerns with a spike in Italian sovereign yields and the cost to insure Italy's credit. Fears have since ebbed as Italian officials have pledged to reduce the deficit in future years, but this episode bears monitoring.

The fiscal outline put forth by Italy is a challenge to Eurozone policymakers, as the deficit flirts with the bloc's 3.0% mandated limit. Without details of the underlying assumptions driving the proposed budget, it is difficult to ascertain if more conservative projections might raise the deficit even higher. The proposal also sowed internal consternation, breaching the sustainable targets offered by Finance Minister Giovanni Tria. The use of deficit-funded proceeds is also a concern as a lower retirement age, less taxes, and citizens' income may not provide the supply-side support necessary to jolt Italy's growth trajectory upwards.

In a rebuke of Italian policymakers, investors have sold off Italian bonds, causing sovereign yields to spike towards levels last achieved in 2014. Credit-default swaps on sovereign debt, representing the cost to insure Italian bonds against default, have also risen to multi-year highs. What's more, a negative outlook looms as the credit rating agencies may soon weigh in on Italy's situation. Finally, the equity of Italian banks has come under pressure due to the high proportion of sovereign debt that they hold on their balance sheets (Exhibit 5). Ultimately, BofA Merrill Lynch Global Research expects the markets to persuade Italy into adopting a more prudent fiscal path, and that may have been evidenced by recent tweaks to future year projections.

Fears of contagion across the Eurozone have yet to materialize, however, investors will continue to gauge the bloc's ensuing engagement with its third largest economy, according to the International Monetary Fund (IMF) from April 2018. While Italy seems responsive to outside concerns now, tranquility is not assured. We recommend a cautious approach towards Europe in light of political risks.

Exhibit 5: Italian Assets Have Sold off as Idiosyncratic Risks Rise.



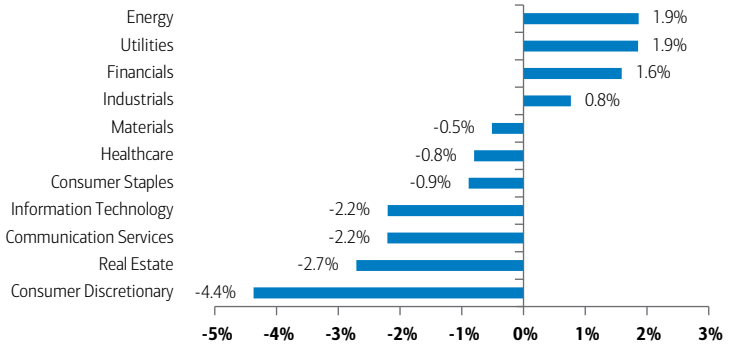
Sources: Bloomberg; Chief Investment Office. Data as of October 3, 2018.

MARKETS IN REVIEW

Equities

	Current	Total Return in USD (%) WTD	MTD	YTD
DJIA	26,447.05	0.0	0.0	8.8
NASDAQ	7,788.45	-3.2	-3.2	13.7
S&P 500	2,885.57	-0.9	-0.9	9.5
S&P 400 Mid Cap	1,967.99	-2.5	-2.5	4.8
Russell 2000	1,632.11	-3.8	-3.8	7.3
MSCI World	2,143.57	-1.5	-1.5	3.9
MSCI EAFE	1,910.14	-2.3	-2.3	-3.7
MSCI Emerging Mkts	995.50	-4.5	-4.5	-11.8

S&P 500 Sector Returns



Fixed Income[1]

	Current	Total Return in USD (%) WTD	MTD	YTD
Corporate & Government	3.54	-0.9	-0.9	-2.8
Agencies	3.14	-0.5	-0.5	-1.0
Municipals	2.97	-0.6	-0.6	-1.0
U.S. Investment Grade Credit	3.60	-0.9	-0.9	-2.5
International	4.21	-1.1	-1.1	-3.4
High Yield	6.41	-0.4	-0.4	2.1

	Current	Prior Week End	Prior Month End	2017 Year End
90 Day Yield	2.16	2.16	2.16	1.32
2 Year Yield	2.89	2.82	2.82	1.89
10 Year Yield	3.23	3.06	3.06	2.41
30 Year Yield	3.41	3.21	3.21	2.74

Commodities & Currencies

Commodities	Current	Total Return in USD (%) WTD	MTD	YTD
Bloomberg Commodity	179.90	2.0	2.0	0.0
WTI Crude $/Barrel[2]	74.34	1.5	1.5	23.0
Gold Spot $/Ounce[2]	1,202.95	0.9	0.9	-7.7

Currencies	Current	Prior Week End	Prior Month End	2017 Year End
EUR/USD	1.15	1.16	1.16	1.20
USD/JPY	113.72	113.70	113.70	112.69
USD/CNH	6.90	6.88	6.88	6.51

Source: Bloomberg, Factset. [1] Bloomberg Barclays Indices. [2] Spot price returns. All data as of the 10/5/18 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	●	•	•	•	•
Alternative Investments*	see CIO Asset Class Views				
Hedge Funds					
Private Equity					
Real Assets					
Cash	We are neutral				

* Many products that pursue Alternative Investment strategies, specifically Private Equity and Hedge Funds, are available only to pre-qualified clients.

Economic and Market Forecasts (as of 10/5/18)

	Q1 2018A	Q2 2018A	Q3 2018A	2016A	2017A	2018E	2019E
Real global GDP (% y/y annualized)	-	-	-	3.1	3.8	3.8	3.7
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	2.7*	1.3	2.1	2.5	2.4
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	3.06	2.44	2.41	3.25	3.35**
S&P 500, end period	2641	2718	2914	2239	2674	3000	-
S&P earnings ($/share)	37	41	41*	118	132	162	172
U.S. dollar/euro, end period	1.23	1.17	1.16	1.05	1.20	1.20	1.25
Japanese yen/U.S. dollar, end period	106	111	114	117	113	115	105
Oil ($/barrel), end period	65	74	73	54	60	70	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.

The **Standard & Poor's 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.

Conference Board Leading Economic Index is an American economic leading indicator intended to forecast future economic activity. It is calculated by The Conference Board, a non-governmental organization, which determines the value of the index from the values of ten key variables.

FTSE Italia All-Share Index is a free float capitalization weighted index that comprises all of the constituents in the FTSE MIB, FTSE Italia Mid Cap and FTSE Italia Small Cap indices.

NFIB Small Business Optimism Index is compiled from a survey that is conducted each month by the National Federation of Independent **Business (NFIB)** of its members.

IMPORTANT DISCLOSURES

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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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