Capital Market Outlook

Chief Investment Office

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

NOVEMBER 13, 2018

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MACRO STRATEGY

October data show widespread job growth with rising non-inflationary wage gains, especially for lower-paid workers. Business and consumer confidence remain around all-time highs despite the litany of worries cited to justify the stock market correction. All in all, the slowdown view seems to be a figment of economists' imagination. The U.S. economy appears poised for an outstanding holiday season.

GLOBAL MARKET VIEW

While aggregate U.S. household debt metrics have improved since the crisis, pockets of pressure in the auto, credit card and student debt sectors could pose a threat to growth down the road. Although we do not believe this uptick in leverage represents a systemic risk to the U.S. economy near term, this dynamic bears close watching as the expansion matures and as the bias of the Federal Reserve (Fed) remains toward monetary tightening.

THOUGHT OF THE WEEK

One of the world's largest online shopping day occurred on November 11—cleverly known as "Singles' Day" in China, the tenth edition of the annual event. With $30.7 billion in online spending, "Singles' Day" is emblematic of the fact that the Chinese consumer is moving to the fore as a future driver of growth.

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

BIGGER WAGE GAINS FOR LOWER-PAY OCCUPATIONS

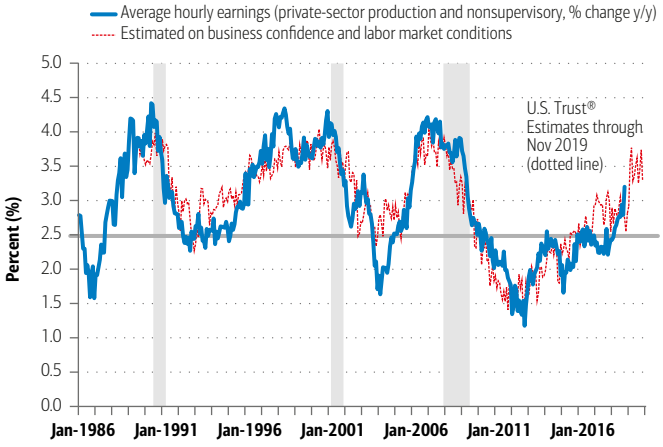
Chief Investment Office Macro Strategy Team

October employment data show no signs of the slowdown markets continue to fear. Despite trade tensions, Fed rate hikes and the political uncertainty surrounding the mid-term elections, the U.S. economy continues to the upside. Payroll employment, household survey employment and the ADP survey measure of private job creation all rose by over 200,000 in October, surpassing economists' forecasts by a wide margin. All the worries cited to rationalize the recent stock market correction have not dented consumer and business confidence, which still stands near record levels only briefly rivaled twice before in the past half century. The latest three-month average of the Composite Institute for Supply Management index, which combines the manufacturing and nonmanufacturing indices, topped 60 for the first time in the history of the survey, which extends back to 1997, when the nonmanufacturing survey began. This is a strong indication that U.S. growth remains robust in spite of so much negative market commentary.

The cornucopia of positive economic news keeps defying all the market watchers scrambling to be first to declare the end of the long equity bull market and second-longest expansion on record, according to the National Bureau of Economic Research. Typically, excessive wage pressures materialize late in the cycle when unemployment approaches unsustainably low levels that create inflation and damage corporate profit margins. While year-over-year wage gains picked up to the 3% threshold in October for the first time in about a decade (Exhibit 1), they remain well below levels that signal excessive inflationary pressure.

Data as of 11/13/2018 and subject to change.

Exhibit 1: Wage Pressures Moving Through Mid-Cycle Levels.



Sources: Bureau of Labor Statistics/Haver Analytics, CIO. Data as of November 2, 2018

Indeed, based on leading indicators from the economy and labor market conditions that foreshadow wage gains (as seen in the dotted line in Exhibit 1), we anticipate another half percentage-point rise in average hourly earnings to about 3.5% by the end of 2019. As can be seen in the exhibit, wage gains approached 4% in the years leading up to the past three recessions, a level we expect to see sometime in 2020 if current trends persist.

Whether the acceleration in wage gains is inflationary ultimately depends on whether productivity keeps pace with the rise in wages as it did over the past year. Unit labor costs, which adjust for productivity gains, remain below 2% despite the pickup in average hourly earnings because productivity increased even more. This is keeping inflation well contained near the Fed's target.

As we have discussed in past Capital Market Outlook pieces, the determinants of productivity growth that we monitor to forecast future productivity seem to be working to bolster wage gains without inflationary consequences. One important determinant of productivity is a strong dollar, which forces U.S.-based companies to work harder to compete in international markets. This is one of the many ways that a strong dollar helps to hold down the inflation rate and obviate the need for more Fed rate hikes. A tight, fully employed labor market also puts additional pressure on businesses to bolster productivity just as a strong dollar does.

The strong third-quarter corporate earnings results show U.S. companies are rising to the challenges posed by the tight labor market and strong dollar. Lower corporate tax rates have helped by making U.S. companies much more competitive in global markets. Despite widespread mentions of labor scarcity, cost and tariff pressures, and the strong dollar's negative impact on foreign-sourced earnings, net profit margins rose in the third quarter according to BofA Merrill Lynch Global Research. While short-term oriented analysts tend to focus on the negative translation impact that the strong dollar exerts on foreign-sourced earnings, a longer-term view suggests the stronger, non-inflationary growth that comes from a strong currency's impact on productivity and an expansion's longevity deserves more consideration in valuing long-lived assets like equities.

In addition to holding down inflation, stronger productivity raises the potential growth rate of the economy. Most of the consensus view on Wall Street and at the Fed, as well as in the academic economic community, is predicated on "secular stagnation": the view that some mysterious productivity-killing disease has doomed the U.S. economy to a paltry 1.8% growth limit. If, however, supply-side tax cuts and deregulation are curing this mystery disease, there is quite a bit more room to run before the economy reaches its inflationary limits. The latest news on labor costs and productivity supports this contrarian view.

In the meantime, the widening gap between labor demand (about 7 million unfilled job openings) and labor supply (about 6 million unemployed) is helping workers get bigger pay gains. While the average wage increase over the past year is a tad above 3%, there are big differences among industries. Goods-producing jobs saw average gains closer to 4%, with many mining, logging and construction workers enjoying well-above-average raises.

Service workers, on the other hand, saw more mixed results with most categories (financial, 0.9%; transportation and warehousing, 2.7%; education and health services, 2.7%) seeing below-average gains while retail trade (4.6%), and leisure and hospitality (4.2%) did noticeably better. These latter categories happen to be the lower-paid jobs that have benefitted most from the spate of minimum-wage increases around the country announced by many companies after the big corporate tax cut last December. On average, these two categories make about a third less than the overall average. That's not to say only the lower end of the wage spectrum got better-than-average wage hikes this year. Information service workers are considered the highest paid of these broad categories, and they averaged 5.1% gains. As you would expect, bigger gains went where the tight labor market is tightest as well as where companies decided to help lower-paid workers.

All told, private sector payrolls grew 5.4% during the 12 months through October, in line with the 5.5% growth rate of nominal gross domestic product (GDP) over the same period, the strongest showing since 2006. Nominal growth averaged below 4% throughout the decade after 2006. The breakout above 5% is key evidence that the economy is finally normalizing. One important consequence is that interest rates are normalizing as well. Perhaps the drop in the equity earnings multiple simply

reflects the market's belief that more normal interest rates are here to stay after a long stretch of abnormally low rates.

In any event, the healthy growth in worker incomes points to a surprisingly robust holiday shopping season expected in 2018.

GLOBAL MARKET VIEW

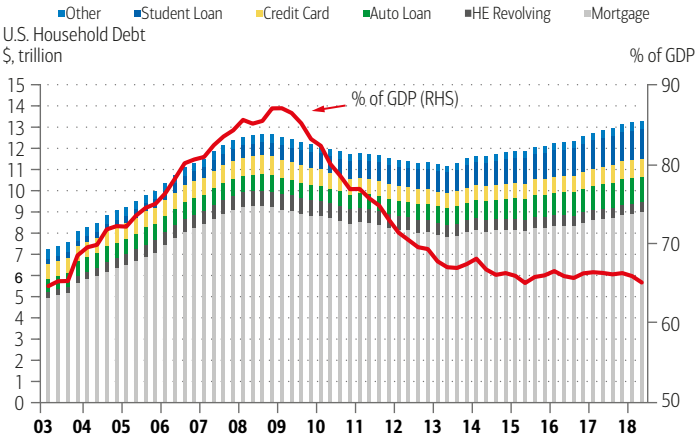
CONSUMER DEBT FIGURES MASK POTENTIAL WARNING SIGNS FOR U.S. EQUITIES

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

Despite a 'Red October' for U.S. stock markets, many metrics of consumer health continue to flash green — current job creation remains strong; the unemployment rate is at a 49-year low; wages are rising; disposable incomes are improving after tax reform; consumer confidence is near all-time highs; and growth in personal consumption has gained momentum.

This heightened optimism and consumer spending comes against the backdrop of a strong household balance sheet, with household net worth currently at record highs. Though aggregate U.S. household debt has been rising, it's important to consider these liabilities in the context of a robust $20 trillion U.S. economy. As a percentage of GDP, consumer debt has noticeably improved from pre-crisis levels (Exhibit 2). And, compared to other highly leveraged advanced economies (Australia, Canada, Denmark, the Netherlands, New Zealand, Norway, Sweden, Switzerland), the household debt burden in the U.S. appears relatively mild.

Exhibit 2: Household Debt Steadily Rising, But Contained Relative to GDP.



Sources: Federal Reserve; Bureau of Economic Analysis; Haver Analytics. Data as of October 2018.

While all the above suggests that the U.S. consumer is in good shape, the headline figures hide important trends in the data that are worth highlighting, especially in the later stages of the business cycle. Though we do not believe that household debt poses a systemic risk to the economy in the near term, pockets of pressure within the credit card, auto loans and student debt sectors could weigh on certain sectors of U.S. equity markets in the medium term.

EXAMINING THE "TRILLION-DOLLAR TRIFECTA"

Since mortgages represent the largest portion of U.S. household debt, they tend to drive trends in the data. Most of the deleveraging that occurred after the financial crisis came in the housing sector, and thanks to the slow growth in housing-related debt since then, U.S. mortgage balances are still below their 2008 highs. Credit quality has also improved. Mortgage delinquency rates continue to trend downward, with a greater portion of debt being taken on by borrowers with higher credit scores.

Yet non-mortgage debt has been rapidly rising in the decade following the crisis, growing into a "trifecta of trillion-dollar" balances on student loans, auto loans and credit card debt. As a result, these sectors have been accounting for a greater portion of overall household debt (26% in 2018 vs. 18% in 2008), while mortgage loans have declined in significance (74% of total consumer debt in 2008 vs. 68% in 2018). While credit conditions in the U.S. housing market have been relatively benign, excesses building in the non-mortgage debt sector should be closely watched by investors.

- Student loan balances have more than doubled over the past ten years to $1.6 trillion as tuition costs soared and state and local funding for education declined. Currently, there are about 44 million student loan borrowers, with the average student leaving school $37,000 in debt.[1]
- Auto loans outstanding now equal $1.1 trillion. Subprime borrowers account for a substantial share of new auto loan originations (around 21% vs. 4% for mortgages), though the share has trended slightly lower in recent years.[2]
- Credit card balances are also trending upward, with revolving credit outstanding at $1.0 trillion. The average balance per borrower grew 2.2% in Q2 2018 from a year ago, primarily driven by subprime growth.[3]

All totaled, consumer credit (excluding mortgage debt)

[1] Wharton Business School, "Will a Student Loan Debt Crisis Sink the Economy," October 24, 2018.

[2] Federal Reserve. Subprime borrowers defined as sub-620 credit score 2018.

[3] TransUnion. Data as of September 25, 2018.

outstanding and securitized as a percentage of consumers' disposable income is near all-time highs.

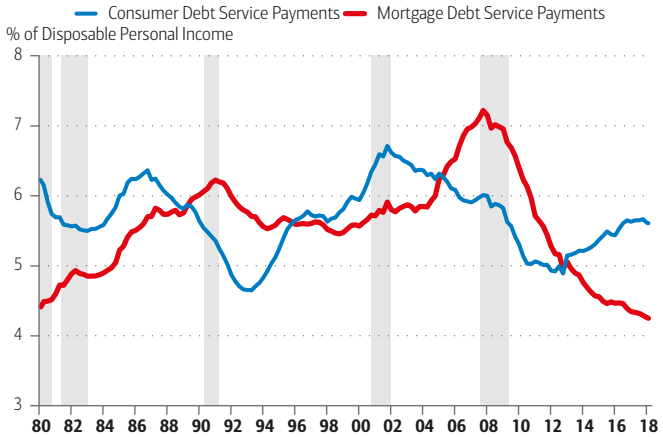
MANAGEABLE, BUT WATCH CURRENTLY RISING RATES AND DELINQUENCIES

Much of the rise in consumer debt over the past decade can be attributed to ultra-low interest rates, which allowed consumers to take on debt at low costs. However, as rates rise, the cost to service these debts will increase, which could result in a weakening of credit quality and tighter lending standards. Average 30-year fixed mortgage rates climbed to 4.9% in October, up from 3.9% a year ago. Meanwhile, credit card interest rates have climbed 130 basis points (bps) in the past year to 14.4%, a 17-year high.

Rising rates are particularly concerning for non-mortgage debt, where about 40%–45% of the debt outstanding is floating rate.[4] By contrast, adjustable rate mortgages represent less than 10% of new mortgage originations, according to the Mortgage Bankers Association. With non-mortgage debt accounting for a greater portion of total debt, American consumers could be more vulnerable to the Fed's current tightening cycle.

As Exhibit 3 highlights, non-mortgage debt payments have been picking up due to rising debt levels and their greater sensitivity to changes in interest rates. However, total consumer debt service payments-to-income ratios remain near historic lows, thanks to the deleveraging of mortgage debt.

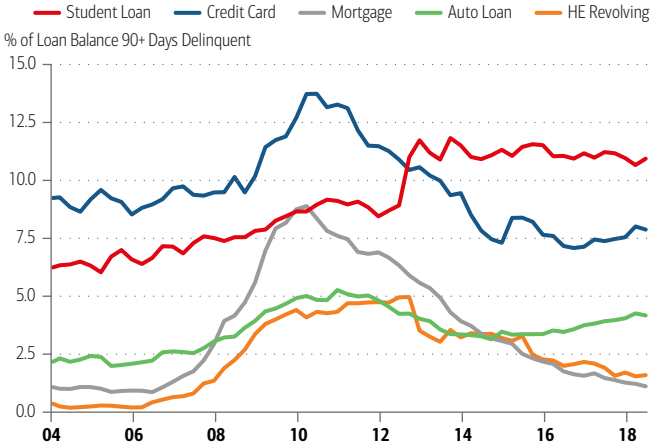
Exhibit 3: Rising Debt Service Payments on Consumer Credit.



Source: Federal Reserve. Data as of Q2 2018.

Similarly, consumer delinquency rates have been relatively muted this cycle, but recent signs of a pickup in credit card and auto delinquencies have become a concern for creditors (Exhibit 4). Especially at risk are subprime loans issued by auto finance companies, which have been transitioning into 90-day delinquency at rates near those during 2008. Delinquency rates are the highest for student loan balances, although they have been trending lower in recent years. We expect delinquencies to continue to increase as the Fed raises rates.

Exhibit 4: On Watch: Rising Delinquencies for Auto and Credit Card Debt.



Source: Federal Reserve. Data as of August 2018.

INVESTMENT SUMMARY

In the end, recent low mortgage debt growth and rising incomes have kept consumer debt relatively contained. While excesses may be building in parts of the household balance sheet, we do not believe they pose a systemic risk to the U.S. economy. When the housing market peaked in 2008, mortgages outstanding represented 74% of consumer debts and over 60% of U.S. GDP. Currently, credit card, auto and student loans each represent less than 12% of U.S. household debt and less than 8% of GDP. Thus, stress in the auto loan market or worries about student loans shouldn't have as wide-reaching effects as did the 2008 housing market bust, in our opinion.

That said, we remain cautious about a cyclical slowdown in consumer sectors that could result from rising rates, higher delinquencies and record levels of consumer debt. Rising consumer debt may signal higher growth in the short-term but lower consumer spending in the long-term. We are closely watching the progression of rising rates, increasing debt service payments, higher delinquencies, tighter credit conditions, slower consumer spending and weaker economic growth.

In addition to increased costs associated with higher rates, higher *levels* of debt may also weigh on spending. The growing burden of student debt may continue to pressure millennial consumers, who are now entering their prime buying age for big ticket purchases like a house or a car. According to a study

[4] UBS, "Credit Perspectives: Are U.S. Housing & Autos Signaling an End to the Consumer Cycle?" Data as of October 15, 2018.

by the Fed, having student loans dampens homeownership rates, and greater debt balances are associated with even lower homeownership.[5] This could help explain some of the downtrend in homeownership among millennial borrowers, which has only recently started to shift higher.

While the markets have not been all that concerned with the gradual build-up in consumer debt, this "trillion-dollar trifecta" bears close watching given the importance of the consumer to the U.S. economy. Consumption-led sectors have been an important driver of equity markets over the course of the U.S. economic expansion. Since June 2009, consumer discretionary has been the best performing sector in the S&P 500, rising 387% in price terms versus a 206% gain for the overall index. Consumer staples performance has lagged, as is typical when the business cycle matures, but we expect growth in global consumption to support individual groups within the sector.

We do not see the auto/credit card/student debt trifecta impairing consumers' spending patterns sharply in the near term, but this dynamic could gradually chip away at consumer confidence and profits in the long-term. Risks could arise if debt service payments grow faster than wages and start to crowd out discretionary spending. As we head into the most important quarter of the year for retailers, we don't see these rising debt payments being a significant headwind to growth just yet, but something that could evolve in the coming years after more planned rate hikes. Expected sturdy wage growth and a strong season of tax refunds in the first half of 2019 should also support consumer spending, so any pressures to consumer stocks could take longer to materialize.

[5] Federal Reserve Bank of New York, "Diplomas to Doorsteps: Education, Student Debt, and Homeownership," April 3, 2017.

THOUGHT OF THE WEEK

THE CHINESE ECOMMERCE DREAM

Lauren J. Sanfilippo, Vice President and Market Strategy Analyst

To the dismay of many a litany of seasonal retailer ads has already hit America's media for the holidays. But all U.S retailers really want for Christmas are "Singles' Day" sales numbers.

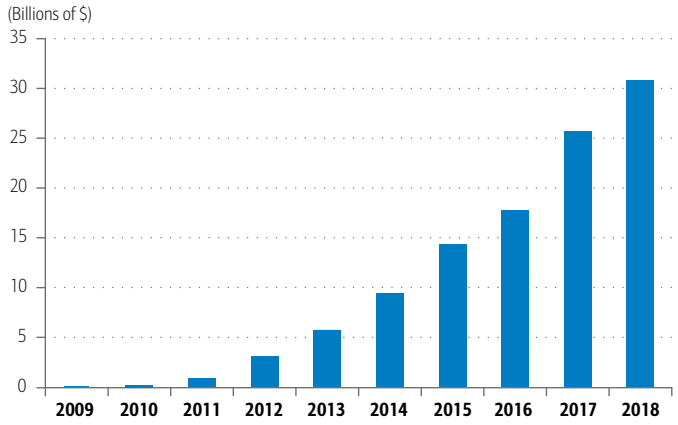
One of the largest online shopping day occurred on November 11— cleverly known as "Singles' Day" in China. Numerically, (11/11), the digits resemble "bare branches," a Chinese expression for singles and a 24-hour Alibaba Group eCommerce shopping extravaganza, drawing in thousands of retailers and hundreds of millions of shoppers of all ages. The country's growing and rising 400 million middle class population has turned this day into a phenomenon celebrating singledom—or not—and popularizing "Singles' Day" as the hottest online shopping holiday in the world by doling out hefty discounts. In 2009, the first year of "Singles' Day" outlays totaled just $100 million.

This year's tenth edition of the annual online shopping event raked in $30.7 billion within 24 hours of unhinged online spending. More than twice as much merchandise was sold over the 24-hour period than during the entire five-day U.S. holiday buying spree that begins on Thanksgiving, runs through "Black Friday" and ends on "Cyber Monday". Every year has exceeded the one before, with this year's sales climbing 27% to $30.7 billion (Exhibit 5).

China, the largest eCommerce market in the world, accounts for over half of global eCommerce spending and the highest penetration rate as a percent of total retail sales in the world with a staggering 28% versus 10% in the U.S. or an 11% global average.[6]

Domestic consumption continues to play a more prominent role in driving growth in China, contributing to 77.8% of China's economic growth in the first three quarters of this year, up from 64.5% over the same period last year.[7] "Singles' Day" proves this: China, established second in the world wealth hierarchy, has huge stamina and consumption potential of total wealth of $51.9 trillion[8] as the consumer is moving to the fore as a future growth driver, with "Singles' Day" emblematic of this potent trend.

Exhibit 5: Alibaba's "Singles' Day" Sales.



Source: Alibaba. Data as of November 2018.

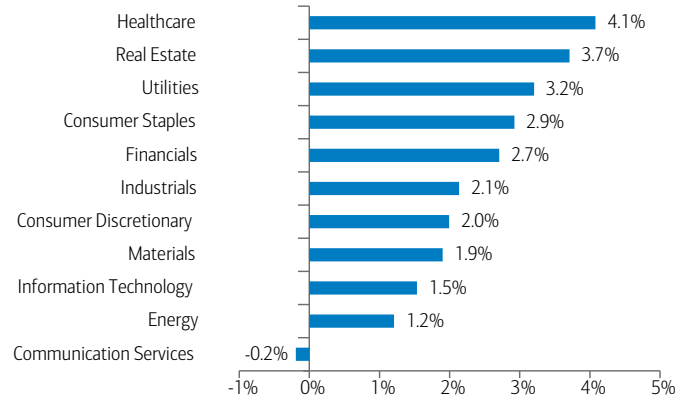
[6] eMarketer, for year 2018.
[7] China's National Bureau of Statistics, 2018.
[8] Credit Suisse, Global Wealth Report 2018, October 2018.

MARKETS IN REVIEW

Equities

	Current	Total Return in USD (%) WTD	MTD	YTD
DJIA	25,989.30	3.0	3.6	7.2
NASDAQ	7,406.90	0.7	1.4	8.3
S&P 500	2,781.01	2.2	2.7	5.7
S&P 400 Mid Cap	1,882.54	1.1	3.2	0.3
Russell 2000	1,549.49	0.1	2.6	1.9
MSCI World	2,063.16	1.3	2.1	-0.3
MSCI EAFE	1,840.67	0.2	1.5	-8.0
MSCI Emerging Markets	976.17	-2.0	2.1	-13.9

S&P 500 Sector Returns[1]



Fixed Income[2]

	Current	Total Return in USD (%) WTD	MTD	YTD
Corporate & Government	3.57	0.3	0.0	-2.7
Agencies	3.17	0.1	-0.1	-0.8
Municipals	3.05	0.2	-0.1	-1.1
U.S. Investment Grade Credit	3.64	0.3	0.0	-2.4
International	4.29	0.5	0.2	-3.5
High Yield	6.81	0.1	0.3	1.2

	Current	Prior Week End	Prior Month End	2017 Year End
90 Day Yield	2.27	2.26	2.24	1.32
2 Year Yield	2.93	2.91	2.87	1.89
10 Year Yield	3.18	3.21	3.14	2.41
30 Year Yield	3.39	3.46	3.39	2.74

Commodities & Currencies

Commodities	Current	Total Return in USD (%) WTD	MTD	YTD
Bloomberg Commodity	171.99	-1.1	-0.3	-4.4
WTI Crude $/Barrel[1]	60.19	-4.7	-7.8	-0.4
Gold Spot $/Ounce[1]	1,209.85	-1.9	-0.4	-7.2

Currencies	Current	Prior Week End	Prior Month End	2017 Year End
EUR/USD	1.13	1.14	1.13	1.20
USD/JPY	113.83	113.20	112.94	112.69
USD/CNH	6.95	6.90	6.97	6.51

Source: Bloomberg, Factset.[1] Total Returns from the period of 11/5/18 to 11/9/18. [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	●	•	•	•	•
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 10/26/18)

	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	3.5	1.6	2.2	2.9	2.7
CPI inflation (% y/y)	2.2	2.7	2.6	1.3	2.1	2.5	2.2
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	3.13
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.

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 400 Mid Cap Index is representative of 400 stocks in the mid-range sector of the domestic stock market, representing all major industries.

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.

S&P Small Cap 600 measures the small-cap segment of the U.S. equity market. The index is designed to track companies that meet specific inclusion criteria to ensure that they are liquid and financially viable.

MSCI EAFE (Europe, Australasia, and Far East) Index comprises 21 MSCI country indices, representing the Developed Markets outside of North America.

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

MSCI World Index is a broad global equity benchmark that represents large and mid-cap equity performance across 23 developed markets countries. It covers approximately 85% of the free float-adjusted market capitalization in each country and does not offer exposure to emerging markets.

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.

Neither Merrill Lynch, U.S. Trust nor any of their affiliates or advisors provide legal, tax or accounting advice. You should consult your legal and/or tax advisors before making any financial decisions.

The investments discussed have varying degrees of risk. Some of the risks involved with equities include the possibility that the value of the stocks may fluctuate in response to events specific to the companies or markets, as well as economic, political or social events in the U.S. or abroad. Bonds are subject to interest rate, inflation and credit risks. Investments in high-yield bonds may be subject to greater market fluctuations and risk of loss of income and principal than securities in higher rated categories. Investments in foreign securities involve special risks, including foreign currency risk and the possibility of substantial volatility due to adverse political, economic or other developments. These risks are magnified for investments made in emerging markets. Investments in a certain industry or sector may pose additional risk due to lack of diversification and sector concentration. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates, and risk related to renting properties, such as rental defaults. There are special risks associated with an investment in commodities, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and the impact of adverse political or financial factors. Income from investing in municipal bonds is generally exempt from federal and state taxes for residents of the issuing state. While the interest income is tax exempt, any capital gains distributed are taxable to the investor. Income for some investors may be subject to the federal alternative minimum tax (AMT).

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