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Maintain a long term approach during this Buyer's Strike

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Chief Investment Office

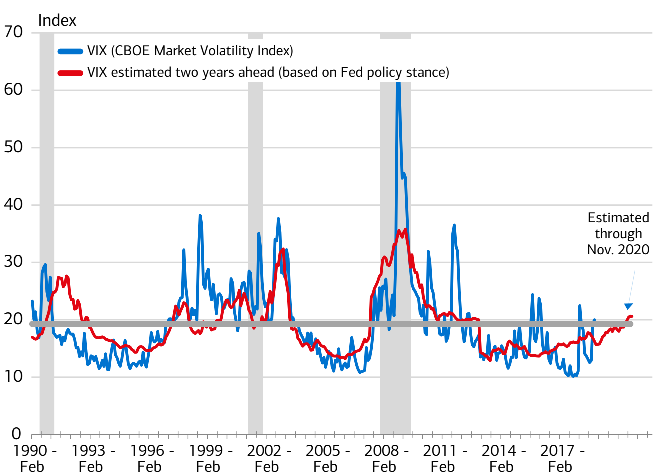
As we move into the last two weeks of trade for 2018 and are just a few days away from the last Federal Open Market Committee (FOMC) meeting for the year, equity markets remain weak. Despite still-positive economic news in the U.S., the overseas environment continues to struggle, particularly in Europe and China. Investors have pulled back on their risk appetite as the global scene remains unclear on many fronts and the Federal Reserve (Fed) is expected to nudge short-term interest rates higher by another 25 basis points at next week's meeting. This has created a so-called "buyer's strike" across various equity and credit markets. The latest flow data confirms this "risk-off" environment. According to AMG Data Services, for the week ending 12/12/18, investors pulled more than $45 billion from equity mutual funds, which is the largest outflow on record. In addition, over the same period, a record of more than $14 billion was liquidated in taxable bond funds. Bearish sentiment is at its highest level in recent times. Another meaningful increase in negative sentiment could result in a contrarian buy signal for investors who have been waiting for more attractive equity prices and are below their long-term strategic equity allocations.

With the overall political climate changing by the day (U.S./China trade negotiations, U.S. budget and debt ceiling talks, Brexit, etc.) and a "growth scare" (yield curve concerns) still top of mind for investors, we expect market activity to remain volatile over the coming weeks if not months. In our year-ahead report for 2019, *Powerful Waves of Change*, we discussed two events that in our view need to happen to help stabilize risk assets. The first is our position that the Fed is likely to begin to focus on the inflation data that specific indicators are already exhibiting. This will allow the Fed to signal more dovish viewpoints, which could lead to a pause sooner rather than later. In other words, there is a significant risk that there will be fewer than four hikes next year. The Fed funds futures market is currently pricing in zero hikes for 2019, but equity investors have yet to factor this into their positioning. We should have greater clarity on this front by the end of next week. Second, a short-term U.S./China trade agreement is needed to alleviate some of the growth scare that has gathered momentum since the market highs in late September. In the next three-plus months we should see a number of different announcements on this front.

We still believe that although nominal GDP growth is slowing meaningfully, real growth should still grow above-trend for 2019, led by consumer spending. This should support corporate earnings growth of 5-6% or better for next year. At current levels on the S&P 500 of close to 2600, and a fair value estimate of 2900 for next year, equities remain attractive on an absolute basis and relative to fixed income, in our opinion. If business and/or consumer confidence is negatively affected in a meaningful way in 2019, due to prolonged uncertainty regarding global trade or short-term interest rates, our above-trend real gross domestic product (GDP) growth story would also be affected. If these signs develop, we would begin to position portfolios in a more defensive manner. However, given certain factors – including our view that rates are set to peak next year, the economic climate in the U.S. is slowing but still above-trend, and emerging market economies are bottoming out -- we maintain our pro-equity stance. The areas that remain our largest concern continue to be the non-U.S. developed markets that have significant European equity exposure. This area remains on our negative watch list.

We continue to advocate a long-term investing approach and do not believe that market timing can be successful over long periods of time. Rather, bull-market environments, mixed with periods of re-sets, or bear markets in which over-valuation is corrected and/or the economy rolls over due to policy errors or exogenous shocks, are to be expected. The volatility we have seen this year may seem to be at an extreme, especially given the record low levels in 2017, but it is actually quite normal when seen in the context of the historical activity of the Chicago Board Options Exchange (CBOE) VIX index (Exhibit 1).

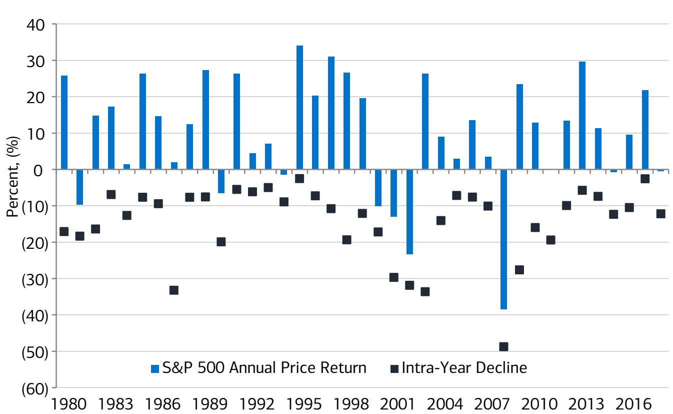
Exhibit 1: Volatility Heading Towards Normal



Sources: Wall Street Journal/Haver Analytics, Chief Investment Office. Data as of November 26, 2018.
Past performance is no guarantee of future results.

This is particularly the case considering the evolving market structure today, which includes significantly more quantitative-model and machine-led, short-term trading strategies across the marketplace. Times of market stress are difficult, but stepping away from the day-to-day, week-to-week gyrations of the market is important, in order to adhere to your personal long-term goals. Long-term goal achievement requires long-term thinking. **Our preferred strategic path is to develop a comprehensive plan, maintain a diversified portfolio objective, and deploy a disciplined approach to re-balancing during extreme periods on the upside and downside.** This helps build more consistent risk-adjusted returns that are compounded over time through various market cycles (Exhibit 2 and 3).

Exhibit 2: Intra-year declines are poor indicator of future annual performance.



Sources: Bloomberg; Chief Investment Office. Data as of December 2018.
Past performance does not guarantee future results.

Exhibit 3: Excluding The Best Ten Days

Decade	Price Return	Excluding Best 10D Per Decade
1930	-42%	-79%
1940	35%	-14%
1950	257%	167%
1960	54%	14%
1970	17%	-20%
1980	227%	108%
1990	316%	186%
2000	-24%	-62%
2010	148%	70%
Since 1930	**13363%**	**67%**

Source: BofAML U.S. Equity & Quant Strategy. Data as of October 19, 2018.
Past performance is no guarantee of future results.

IMPORTANT DISCLOSURES

Merrill Lynch
Bank of America Corporation