



Principles for Successful Long-Term Investing

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Investors today are inundated with a 24/7 news cycle. As a result, it has become increasingly challenging to separate genuine and actionable investment insight from the churn that tends to confound markets on a day-to-day basis. This “noise volatility” magnifies the propensity for behavioral mistakes rooted in the human emotions of greed and fear, often leading to suboptimal investment outcomes. One research shows that an average equity fund investor fails to keep pace with the S&P 500, underperforming the index by over 2.9% a year¹ when looked at from 1996 to 2016. What leads to this poor record? Imprudent market timing, deficient asset allocation, lack of patience or discipline, and the absence of a coherent financial plan can all derail even the most well-laid investment objectives.

The following principles of a sound, long-term investment strategy can help investors avoid costly pitfalls on the path toward achieving their financial goals, in our view:

- Understand, take on and manage risk appropriately
- Time in the market is important, not market timing
- Over the long term, a diversified portfolio is best
- Monitor and maintain a disciplined plan

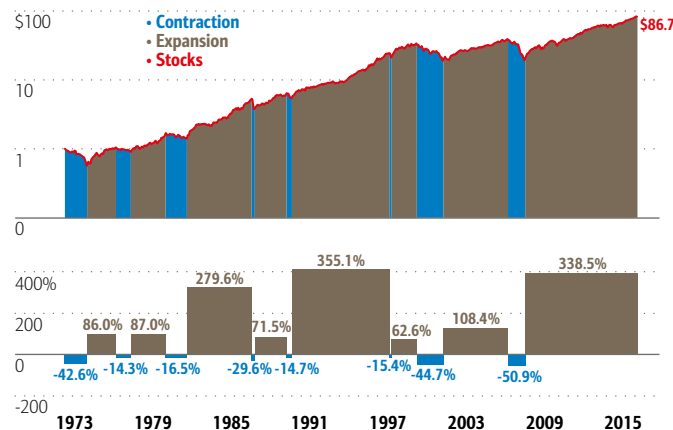
UNDERSTAND, TAKE ON AND MANAGE RISK APPROPRIATELY

Risk and return go hand in hand when investing in the financial markets. Investing requires taking calculated positions that will be influenced by future outcomes that are presently unknown but may be assessed with some degree of confidence. In general, higher risk provides the opportunity for higher returns but can also incur higher levels of losses. Investors have to assess for their situation which risks they want to assume—market risk, credit risk, interest rate risk, liquidity risk among others; how much of each risk to take on and then how to

¹ Dalbar Inc. 2016.

manage those risks within the ever-changing landscape of the global capital markets. Volatility, or market fluctuation, often carries a negative connotation but should be expected (Exhibit 1). In fact, market pullbacks happen quite often within the context of a long-term upward trend—the S&P 500 Index has averaged +10% pullbacks once a year and +5% pullbacks three times a year dating back to the 1980s, according to Strategas Research.

Exhibit 1: Equities Have Overcome Pullbacks



Source: Morningstar. Data as of December 31, 2017. Past performance is no guarantee future results.

On the other hand, permanent loss of capital and being too risk averse may cause investors to come up short in the desired level of growth of their portfolios. Permanent loss of capital can happen when investors sell at market lows and lock in those losses during a downturn, a common behavioral mistake. Alternatively, being too risk averse, for example by staying in cash, may help one sleep at night but at the risk of foregoing the opportunity for upside. Taking less risk may be appropriate for some investors but for those seeking growth of capital, it can lead to a shortfall in meeting their financial goals.

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TIME IN THE MARKET IS IMPORTANT, NOT MARKET TIMING

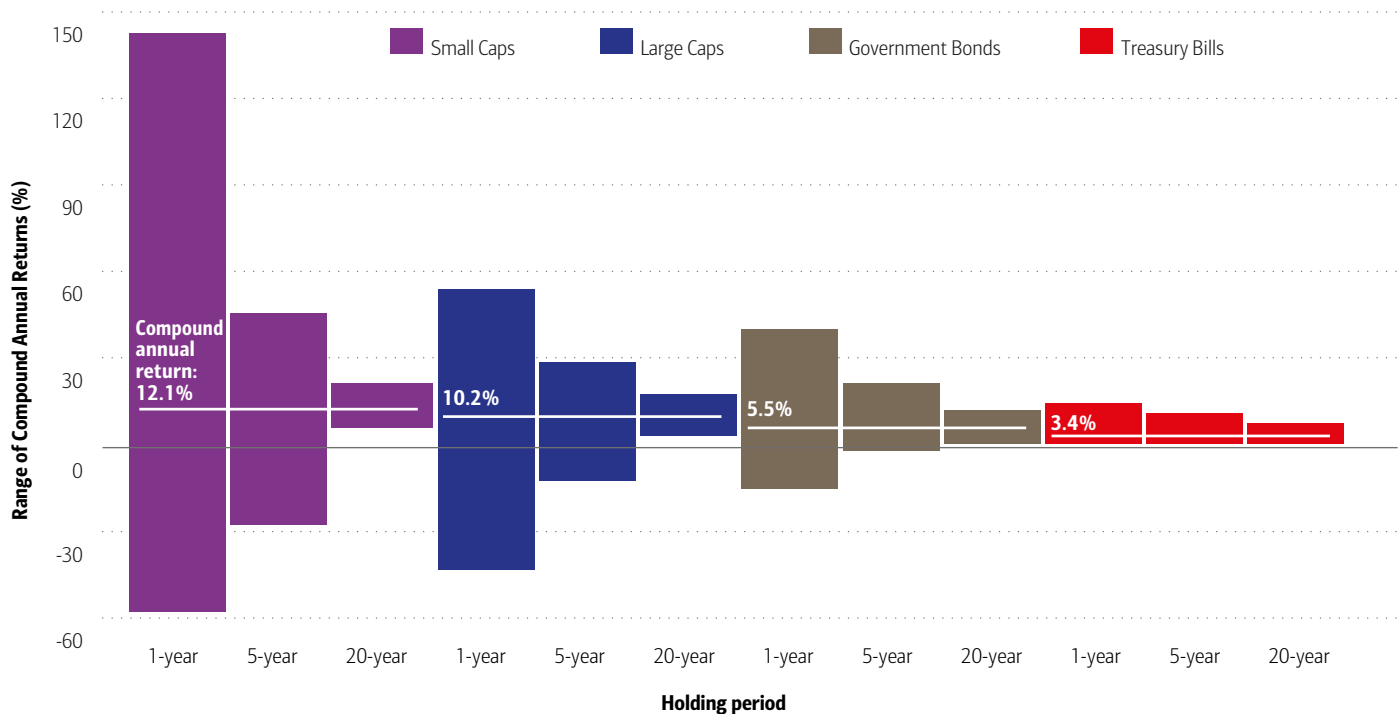
“Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves.”

— Peter Lynch, Mutual Fund Manager and Philanthropist.

The temptation to avoid price declines is logical, but it can be difficult to spot market swoons in advance. The stakes associated with not staying invested can be high as asset prices typically grind higher over the long term while dividends, buybacks and interest payments add up. In addition, returns are also often concentrated to a select number of trading days, magnifying the opportunity cost of mistimed participation. For example, since 1930, if an investor excluded the ten best-performing days of the S&P 500 from each decade, it would have resulted in a net performance drag of 11,798%.²

Market timing involves making multiple decisions including when to remove exposure, which to remove, and when to reintroduce those exposures. These decisions can be complex, and studies have shown that individual investors struggle to correctly make them on a consistent basis. Instead of market timing, investors should focus on implementing a disciplined approach of constant and consistent participation, which increases the potential of long-term investment success. For most asset classes, the longer the holding period, the greater the probability of achieving positive returns (Exhibit 2). This is especially true of riskier assets like equities, which can be volatile and unpredictable over shorter time horizons, but if held to 20 years, historically have produced positive returns.³ Therefore, as it relates to investing, history would imply that time in the market can be used to your advantage.

Exhibit 2: The Longer an Investment Is Held, the Better the Potential for Success



Source: Morningstar. Data as of December 31, 2018. Small stocks are represented by the Ibbotson® Small Company Stock Index. Large stocks are represented by the Ibbotson® Large Company Stock Index, government bonds by the 20-year U.S. government bond, Treasury bills by the 30-day U.S. Treasury bill, and inflation by the Consumer Price Index. **Past performance is no guarantee future results.**

² BofA Merrill Lynch (BofAML) Global Research. Data as of December 31, 2018.

³ Morningstar. Data as of December 31, 2018.

OVER THE LONG TERM, A DIVERSIFIED PORTFOLIO IS BEST

“My favorite time frame for holding a stock is forever.”
— Warren Buffett, Investor and Philanthropist.

Growing wealth over the long term is as much about taking risk in the market as it is about minimizing debilitating drawdowns that can be difficult to recover from. A diversified portfolio comprising a mix of asset classes—such as stocks, bonds, cash and so on—constructed in accordance with an investor’s risk tolerance and return expectations, can help in this regard, and over the long term should lead to better risk-adjusted returns. However, in the short term, a diversified⁴ portfolio will likely underperform the best-performing asset classes. This is to be expected, as in any given year, some asset classes will perform well while others do poorly, and it is hard if not impossible for investors to anticipate these trends (Exhibit 3).

⁴ Diversification does not ensure a profit or protect against loss in declining markets.

Proper diversification should expose investors to various asset classes that can act as levers providing unique utilities within a balanced portfolio. For example, history suggests that U.S. stocks could be expected to provide long-term growth of capital, while fixed income may provide diversification and/or income. Alternative investments for qualified investors can potentially provide excess returns, in some cases through exposure to the illiquidity premium. The logic is therefore simple. All-equity portfolios have historically performed well over the long-term but they occasionally subject investors to large drawdowns, losses which prove too difficult for some investors to bear. Adding fixed income to a portfolio can help reduce this risk and create a more palatable investment experience. This should enhance risk-adjusted returns over the long term, and therefore increases the probability that investors achieve their financial goals.

Exhibit 3: Performance Fluctuations across Asset Classes Makes Diversification Important

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
EM Equity 78.51%	US SCG 29.08%	Govt FI 9.19%	EM Equity 18.23%	US SCG 43.30%	US LCV 13.45%	US LCG 5.67%	US SCV 31.74%	EM Equity 37.28%	Intl FI 3.17%
High Yield FI 56.28%	US SCV 24.51%	Corp FI 7.51%	US SCV 18.05%	US SCV 34.52%	US LCG 13.05%	Mtge FI 1.46%	High Yield FI 17.34%	US LCG 30.21%	Inflation 2.18%
US LCG 37.20%	EM Equity 18.88%	Mtge FI 6.14%	US LCV 17.51%	US LCG 33.48%	Intl FI 9.07%	Intl FI 1.35%	US LCV 17.34%	Intl Eq 24.21%	Cash 1.87%
US SCG 34.49%	US LCG 16.71%	High Yield FI 4.50%	Intl Eq 16.41%	US LCV 32.53%	ML Mod. Alloc. 7.95%	Govt FI 0.84%	US SCG 11.32%	US SCG 22.17%	Mtge FI 1.00%
Intl Eq 33.67%	US LCV 15.51%	Intl FI 4.04%	High Yield FI 15.44%	Intl Eq 21.02%	Corp FI 7.51%	Inflation 0.73%	EM Equity 11.19%	US LCV 13.66%	Govt FI 0.83%
US SCV 20.59%	High Yield FI 15.24%	Inflation 2.96%	US LCG 15.27%	ML Mod. Alloc. 17.05%	Mtge FI 6.07%	ML Mod. Alloc. 0.18%	ML Mod. Alloc. 8.05%	ML Mod. Alloc. 13.30%	US LCG -1.51%
ML Mod. Alloc. 20.37%	ML Mod. Alloc. 12.33%	US LCG 2.64%	US SCG 14.59%	High Yield FI 7.38%	Govt FI 5.88%	Cash 0.05%	US LCG 7.08%	US SCV 7.84%	Corp FI -2.25%
Corp FI 19.76%	Corp FI 9.52%	ML Mod. Alloc. 2.08%	ML Mod. Alloc. 11.79%	Inflation 1.51%	US SCG 5.60%	Corp FI -0.63%	Corp FI 5.96%	High Yield FI 7.48%	High Yield FI -2.26%
US LCV 19.69%	Intl Eq 8.95%	US LCV 0.39%	Corp FI 10.37%	Intl FI 1.33%	US SCV 4.22%	US SCG -1.38%	Intl FI 5.19%	Corp FI 6.48%	ML Mod. Alloc. -4.78%
Mtge FI 5.76%	Mtge FI 5.67%	Cash 0.10%	Intl FI 6.59%	Cash 0.07%	High Yield FI 2.45%	Intl Eq -3.04%	Intl Eq 2.75%	Intl FI 2.51%	US LCV -8.27%
Intl FI 4.67%	Govt FI 5.61%	US SCG -2.91%	Mtge FI 2.59%	Mtge FI -1.39%	Inflation 0.76%	US LCV -3.83%	Inflation 2.07%	Mtge FI 2.45%	US SCG -9.31%
Inflation 2.72%	Intl FI 3.28%	US SCV -5.50%	Govt FI 2.19%	Corp FI -1.46%	Cash 0.03%	High Yield FI -4.55%	Mtge FI 1.67%	Govt FI 2.42%	US SCV -12.86%
Cash 0.21%	Inflation 1.50%	Intl Eq -12.21%	Inflation 1.74%	EM Equity -2.60%	EM Equity -2.19%	US SCV -7.47%	Govt FI 1.15%	Inflation 2.24%	Intl Eq -14.09%
Govt FI -2.58%	Cash 0.13%	EM Equity -18.42%	Cash 0.11%	Govt FI -3.21%	Intl Eq -4.32%	EM Equity -14.92%	Cash 0.33%	Cash 0.86%	EM Equity -14.58%

Sources: Morningstar Direct & CIA System. Income and dividends are included in all returns figures. Data as of 12/31/2018. ML Moderate Allocation represents the Strategic Asset Allocation set by the GWIM ISC for the highest liquidity needs with none of the portfolio invested in alternative asset categories for U.S. Investor. Results shown are based on an index and are illustrative; they assume reinvestment of income and no transaction costs or taxes. Indexes are unmanaged. Direct investment cannot be made in an index. Please refer to page 5 for additional information. **Past performance is no guarantee of future results.**

MONITOR AND MAINTAIN A DISCIPLINED PLAN

Principles for successful long-term investing can be difficult to manage without a proper plan in place to encourage discipline, evaluation and evolution as circumstances change. As they say—life happens! And with it, there is a natural evolution of an investor’s purpose and goals for investing, along with their risk tolerance. A sophisticated process involving the development of strategic asset allocation, tactical allocation overlay, manager selection using a rigorous due diligence process, and risk management through monitoring and periodic rebalancing can help to maximize the potential for success.⁵

Certain strategies can be implemented alongside a financial plan to further help manage behavioral biases and increase the potential for positive outcomes:

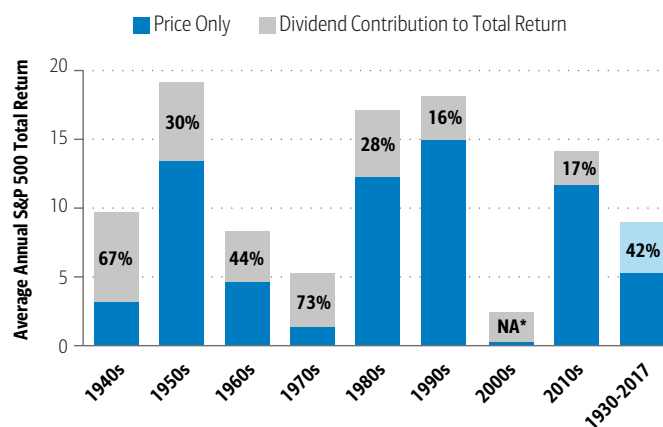
Rebalancing: Portfolio rebalancing should be done on a systematic basis, when allocations breach a specific range or opportunistically within the framework of a tactical asset allocation. This risk-management approach allows investors to remain within their specified risk-budget, as they harvest profits from areas of the market that have appreciated and buy those which have underperformed.

Dollar-Cost Averaging (DCA): This involves investing a fixed dollar amount on a regular basis, thus accumulating assets without trying to time a market entry point. The intuition being that purchasing at pre-specified intervals will smooth out the entry price of that particular asset. DCA helps investors avoid investing too much when the market is high and too little when the market is low. In a declining market, this can help to preserve value but in a rising market DCA is less efficient.⁶

Dividend Reinvestment: Investors ought to allow their invested money to work for them. The ability to have invested funds grow upon themselves, or compound, is powerful over time. Dividend reinvestment helps to automate that process—from 1930 to 2017, for example, dividend income’s contribution to the total return of the S&P 500 Index averaged 42% (Exhibit 4).

*“Compound interest is the eighth wonder of the world”
— Albert Einstein, Theoretical Physicist.*

Exhibit 4: Dividends Play a Significant Role in Investor Returns



Source: Morningstar. Data as of January 18, 2019. *Total Return for the S&P 500 was negative for this period and dividends yielded 1.8% on an annualized basis. **Past performance is no guarantee of future results.**

CONCLUSION

The financial markets can seem complex. However, the power of the most advanced concepts can be distilled into a few simple principles including diversification, risk-management and a disciplined investment process to help investors on the path toward long-term success.

⁵ Risk management, diversification and due diligence processes seek to mitigate, but cannot eliminate risk, nor do they imply low risk.

⁶ Keep in mind that dollar cost averaging cannot guarantee a profit or protect against a loss. Since such an investment plan 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.

INDEX DEFINITIONS

Asset Class	Index	Definition
Inflation	IA SBBI US Inflation	The Consumer Price Index for All Urban Consumers, or CPI-U, is used by IA SBBI to measure inflation, which is the rate of change of consumer goods prices. All inflation measures are constructed by the U.S. Department of Labor, Bureau of Labor Statistics, Washington.
Cash	IA SBBI US 30 Day TBill TR USD & BAML U.S. Treasury Bills 3 months	For the IA SBBI U.S. Treasury Bill Index, the CRSP U.S. Government Bond File is the source from 1926 to 1976. Each month a one-bill portfolio containing the shortest-term bill having not less than one month to maturity is constructed. (The bill's original term to maturity is not relevant). The ICE BofAML US 3-Month Treasury Bill Index is comprised of a single issue purchased at the beginning of the month and held for a full month. At the end of the month that issue is sold and rolled into a newly selected issue.
US Large Cap Growth	Russell 1000 Growth Total Return	Russell 1000 Growth Total Return measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.
US Large Cap Value	Russell 1000 Value Total Return	Russell 1000 Value Total Return measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values.
US Small Cap Growth	Russell 2000 Growth Total Return	Russell 2000 Growth Total Return measures the performance of the broad growth segment of the U.S. equity universe. It includes those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values.
US Small Cap Value	Russell 2000 Value Total Return	Russell 2000 Value Total Return measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 2000 companies with lower price-to-book ratios and lower expected growth values.
International Equity	MSCI Daily TR Net World Ex USA USD	The MSCI World ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries – excluding the United States. The index covers approximately 85% of the free float-adjusted market capitalization in each country.
Emerging Markets	MSCI Daily TR Net EM USD	The MSCI Emerging Markets (EM) Index captures large and mid cap representation across 23 Emerging Markets countries and targets coverage of approximately 85% of the free float adjusted market capitalization in each country.
U.S. Government & Quasi Government	ICE BofAML AAA U.S. Treasury/Agency Master	The ICE BofAML US Treasury & Agency Index tracks the performance of US dollar denominated US Treasury and non-subordinated US agency debt issued in the US domestic market.
U.S. Mortgage Backed	ICE BofAML Mortgage Master	The ICE BofAML US Mortgage Backed Securities Index tracks the performance of US dollar denominated fixed rate and hybrid residential mortgage pass-through securities publicly issued by US agencies in the US domestic market.
U.S. Corp Master	ICE BofAML U.S. Corp Master	The ICE BofAML US Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market.
USD High Yield	ICE BofAML High Yield Cash Pay	The ICE BofAML US Cash Pay High Yield Index tracks the performance of US dollar denominated below investment grade corporate debt, currently in a coupon paying period, that is publicly issued in the US domestic market.
International Fixed Income	ICE BofAML Global Broad Market TR ex USD (Hedged)	The ICE BofAML Global Broad Market Excluding US Dollar Index tracks the performance of investment grade debt publicly issued in the major domestic and eurobond markets, including sovereign, quasi-government, corporate, securitized and collateralized securities, excluding all securities denominated in US dollars.

ML Moderate Allocation, US SAA: The hypothetical historical returns are based on the US-biased Tier 0 Strategic Asset Allocation and proxy indices as of March 2018. The calculations are performed in Morningstar using daily returns and monthly rebalancing. Results shown are based on indexes and are illustrative; they assume reinvestment of income and no transaction costs or taxes. Indexes are unmanaged. Direct investment cannot be made in an index. It is composed as follows: From 12/19/2017 through current quarter end: 12% Russell 1000 Growth | 19% Russell 1000 Value | 2% Russell 2000 Growth | 2% Russell 2000 Value | 14% MSCI World ex USA NR | 5% MSCI EM NR | 11% BofAML US MBS | 13% BofAML US Corporate | 14% BofAML US Trsy&Agcy | 2% BofAML Gbl Brd Mkt xUS HUSD | 4% BofAML US Cash Pay HY | 2% BofAML US 3M Trsy Bill. From 01/10/2017 through 12/18/2017: 12% Russell 1000 Growth | 19% Russell 1000 Value | 2% Russell 2000 Growth | 2% Russell 2000 Value | 13% MSCI World ex USA NR | 5% MSCI EM NR | 11% BofAML US MBS | 14% BofAML US Corporate | 14% BofAML US Trsy&Agcy | 2% BofAML Gbl Brd Mkt xUS HUSD | 4% BofAML US Cash Pay HY | 2% BofAML US 3M Trsy Bill. From 04/14/2009 through 01/09/2017: 23% Russell 1000 Growth | 23% Russell 1000 Value | 2% Russell 2000 Growth | 2% Russell 2000 Value | 8% MSCI EAFE NR | 2% MSCI EM NR | 9% BofAML US MBS | 13% BBgBarc US Govt | 9% BBgBarc US Credit | 2% BofAML Gbl Brd Mkt xUS Loc | 2% BofAML US Cash Pay HY | 5% IA SBBI US 30 Day Tbill. From 04/04/2007 through 04/13/2009: 23% Russell 1000 Growth | 23% Russell 1000 Value | 2% Russell 2000 Growth | 2% Russell 2000 Value | 10% MSCI EAFE NR | 9% BofAML US MBS | 13% BBgBarc US Govt | 9% BBgBarc US Credit | 2% BofAML Gbl Brd Mkt xUS Loc | 2% BofAML US Cash Pay HY | 5% IA SBBI US 30 Day Tbill.

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Investing involves risk, including the possible loss of principal. 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.

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.

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).

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).

Past performance is no guarantee of future results.

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