Capital Market Outlook

Chief Investment Office

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

JUNE 18, 2018

IN THIS ISSUE

MACRO STRATEGY

The Federal Reserve's (Fed's) view of the neutral interest rate consistent with the non-accelerating inflation rate of unemployment (NAIRU) has changed dramatically over the past five years. This is making policy makers more cautious about avoiding an over-tightening policy mistake. As a result, the yield curve is becoming a more-watched indicator of the monetary policy stance.

GLOBAL MARKET VIEW

We are bullish on waste and garbage because never before in the history of mankind have so many people had so much to throw away or discard, notably in the developing nations. There, greater urbanization and rising per capita incomes among a burgeoning middle class equals more consumption of goods and the soaring residual of modern life: aka, garbage.

THOUGHT OF THE WEEK

The path of least resistance for macro financial conditions is likely to be flat-to-slightly-tighter over the rest of the year and is worth watching. For now, macro conditions are neutral and support our view that equities should grind higher.

PORTFOLIO CONSIDERATIONS

We maintain a positive view on equities with a heavier emphasis on the U.S. given our recent downgrade of international developed markets to neutral.

MACRO STRATEGY

HAWKISH OR DOVISH?

Chief Investment Office Macro Strategy Team

The June 13 Federal Open Market Committee (FOMC) meeting was generally judged to result in a slightly hawkish outcome. For example, the *Financial Times* declared "Hawkish Fed lifts rates as Trump tax cuts fuel economic expansion." There were slight upticks in the Fed's outlook for gross domestic product (GDP) growth, inflation and the Fed funds rate for the next two years as well as a downward revision to the expected unemployment rate. A hotter economy with a little more inflation naturally leads the FOMC to project somewhat higher interest rates for year-end 2018 and 2019. The range of estimates for the future federal funds rate actually narrowed, with some "doves" lifting their rate projections for 2018, while the 2019 and 2020 projection ranges saw both "doves and hawks" move toward the center.

Lost in the shuffle was the bigger issue of what constitutes a neutral interest rate. Up to this point, the FOMC has been comfortable declaring that "*the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run.*" For the first time in the post-financial-crisis period, this commitment to accommodation was dropped from the June 13 policy statement.

It is not surprising that policymakers have begun a more intense focus on the issue of what constitutes a neutral policy rate. Perceptions of the neutral rate are implicit in the FOMC's projection of the longer-run federal funds rate that members expect. The longer-run rate is presumably the rate that they see prevailing in the absence of too much or too little monetary accommodation. Alternatively, it can be seen as the average of the funds rate over the business cycle, which encompasses both the easier phase and the restrictive phase. In the transition from accommodative to restrictive policy, the fed funds rate by definition passes through neutrality—the rate where monetary policy is consistent over the longer run with the economy growing at potential and inflation on target. A lower rate is stimulative beyond those limits, while a higher rate implies that policy is restraining growth and inflation below target.

Data as of 06/18/2018 and subject to change.

Unfortunately, the neutral interest rate, like the natural rate of unemployment, is unobservable, and the Fed's track record for gauging both measures is not especially good. In fact, Fed estimates for these unobservable variables tend to track the consensus outlook of economists, which has had systematic errors. For example, over the past six months, both the Fed's and the Blue Chip consensus forecast representing economists' outlooks for 2018 GDP growth have been slowly rising from just under 2.5% to just under 3%.

The longer-run track record of economists and the Fed's systematic forecast errors is evident in the FOMC projections of member forecasts for the so-called neutral rates of interest and unemployment over the past five years (Exhibit 1).

Exhibit 1: FOMC Median Projections for Longer Run Values

	Inflation	Unemployment Rate	GDP	Federal Funds Rate
March 2013	2.0	5.6	2.4	4.0
March 2014	2.0	5.4	2.3	4.0
March 2015	2.0	5.1	2.2	3.6
March 2016	2.0	4.8	2.0	3.3
March 2017	2.0	4.7	1.8	3.0
June 2018	2.0	4.5	1.8	2.9

Source: FOMC. Data as of June 14, 2018

As can be seen, there has been a steady downward bias in revisions to the FOMC view of the long-run values for the unemployment rate, GDP growth and the federal funds rate. Notice the longer-run projections for inflation have not changed from the Fed's 2.0% target rate. That's because the Fed believes that:

The inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation. The Committee reaffirms its judgment that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate.[1]

While 2% inflation is the long-run target of monetary policy, its other objective—maximum employment "*Is largely determined by nonmonetary factors that affect the structure and dynamics of the labor market.*" Since those factors change over time, so does the unemployment rate associated with the 2% inflation target. As can be seen in Exhibit 1, the FOMC has been chasing the maximum unemployment rate down for five years and now believes that it is 4.5% instead of the 5.6% rate projected in 2013. Furthermore, the range of estimates for the NAIRU is wide (4.1% to 4.7% now compared to 5.0% to 6.0% in 2013). Clearly the Fed (and economists) appear to have missed the boat in trying to forecast this concept. As a result, Fed Chairman Powell has expressed a healthy skepticism about tying policy too closely to economists' projections of unobservable variables that have proven so far off the mark.

In sum, as regards to the NAIRU, the evidence suggests that there is still a lot of uncertainty among economists about how low it is and therefore whether monetary policy should move beyond neutral toward restrictive. If 4.5% is truly the NAIRU then at 3.8% the unemployment rate is well below that level and should stimulate persistent rising inflation. This is implicit in the recent FOMC adjustment of its rate outlook slightly above its assessment of the neutral rate. The FOMC sees a 3.4% funds rate in 2020 compared to a "neutral" estimate of 2.9%, implying policy will be restrictive in 2020.

Powell has, however, emphasized that these point estimates are less important than the fact that the range of uncertainty around them is big. For example, the top of the neutral interest rate range is 3.5%, which implies policy would only be approaching neutral in 2020 with a 3.4% funds rate. This would cause an undershoot in policy that would allow for a bigger overshoot in inflation. Alternatively, the low end of the longer-run funds rate estimate at 2.3% implies that a 3.4% funds rate would be restrictive and more likely to invert the yield curve and cause a recession.

Since these critical concepts are unobservable variables, the Fed must rely on market feedback from useful leading indicators to gauge the accuracy of its estimates of these concepts. Leading indicators are necessary because inflation is a lagging variable with lots of inertia. By the time it gets too hot, it is harder to contain. Essentially, the persistent downward revision of economists' views about NAIRU and the neutral funds rate reflects their forecasts' inconsistency with real-world feedback. In his news conference following the latest FOMC meeting on June 13, Chairman Powell singled out the yield curve as a useful leading indicator for judging the appropriate stance of policy.

The yield curve is creeping into more Fed speeches and analysis. It has one of the best track records as a leading indicator and as a result gets the biggest weight in the aggregate index of leading indicators. Currently, the gap between the fed funds rate and the 10-year treasury note is about 100 basis points, which is near the historical average, suggesting that monetary policy is already about neutral. Some Fed officials have been arguing that the neutral rate is as low as 2.3% to 2.5%. This would imply that the funds rate would be at neutral by year-end given an outlook for two more rate hikes in 2018. A flat yield curve at that point would suggest that policy is past the point of neutrality and into the restrictive realm.

[1] Statement on Longer-Run Goals and Monetary Policy Strategy adopted effective January 24, 2012, as amended effective January 30, 2018.

THEMATIC UPDATE: BULLISH ON WASTE AND GARBAGE

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Multiple investment opportunities pivot around the emerging markets. As part of our thematic research, we have highlighted many of these investment considerations in the past, with emerging market consumers—more specifically the burgeoning global middle classes in Asia, Africa, the Middle East and Latin America—key drivers of economic growth and corporate earnings in such global sectors as technology, health care, energy, travel and leisure, transportation and eSports, to name just a few.

This report highlights yet another play on the secular rise of the global middle class: waste. Or less elegantly put: garbage. We are bullish on waste and garbage because never before in the history of mankind have so many people had so much to throw away or discard. Waste management, accordingly, is one of the most vibrant industries in the world, with an estimated worth of $2 trillion by 2020.[2]

In this report, our definition of waste/garbage is two-fold: 1) municipal solid waste (MSW), which is defined as residential, industrial, commercial, institutional, municipal, and construction and demolition waste; and 2) electronic waste (eWaste), which consists of discarded mobile phones, computers, air conditioners, televisions, LED lights, refrigerators, printers and similar goods. Per the former, or MSW, roughly 1.7 billion tons of waste is generated each year, with the figure only expected to increase in the future. Meanwhile, some 50 million tons of eWaste is generated each year, with this number, like MSW, set to rise as well.

RISING AFFLUENCE = WASTE + GARBAGE

The underlying equation for our waste theme is quite simple: greater urbanization + rising per capita incomes among a burgeoning middle class = more consumption of mass-produced goods + the soaring residual of modern life: aka, waste products like cardboard, plastics, glass, scrap metals, spoiled food, wood and a host of related items. Rarely contemplated by consumers (or you and I), the more one consumes, the more one has to dispose of or discard. Every day, the typical American generates 4.5 pounds in waste.

Now take the number and apply it to a world that is rapidly urbanizing and to a world where the number of middle class consumers has never been higher, and what are you left with? Heaps of garbage and waste—the majority of it uncollected or recycled.

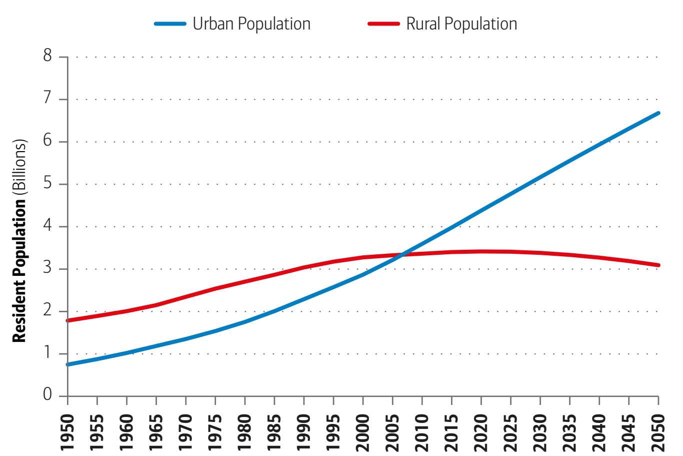
[2] See "No Time to Waste—global waste primer," BofA Merrill Lynch Global Research, April 2013.

Waste and garbage are growth industries due in large part to steadily increasing levels of global consumption, with global consumption expenditures expanding from $20.1 trillion in 2000 to $43.6 trillion in 2016, a compound annual average rate of growth of 5%. Not surprisingly, the bulk of this growth has emanated from the developing nations, where a number of variables—a better educated labor force, rising per capita incomes, greater female workforce participation rates, the proliferation of the internet—has converged to boost the spending power of consumers long accustomed to living off basic staples.

As a share of global personal consumption, the developing nations now account for roughly 40% of the total versus a share of 24% at the start of the century. Total consumption in the developing nations rose from $4.8 trillion in 2000 to an estimated $17.3 trillion in 2016. That's almost a 300% increase—and reflects soaring demand for processed foods, beverages, electronics, cars, luxury items, goods wrapped in plastic or cardboard, and related items. The residual: more and more trash.

Another contributing factor to the growth of waste and garbage has been the increase in global urbanization and, more specifically, the explosion in mega-cities over the past few decades. When it comes to life in the city, we have reached the point of no return. That is, more people now live in the city than in rural areas, with that tectonic threshold crossed in 2008. In 1950, in contrast, only 30% of the world's inhabitants (751 million) lived in the cities. The level of global urbanization was 55% in 2018 and is set to reach nearly 70% in 2050 based on estimates from the United Nations (UN) (Exhibit 2). Ninety percent of this increase to 2050 will take place in Asia and Africa—amounting to an additional 2.5 billion people residing in urban areas.

Exhibit 2: The World's Residents



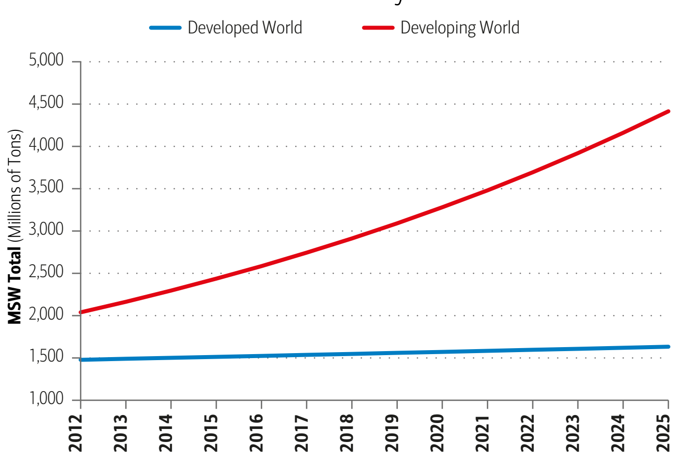
Source: United Nations World Urbanization Prospects 2018. Data as of May 16, 2018.

Helping to drive this trend: the explosion in the world's mega-cities—or a city with a population of 10 million people or more. While over the 1950s, only Tokyo and New York were considered mega-cities, today there are 32 so-called mega-cities, with most of these cities in Asia and Africa.

Greater urban living among an expanding global middle class speaks volumes to the economic progress of the past half century. Across the world, life expectancies are rising, infant mortality rates are declining, the digital world keeps expanding, and women are better educated. These are key metrics of economic success, although this success comes with a heavy cost: mountains of trash amid failing/floundering attempts of the public sector to keep up.

The level of solid waste produced each year is expected to reach 2.2 billion tons by 2025, according to estimates from the World Bank. Presently, it's the high-income nations that produce the most waste on a per-capita basis, although when it comes to total waste generation, it's the developing nations that spew out the most waste, led by China, which surpassed the U.S. as the world's largest waste generator in 2004. Not to be outdone, in India, towering mounds of garbage are becoming so high that in the not-too-distant future, planes might find it difficult to land in New Delhi, one of the largest cities in the world.[3] By 2025, the World Bank expects the developing nations to account for 70% of annual municipal solid waste, up from roughly half in 2012 (Exhibit 3).

Exhibit 3: Trash Generation Globally



Sources: World Bank, CIO Market and Thematic Strategy Team aggregates. Data as of 2018.

And that said, there's more to waste/garbage than just MSW. When you add in construction waste, automotive waste, agricultural and forestry waste, the annual global production of waste is in the range of 10-11 billion tons of solid waste per year according to the United Nations.

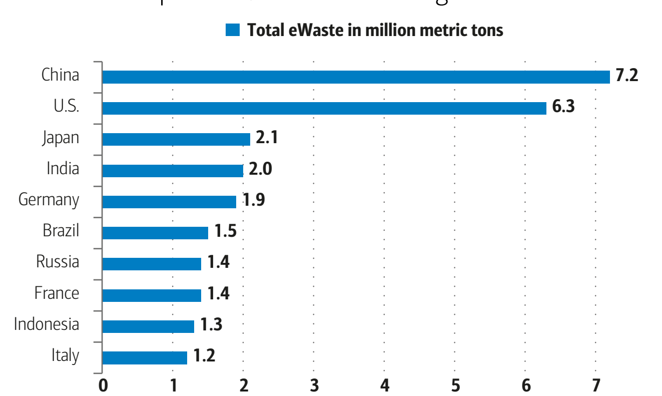
In the end, the world is not even close to "peak trash." As the UN notes, "there is no end in sight to this trend. Public waste systems in cities cannot keep pace with urban expansion".[4] The result: increased environmental stress like flooding, polluted water, rising levels of airborne diseases, and elevated health risks to millions of people around the world. And hence more private and public sector attention (and capital) to improve waste management, including a greater emphasis on industrial treatment, waste-to-energy conversion, energy-to-waste, sewage treatment, general recycling and scrap, and sustainable packaging. In other words, waste management offers multiple entry points for investors.

IT GETS TRASHIER: EWASTE AS A GROWTH INDUSTRY

If only the rising mountain of global garbage was just about cardboard boxes, plastics, wood, hazardous materials, glass, scrap metals, concrete, pharma waste, spoiled food, steel and numerous other by-products of affluence. Unfortunately, it does not end here. Also contributing to the ever-rising tide of global waste and garbage is eWaste—or the residual of a world gone digital. Think discarded devices like mobile phones, PCs, televisions, refrigerators, printers and related electronic items amounting to 50 million tons a year according to figures from the United Nations.

Trends like an expanding internet user base with expanded networks and services, rising incomes backing the wants and needs of popular household appliances, and shortened product lifecycles all contribute to the attendant rise of eWaste. By a large margin, China and the U.S. are the world's biggest producers of electronic waste (Exhibit 4). When combined, these two countries produce just over a third of global eWaste. China is particularly entangled in the eWaste industry with its populous electronics consumer base and home to a strong manufacturing industry, but is also responsible for recycling and treating the rest of the world's eWaste.

Exhibit 4: Top 10 Countries Generating the Most eWaste



E-Waste includes discarded products with a battery or plug including mobile phones, laptops, televisions, refrigerators, electrical toys and other electronic equipment. Source: The Global E-Waste Monitor 2017. Data as of 2018.

[3] See "In Rotten, Teetering Towers, Garbage is Piling up in India", The New York Times, June 11, 2018.

[4] See, "The world's trash crisis, and why many Americans are oblivious, "Los Angeles Times, April 26, 2018.

"Recycling" eWaste, meanwhile, has become a huge business onto itself. One study estimates that the recovery of valuable secondary raw materials in million mobile phones allows the recovery of 50 pounds of gold, 550 pounds of silver, 20 pounds of palladium and more than 20,000 pounds of copper.[5] As noted by the United Nations, one ton of eWaste contains more gold than 17 tons of gold ore. In terms of market potential, it is worth noting that only a small fraction of eWaste is presently recycled. For instance, 40% of eWaste in Europe is recycled, versus 24 – 30% in China and Japan, and 12% in the United States.

INVESTMENT SUMMARY

Efficient waste management is becoming a top priority of both the public and private sectors, helped along by a growing global middle class demanding more environmental protection and sustainable best-practices. Against this backdrop, investment opportunities on our waste/garbage theme pivot around 1) pure waste management and recycling plays; 2) water utilities and water treatment companies; 3) infrastructure material and industrial companies; 4) "green" energy management and 5) smart cities and Real Estate Investment Trusts (REITs).

As mentioned, there are multiple entry points to this investment theme. As 3 billion people lack access to basic waste management services, waste and garbage remains among our high conviction themes. In the end, if there was ever an industry that had the wind at its back (foul as it may be), and is poised to grow well above the annual rate of the global economy for the next decade, it is waste management.

[5] UN Environmental Program 2017.

THOUGHT OF THE WEEK

UPDATE ON U.S. FINANCIAL CONDITIONS

Chief Investment Office Macro Strategy Team

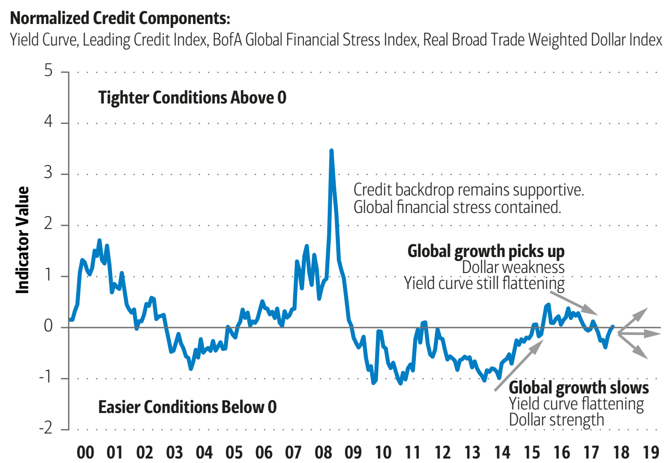
The path of least resistance for macro financial conditions is likely to be flat-to-slightly-tighter over the rest of the year and is worth watching. A sharp move higher would be a negative signal for equities and risk assets overall. For now, macro conditions are neutral and support our view that equities should grind higher. This is consistent with our view that Fed policy is also near neutral.

Looking at the components, the yield curve is likely to remain stable or flatten further as the Fed raises rates, credit spreads are already very tight and could widen if profit margins come under pressure, and international economic uncertainties are showing up in lower bond yields but a stronger dollar. The upside for risk assets (easier macro conditions) is a reacceleration in global growth or an easing of these international growth uncertainties. The downside for risk assets (and tighter macro conditions) is weaker than expected global growth or excessive Fed tightening.

The level of nonfinancial corporate debt as a percentage of GDP is also being flagged as a risk that we could be facing a tightening of credit and liquidity conditions. The credit backdrop has been consistently supportive of macro conditions and risk assets for the last few years. The change in nonfinancial profit margins is the key indicator to watch here as it has a tight link with the change in credit spreads. Given the stage of the business cycle, margin contraction is more likely than margin expansion, another reason to suspect macro conditions could tighten. The offsetting factor in the current environment is stronger nominal growth, which is supportive of topline growth and margins overall. Low overall corporate rates also help.

Our base case is that global growth stabilizes around the current pace and the dollar remains mostly stable, leaving room for equities to continue to grind higher. Global financial stress is a bit of a wildcard but remains contained for now.

Exhibit 5: CIO Macro Financial Conditions Indicator



Source: Bloomberg; Chief Investment Office. Data as of June 11, 2018

MARKETS IN REVIEW

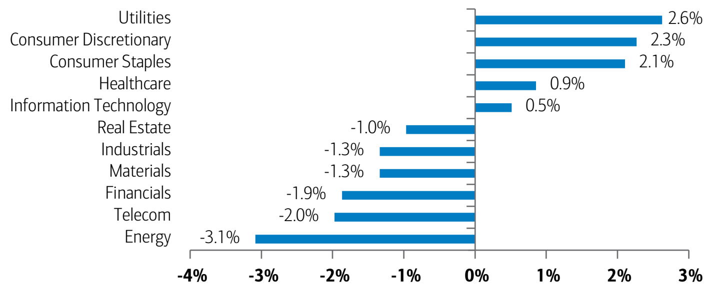
Equities

		Total Return in USD (%)		
	Level	WTD	MTD	YTD
DJIA	25,090.48	-0.8	2.9	2.6
NASDAQ	7,746.38	1.3	4.1	12.8
S&P 500	2,779.66	0.1	2.8	4.9
S&P 400 Mid Cap	1,992.37	-0.4	2.4	5.6
Russell 2000	1,683.91	0.7	3.1	10.3
MSCI World	2,134.15	-0.1	2.0	2.5
MSCI EAFE	2,000.09	-0.5	0.8	-0.8
MSCI Emerging Mkts	1,113.76	-1.8	-0.5	-3.1

Fixed Income[1]

		Total Return in USD (%)		
	Yield (%)	WTD	MTD	YTD
Corporate & Government	3.28	0.1	-0.5	-2.2
Treasury Bills	1.96	0.0	0.1	0.7
Treasury Notes and Bonds	2.77	0.1	-0.5	-1.6
Agencies	2.81	0.0	-0.3	-0.8
Municipals	2.69	0.0	-0.2	-0.5
U.S. Investment Grade	3.33	0.1	-0.5	-1.9
International	4.00	0.2	-0.5	-3.2
High Yield	6.23	0.4	1.0	0.7

S&P 500 Sector Returns (For the week ending 6/15/18)



Commodities & Currencies

		Total Return in USD (%)		
	Level	WTD	MTD	YTD
Bloomberg Commodity	180.42	-2.5	-3.2	0.3
WTI Crude $/Barrel[2]	65.06	-1.0	-3.0	7.7
Gold Spot $/Ounce[2]	1,279.55	-1.5	-1.5	-1.8
Level	Current	Prior Week End	Prior Month End	2017 Year End
EUR/USD	1.16	1.18	1.17	1.20
USD/JPY	110.66	109.55	108.82	112.69

Source: Bloomberg, Factset. [1] Bloomberg Barclays Indices. [2] Spot price returns. All data as of the 6/15/18 close. **Past performance is no guarantee of future results.**

Asset Class Weightings (as of 6/13/18)

	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. IG Tax Exempt	•	•	●	•	•
U.S. HY 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 Ranges (as of 6/8/18)

	Q3 2017	Q4 2017	Q1 2018E	Q2 2018E	2016	2017	2018 E
Real global GDP (% y/y annualized)					3.2	3.8	3.5 – 4.0
Real U.S. GDP (% q/q annualized)	3.2	2.9	2.2	4.5	1.5	2.3	3.0 – 3.5
CPI inflation (% y/y)*	2.1	2.1	2.1	2.1	1.3	2.1	2 – 3
Core CPI inflation (% y/y)*	2	1.8	1.8	1.8	2.2	1.8	2 – 3
Unemployment rate, period average (%)	4.3	4.1	4.1	3.8	4.9	4.4	3.8
Fed funds rate, end period (%) **	1.12	1.37	1.62	1.87	0.62	1.37	1.87 – 2.37
10-year Treasury, end period (%)	2.33	2.41	2.74	3	2.45	2.41	2.87 – 3.38
S&P 500, end period	2519	2674	2641	2800	2239	2674	2800-3000
S&P operating earnings ($/share)	33	38	37	39	119	132	148 – 158
U.S. dollar/euro, end period	1.18	1.2	1.23	1.18	1.05	1.2	1.18 – 1.28
Japanese yen/U.S. dollar, end period	113	113	106	110	117	113	105 – 115
Oil ($/barrel), end period	52	60	65	67	54	60	65 – 85

The average quarterly percent growth for the current calendar year divided by the average quarterly percent growth for the previous calendar year, annualized (unless stated otherwise). E = Estimate.

* Latest 12-month average over previous 12-month average

** Fed funds rate, end period based on market indications.

Past performance is no guarantee of future results. There can be no assurance that the forecasts will be achieved.

Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment performance.

Source: 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.

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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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