Capital Market Outlook

Chief Investment Office

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JULY 16, 2018

IN THIS ISSUE

MACRO STRATEGY

Stronger productivity is lifting U.S. growth and containing inflation. Policies that helped end the 1970s stagflation are now helping to end "secular stagnation." As in the 1980s, those policies appear to be spreading from the U.S. to the rest of the world.

GLOBAL MARKET VIEW

The rise of geo-economics—the use of economic instruments to promote national objectives—has caught investors by surprise. The markets have underestimated the Trump administration's willingness to use trade and finance as means of statecraft; despite near-term market volatility and associated risks, the U.S. could emerge as a long-run winner in this new era.

THOUGHT OF THE WEEK

While geopolitical tensions can make investors nervous, fundamentals ultimately drive asset returns. For investors trying to manage potential adverse effects of geopolitical events to their portfolios by limiting exposures to risk assets, history suggests a different course of action.

PORTFOLIO CONSIDERATIONS

We reaffirm our positive view on equities and negative view on fixed income given the growth momentum building, particularly in the U.S.

MACRO STRATEGY

U.S. OUTLOOK STILL IMPROVING

Chief Investment Office Macro Strategy Team

One thing is clear halfway through calendar-year 2018. The pundits seriously underestimated the positive effects of fiscal reform on the U.S. economy. The latest consensus forecasts in the Blue Chip Economic Indicators tell the story. Once again, surveyed economists raised their forecast for 2018 investment spending growth from 6.2% in May to 6.5% in June. A year ago, the consensus only saw 3.7% growth in investment for 2018. Since then, they have also raised their overall outlook for real gross domestic product (GDP) growth in 2018 from 2.4% to 2.9%. Critically, this rise in growth is largely attributable to upward revisions in the investment spending outlook. The consensus forecast for 2018 consumer spending growth, in contrast, remains the same as a year ago at 2.5%.

It's common to criticize the late-cycle fiscal stimulus as a "sugar high" that will dissipate once households have spent their tax cuts. The fact that more of the growth pickup is coming from increased capital spending suggests otherwise. Capital spending is a key ingredient for raising productivity. Weak productivity growth has been at the heart of the secular stagnation that has plagued the U.S. economy since the financial crisis. The only other period of persistent sub-1% productivity growth in the U.S. was the stagflation era of the late 1970s and early 1980s. We believe a perfect storm is brewing for a return to more historically normal productivity growth in the years ahead. A more pro-investment U.S. tax structure is an important part of that belief.

Early indications of the productivity pickup are starting to appear in the data (Exhibit 1). From a post-World War II low point, the growth rate of productivity has crept up since 2014 and breached the 1% threshold in 2017. Early indications for 2018 suggest that this improving trend continues. That helps explain how GDP growth has accelerated to around 3% while the growth rate of hours worked remains about the same as it was when GDP growth was only 2%, or so. Higher productivity means more GDP from the same amount of labor input.

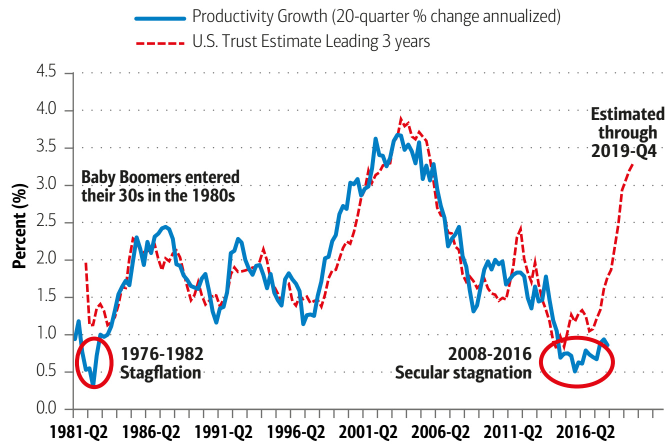
Data as of 7/16/2018 and subject to change.

Exhibit 1: Productivity Growth Creeping Higher Since 2014.

	4Q Y/Y%				Q/Q% Annualized
	2014	2015	2016	2017	2018-Q2
Real GDP	2.7%	2.0%	1.8%	2.6%	4.5%*
Real Output	3.4%	2.2%	2.1%	3.3%	5.0%*
Hours Worked	3.0%	1.5%	1.2%	2.1%	2.0%*
Productivity	**0.3%**	**0.7%**	**0.9%**	**1.2%**	**3.0%***

*Estimate
Source: Evercore ISI. Data as of June 29, 2018.

Exhibit 2: Productivity Growth Trend Poised to Reaccelerate Out of the Secular Stagnation Rut.



Source: Bureau of Economic Analysis/Haver Analytics. Data as of July 12, 2018.

The capital spending renaissance is critical for a sustained improvement in potential growth beyond the disappointing secular stagnation levels. By boosting productivity, investment spending allows wages to rise without causing inflation. This is key for extending the expansion in an ever-tighter labor market. It appears for now that the positive supply-side effects of reduced corporate tax rates are working to boost capital spending and the potential growth rate of the economy.

Another supply-side stimulus from the fiscal reform is evident in the surprise rise in the June labor force participation rate. Even though job growth was stronger than forecast, the unemployment rate rose and labor-market conditions loosened as more people flooded into the jobs market. Slower labor force growth is the other half of the secular stagnation problem. Lower income tax rates appear to be working along with rising wages in a tight labor market to induce more working-age people back into the labor force. After about 15 years of decline, the labor force participation rate has leveled off in recent years as more working-age people come back into the labor force, helping to offset losses from retiring baby boomers.

Putting it together, the potential growth rate of the economy will rise if (1) productivity increases with more capital spending and (2) labor force participation rises among the prime working-age population, as we have seen recently. Lower tax rates on households' incomes and business profits incentivize these forces and seem to be working. This is quite different from a demand-induced "sugar high."

There are a host of other factors beyond tax reform that are in place to create a "perfect storm" of faster productivity growth over the next few years. These are captured in the relationship depicted in Exhibit 2. As can be seen, the factors that lead the intermediate-term (five-year) trend in productivity growth are in a position that in the past heralded major acceleration in productivity growth in subsequent years. These include (1) slower labor supply growth, (2) a stronger dollar, (3) rising GDP growth and (4) higher confidence levels.

1. When labor force growth is slower, businesses naturally start to respond to the relative scarcity of labor by substituting capital and better technology to boost output. This happened in the 1950s, causing productivity to rise and keep GDP growth strong despite the historically slow labor force growth of that decade. In an era of artificial intelligence and machine learning, finding alternatives to scarce labor should be especially easy.
2. The generally stronger dollar since the financial crisis incentivizes U.S. producers to bolster productivity to offset this currency disadvantage in international trade. This effect was quite apparent in Japan during its deflationary decades when the yen was the strongest currency in the world. Faster productivity growth helped Japanese producers to stay competitive. Now the currency effect is working to boost U.S. productivity.
3. And (4) After a post-financial crisis decade of sub-par growth, GDP is returning to a more normal higher trend and business and household confidence is back at much higher levels. These favorable conditions improve the outlook and make longer-term investment seem less risky. A self-reinforcing cycle of stronger business investment enhances productivity.

The bottom line is that we believe that productivity growth is at a historic turning point, with the stars aligned for better expected performance. In addition to the strong economic fundamentals for better productivity and stronger growth ahead, there are demographic and geopolitical reasons to expect better growth after the secular stagnation aberration.

The long period of stagflation and weakening productivity in the 1970s and early 1980s coincided with the demographic wave of young baby boomers entering the labor force. Young people have much lower productivity on average than older more experienced workers. As baby boomers transitioned from their entry-level years (20s) to their more experienced years (30s), productivity growth started to turn higher, as seen in Exhibit 2, during the early 1980s. The millennial generation, the biggest age cohort in U.S. history, is at a similar inflection point today as the median-age millennials are moving into their 30s.

Also similar to the productivity inflection in the 1980s is the similarity between the Reagan and Trump disruptions to the established geopolitical order. When former U.S. President Ronald Reagan and former U.K. Prime Minister Margaret Thatcher shifted U.S. and U.K. policies back in a pro-business direction after a long leftward drift, it forced the rest of the world to also move back toward more pro-business polices (for example, lower tax and regulation). Likewise, the recent U.S. tax and regulatory reforms have enhanced the competitive position of the U.S. and caused other governments to feel pressure to move in a similar direction.

Over the past year, the Congressional Budget Office has raised its outlook for U.S. nominal GDP growth by $6 trillion, or $49,000 per U.S. household, over the next decade. This also includes an upward revised outlook for additional jobs compared to its year-ago forecast. This relatively stronger U.S. outlook and enhanced competitive position will pressure the rest of the world to move in a similar direction or else fall behind. At least that's what played out in the 1980s, when the U.S. shifted to a more pro-business policy regime. According to Strategas Research Partners, *"When the U.S. slashed its corporate tax rate in 1986, other countries quickly followed suit, largely because they had no choice. The after-tax rate of return in the U.S. is now on par with the rest of the world and other countries need to adjust."*

The Strategas researchers go on to cite numerous media accounts of new tax reforms being considered around the globe. The improved U.S. outlook is a model for the global economy. After all, secular stagnation was not confined just to the U.S. Neither was the stagflation of the 1970s. Better policies helped then and are likely to help now, as we are already seeing in the strengthening U.S. economy.

GLOBAL MARKET VIEW

INVESTING IN THE ERA OF GEO-ECONOMICS

Joseph P. Quinlan, Head of Market Strategy
Lauren J. Sanfilippo, Vice President and Market Strategy Analyst

***'Geo-economics—the systematic use of economic instruments to accomplish geopolitical objectives'*[1]**

The global economic order is being upended. We are shifting from an era of geopolitics based on conventional military might to geo-economics—whereby foreign security goals and national interests are fought with markets, currencies and commerce, rather than with missiles, submarines and drones.

This is not to say that conventional military hardware is unessential to the practice of statecraft. Hardly. Military might still matters in a multipolar world fraught with fault lines in the Middle East, the Indian subcontinent, Africa and Asia. The world's a messy place, and that is one key factor behind our high-conviction sector call on defense and cybersecurity.

That said, however, rarely has Washington so openly and blatantly used its economic might and resources in pursuit of national and global interests. The use of U.S. import tariffs on a variety of products—solar panels, dishwashers, aluminum, steel, potentially automobiles and much more—is war by other means. The long-time refrain among policymakers—that the United States "too often reaches for the gun instead of the purse in its international conduct"—has been turned on its head by a White House bent on harnessing America's economic might to its strategic interest and advantage.

THE LEVERS OF GEO-ECONOMICS

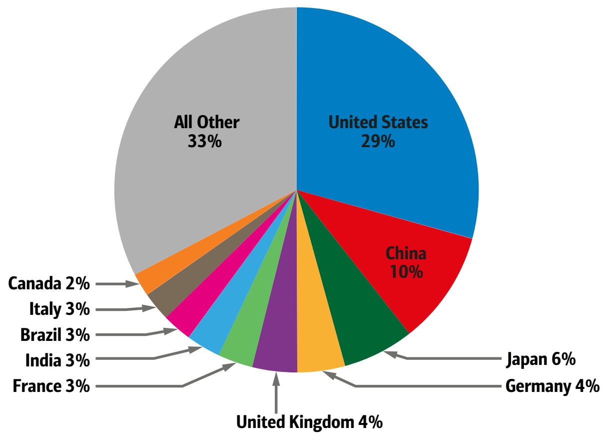
It's America's large and wealthy consumer market, along with the U.S. dollar's global reign, that gives the United States so much economic throw-weight relative to the rest of the world. Per the former, no market in the world—including China—offers foreign countries and companies as much commercial opportunity as the United States, home to only 4.5% of the world's population* yet 29% of total global personal consumption (Exhibit 3). While America's share of global consumption has trended lower over the past few decades, falling from 34% in 2000 to 29% last year*, the U.S. consumer remains one of the most potent economic forces on earth.

Similarly, for decades, no market in the world has been as open to foreign competition as the United States, home to some of the lowest general tariffs on trade on the planet. The latter was purposeful or by design since liberal cross-border trade and investment regulations have long suited America's consumption-

[1] From the book, *War by Other Means: Geoeconomics and Statecraft*, by Robert Blackwill and Jennifer Harris 2016.

*United Nations, 2017.

Exhibit 3: Personal Consumption Expenditures as a Percent of the World Total. (2016, Percent of World Total)



Source: United Nations. Data as of 2016

led economy. The lower the tariffs on imports, the lower the cost of foreign goods and services to U.S. consumers and the more choices of goods from which to choose. In addition, giving nations like Germany, Japan, South Korea and others liberal access to the U.S. market helped underpin economic growth in a number of U.S. allies over the post-war era, promoting the global strategic interests of the United States. As depicted in Exhibit 4, the U.S. remains the world's largest importer, reflecting, in part, the ease of access to U.S. consumers.

Today, however, access to the U.S. market isn't a given; in addition, the cost of doing business is set to rise for a number of countries/companies if the U.S. continues down the path of protectionism.

Beyond America's sizable and wealthy consumer market, the nation's pre-eminent geo-economic lever is the U.S. dollar and the fact that the global financial architect pivots on the greenback. While the world can do without many currencies, it cannot survive, at least for now, without the greenback. The U.S. dollar is the primary grease of global commerce, lubricating virtually every foreign transaction, every day of the year. As *The Economist* recently noted:

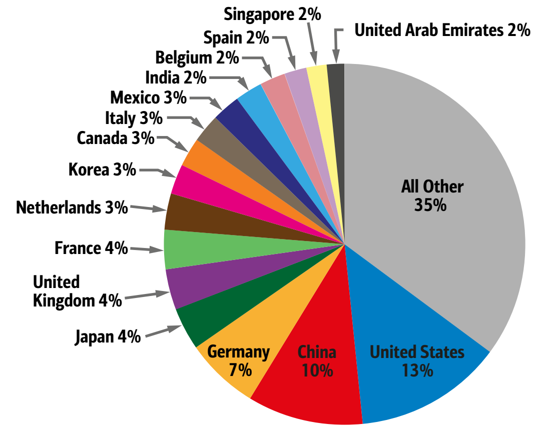
"On average, countries' dollar imports are worth five times what they buy from America. More than half of all global cross-border debt is dollar-denominated. Dollars make up nearly two thirds of central bank reserves. That gives the Treasury a veto over much of global commerce."[2]

Now, consider the following—that developing nations' collectively owe $2 trillion in dollar-denominated debt, that roughly 88% of global foreign exchange turnover involves the dollar,* and that the dollar's share of cross-border borrowing

* "Dollar's Dominance Creates Ripples Globally", Wall Street Journal, May 10, 2018

[2] See "About that Big Stick," The Economist, May 19, 2018.

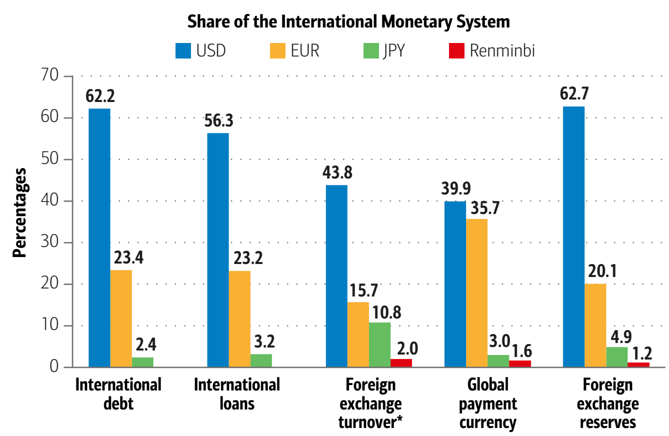
Exhibit 4: The World's Top Importers. (2017, Percent of World Imports)



Source: International Monetary Fund. Data as of 2017.
Note: Percentages shown in figure may not add up to 100 because of rounding.

now stands at 62% (2017) versus 45% in 2008*—and the global potency of the U.S. dollar becomes even clearer (Exhibit 5).

Exhibit 5: Dollar Dominates the International Monetary System.



*USD was involved in 88% of FX transactions. Since there are two currencies involved in each transaction, the dollar's share of FX turnover (out of 100%) was calculated by dividing this figure by 2.
Source: European Central Bank. Data as of Q4 2017 or latest available.

Through the U.S. Federal Reserve, the Department of the Treasury and Wall Street, America controls the financial plumbing of the global economy. The global payments system runs on dollars and is routed through the canyons of Wall Street, giving Washington tremendous leverage to deny virtually any foreign country or company access to U.S. dollars. And being without dollars is like being without oxygen—you cannot function or survive for long.

Case in point: After the U.S. Treasury slapped sanctions against Russia in April 2018, Rusal, an aluminum producer, was frozen out of financial markets, causing its publicly traded shares to decline by more than half. U.S. sanctions against Chinese smartphone maker ZTE—albeit recently repealed—had a similar devastating financial impact on the company.

Meanwhile, the principal pain point for Iran in confronting U.S. economic sanctions is the U.S. dollar, or the lack of dollar-based financing as Washington attempts to ban Iranian access to SWIFT—the secure messaging system that supports cross-border flows of global capital. In addition, as a clear example of geo-economics, Washington has put the world on notice that any firms doing business with Iran will be denied access to U.S. dollars and the U.S. market, triggering many European firms to close shop in Iran out of fear of losing access to U.S. capital and markets.

GOING WHERE OTHERS HAVE GONE BEFORE

In the new and unfolding era of geo-economics, the United States is playing catch-up to more seasoned practitioners like Russia, China and many other states. With its massive domestic market as leverage, China has denied or curtailed goods and services from Japan, South Korea, the Philippines and Taiwan, to name a few nations that have pursued policies contrary to the interests of China.

Leveraging its massive surplus savings, Beijing now provides more loans to Latin American than either the World Bank or the International Monetary Fund, both traditional western-backed institutions. The Chinese-led Asian Infrastructure Bank now rivals any western financial institution and, along with China's "One Belt, One Road" initiative, is one of the starkest examples of geo-economics in action. Ditto for China's globally competitive state-owned enterprises, also instruments of geo-economics.

As for Russia, the energy power is not shy about shutting off energy supplies in the winter to either Ukraine or other parts of Europe when annoyed or threatened by external forces. After Poland protested against Russia's intervention in Crimea, Moscow suspended cheese imports in retaliation. In the Middle East, meanwhile, economic and financial instruments (petro dollars) have long been deployed as instruments of statecraft by Saudi Arabia, the United Arab Emirates and others. Massive sovereign wealth funds—with the ability to invest (or not) billions of dollars in any particular market or economy—serve the same purposes.

GAME ON: KEY RISKS TO THE UNITED STATES

With the largest and wealthiest consumer market in the world, and with the U.S. dollar the linchpin of global finance, among other attributes, the United States wields tremendous geo-economic power. This power, however, needs to be used judiciously. While there is no real substitute for the dollar at the moment, leaving the world dependent on the greenback and dollar payment systems, the dollar's global reign is not preordained.

The more the dollar is used as an instrument of statecraft to the detriment of other nations, the greater the momentum to find an alternative currency (bitcoin, for instance) and the greater the incentive to move toward a multipolar currency, hastening the dollar's decline. To wit, China and many of its trading partners are already trading in local currency, a trend that could accelerate with the unpredictable tone and policies of Washington.

That said, it's worth recalling that the dollar's global dominance bestows a number of unique advantages on the U.S. 'King Dollar' allows the U.S. to borrow cheaply, run chronic trade deficits, issue debt in its own currency and generally live beyond its means—which the nation has been doing for decades. However, all of these advantages would wane if the buck became a weapon of Washington, galvanizing the world to create an alternative. Another key risk: U.S. firms in the coming months are denied market access in China, Europe and other foreign markets in response to U.S. protectionist measures. Or just as damaging, they become targets of government/consumer boycotts, depressing foreign earnings—although these signs have yet to emerge.

INVESTMENT SUMMARY

The rise of geo-economics—or the use of economic instruments to promote and defend national objectives—has caught investors by surprise. In particular, the markets have underestimated the Trump administration's willingness to use trade and finance as means of statecraft and diplomacy. While there's nothing new about the United States slapping tariffs and sanctions on rogue regimes, the blunt application of various economic weapons against America's main trading partners and allies has unnerved investors, and for good reason. Combat through economic means has the potential to be very destructive. There are plenty of risks. Hence, the whipsawed nature of the capital markets this year.

Yet, seeing the glass half full, the upside is just as significant. The unfolding era of geo-economics could significantly reconfigure the global playing field, resulting in a more liberal and open market in China (already underway), the updating of various trade agreements (think North American Free Trade Agreement [NAFTA]), and new bilateral deals that spur sector growth (think soaring U.S. energy exports). These, among other things, should ultimately help level the playing field for U.S. companies.

There is a reason the S&P 500—notwithstanding all the daily headline risks—is up nearly 5% for the year, trading just 2.5% off its all-time high, and outperforming the rest of the world. In addition to currently solid U.S. economic growth, strong earnings and corporate tax reform, the markets sense that in the new unfolding era of geo-economics, the U.S. should emerge a clear winner. Stay tuned.

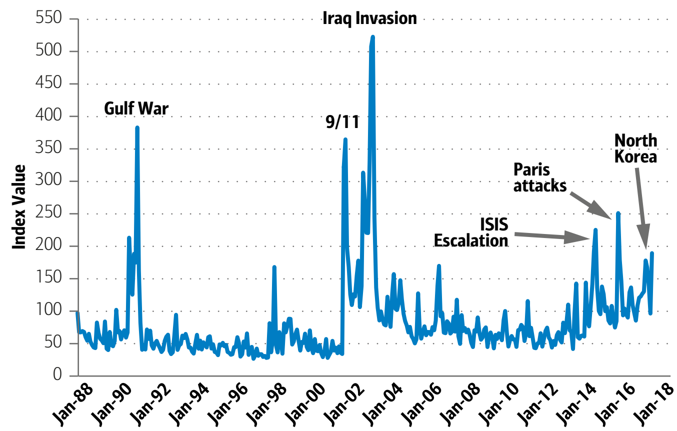
IMPACT OF GEOPOLITICS

Emmanuel D. (Manos) Hatzakis, Director, Senior Investment Strategist

Significant geopolitical events or risks have become more frequent in recent years. The flashpoints run the gamut and include tensions on the Korean peninsula, discord in the South China Sea, widening strife in the Middle East, and soaring levels of global cyber security threats. They also include various challenges to the established order such as the rise of populism, political separatist movements and trade wars. In any form, geopolitics invariably become sources of worry for investors and causes of market volatility and drawdowns. Economists at the Federal Reserve have constructed a geopolitical risk (GPR) index which, as Exhibit 6 shows, tends to spike at the time of major events.

For investors trying to manage potential adverse effects of geopolitical events to their portfolios by limiting exposures to risk assets, history suggests a different course of action. As long as fundamentals remain intact and materially unaffected by a geopolitical event or worry, investors should consider "staying the course" and perhaps even consider opportune tactical tilts, since any asset price decline caused by the geopolitical threat could potentially create a good entry point into the asset. According to a July 2018 study by BCA Research, the S&P 500 did decline by about 9% on average around the time of all major geopolitical crises since the end of World War II. However, it recovered and rose 5% on average within six months and 8% within 12 months of the crises. A telling example is how markets rallied following the Brexit vote in the summer of 2016, in defiance of expectations.

Exhibit 6: Geopolitical Risk Index



Source: Dario Caldara and Matteo Iacoviello, Federal Reserve Board. Data as of July 11, 2018.

MARKETS IN REVIEW

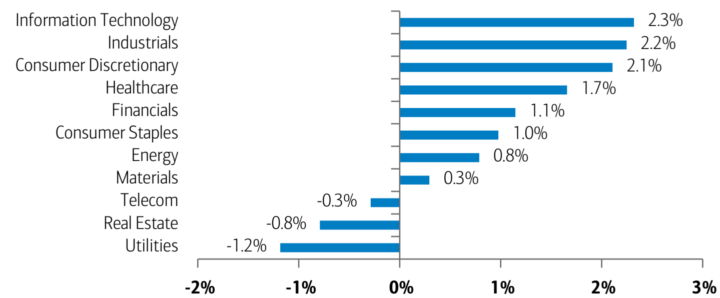
Equities

		Total Return in USD (%)		
	Level	WTD	MTD	YTD
DJIA	25,019.41	2.3	3.2	2.4
NASDAQ	7,825.98	1.8	4.2	14.0
S&P 500	2,801.31	1.5	3.1	5.9
S&P 400 Mid Cap	1,996.35	0.4	2.3	5.9
Russell 2000	1,687.08	-0.4	2.7	10.6
MSCI World	2,134.60	1.0	2.2	2.6
MSCI EAFE	1,972.68	0.2	0.7	-2.0
MSCI Emerging Mkts	1,075.64	1.7	1.0	-5.8

Fixed Income[1]

		Total Return in USD (%)		
	Yield (%)	WTD	MTD	YTD
Corporate & Government	3.22	0.2	0.5	-1.4
Treasury Bills	2.00	0.0	0.1	0.8
Treasury Notes and Bonds	2.72	0.1	0.2	-0.9
Agencies	2.80	0.0	0.1	-0.4
Municipals	2.63	0.2	0.4	0.1
U.S. Investment Grade	3.27	0.2	0.4	-1.2
International	3.95	0.4	0.9	-2.4
High Yield	6.39	0.5	0.5	0.7

S&P 500 Sector Returns (For the week ending 7/13/18)



Commodities & Currencies

		Total Return in USD (%)		
	Level	WTD	MTD	YTD
Bloomberg Commodity	172.72	-2.7	-4.0	-4.0
WTI Crude $/Barrel[2]	71.01	-3.8	-4.2	17.5
Gold Spot $/Ounce[2]	1,241.45	-1.1	-0.9	-4.7

Level	Current	Prior Week End	Prior Month End	2017 Year End
EUR/USD	1.17	1.17	1.17	1.20
USD/JPY	112.38	110.47	110.76	112.69

Source: Bloomberg, Factset. [1] Bloomberg Barclays Indices. [2] Spot price returns. All data as of the 7/13/18 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. 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 7/16/18)

	Q3 2017	Q4 2017	Q1 2018	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	2.0	4.0 – 4.5	1.5	2.3	3.0 – 3.5
CPI inflation (% y/y)*	2.1	2.1	2.1	2.2	1.3	2.1	2 – 3
Core CPI inflation (% y/y)*	2	1.8	1.8	1.9	2.2	1.8	2 – 3
Unemployment rate, period average (%)	4.3	4.1	4.1	3.9	4.9	4.4	3.8 – 4.0
Fed funds rate, end period (%) **	1.12	1.37	1.62	1.87	0.62	1.37	2.13 – 2.38
10-year Treasury, end period (%)	2.33	2.41	2.74	2.86	2.45	2.41	2.87 – 3.38
S&P 500, end period	2519	2674	2641	2718	2239	2674	2800-3000
S&P operating earnings ($/share)	33	36	38	40	119	132	156 – 162
U.S. dollar/euro, end period	1.18	1.2	1.23	1.17	1.05	1.2	1.10 – 1.20
Japanese yen/U.S. dollar, end period	113	113	106	111	117	113	105 – 115
Oil ($/barrel), end period	52	60	65	74	54	60	60 – 80

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

** Midpoint of the target range for the Fed Funds rate, end of period.

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.

These ranges are indicative of potential trends. The ranges are not deemed to be forecasts.

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.

Geopolitical Risk (GPR)Index: measuring frequency of articles in leading newspapers discussing rising geopolitical tensions. mostly driven by threat of adverse geopolitical events rather than their realization.

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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