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CHIEF INVESTMENT OFFICE

Capital Market Outlook

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All data, projections and opinions are as of the date of this report and subject to change.

IN THIS ISSUE

Macro Strategy—*Stock and Bond Rallies Confirm Structural Shift to Higher Long-Term Inflation Regime:* The strong positive correlation between stock and bond returns as the Federal Reserve (Fed) pivoted and financial conditions eased confirms the structural shift to a new higher long-term inflation regime.

Easier monetary policy should drive an ongoing shift to the beneficiaries of lower interest rates that suffered through most of 2023 when rates were rising.

Market View—*Ten Macro Questions for 2024:* Many question marks loom over the capital markets in 2024, and include some of the following: will the U.S. economy slip into recession? Is the Fed's battle against inflation over? Will 2024 see better market breadth after a very narrow-driven market in 2023? Is China the next Japan? Will U.S.-Sino relations improve this year? Will the U.S.—yet again—outperform the Rest of World? How will the U.S. elections impact the markets this year? And will the effects of Artificial Intelligence (AI) become more transparent this year?

The answers to these questions will help dictate market direction and asset performance over the balance of the year.

Thought of the Week—*Momentum into 2024:* Although numerous crosscurrents cropped up both globally and domestically throughout 2023, the S&P 500 proved durable by capping an above-average annual return.

There is significant momentum carried into the New Year as the S&P 500 bumps up against its all-time high. The Chief Investment Office (CIO) begins the year with an investment rationale that emphasizes balanced and diversified allocations across Equities and Fixed Income.

MACRO STRATEGY ▶

Chief Investment Office
Macro Strategy Team

MARKET VIEW ▶

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THOUGHT OF THE WEEK ▶

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MARKETS IN REVIEW ▶

Data as of 1/2/2024, and subject to change

Portfolio Considerations

While we continue to anticipate a choppy market environment given elevated headline risk, we believe the next couple of months will bring the beginning of a long rotation in Equities that includes a move up in areas that have significantly lagged and areas that are well placed for a more substantive rally later this year. Our portfolio strategy remains "balanced" while fully invested to start the year, as we believe that adjustments below the surface in terms of Value and Growth, Small- and Mid-capitalization shares versus Large-capitalization, and U.S. versus non-U.S. (including Emerging Markets) are paramount in 2024.

MACRO STRATEGY

Stock and Bond Rallies Confirm Structural Shift to Higher Long-Term Inflation Regime

Chief Investment Office, Macro Strategy Team

In 2019 the Fed began the first public evaluation of its monetary policy framework. As a result of that process, it amended its "Statement on Longer-Run Goals and Monetary Policy Strategy" on August 27, 2020, in the midst of the pandemic to reflect the results of its review.

The results were heavily influenced by the fact that, for two decades, policy had fallen persistently short of its 2% inflation target, and the belief that the so-called "neutral" policy rate had declined in a new world of "excess savings." This lower-rate environment meant policy was more likely to encounter the "zero-rate" bound, making it harder to achieve the Fed's goals of maximum employment and 2% inflation in downturns.

In response to these concerns, the Fed altered its statement of longer-term goals in two fundamental ways. First, it reversed the order of its inflation and employment discussion, putting employment first followed by inflation. Symbolically, this represented an elevation of employment concerns over inflation. Second, and more significantly, it altered its inflation policy asymmetrically to allow that, "following periods when inflation has been running persistently below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time."

Since this fundamental shift in monetary policy strategy, inflation has run closer to 5% on average than the 2% target for several years. This raises the question of whether the Fed will continue this policy of deliberate inflation overshoots, or whether it will allow undershoots to offset them in a symmetric way that would restore the credibility of a 2% target.

Every January the Fed reissues an updated statement of its longer-term goals. The 2024 statement may or may not deal with this asymmetry in the Fed's inflation policy. The markets are pricing in a continuation of the new, easier Fed policy after its recent pivot which has dramatically eased financial conditions over the past two months. Market and academic commentators are increasingly suggesting the Fed's target will be raised, perhaps at the next public monetary policy review, which the Fed has suggested will happen roughly every 5 years—making 2024 and 2025 potential times to make the shift, probably after the election to minimize the political overtones. In the meantime, current policy is clearly making 2% the lower limit on the longer-term inflation picture rather than the upper limit, as was the case in the two decades prior to the pandemic.

The recent strong positive correlation in stock and bond returns reflects this new higher inflation outlook. During the low and falling inflation era prior to the pandemic, the correlation between stock and bond returns went negative, giving rise to risk-parity strategies that used bonds which tended toward positive returns when stocks were falling. In the low-inflation world, a higher risk of deflation and the zero-bound constraint on monetary policy made bonds a good hedge against a scenario where stocks would have negative returns.

Historically, at least in the post-World War II world, this low-inflation world was an anomaly. The lowest average nominal gross domestic product (GDP) growth trend since the 1930s kept the fear of deflation alive enough in a highly leveraged world to make bonds an attractive alternative for equity bear markets. Normally, however, aside from this low inflation, low interest rates world, inflation has averaged about 3% over time in the U.S. and the stock-bond return correlation has been positive, as we are now seeing.

Investment Implications

Investors should take advantage of the near-term decline in inflation to increase allocations to the beneficiaries of higher inflation over the longer term including most real asset classes.

Interest rates tend to average around nominal GDP growth rates which are heavily influenced by inflation. The shift up in inflation and interest rates seems to have restored the normal positive correlation between equity and bond returns. With reduced risk of deflation, bonds become a much less attractive alternative to Equities as they are more vulnerable in a higher-inflation environment, as we have seen in recent years. While stocks have regained most of their bear market losses from 2022, bonds are still deeply underwater from their peaks.

The more aggressive use of fiscal policy to support demand, combined with unprecedented pandemic monetary stimulus, has altered the global savings glut picture as big fiscal deficits in many countries have absorbed the savings excess and raised the so-called "neutral" rate of interest off the low level of the pre-pandemic era. The surge in interest costs to fund much bigger government debts reflects the growing strain on the global savings supply to fund rapidly growing government expenditures. Rising defense needs, aging demographics and environmental programs will face stiffer competition from the rising interest expense to fund the government debt. These are classic conditions for fiscal policy to put pressure on monetary policy for higher inflation, which is the path to debt mitigation in modern economies. The surge in discussion of fiscal dominance over monetary policy in 2023 in academic forums like the Fed's Jackson Hole Symposium reflects this growing trend.

This new normal is really a return to the old normal, where inflation and interest rates run closer to their historical averages and the risk inflation breaks out to the upside as it did in the 1970s.

For investors, this means it's more important to own real assets that tend to hold their value over time, as money loses its purchasing power. Since World War II the purchasing power of the dollar today is worth less than a dime back then. While the S&P 500 Index is back near its 2021 peak, its real value is considerably less because of the inflation since then.

The breakout in gold prices to all-time highs in most currencies, including the dollar, suggests market participants are positioning for money to lose value at a faster rate in the future. While we expect inflation to fall and, perhaps, surprise to the downside in 2024, it would not be surprising if the Fed takes advantage of this short-term win to reinflate the economy before inflation is sustainably back to its 2% target.

RETURN TO FIRST PAGE

MARKET VIEW

Ten Macro Questions for 2024

Joseph P. Quinlan, Managing Director and Head of CIO Market Strategy
Lauren J. Sanfilippo, Director and Senior Investment Strategist

Rarely has the investment landscape been as unpredictable as it is today. As we enter 2024, the world is challenged by wars in Europe and the Middle East, deteriorating U.S.-Sino relations, a slowing U.S. economy and the prospect of a world on the cusp of some 40 elections this year. Much uncertainty, in short, looms over 2024. Below are the 10 key questions of this year.

One, can the U.S. avoid recession in 2024? We believe the answer is yes, with the consensus expecting moderate real growth-cum-decelerating inflation this year, supported by a relatively healthy labor market, rising real incomes and increasing levels of capital spending. As growth slows into 2024, and inflation eases, the Fed is expected to start cutting rates by March. All of the above might sound too good to be true, so here's what to watch for per the U.S. recession call: the staying power of the U.S. consumer, cracks in the U.S. labor market and commercial real estate, and the depth and duration of the downturn in the "goods" economy.

Two, has the Fed won the fight against inflation? No, not yet, but the Fed has made substantial progress in lowering inflation and inflationary expectations since the Consumer Price Index hit a peak of 9.1% in June 2022. The Fed's preferred inflation gauge—core personal consumption expenditures (PCE) price index—came in at 3.2% in November, a level not seen since 2021. The last mile—or hitting the 2% inflation target—won't be easy and will depend on a number of variables, including rental price increases, geopolitics and potential swings in global oil prices, and wage costs and productivity gains. These are the key metrics we are monitoring.

Three, given the year-end rally in stocks and bonds in 2023, is all the good news already priced into the stock market? No, while it was a historically strong close to the year, not all the good news is priced in. Surprises in the form of geopolitical resolution, solid economic numbers averting a more moderate slowdown, earnings not only growing but accelerating, and inflation and interest rates easing more than anticipated—any mispricing among these variables could result in upward surprises. Broader participation among the capitalization spectrum, value-oriented industries, or more diverse sector participation could also aid the next leg higher in 2024. One other key variable: the massive sum (roughly $6 trillion) in money market funds, which we believe is dry powder for equities as interest rates and yields trend lower this year.

Four, bad or better breadth for the S&P 500? We opt for the latter—or after a narrowly led, tech-supported rally in 2023, we expect the S&P 500 to exhibit better market breadth in 2024. The year-end broadening of market performance has been an encouraging sign, with participation percolating from a size, sector and style perspective. We expect a continuation of this broadening this year, and to this point, we are carefully watching the following: improving earnings trends and guidance (we expect earnings growth somewhere in the mid-single digits this year), margin expansion, valuations and moderate/steady economic growth.

Five, will the U.S. outperform the emerging and international developed markets again? Our answer: most likely. While both the emerging and international developed markets trade at a discount relative to U.S. equities, contain more of a balance between Value and Growth sectors and offer relatively attractive dividend yields, our bias remains tilted towards the U.S. Europe remains challenged by a number of structural headwinds (higher energy costs, the war in Ukraine, aging labor force), while the emerging markets continue to be held back by the underperformance of China, which confronts several structural constraints of its own. What to watch for this year: the slowdown in global trade

Portfolio Considerations

The ebb and flow of macro dynamics can have an outsized effect on market returns and asset pricing. In general, we expect more upside to U.S. Equities again this year, but nothing about investing is linear. The following questions—and potential answers—are what we are monitoring carefully this year.

RETURN TO FIRST PAGE

volumes, commodity prices, China and bubbling geopolitical risks. For these reasons, the CIO preference remains tilted towards U.S. assets.

Six, U.S.-Sino relations: Sweet or sour in 2024? Our answer is to expect a little bit of both this year. Yes, U.S.-China relations have taken on a more constructive tone since the Asia-Pacific Economic Cooperation meeting in San Francisco, but bilateral tensions remain over Taiwan, trade tariffs and investment restrictions, to name a few hot spots. Foreign direct investment inflows to China decelerated sharply last year, as more multinationals rethink their China-centric global supply chains. That said, as a critical source of both supply (labor) and demand (consumers), China remains a critical node in the success of Corporate America. What to watch for in 2024: signs that the bilateral relationship has stabilized, and that a floor has been put in that prevents any further signs of decoupling.

Seven, is China the next Japan? We don't think so, but China does urgently present a number of structural challenges that are reminiscent of Japan in the late 1980s and 1990s. Like Japan over the 1990s, China faces a stagflation-like environment brought by an overleveraged property market, unfavorable demographics, rising trade tensions and soaring public and private sector debt levels. The policy response to these problems has been rather mute thus far, but we expect more aggressive fiscal and monetary policies from Beijing over the course of 2024. China recognizes that its investment-led growth model of the past needs to be revamped. The key to watch for: policies that incentivize more personal consumption, with consumers in China accounting for only 40% of GDP.

Eight, how will the upcoming U.S. election affect the capital markets this year? We believe the November elections could inject an element of uncertainty and volatility into the capital markets as election day nears. However, any significant dip in the major indexes would represent, in our opinion, a buying opportunity since over the long run, asset prices are determined more by economic fundamentals than politics and elections. What to watch for: how close the race for the White House becomes, and the major policy platforms of both parties. Investors will be keenly attuned to policies related to taxes, immigration, trade, China and healthcare.

Nine, how will geopolitical risks shape the 2024 investment landscape? Geopolitics have become a significant swing variable for investors. Wars in Europe and the Middle East, closed or clogged shipping lanes, U.S.-Sino tensions over Taiwan, incessant cyber security threats—given these variables, the geopolitical landscape remains fluid, and suggests that portfolio construction tilt toward high-quality diversified assets, and toward hard assets (energy, copper) and hard power (Large-cap defense, cyber leaders). What to watch out for in 2024: some 40 elections will be held around the world this year, and the results (the policies and the personalities) will help sculpt the geopolitical landscape for the remainder of the decade.

Ten, will the effects of AI become "real" in 2024? Yes, we do believe the tangible benefits from AI will become more prevalent this year, notably in such sectors as education, healthcare and manufacturing. AI innovation has been building since late 2022, when investors began pricing in lofty earnings-enhancing scenarios for companies they believed were best positioned to harness AI. A "show me" story has developed across industries and sectors as companies have ratcheted up their capital spending on AI investments. The magnitude and timing of AI's effect on corporate earnings will again be variable and varied in 2024, with applications spreading to non-tech industries. What to watch for: regulation headwinds are building and could cut into AI's boost to earnings and the productivity for the economy at large.

THOUGHT OF THE WEEK

Momentum Into 2024

Lauren J. Sanfilippo, Director and Senior Investment Strategist

Ariana Chiu, Wealth Management Analyst

Ending on a high note by capping a ninth straight week of gains, U.S. equities are carrying significant momentum into the New Year while bumping up against the S&P 500's all-time high. It's a grand finale for the index, which has returned 26% in 2023—more than double its average annual gain of 11%. Since inception, the benchmark index has ended in positive territory 73% of the time, although returns of this magnitude are more of a rarity, there being only 24 better years of performance dating back to 1928.

Under the aggregate index level, the Technology and Communication Services sectors returned more than 55% while the Consumer Discretionary sector gained more than 40%—indicative of two standout market narratives: enthusiasm around AI and the resilience of the U.S. consumer. The majority of stocks (about 350) within the S&P 500 ended in the green for the year, as a handful of names from chip makers to cruise line operators gained over 100%. On the other end of the spectrum, and littering last year's laggards list, were banks and clean energy companies. A significant spread of over 280% separated the best-performing and worst-performing stocks in the index. Skewed too were the more than 70% of stocks that underperformed what the index offered.

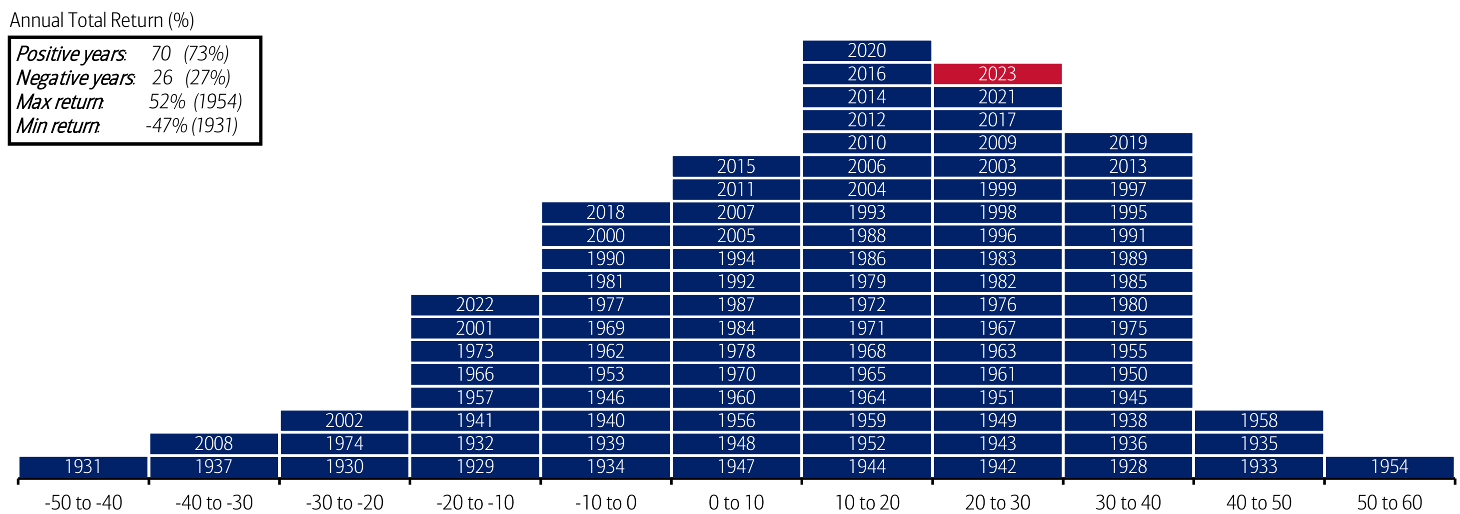
The exceptional year was anything but uninterrupted, including an almost 8% drop during February and March to accompany a banking crisis, and a 10% correction from August through October given festering rising interest rate concerns. Another hallmark of the year: the Magnificent 7[1] leadership (and $5 trillion added to the group's market cap), supercharging one of the narrowest advances in equity market history. The S&P 500's gains on a market cap-weighted basis about doubled that of the comparable equal-weight measure, with performance converging within the last month and a half of the year.

Following a loss of 18% in 2022, 2023's gain of 26% proves variability in year-to-year returns is a near constant. Such unpredictability drives home the importance of sticking to a long-term, disciplined investment strategy. Even given the structurally weaker economy we foresee for this year, a less restrictive Fed (and pivot in policy), along with rising corporate earnings, could prop up equities. Other cross-currents to watch include election year seasonality with patterns of volatility, as well as contagion to financial markets from geopolitical conflicts, and potential policy shifts around a global election cycle.

Portfolio Considerations

As we consider how 2024 could unfold, we have an overall constructive view on stocks and bonds for the New Year. We remain neutral on Equities relative to our strategic target while emphasizing a balanced approach to portfolio construction.

Exhibit 1: S&P 500 Performance 1928-2023.



Source: Bloomberg. Data as of December 2023. **Past performance is no guarantee of future results. It is not possible to invest directly in an index. Please refer to asset class proxies and index definitions at the end of this report.**

[1] Apple, Amazon, Alphabet, NVIDIA, Meta, Microsoft and Tesla.

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	37,689.54	0.8	4.9	16.2
NASDAQ	15,011.35	0.1	5.6	44.6
S&P 500	4,769.83	0.3	4.5	26.3
S&P 400 Mid Cap	2,781.54	-0.1	8.7	16.4
Russell 2000	2,027.07	-0.3	12.2	16.9
MSCI World	3,169.25	0.6	4.9	23.8
MSCI EAFE	2,236.35	1.2	5.3	18.2
MSCI Emerging Markets	1,024.67	3.2	3.9	9.8

Fixed Income†

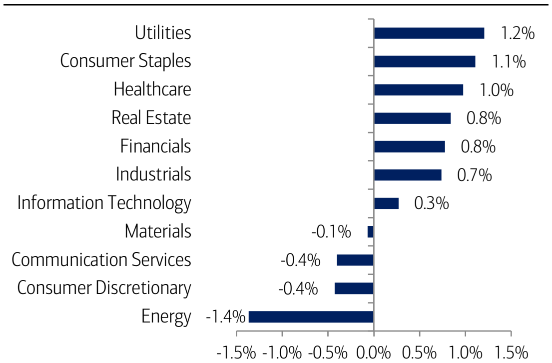
	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	4.45	0.49	3.68	5.72
Agencies	4.46	0.27	1.90	5.13
Municipals	3.22	0.18	2.32	6.40
U.S. Investment Grade Credit	4.53	0.48	3.83	5.53
International	5.06	0.65	4.34	8.52
High Yield	7.59	0.40	3.73	13.45
90 Day Yield	5.33	5.35	5.39	4.34
2 Year Yield	4.25	4.32	4.68	4.43
10 Year Yield	3.88	3.90	4.33	3.87
30 Year Yield	4.03	4.05	4.49	3.96

Commodities & Currencies

	Total Return in USD (%)			
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	226.43	-0.6	-2.7	-7.9
WTI Crude $/Barrel††	71.65	-2.6	-5.7	-10.7
Gold Spot $/Ounce††	2062.98	0.5	1.3	13.1

	Total Return in USD (%)			
Currencies	Current	Prior Week End	Prior Month End	2022 Year End
EUR/USD	1.10	1.10	1.09	1.07
USD/JPY	141.04	142.41	148.20	131.12
USD/CNH	7.13	7.15	7.15	6.92

S&P Sector Returns



Sources: Bloomberg; Factset. Total Returns from the period of 12/26/2023 to 12/29/2023. †Bloomberg Barclays Indices. ††Spot price returns. All data as of the 12/29/2023 close. Data would differ if a different time period was displayed. Short-term performance shown to illustrate more recent trend. **Past performance is no guarantee of future results.**

Economic Forecasts (as of 12/29/2023)

	Q4 2023E	2023E	Q1 2024E	Q2 2024E	Q3 2024E	Q4 2024E	2024E
Real global GDP (% y/y annualized)	-	3.1	-	-	-	-	2.8
Real U.S. GDP (% q/q annualized)	1.5	2.5	0.5	0.5	0.5	1.0	1.4
CPI inflation (% y/y)	3.2	4.1	2.8	2.9	2.6	2.4	2.7
Core CPI inflation (% y/y)	4.0	4.8	3.6	3.2	3.2	3.0	3.2
Unemployment rate (%)	3.9	3.7	4.0	4.1	4.2	4.3	4.1
Fed funds rate, end period (%)	5.33	5.33	5.38	5.13	4.88	4.63	4.63

The forecasts in the table above are the base line view from BofA Global Research. The Global Wealth & Investment Management (GWIM) Investment Strategy Committee (ISC) may make adjustments to this view over the course of the year and can express upside/downside to these forecasts. Historical data is sourced from Bloomberg, FactSet, and Haver Analytics. **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.**
A = Actual. E = Estimate.
Sources: BofA Global Research; GWIM ISC as of December 29, 2023.

Asset Class Weightings (as of 12/5/2023)

	CIO View				
Asset Class	Underweight		Neutral	Overweight	
Global Equities			●		
U.S. Large Cap Growth			●		
U.S. Large Cap Value				●	
US. Small Cap Growth			●		
US. Small Cap Value			●		
International Developed		●			
Emerging Markets			●		
Global Fixed Income			●		
U.S. Governments				●	
U.S. Mortgages				●	
U.S. Corporates		●			
International Fixed Income			●		
High Yield		●			
U.S. High Yield Tax Exempt		●			
U.S. Investment-grade Tax Exempt			●		
Alternative Investments*					
Hedge Funds			●		
Private Equity			●		
Real Assets			●		
Cash					

CIO Equity Sector Views

	CIO View				
Sector	Underweight		Neutral	Overweight	
Energy					●
Healthcare					●
Utilities			●		
Consumer Staples			●		
Information Technology			●		
Communication Services			●		
Industrials			●		
Financials			●		
Materials		●			
Real Estate		●			
Consumer Discretionary	●				

*Many products that pursue Alternative Investment strategies, specifically Private Equity and Hedge Funds, are available only to qualified investors. CIO asset class views are relative to the CIO Strategic Asset Allocation (SAA) of a multi-asset portfolio. Source: Chief Investment Office as of December 5, 2023. All sector and asset allocation recommendations must be considered in the context of an individual investor's goals, time horizon, liquidity needs and risk tolerance. Not all recommendations will be in the best interest of all investors.

RETURN TO FIRST PAGE

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 U.S. dollars.

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.

Consumer Price Index measures the overall change in consumer prices based on a representative basket of goods and services over time.

Personal Consumption Expenditure (PCE) Price Index measures the changes in the price of goods and services purchased by consumers for the purpose of consumption, excluding food and energy.

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Alternative Investments are speculative and involve a high degree of risk.

Alternative investments are intended for qualified investors only. Alternative Investments such as derivatives, hedge funds, private equity funds, and funds of 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.

Nonfinancial assets, such as closely-held businesses, real estate, fine art, 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 in the best interest of 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.

RETURN TO FIRST PAGE