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CHIEF INVESTMENT OFFICE

Capital Market Outlook

January 21, 2025

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IN THIS ISSUE

Macro Strategy—*It's the "Tat" in Tit-for-Tat Trade Wars that Should Concern Markets:* Wall Street has taken the angst of higher U.S. import tariffs in stride, with the average year-end S&P 500 target implying a greater than 10% return this year. While we remain bullish heading into 2025, we believe that, when it comes to tit-for-tat trade wars, what isn't fully discounted is the "tat"—or how the rest of the world responds to U.S. protectionism. "Tat" could imply more global supply chain disruptions-cum-lower corporate earnings growth, higher prices for goods and services, more crosscurrents for central banks to navigate and, in some cases, downright recessions in some trade-dependent economies (Germany and Canada, for instance).

And unlike Trump's first term, when U.S. tariffs caught the world by surprise, governments globally are better prepared this time, equipped with their own lists of potential tariffs on U.S. goods and services. The higher the U.S. tariffs, the greater the pushback from the rest of the globe, and the greater the potential damage to global growth and earnings. Amid these "tit" and "tat" dynamics, investors should expect more chop and churn this year. We continue to prefer the region most equipped to weather the storm—the U.S.

Market View—*Road Trip 2025: Macro Elements to Consider:* A road trip can be either a fun experience or risky endeavor. In our view, top of mind for investors is the state of the economy (the car), how evolving policies may affect it (driving styles) and external elements (i.e., the terrain and the weather).

The U.S. economy has been cruising, with a resilient labor market fueling robust consumption and service sector activity. In China, apparent has become a policy shift increasingly aimed at fostering consumption to drive economic growth. Meanwhile, clearer skies provide plenty of visibility for global themes such as artificial intelligence (AI), defense and infrastructure, to name a few. Yet there are numerous hazards stressing the engines of the global economy, including political uncertainty in Europe, structural vulnerabilities in China, and a rockier geopolitical landscape. In this report, we review various macro elements on our radar that may influence the path forward for the global economy and financial markets.

Thought of the Week—*What Potential Immigration Policies Could Mean for Investors:* Between 2019 and 2024, foreign-born workers accounted for 88% of U.S. labor force growth. A net 2.8 million immigrants were added last year alone—driving the largest annual increase in the U.S. population in over two decades. The bottom line is, "natural" population growth (measured in births minus deaths) is simply not enough to keep the U.S. population and labor force in growth mode.

Now, with the inauguration behind us, the first 100 days of President Trump's second term have officially begun. At the top of Trump's agenda: tighter immigration control. As we describe below, policy clarity over the coming weeks and months will be key to investors. Among potential effects of sweeping anti-immigration policy: fewer available workers, higher wage costs, and potential upward pressure on inflation expectations currently struggling to shake 3%. Also on watch will be how policy affects international students, who already depart the U.S. at high rates and remain key to future U.S. competitiveness.

MACRO STRATEGY ▶

Joseph P. Quinlan
Managing Director and Head of CIO Market Strategy

MARKET VIEW ▶

Rodrigo C. Serrano, CFA®
Director and Senior Investment Strategist

THOUGHT OF THE WEEK ▶

Ariana Chiu
Wealth Management Analyst

MARKETS IN REVIEW ▶

Data as of 1/21/2025, and subject to change

Portfolio Considerations

Investors should consider a more diversified approach to Equities in the coming year as the more highly valued areas share some of the spotlight with the rest of the market in 2025.

This month, we adjusted our U.S. Equity sector views, with a downgrade of Healthcare to neutral from slight overweight, and in turn we reduce the magnitude of our underweight to Consumer Staples with an upgrade to slight underweight.

Within Fixed Income, our highest conviction call remains that the yield curve will normalize by short rates moving lower, and investors should therefore consider moving out investable cash into their strategic duration target as cash yields are likely to decrease from here, and the backup in yields may be an opportunity.

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MACRO STRATEGY

It's the "Tat" in Tit-for-Tat Trade Wars that Should Concern Markets

Joseph P. Quinlan, Managing Director and Head of CIO Market Strategy

The capital markets are braced for higher U.S. import tariffs, although the market consensus is that the looming tariff hikes will be more bark than bite. The expectations are that, in the end, the tariffs will be more strategic than universal; more gradual than introduced all at once, and relatively lower than originally proposed (60% on China, 25% on U.S.-Mexico-Canada Agreement partners, and 10% to 20% on the rest of the world). In addition, tariffs are being considered as a one-off boost in price levels—imparting more transitory than lasting effects on price levels.

Against this backdrop, Wall Street has taken the tariff talk in stride, evident by the fact that the average year-end target for the S&P 500 (6,614) among sell-side analysts implies a greater-than-10% return this year. "What, me, worry?" seems to be the attitude of much of Wall Street when it comes to restrictions on trade.

That said, we are bullish as well on the outlook for 2025 but believe that when it comes to tit-for-tat trade wars, investors should pay more heed to the "tat." The latter—how the rest of the world responds to U.S. protectionism—is a major known unknown at this juncture. It's a wildcard not fully discounted, and it could prove to be highly disruptive and costly for U.S. firms.

"Tat" could lead to more global supply chain disruptions-cum-lower corporate earnings growth; higher prices for goods and services, and higher inflation expectations; more crosscurrents for central banks to navigate, stalling the global easing cycle; and, in some cases, downright recessions in some trade-dependent economies (Germany and Canada, for instance). According to Bloomberg, Canada has already prepared a "tat" list of tariffs totaling $105 billion.

It's different this time. In addition to the above, it's different this time. Unlike Trump's first term, when the world was caught flat-footed by U.S. tariffs and scrambled in reaction to America's trade gamesmanship, the world is better prepared this time and lying in wait.

Indeed, determined not to be ambushed a second time, governments around the world are preparing their own lists of potential tariffs on U.S. goods and services. With history as a guide, think potential retaliatory tariffs on U.S. agricultural goods like soybeans, pork, almonds and wheat (China). Or tariffs on automobiles and machinery, as well as consumer goods like whiskey and wine (Europe). Lumber, crude oil and natural gas are on the list of some nations (Canada and Mexico).

In the end, the higher the U.S. tariffs ("tit"), the greater the push back from the rest of the world ("tat"), and the greater the potential damage to global growth and earnings, the U.S. included. As Exhibit 1A depicts, the potential spike in U.S. tariff rates is literally and figuratively off the charts relative to the past eight decades.

And it may not stop with tariffs on goods and services. Other retaliatory measures from the rest of the world could materialize under other different and damaging guises. Think more investment restrictions, which, as Exhibit 1B highlights, have soared over the past decade. Or more company-specific regulatory investigations (blacklists) from Europe and China that make it harder for U.S. companies to operate at home and abroad. U.S. technology companies are front and center when it comes to more restrictions on cross-border digital activities. Domestic subsidies and export controls, meanwhile, are also becoming popular.

In the end, "tat" comes in many colors and can take on some interesting and unexpected twists. To this point, reflecting the global sweep of trade and investment protectionism, in Japan, the Canadian takeover of 7-Eleven, a convenience store chain, is now being reviewed as an "economic security" deal. Last year, the company was designated as a "core" industry in Japan by the Finance Ministry. Really? In Spain, meanwhile, the

Investment Implications

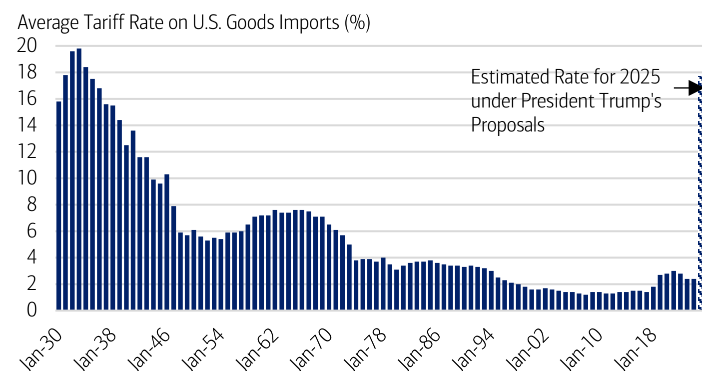
How the rest of the world responds to higher U.S. import tariffs has potential implications for global supply chains (disrupted), inflation expectations (higher), the global central bank easing cycle (stalled), corporate earnings (lower), and global economic growth (slower). As tit-for-tat restrictions unfold this year, investors should expect higher market volatility. We maintain our positive bias toward U.S. Equities given U.S. economic and earnings resiliency.

government is now considering a 100% surcharge on real estate purchases of non-European Union buyers. And in Indonesia, one of the largest mobile phone markets in the world, Apple has been banned from selling its iPhone 16 because the company does not meet the rules of sourcing materials locally.

And then there is China, who, in the past few months, has aggressively pushed back on U.S. trade and investment restrictions with their own anti-trade policies. A recent headline in the *Wall Street Journal* is suggestive of the turbulent times ahead, "China Comes Out Swinging as Trump Trade War Looms." Just in the past two months, China has launched a regulatory probe into Nvidia, disrupted the supply chains of a key drone manufacturer and blocked the export of critical minerals to the U.S. The upshot: The risks of rising tit-for-tat trade restrictions between the U.S. and China remain a real and present danger.

Exhibit 1: Tit-for-Tat Trade Wars Go Both Ways.

1A) Potential Spike in U.S. Tariff Rates Looms.



1B) Protectionism is Back: Global Investment Restrictions Soar.

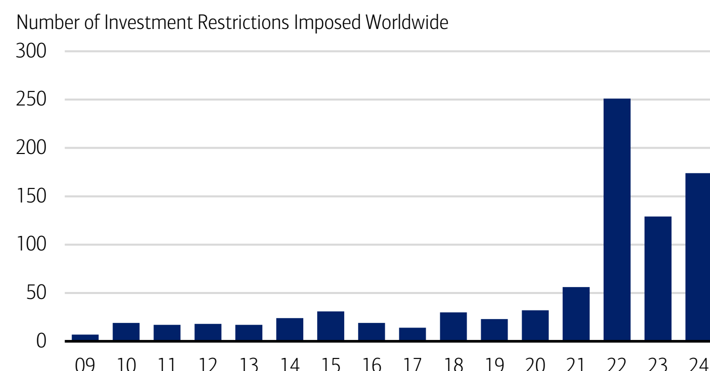


Exhibit 1A) Source: Tax Foundation. 2025 estimate assumes 20% universal tariff and 60% tariff on imports from China. Data as of October 2024. Exhibit 1B) Source: Global Trade Alert. Data for each year refers to restrictions implemented between January 1 and December 31. Data as of January 13, 2025.

Bricks in the wall. Think of each "tit" and "tat" as bricks, with each policy and corresponding response as more bricks in the wall of global protectionism. Unfortunately, the bricklayers have been busy as of late, and the higher and wider the wall, the greater the risks to global growth, the U.S. included. We are not envisioning a Smoot-Hawley Tariff type of scenario—or a 1930s redux that saw tit-for-tat trade restrictions precipitate a two-thirds drop in global trade, a sharp downdraft in global output and ultimately a global depression.

But tariffs can be a slippery slope to more global protectionism and its knock-on effects: a more fragmented, inward global economy that potentially limits the access of U.S. firms to foreign resources and markets. Rising inflation expectations, upended global supply chains, and lower economic global growth are other critical residuals of a world sparring and jabbing with tariffs.

Even the U.S., blessed with a relatively self-contained, continent-sized economy, and among the least trade-dependent states in the world, would not be spared the consequences of a world gone tit-for-tat mad. Of particular note, a more tariff-loving America puts at risk large foreign capital inflows required to fund America's perennial federal savings gap. For decades, America's savings deficit has been offset by importing the world's excess capital surplus, with foreign ownership of U.S. securities totaling a whopping $30.7 trillion in Q3 2024. Minus these inflows, America's cost of capital would be even higher considering that foreign investors own roughly 31% of marketable U.S. Treasurys, 37% of the U.S. corporate bond market, and 20% of U.S. Equities. Against this backdrop, can the U.S. expect the world to go on funding its savings deficit, while Washington wields a sledgehammer to its trading partners—or the very nations that recycle their savings/trade surpluses to the U.S.?

We will see. Suffice it to say that "tit" and "tat" are dynamics that aid and abet market volatility. Investors should expect more chop and churn this year, although in the aggregate, given the resiliency of the U.S. economy and continued earnings growth, we maintain our positive bias toward U.S. Equities.

RETURN TO FIRST PAGE

MARKET VIEW

Road Trip 2025: Macro Elements to Consider

Rodrigo C. Serrano, CFA®, Director and Senior Investment Analyst

A fun road trip for investors this year may entail continued economic strength in the U.S. joined by a cyclical rebound in China, providing better balance for global growth. Yet among other elements, hasty driving, exacerbating policy uncertainty, may make investors more apprehensive toward the trade and fiscal outlook. The following are potential elements and catalysts on watch.

Efficiency of Driving Styles. In the U.S., new manufacturing orders for December neared their fastest pace of growth since mid-2022, according to the Institute for Supply Management. Suggesting a budding rebound in manufacturing and greater investment, this evolution has coincided with an increase in business confidence (Exhibit 2A). This optimism has been attributed to President Trump's proposed pro-growth economic policies, including deregulation and an extension of the 2017 tax cuts. Evoking the experience of solid economic performance in his first term, investors also remember his sympathy for stability in the stock market and constructive financial conditions. Bottom line: Signs of a more moderate, cautious drive in implementing policy proposals may provide relief and an upside catalyst for financial markets.

Meanwhile in China, evolving economic policy should be taken in context, in our opinion. An existing policy of Dual Circulation, aimed at creating economic self-sufficiency particularly by strengthening consumption seems to have been accelerated. Moreover, expectations have risen for an official growth target of 5% for gross domestic product this year, likely to be announced at the March "Two Sessions" legislative meetings. This possibility, despite the prospect of tariffs from the U.S., may suggest that officials seek to show strength and prioritize social stability under the aegis of national security. We believe a best nearer-term case may involve steps to foster consumption, such as direct fiscal stimulus to households, while nursing its sustainability with structural reforms to strengthen social safety nets. Greater visibility in economic relations with the U.S. would also help improve the economic outlook. With pervasive investor pessimism and cheap valuations, this evolution could allow for Chinese Equities to preserve a floor established last year.[1]

Challenging Hazards. Even if a negotiation tool, potential U.S. tariff policy, particularly involving major trading partners, has fostered business uncertainty, which may fog visibility for long-term business planning and investment. Unique has been a more consistent approach using trade policy to aim at foreign policy objectives. We think this may introduce more unpredictable, non-economic elements in decision-making.

Another consideration is the referenced role of tariffs as a revenue enhancer within evolving fiscal policy. Among other suggested tax breaks, President Trump has proposed a permanent extension of the provisions of the 2017 Tax Cuts and Jobs Act. The Tax Foundation estimates that this would cost between $3.4 trillion and $4.2 trillion over the following decade, an amount well above a forecast $2.8 trillion generated by a 20% universal tariff, assuming little retaliatory response from trade partners. Meanwhile, over the past seven decades, tariffs have never accounted for much over 2% of total federal revenue, with last year generating $77 billion or 1.6%, according to the Congressional Research Service. This implied notable shift in the government's funding model, plus worry over its inflationary effects, may drive further uncertainty for the fiscal and monetary policy outlook amid higher interest rates (Exhibit 2B). Bottom line: Tariff and fiscal policy may be inextricably linked, which may limit the potential extent of pro-growth fiscal policy.

From a global view, fallout from renewed trade tensions may consign China and others to the slow lane of economic growth, risking competitive devaluations or currency wars.

Portfolio Considerations

Anticipating continued U.S. exceptionalism, our team's Equity overweight of the region considers economic resilience and pro-growth initiatives from Washington. Moreover, we remain positive on long-term thematic opportunities, such as those arising from a geopolitical friend-shoring of supply chains, infrastructure and hard assets, such as industrial metals. We suggest Gold as a strategic diversifier. We remain watchful over the behavior of longer-dated sovereign bond yields and spillover effects globally, amid evolving fiscal- and trade-related policy.

[1] Referencing the MSCI China Index.

RETURN TO FIRST PAGE

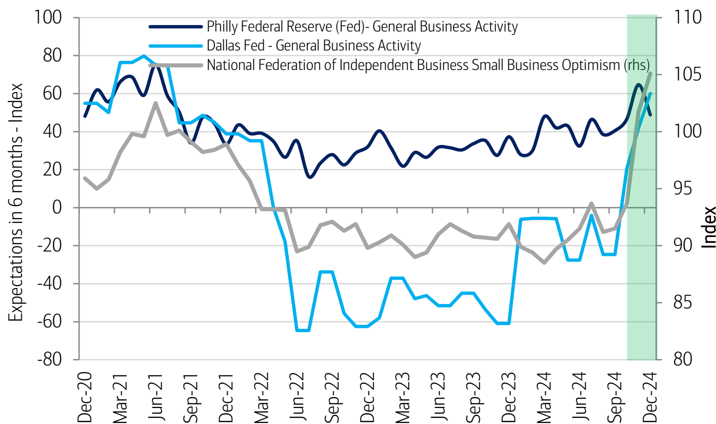
Aside from geopolitical developments, we are also monitoring those related to enhanced export restrictions in the Technology sector, which may continue a global fragmentation in this space.[2]

Contending with these headwinds, political uncertainty has also factored in subdued business confidence in Europe. Fiscal policy has confounded governments in France and, more recently, the United Kingdom amid a regionwide effort to balance fiscal ledgers. A dilemma in Germany pits national security concerns with trade-focused foreign policy, particularly with regards to China and increasingly the U.S. A snap election expected on February 23 will be closely watched by investors for a mandate to reform the nation's constitutionally enshrined debt brake. This evolution may crystallize a growing recognition for fiscal policy as a critical tool to develop beyond the country's export-oriented growth model.

Conclusion. In the U.S., economic resilience has translated to a relatively better corporate earnings backdrop, providing fundamental support for equity markets. Similarly low unemployment in Europe has supported growth of the dominant services sector, while a higher savings rate argues for upside potential if confidence can improve. Better traction of stimulus efforts in China may also provide better balance for global growth. However, uncertainty in fiscal and trade policy have produced near-term crosscurrents in the outlook for inflation and interest rates, raising market volatility. These symptoms may signal a greater need for governments to introduce credible holistic approaches in economic growth policy, including longer-term plans to raise productivity.

Exhibit 2: Can the U.S. Bond Market Get on Board?

2A) Confidence has seen a "Trump Bump."



2B) A notable rise in longer-dated yields may suggest unease over U.S. trade and fiscal policy.

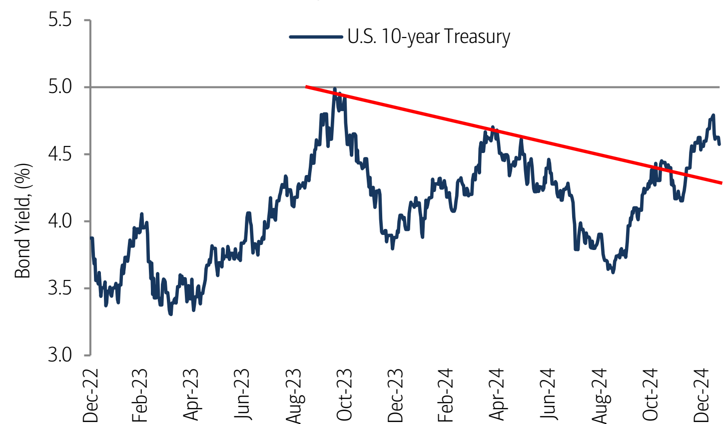


Exhibit 2A) Source: Bloomberg. Data as of December 2024. Exhibit 2B) Source: Bloomberg; Chief Investment Office; Data as of January 21, 2025. **Past performance is no guarantee of future results.**

[2] Biden's sweeping new AI export controls cover most of the world, *The Washington Post* (January 13, 2025).

What Potential Immigration Policies Could Mean for Investors

Ariana Chiu, Wealth Management Analyst

The proverbial first 100 days of President Trump's second term have begun. At the top of the president's agenda: tighter immigration control.

There's little doubt that immigration has been a major driver of U.S. population and labor force growth over the past few years. If anything, we've woefully underestimated its significance. Exhibit 3A is a good case in point: Recent Census Bureau revisions indicate that the U.S. added a net 2.8 million immigrants last year—driving the largest annual population increase in over two decades.[3] Another 2.3 million immigrants were added the prior year, a whopping 1.2 million above original estimates.

In total, the U.S. has added more immigrants to its population in the last three years than in the prior seven years combined. Meanwhile, "natural" population growth (measured in births minus deaths) has remained structurally low after more than a decade of steady decline. Against this backdrop, between 2019 and 2024, foreign-born workers accounted for 88% of U.S. labor force growth, a dynamic that served as a key safety valve in dampening wage inflation and supporting underlying consumer demand.[4]

What does this—and the possibility that the current trend won't continue—mean for investors? First, sweeping anti-immigration policy could translate to fewer available workers, higher wage costs for U.S. companies, and further strain on industries already grappling with worker shortages. It also implies potential upward pressure on inflation expectations, further complicating the path to the Fed's 2% target.

Consider too the long-term impacts to human capital in the U.S. Anti-immigration policies may drive international students (who already tend to leave the U.S. per Exhibit 3B) to pack up their bags—and with it, their intellectual capital, consumption power, and capacity for innovation, particularly in STEM[5]-oriented fields. According to a recent working paper from the National Bureau of Economic Research, Chinese students were 15% less likely to attend a U.S.-based PhD program between 2016 and 2019 due to rising tensions between the U.S. and China. And for those who did attend, students became 4% less likely to remain in the U.S. post-graduation.[6]

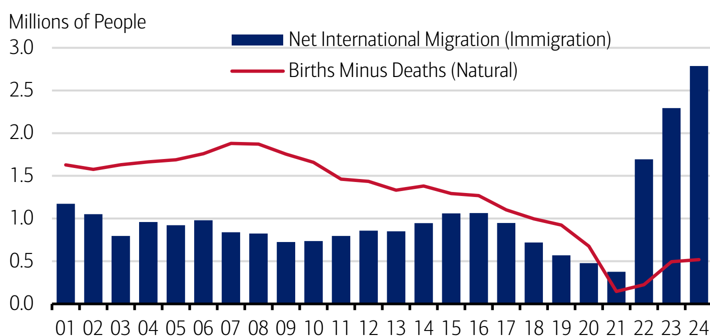
In other words, when it comes to both the present workforce and future U.S. competitiveness, foreign-born workers matter. Whether President Trump's rhetoric on immigration is more bark or bite will be a key focus of the coming weeks and months, with potential macro (labor force, wage inflation, path of monetary easing) and micro (human capital, innovation) implications.

Portfolio Considerations

As investors await more clarity on the immigration policy of the incoming administration, stricter controls on net immigration could affect U.S. economic growth and company earnings over the long term via slower labor force growth, rising wage costs, higher inflation, and a diminished pool of skilled labor.

Exhibit 3: Foreign-Born Workers Matter.

3A) Immigration Swoops in as U.S. Population Ages



3B) International Students Pack Up Their Bags.

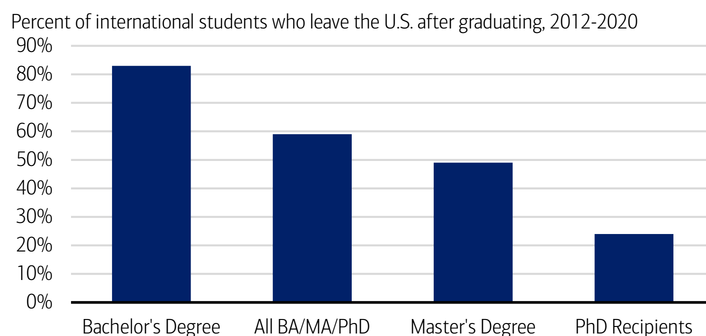


Exhibit 3A) Annual data represents period from July 1st of prior year through June 30th of following year. For example, 2024 population data refers to 7/1/23-6/30/24 period. Source: Census Bureau. Data as of December 20, 2024. Exhibit 3B) Source: Economic Innovation Group. Analysis from June 2024, as of January 2025.

[3] Refers to period between July 2023 and July 2024.
[4] National Foundation for American Policy, October 2024.
[5] Science, technology, engineering, and mathematics
[6] Flynn et al., "Building a Wall Around Science: The Effect of U.S.-China Tensions on International Scientific Research," NBER, October 2024.

RETURN TO FIRST PAGE

Equities

	Total Return in USD (%)			
	Current	WTD	MTD	YTD
DJIA	43,487.83	3.7	2.3	2.3
NASDAQ	19,630.20	2.4	1.7	1.7
S&P 500	5,996.66	2.9	2.0	2.0
S&P 400 Mid Cap	3,239.76	4.5	3.9	3.9
Russell 2000	2,275.88	4.0	2.1	2.1
MSCI World	3,777.85	2.7	1.9	1.9
MSCI EAFE	2,288.56	1.9	1.2	1.2
MSCI Emerging Markets	1,070.12	1.3	-0.4	-0.4

Fixed Income†

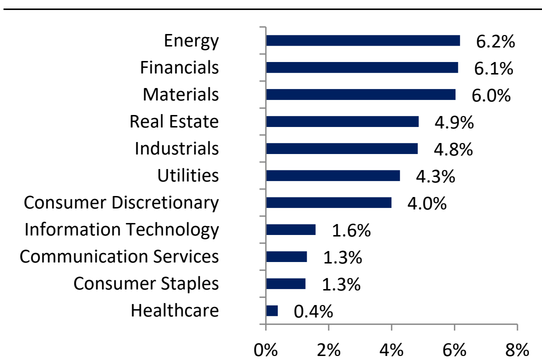
	Total Return in USD (%)			
	Current	WTD	MTD	YTD
Corporate & Government	4.82	0.92	-0.03	-0.03
Agencies	4.64	0.54	0.13	0.13
Municipals	3.80	0.35	-0.31	-0.31
U.S. Investment Grade Credit	4.94	0.99	-0.02	-0.02
International	5.38	1.07	-0.04	-0.04
High Yield	7.29	0.80	0.84	0.84
90 Day Yield	4.30	4.32	4.31	4.31
2 Year Yield	4.28	4.38	4.24	4.24
10 Year Yield	4.63	4.76	4.57	4.57
30 Year Yield	4.86	4.95	4.78	4.78

Commodities & Currencies

	Total Return in USD (%)			
Commodities	Current	WTD	MTD	YTD
Bloomberg Commodity	251.04	1.3	5.2	5.2
WTI Crude $/Barrel††	77.88	1.7	8.6	8.6
Gold Spot $/Ounce††	2703.25	0.5	3.0	3.0

	Total Return in USD (%)			
Currencies	Current	Prior Week End	Prior Month End	2022 Year End
EUR/USD	1.03	1.02	1.04	1.04
USD/JPY	156.30	157.73	157.20	157.20
USD/CNH	7.34	7.36	7.34	7.34

S&P Sector Returns



Sources: Bloomberg, Factset. Total Returns from the period of 1/13/2025 to 1/17/2025. †Bloomberg Barclays Indices. ††Spot price returns. All data as of the 1/17/2025 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 1/17/2025)

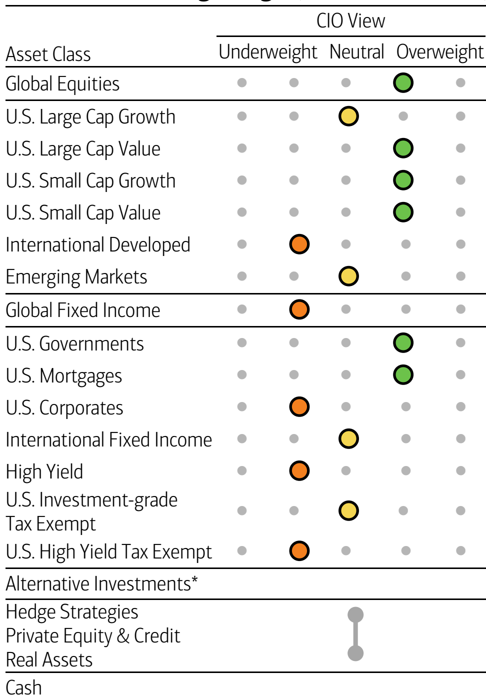
	Q4 2024E	2024E	Q1 2025E	Q2 2025E	Q3 2025E	Q4 2025E	2025E
Real global GDP (% y/y annualized)	-	3.1*	-	-	-	-	3.2
Real U.S. GDP (% q/q annualized)	2.0*	2.8*	2.5	2.3	2.2	2.2	2.4
CPI inflation (% y/y)	2.7	3.0	2.6	2.6	2.9	2.7	2.7
Core CPI inflation (% y/y)	3.3	3.4	3.0	2.9	3.2	3.1	3.0
Unemployment rate (%)	4.2	4.0	4.3	4.3	4.4	4.4	4.4
Fed funds rate, end period (%)	4.33	4.33	4.38	4.38	4.38	4.38	4.38

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.**

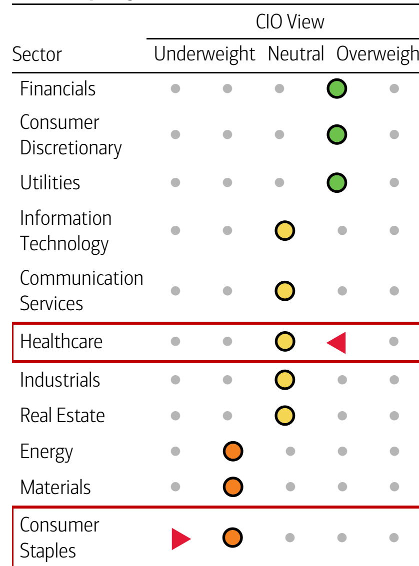
A = Actual. E/* = Estimate.

Sources: BofA Global Research; GWIM ISC as of January 17, 2025.

Asset Class Weightings (as of 1/7/2025)



CIO Equity Sector Views



*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 January 7, 2025. 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.

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 is a market-capitalization-weighted index that is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

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