

INVESTMENT STRATEGY OVERVIEW

December 2016

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2017 Year Ahead: A World of Change

The Investor Strikes Back!

Over the years, our Year Ahead themes have included the Year of Deleveraging, in 2008, Crossing The Rubicon, in 2010, Where the Buffalo Roam, in 2015, and last December, when we published the Year Ahead for 2016, we envisioned a “grind it out year” that had the potential to produce returns of 7%-8% (before dividends) in U.S. equities and contain more episodic volatility versus a consistently elevated level. We called 2016 The Twilight Zone: A new dimension that would bring new complexities, but one in which economic growth and equities should edge higher. As we close out the year, it appears that we have indeed experienced “The Twilight Zone,” with a strange end to this year characterized by renewed enthusiasm at or close to all-time highs on the major indexes. However, investors had to endure quite a bit to get to this point. In fact, one could characterize 2016 as The Year of The Unlikely in many aspects.

We began the year with deep worries regarding China’s growth path, a second wave of collapsing oil prices, a Federal Reserve (Fed) hiking into deflationary headwinds, the impact of negative interest rates in Europe and Japan, concerns over a potential U.S. recession, lower-quality corporate high yield problems, and U.S. consumers who might never spend their savings at the pump. All these worries hit at once in January and February and the S&P 500 fell over 10% from its 2015 closing level of 2043 (and approximately 16% from peak to trough). The index was closing in on the 1820 level in mid-February and the year appeared bleak. Our view was to maintain a balanced and diversified position throughout the downturn, particularly for the long haul, due to our belief that the major concerns, although understandable, were simply not going to fully develop and asset prices would begin to track fundamentals more effectively through the remainder of the year. At this point, valuation was generally fair in equities, macro

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unknowns were still present and investor sentiment was very low. The potential for risk assets to climb higher was there but a catalyst was needed.

Our core belief was centered on healthy consumers who would indeed pick up their spending from savings at the pump and become more confident as job growth continued and real incomes increased. We also believed U.S. financial conditions and the economic backdrop would improve in the second half of the year as the pressure from the strong dollar subsided and the deflationary effects of the collapse in oil prices began to fade. In other words, we were witnessing evidence that the mid-cycle slowdown that had hurt growth in the economy and corporate earnings was ending. While earnings were under pressure or at least stayed in “limbo” for approximately six quarters—so did the broader equity market. Without corporate profits, it is difficult to establish another uptrend—especially given the valuation level. As bond yields bottomed out in June and July, when approximately one-third of the world’s bond markets were in a negative yield environment, we began to see some cyclical improvements in most corners of the globe. Based on this core belief, the “grind it out” year for risk assets would be back on track (the “buffalo” market would roam once again), the business cycle would extend into 2017, bond yields would slowly shift higher, and equity markets had the potential to head toward previous highs (the S&P 500 hit 2190 in August) as an upside case.

Highlights

We have moved from a “get paid to wait” core portfolio theme to a more cyclical- and value-oriented theme in multi-asset portfolios.

- Equities remain attractive versus fixed income on a relative basis.
- Within equities, we favor U.S. large caps, U.S. small caps and emerging markets. We also favor value over growth and more cyclical assets versus defensives.
- Within fixed income, we prefer credit to Treasuries. We would also consider an allocation to Treasury inflation protected securities (TIPS) where appropriate.

We expect business, consumer and investor confidence to continue to head higher well into 2017 (with most of the newly expected growth to come in 2018), which should underpin equities for most of the year.

Christopher Hyzy
Chief Investment Officer, U.S. Trust

At this point, we did not characterize 2016 as The Year of the Unlikely. However, if you consider specific events throughout the year in finance and sports, it is easy to see that now. We already mentioned the second plunge in oil prices to the mid-\$20s per barrel to start the year, and bond markets in some areas of the world actually had yields that meant the lender paid the entity issuing the bonds to take their money! This was unlikely. How about Brexit? Unlikely. In sports, Villanova University winning the national championship in men’s college basketball (Nova’s first championship since 1985), Leicester—the English football club—winning the Premier League (before this season began, British bookmakers listed them as a 5,000-to-1 shot to emerge as the champion), the Cleveland Cavaliers’ first ever National Basketball Association championship and, of course, the Chicago Cubs winning the World Series for the first time since 1908! All unlikely. But it happened. Last but not least, in our own political backyard, we witnessed Donald Trump’s victory in the U.S. presidential election last month. Also unlikely. We all know markets do not like uncertainty. However, sentiment can shift quickly if fundamentals are not negatively affected, and what was previously determined to be “unlikely” turns to enthusiasm as to what could be. Welcome to our 2017 Year Ahead: A World of Change—The Investor Strikes Back!

Sentiment and confidence can have a powerful effect on asset prices. Throughout the last decade, we experienced many episodes on both the downside and upside. In addition, business cycles typically last between five and seven years before fundamentals deteriorate, usually due to a policy error of some sort. This can produce a recession and/or a bear market, which tend to correct the excesses that have been built up and kick-start a new cycle. Bull markets and cycles do not die of old age—there needs to be a fundamental catalyst that emerges and pushes the trends back the other way. We are approaching our ninth year in the current cycle despite all of the complexities and concerns that have come and gone since the credit crisis. We have often described how this cycle has extended this long largely due to the “slow growth” and disinflation backdrop that has deterred a boom-bust type of

atmosphere typically associated with cycles. In fact, we could have extended this cycle another few years along the same path given the secular stagnation that prevailed. This era needed ultra-accommodative central bank monetary policy just to keep things stable and plodding along this far into the cycle. It also needed corporations willing to manage their earnings to the penny in a below trend growth world that offered little pricing power. And finally, this cycle needed U.S. and emerging market consumers to continue to switch from deleveraging to spending as their balance sheets and incomes improved. This dynamic could have continued for a bit, but monetary policy has become tired. Negative interest rates have become a headwind, not a tailwind, in our view. To break from the era of secular stagnation and to begin to grow at trend (let alone above trend), fiscal policy and structural reform are urgently needed. Corporations need pricing power and a more competitive landscape, banks need a more pronounced and upward shifting yield curve, consumers still need job growth and, just like sports fans, investors need a catalyst to break from the past. Visible positive catalysts tend to turn into improved sentiment and confidence. Through the years, economists have called this “animal spirits.” Animal spirits begin as hope, turn into enthusiasm, and ultimately need visible action to keep the spirited momentum going. After all, economics is a behavioral science. It is our view that we are breaking from the era of secular stagnation and heading into fiscal reflation. This new era should have its fits and starts and will not be in a straight line. It should also include different stages and speeds from various economic regions globally. Furthermore, it should contain some “unlikely” outcomes. With any cycle, we will have to take the good (higher nominal growth) with the potential bad (higher volatility) and investors will have to reposition portfolios, rebalancing when necessary, in order to take advantage of the new era.

Prior to the U.S. presidential election, and even dating back to the summer months, when yields bottomed, the economy was already beginning to improve. As we mentioned earlier, the cyclical winds were beginning to blow, driven by the fact that the negative effects of the strong dollar and collapse in oil prices had ended. Corporate earnings were picking up, the consumer was spending at a healthy clip, there were some subtle signs of positive surprises in European economic activity, and the emerging market bear market (and negative earnings revisions) ceased. We were certainly not waving the celebratory flag on growth, but the economy was getting up off the ground, which is what risk assets need sometimes. We call this the “improvement factor.” If the improvement factor is not discounted, then risk assets have a chance to climb the wall of worry and surprise to the upside. This began to unfold in the last few months. In October, we raised emerging market equities to an overweight (a small overweight in Equities versus Fixed Income overall), while maintaining an overall

balanced viewpoint across asset classes. This was our initial step in repositioning our tactical asset allocation toward a more cyclical, pro-growth and value orientation. Ahead of the election, markets were consolidating, asset prices were stuck in a range and investor flows still favored fixed income over equities, but leading economic indicators and global earnings revisions continued to inch forward. However, the S&P 500 had lost momentum heading into the election, as investors worried that the secular stagnation era would continue and that monetary policy had lost its effectiveness.

Market sentiment changed dramatically during the early morning hours on November 9. The surprise victory by Donald Trump caught most investors off-guard. The potential for fiscal stimulus measures, reduced regulation, corporate tax reform and other potential pro-growth initiatives increased. Animal spirits perked up. Investor positioning was heavily skewed toward long-duration fixed income, low-volatility equities and high-dividend-paying companies. These areas significantly outperformed in the first half of the year but started to lose momentum once rates bottomed mid-year. However, investor positioning did not change materially at first. Portfolios were still generally overexposed to higher-quality, rate-sensitive investments—otherwise known as “bond proxies.” In our Hills Have Eyes strategy report, published on November 16, we outlined the need to rebalance portfolios given our belief that we were already transitioning toward the late-cycle expansion phase and that the new enthusiasm for pro-growth policies would begin to accelerate investor flows toward more cyclical investments. Given the high degree of underexposure to late-cycle investments by investors, we believed such a rotation would cause a melt-up in equities toward new highs over time. We characterized this switch as Phase I of three phases of portfolio management.

Phase I, still under way, should last into early 2017 as investors, including mutual and hedge fund managers, reposition portfolios for higher nominal growth, increasing yields and volatility, more cyclicity and value versus defensive, as well as lower exposure to long-duration bonds, low volatility and all-growth (versus various strategic and long term benchmarks). The initial phase occurs generally at the asset allocation level with some lowering of fixed income and a subtle increase in equity versus benchmarks and/or some shift higher in the risk profile in order to maintain historical levels of return and risk. Phase I also includes a rotation within asset classes, as allocators take profits in what has worked, lower exposure to areas of concern, like the bond proxies in equities or longer-duration Treasuries in fixed income, and add to areas of significant underexposure that are likely to benefit from a change in market regime.

The second phase of portfolio management includes greater shifts among asset classes, breadth within portfolios plus investors adding new money to their portfolios. This is likely

to occur after a pull-back in the beginning of the year potentially driven by the Fed's move to normalize interest rates, concerns over slower growth in China or perhaps the uncertainty over the European political landscape. This is when investors simply take a break from the big move up since the election and valuation begins to cloud further investment rotation. We expect Phase II to carry through into the summer months, keeping the uptrend in equities intact when, we expect, yet again concerns will develop around China, the Fed, the potential for a resurgence in the dollar and European politics.

The third phase of rotation usually invites those on the sidelines to finally capitulate and position portfolios for the new market and economic regime. It should occur as visible signs develop that actionable steps are leading to higher nominal growth at the end of the year and into 2018. In order for momentum to be maintained, investors will need to see concrete evidence that the corporate profit cycle is gathering momentum. Despite a high probability of pro-growth initiatives being enacted in the next 12-24 months, we believe the macro outlook is going to remain uncertain for a period of time. This should balance out periods of overenthusiasm and keep risk assets from getting too far extended and aggressively overvalued. Furthermore, with long-term global demographics challenging, we do not expect inflation and bond yields to get too far overextended and approach pre-crisis levels anytime soon. So, how are we going to manage portfolios in A World of Change, a world undergoing a major market regime shift, one that is transitioning from the era of secular stagnation to fiscal reflation, and one that still has a considerable amount of uncertainty? We are going to become more prescriptive, remain diversified and balanced, but with more exposure to pro-growth, pro-cyclical areas. We will also likely rebalance more often throughout the year as investor rotation gathers momentum during 2017 and into 2018; periods of volatility provide opportunities to add to areas we favor. In order for you to better understand our portfolio strategy thinking heading into the next cycle, below we outline our full view and answer a number of questions on the minds of clients as we head into 2017!

A WORLD OF CHANGE—THE INVESTOR STRIKES BACK!

Macro Environment:

From secular stagnation to fiscal reflation

Market Regime:

From a defensive search for yield to extracting value and increasing cyclical exposure. Investor flows favor equity versus fixed income, breaking away from earlier post-crisis trends

Growth Catalysts:

Primary: a move toward the late-cycle phase, fiscal stimulus through consumer and corporate tax cuts and the unlocking of corporate capital overseas

Secondary: deregulation in health care, financial industries and energy

Macro Unknowns:

Overall level of growth in the first half of 2017

Future trade policy tensions

Size and magnitude of an infrastructure bill

Degree of future tax cuts for individuals, small businesses and corporations

Degree of tax holiday or tax rate on capital repatriation

Potential unwind of globalization – how far and how fast?

Durability of emerging market recovery given higher bond yields, strong dollar and rising protectionism

Geopolitical risks

European elections impact

Number of Fed rate hikes in 2017

Investment Consequences:

Politics and policy lead to asset class rotation

Increase in inflation

Higher nominal gross domestic product (GDP) growth

Higher bond yields and steeper yield curve

Potentially quicker central bank response than market expectations

Value outperforms growth

Cyclical industries outperform more defensives

Higher commodity prices (except gold)

Higher asset price volatility

Higher deficits and higher debt

Slightly higher dollar versus developed and emerging market currencies

Longer-duration fixed income is vulnerable to rising yields; a shift lower in duration gathers momentum

Main Risks for 2017:

China's debt overhang and the effect on the country's real estate market

European political landscape and the uncertainty regarding integration

A head fake by the U.K. that reverses Brexit

A disconnect between market forecasts and Fed action on interest rates

Fragile geopolitical landscape and a vacuum of power

Higher interest rates and sharply stronger dollar undermining the credit cycle, impacting the economy and fixed income exposure in portfolios

Any unforeseen policy surprise (such as trade tariffs) that dampens the “growth” story

INVESTOR POSITIONING

We expect business, consumer and investor confidence to continue to head higher well into 2017 (with most of the newly expected growth to come in 2018), which should underpin equities for most of the year. Higher nominal growth, an improved picture for corporate profits and continued positive sentiment are the foundation for continued gains in the equity markets and an investor rotation from overexposure to long-dated fixed income into underowned equities. This rotation will need a few periods of confirmation, given the still uncertain broader global macro outlook, but we expect price-to-earnings multiples to remain elevated, despite higher rates, throughout the year. S&P 500 earnings have a wide range of forecasts due to the potential for sizable tax cuts in 2017. Based on this, the S&P 500 could add extra earnings on top of normalized growth, which is expected to be around 9%. At present, a reasonable range, albeit a wide one, is considered to be between \$129 and \$138 with the potential for further upside. In this scenario, where we get pro-growth policies filtering into a higher earnings number, an S&P 500 bull case level of 2700 at the high end is possible. For now, a base case utilizing the five factor framework from BofA ML Global Research, which combines sentiment, valuation and technical, equates to 2300. The market is currently placing more weight on sentiment and technical factors given the rotation of flows we have experienced. The two components that include long-term valuation and 12-month price momentum are indicating that S&P 500 levels between the base and bull case are increasing in probability. Of course, there are a number of scenarios that could unfold that would indicate a wide range of outcomes depending on the multiple or earnings number that ultimately develops. Markets usually do not trade right at fair value at the end of each year; rather, they ultimately discount various scenarios throughout the year. In the end, it all comes down to the path of corporate profits and the visibility on growth, both of which are improving.

Portfolio repositioning is likely to continue through year-end and well into 2017, as developments unfold and the pro-cyclical environment gathers momentum. With growth already heading higher from Q3 2016 onward and earnings turning positive, investors have begun increasing cyclicality

and exposure to value in portfolios at the expense of more defensive sectors and higher-dividend areas within equities. In addition, we expect a larger shift in emphasis toward small capitalization, which has already started, and more domestic-oriented equities due to a slightly stronger dollar, more pro-growth policies and the desire for a hedge against potential retaliatory trade policies from main trading partners. This portfolio shift in positioning is happening but, in our view, is in its early stages.

OUR INVESTMENT VIEW – ADJUSTING OUR TACTICAL ASSET ALLOCATION FURTHER

We have moved from a “get paid to wait” core portfolio theme to a more cyclical and value-oriented theme in multi-asset and all-equity portfolios primarily due to increased business and consumer confidence, which should lead to higher earnings than originally expected. Therefore, we have raised our exposure to equities versus fixed income to a moderate overweight and our new tactical asset allocation view is overweight equities versus its strategic benchmark. Therefore, we are now further underweight fixed income versus equities, underweight versus its strategic benchmark rather than neutral, and have lowered cash to neutral from overweight. Within the asset classes, we have made a number of changes consistent with our view from earlier this year and one that has accelerated post-election. We are now moderately overweight U.S. small capitalization equities and neutral non-U.S. developed markets. We maintain our preference for U.S. high-quality large caps and continue to overweight emerging markets. We continue to favor value over growth and more cyclical areas (such as financials and consumer discretionary) versus defensives (such as utilities and consumer staples).

In fixed income, we have moved from a balanced view to a larger underweight versus the strategic benchmark. However, fixed income still represents an important portfolio diversifier (and a volatility dampener in unforeseen worst-case scenarios) and should be viewed primarily as a cash flow producer versus a total return asset, given the expectations for higher yields. In addition, we have lowered Treasuries to a further underweight but maintain our neutral rating on high yield and underweight on international fixed income. Municipal bonds have corrected to levels that are becoming attractive again, and we are still favorable on investment grade corporate credit. We maintain our neutral rating on real estate and commodities, but we prefer metals and oil to gold.

In addition, the pro-cyclical improvement has started to break down the elevated correlation among and within asset classes since earlier this year. We expect this adjustment to continue as economic volatility picks up and asset class volatility follows suit. Transitions to late-cycle phases tend to invite a higher level of volatility as inflation

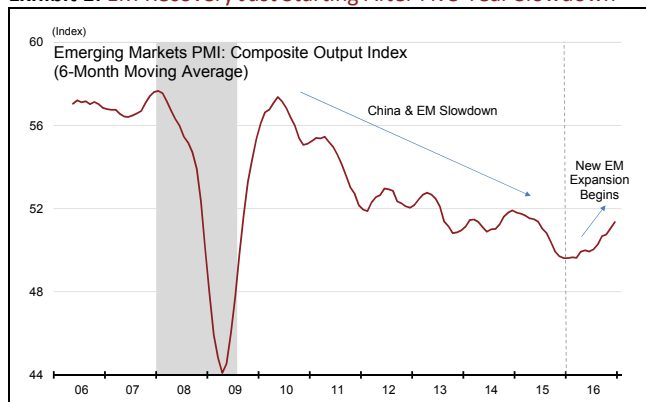
rises and central bank policies shift to nudging short rates higher. In this environment, alternative investments, namely hedge funds, should outperform industry benchmarks, in contrast to recent underperformance. For investors able to withstand a higher allocation of illiquid assets in their portfolio, we prefer timberland for its long term-growth prospects and low correlation to financial assets.

QUESTIONS & ANSWERS

1. Describe the year ahead macro environment around the world. What are the main catalysts? What is changing from 2016, where are we in the business cycle, and what are some of the main events and risks?

Global economic growth bottomed in the first half of 2016 and has begun a cyclical upswing that should last for several years in emerging markets (EMs) and at least through the 2018 mid-term elections in the U.S. Emerging market growth weakened for five years after a 2010 peak and only began to improve in 2016 (Exhibit 1). EMs were less affected by the financial crisis, which emanated from and was concentrated in developed countries’ mortgage markets. Nevertheless, China and other EMs threw everything but the kitchen sink at their economies in 2009 to head off catastrophe. That sparked the last hurrah of China’s long streak of double-digit growth, with many other EMs riding the Middle Kingdom’s coattails. Global growth peaked in 2010 at 5%, led by China, and subsided thereafter, with waning Chinese growth.

Exhibit 1: EM Recovery Just Starting After Five-Year Slowdown



Source: HIS Markit/Haver Analytics.
Data as of December 5, 2016.

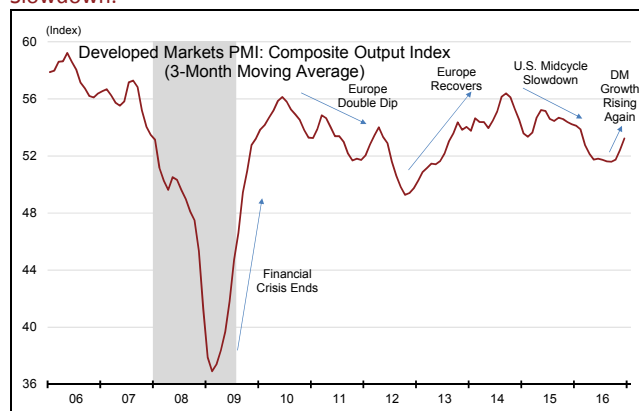
Since 2010, China has transitioned to slower, more service-sector oriented growth of between 6% and 7%. Key to the EM turn this year, China has stopped slowing and has stabilized in its new, lower-growth range, which we expect to continue. Other EMs, like Brazil, have also stabilized after severe recessions and begun cyclical upswings. As a result, the consensus forecast for 2017 EM GDP growth is more than a half point higher (4.7%) than growth in 2016 (4.1%).

Because EM stocks went through a five-year bear market during the 2010-15 slowdown, they began 2016 substantially undervalued relative to Developed Market (DM) stocks. Early signs of the turnaround this winter sparked a new bull market, causing EM stocks to outperform DM stocks in 2016. EM growth is now rising relative to DM growth, and many EMs are at the beginning of economic expansions, as opposed to the

latter stages, where the U.S. is, making EM outperformance likely from a “stage of the cycle” perspective. Other considerations—like potential protectionism, China’s new growth paradigm, a strong dollar and rising U.S. interest rates—complicate the picture and argue for careful country and sector selection in EMs, rather than a blanket overweight endorsement. Still, EMs should provide some good opportunities for outperformance in 2017.

The gap between strong EM growth and slower-growing DMs narrowed after 2010, largely because of relative outperformance in the U.S., which took the global expansion baton from China. Europe vacillated on policy and, as a result, went back into recession just as EMs began to decelerate, causing global growth to slow. When European Central Bank (ECB) President Mario Draghi came on board and ECB policy eased, Europe moved out of recession and DM growth accelerated from 2012 through mid-2014, when the oil price crash and strengthening dollar caused the U.S. to slow from over 3% to about 1% real GDP growth earlier this year (Exhibit 2).

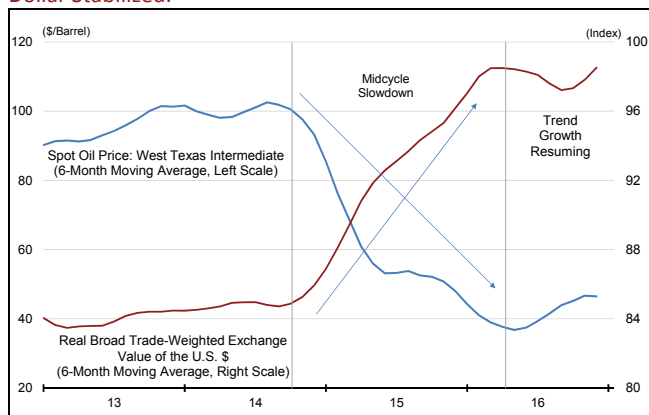
Exhibit 2: DM Expansion Strengthening After U.S. Mid-Cycle Slowdown.



Source: HIS Markit/Haver Analytics.
Data as of December 5, 2016.

After oil prices and the dollar stabilized in the winter (Exhibit 3), U.S. growth picked up and seems to be averaging about 3% for the second half of 2016. The low oil price devastated capital spending, which had been disproportionately concentrated in the energy sector. The strong dollar temporarily hit U.S. manufacturing exports. Now, the positive effects of lower oil prices and the strong dollar for consumers are dominating, lifting household spending back to its 3% real growth trend.

Exhibit 3: Mid-Cycle Slowdown Ended in Early 2016, When Oil and Dollar Stabilized.



Source: HIS Markit/Haver Analytics.
Data as of December 5, 2016.

Deflationary pressures intensified during the global slowdown, with the oil price collapse playing a major role. Central banks responded with more quantitative easing and even negative rates. Japan went so far as adopting a version of helicopter money in September. As oil and commodity prices turned this past winter, deflation pressures began to ebb, EMs began to improve and the U.S. economy reaccelerated. The growing use of fiscal policy cements the outlook for better growth in 2017. Japan is leading the way, with its combined fiscal and monetary approach to reflation. Donald Trump’s surprise victory with a Republican-controlled Congress makes a pro-business program of tax cuts, regulatory relief and infrastructure upgrades most likely for 2017. The equity market response to the election outcome clearly shows an expectation that growth and inflation are headed higher next year. We expect upside risks to push growth higher than the 2.2% that the consensus outlook sees for the U.S. next year.

Global services and manufacturing indicators for November show the global economy ending the year with rising momentum. The global composite PMI is at an 11-month high that historically is consistent “with a robust 3.8% pace of global annual real GDP growth,” according to Ned Davis Research. This suggests consensus estimates for about 3.5% global growth in 2017 might be too low. We believe upside to about 4% is possible.

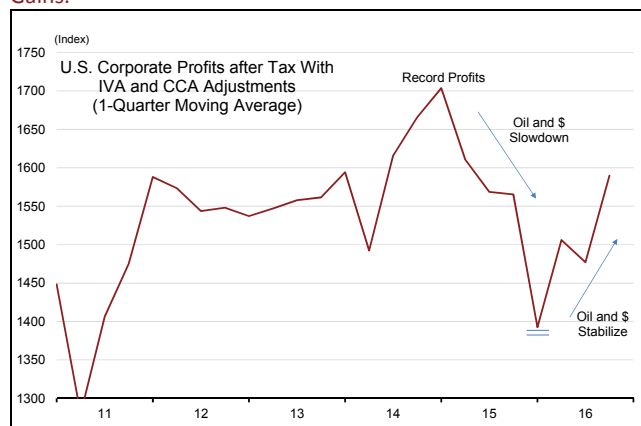
The manufacturing component of the composite PMI shows a widespread global cyclical uptrend to the highest level in 27 months, right before the U.S. slowdown began. New orders, including export orders, are leading the upswing, suggesting capital spending and trade activity are improving going into 2017. The surveys also suggest inventory corrections are complete, part of what’s required to get factories humming again. This widespread improvement in PMIs around the world indicates the global nature of the growth pickup. The main exception is India, where the

recent policy forcing holders to retire large bank notes has created what we believe is just a transitional hiccup in its expansion.

Profits Rising Again

The end of the mid-cycle slowdown marked a turn in corporate profits (Exhibit 4). In the third quarter, after-tax corporate profits were up 14% from their fourth-quarter 2015 bottom. Oil price and dollar effects accounted for most of the profits recession. Equity values stalled in 2015, as is typical in a mid-cycle slowdown. They resumed the cyclical bull market once profits turned. Looking to 2017, U.S. companies were already on course for a 6%-9% rise in S&P 500 earnings per share before the election. The Republican sweep, with its promise of lower corporate taxes, regulatory relief and strong incentives for infrastructure and other investment spending, has added the possibility of a boost to corporate profits growth. Higher nominal growth also adds to the upside for profits. As a result, the outlook for 2017 S&P 500 profits of \$129-\$138 reflects the greater upside risk and heightened uncertainty. This should make equity returns more attractive than originally anticipated next year once dividends are taken into account.

Exhibit 4: Profits Recovery Driving Stronger Growth and Equity Gains.



Source: Bureau of Economic Analysis/Haver Analytics.
Data as of December 1, 2016.

Risks for 2017: Higher rates, a stronger dollar and European politics

One consequence of the improved outlook for nominal GDP (from about 2% at the bottom of the mid-cycle correction to the 5%-6% range next year) is that interest rates are likely to rise faster than was originally expected in the lower-for-longer “secular stagnation” outlook. This is evident in longer-term rates, like the 10-year Treasury yield, which is up about 100 basis points from its summer low. The key to rate risk is the Fed. If the Fed overreacts and tightens too much, the positive growth and inflation outlook would be nipped in the bud. The best gauge of this outcome is the yield spread between the 10-year Treasury and the federal funds

rate. The spread will compress if the Fed mistakenly overplays its hand.

Conversely, if the Fed lets the economy run hot by deliberately staying behind the curve with fewer rate hikes, policy will remain accommodative and not pose a threat to the stronger economic picture we see for 2017. This would be signaled by a “bear steepening” of the yield curve with the 10-year rate rising more than the funds rate. When the curve steepens, it implies monetary policy is more accommodative. That’s what has happened since the summer despite the increased trajectory for expected Fed rate hikes. “Don’t fight the Fed” in this case means the Fed is expected to remain a tailwind for growth. That is unlikely to change until higher inflation becomes more of a threat.

Stronger growth and rising rates are supporting a higher foreign-exchange value for the dollar. The 25% surge in the dollar’s value against the currencies of its trading partners was a major drag on U.S. multinational profits and manufacturing exports in 2015. The dollar went from extremely undervalued to about fair value before it stabilized earlier this year. A strong dollar in a deflationary, slow-growth environment is more damaging than a strong dollar in an inflationary, stronger global-growth environment. This means mild upside to the dollar of say the 5%-10% we see next year is unlikely to derail the positive outlook for U.S. growth and profits. Another 25% jump, on the other hand, could alter the stronger positive outcome we expect. One safety valve to counter excessive dollar strength is Fed policy. As we saw this year, the Fed can dial back its rate-hike plans if a strong dollar tightens financial conditions. When the Fed went from projecting four hikes to two hikes for 2016, the dollar stopped rising. As with higher rates, the downside risks to the economy from a stronger dollar basically require the Fed to mistakenly over-tighten, which we do not expect.

Europe is the Biggest Risk

“...so long as the eurozone fails to deliver widely shared prosperity, it will be vulnerable to politics and economic shocks. Complacency is a grave error.” Martin Wolf in the December 7, 2016, Financial Times.

As has been true in recent years, Europe harbors the biggest potential shock for the global economy. While populist forces for needed changes are growing, they remain stymied by the complacent political elite. Forces for needed changes in the U.S. and the U.K. are no longer blocked by a failing status quo. That’s not true in Europe, where populists won the Italian referendum but still face a long period of procrastination before true change is possible. Kicking the can down the road remains the elites’ modus operandi. As the quote from Martin Wolf suggests, the longer the European

dysfunction continues, the longer the disparities across Europe will fester and grow worse. This means the end game could be much more explosive when it finally comes, with its potential for the European Union to break up.

Suppressing action by kicking the can down the road probably means more palliatives in 2017 before the ultimate solution or disaster materializes. Elections in the Netherlands, France and Germany are potential pitfalls next year but the big confrontation continues to be pushed further out in time. We expect volatility from Europe’s problems but the biggest risk might not come until later, perhaps 2018, when Italy could decide to leave the Union unless the EU reforms itself. Hopefully, Brexit negotiations will include substantive reforms to make the currency union more sustainable.

2. Is the U.S. consumer in overdrive or just getting going into second gear? Where are we in the housing and auto cycles? Any particular trends you would highlight?

With the U.S. the leader of the global expansion, its acceleration in 2017 is likely to spill over to the rest of the world. The U.S. household sector is the biggest single contributor to global consumption. U.S. consumers are entering the “feel good” phase of the economic expansion. During the first seven years of the expansion, there was skepticism about the economic expansion. Most people surveyed believed the economy was still in recession years after the recession had officially ended. This pessimism lasted much longer than it usually does. Eventually, however, every economic expansion reaches a point where people believe the economy is good. Likewise with the stock market. People are dubious about stocks as investments until the latter stages of the cycle, when retail investors finally decide to join the party.

There are signs that the U.S. election has triggered the “let’s party” stage of the cycle. Business and consumer attitudes were weighed down by the ugliness of the election. Businesses put investing on hold to wait for the outcome. Early sentiment indicators since November now suggest “animal spirits” are coming alive. Business confidence and investment leading indicators have turned up. For the first time in this expansion, consumers are putting money into equities rather than taking it out. There are signs that the long-awaited great rotation from bonds to stocks has begun. The stronger nominal growth we expect would drive this rotation and potentially put a nail in the coffin of the more than three-decade-old bull market in bonds. The odds that “secular stagnation” ends and interest rates “normalize” are rising.

While it's late in the cycle by some measures, such as longevity (90 months) and the unemployment rate (4.6%), it is still early by others. The housing recovery was slow to get started and is coming out of the deepest hole since the 1930s. Housing needs to grow strongly for several years to catch up with rising demand from millennials. Vehicle sales were quicker to recover from the recession but need to stay near recent strong levels for a few more years to renovate the aging fleet.

Consumers have repaired their finances, have jobs, and are seeing better wage gains, home equity increases and stock market advances. They are looking forward to tax cuts. Credit for housing and other borrowing is easier to obtain. Housing affordability is still at historically high levels despite the recent pop in mortgage rates.

In short, conditions are ripe for the "exuberance" phase of the cycle to take off as it usually does when an expansion matures. The negative public attitude toward the economy has persisted for longer than usual. There is probably a pent-up demand for enthusiasm after such a long dry spell. All of this suggests that upside surprises from the U.S. consumer are likely for 2017.

Inflation tends to heat up in the exuberance phase of an expansion. Low unemployment feeds good feeling and wage increases. Fortunately, this cycle is coming off the lowest inflation rates of the past half-century. Wage gains are rising, but from very low levels, and have quite a ways to go before turning problematic. Productivity-enhancing regulatory policies could extend the cycle. The Fed Chair has endorsed letting the economy run hot for a while to make sure it escapes the "zero rate" low-inflation trap. Easy monetary policy and constructive fiscal stimulus could feed the exuberance phase and allow the party to run longer than usual before the punch bowl is withdrawn.

Zero and negative rates are the result of a world with low nominal growth and significant deflation risk. Secular stagnation reflects low productivity and sluggish labor force growth. Stronger nominal growth and a pro-business regulatory and tax environment are antidotes to what the conventional wisdom regards as the deterministic result of external forces. In the next few years, we will find out if secular stagnation and abnormally low rates are self-inflicted by poor policy choices or truly the inevitable result of uncontrollable forces.

3. How do you see the European landscape in 2017, given the elections, potential monetary policy extension, and economic trends?

The next 12 months will be a period of increased political uncertainty in Europe, with leadership elections in three core eurozone countries likely to occupy most of the headlines. Voters will go to the polls to elect new governments in the Netherlands, France and Germany in 2017, and the recent gains made by far-right euroskeptic parties in these three countries could cause EU cohesion fears to resurface. The far-right Freedom Party in the Netherlands is leading the polls ahead of the March general election, and has explicitly called for a referendum on EU membership. In France, the far-right National Front has pledged to hold a similar vote if elected by May. Its leader is expected to reach the second round of voting, though the more moderate Republican party candidate is still favored for the presidency at this stage. And in Germany, the governing coalition parties of Chancellor Merkel should retain their majority, but they nonetheless continue to lose public support ahead of federal elections set for September or October. In each of these cases, a U.K.-style exit remains the less likely scenario. But as we have seen on countless occasions throughout the current cycle, rising political uncertainty on the continent has the potential to weaken European asset prices and destabilize global markets. The full electoral calendar could also harden the stance of European leaders toward Brexit as the U.K. government looks to trigger article 50 of the EU Treaty and open its negotiations with the European Commission by the end of the first quarter.

But looking beyond these event risks, the underlying economic picture for the eurozone so far appears more encouraging, and key growth indicators are either stable or improving. Real GDP grew at an annualized 1.2% in the latest release for the third quarter, with the domestic drivers of consumption and investment contributing the most to growth overall. And in the fourth quarter to date, the cyclical manufacturing PMI index has risen to just below its high for the cycle. Furthermore, the eurozone-wide unemployment rate has dipped below 10% over recent months for the first time since the region's double-dip recession began in 2011. And core inflation appears to have stabilized, if at a low level of just 0.8%. Crucially, bank loan growth in the eurozone has also remained relatively stable, at just under 2%, though it remains off its post-recession high. Further downside for bank lending growth due to the low (if gradually improving) rate of nominal activity will be another key risk to watch in Europe next year, and Italy in particular will remain in focus given its surge in non-performing loans since the financial crisis. A number of the country's major banks are likely to need recapitalizations in 2017 (with the potential for forced

participation by bank bondholders), and the political limbo created by the recent “no” vote in the constitutional referendum risks deterring private investors.

Europe’s still- tepid recovery, low inflation and fragile banking system mean that the ECB is likely to remain relatively flexible in its monetary policy stance over the period ahead. Despite its decision this month to reduce its asset purchases from EUR80 billion per month to EUR60 billion per month from April 2017 to the end of the year, it left the door open to extending the program, if necessary. We therefore look for the gradual recovery in Europe to continue. But with a wide band of uncertainty around political and economic outcomes in 2017 likely to keep European equity valuations in check, we expect local markets to continue to lag the U.S. and developed world in aggregate.

4. What’s your view on the emerging markets overall? Have things changed heading into 2017? How about China?

Emerging market equities in 2016 have so far delivered their widest margin of outperformance relative to developed markets since the peak of the last cycle. Commodity producers have led the rally, with Latin America outperforming other regions within the MSCI index. Brazil in particular has been the standout performer, benefitting from a combination of low starting valuations, surging iron ore prices, a forecast exit from recession next year and expectations for market-friendly policies under the newly installed government. Similarly for emerging markets as a whole, a number of external and internal factors have helped the asset class outperform this year. But while we expect the latter to remain supportive, the external environment is likely to become more challenging going into 2017.

Though they have risen from their lows at the turn of the year, EM equity valuations still look undemanding in relative terms. Based on an unweighted average across price-to-earnings and price-to-book value ratios, EM equity multiples reached 1.09x developed market levels at their relative peak in late 2009 but (after the protracted bear market of subsequent years) began 2016 at just 0.64x—a level similar to the early 2000s, before the global boom in credit, trade and commodity prices of the pre-crisis cycle. At 0.70x today, EM valuations have since recovered only around 15% of this relative de-rating and therefore still look moderate by historical comparison.

The local business cycle should also be a support for EM equities going into 2017. The emerging world has already undergone a major slowdown over recent

years, with real GDP growth falling by half since the cycle peak in 2010 and two of its largest economies (Brazil and Russia) slipping into recession in 2015 and 2016. With consensus growth expectations of 3.7% among private forecasters, the current year is forecast to be the weakest for EM growth since 2009. But a full percentage point of acceleration is expected in 2017—the first projected annual growth increase since the end of the financial crisis. This puts emerging economies at a far earlier stage of their economic expansion than developed markets. And unlike in the U.S., local EM policy rates are expected to fall in most countries next year. China appears to be stabilizing in the 6%-7% growth range as measures aimed at cooling the property market, including higher down payment requirements and new home purchase restrictions, slow construction activity. However, this year’s currency weakness appears less of a concern than that of 2015. As the Chinese authorities look to manage the exchange rate to a broader basket of currencies, renminbi depreciation has been broadly in line with trade-weighted dollar strength. Moreover, Chinese foreign exchange reserves have been relatively stable compared to the sharp declines witnessed in the second half of last year.

Going into 2017, the key risks to watch for EMs will be external. In particular, we believe the biggest potential hurdles to continued outperformance are the expected rise in U.S. interest rates, possible further strengthening of the U.S. dollar and the threat of new trade barriers from the incoming Trump administration. We remain moderately positive on emerging markets overall, though the new risks on the horizon temper our optimism for the asset class. On a country basis, our favored market remains India, given its rapid trend rate of nominal growth, its balanced current account position, its relatively low foreign debt exposure and its ongoing domestic reforms. The recent surprise withdrawal of large-denomination bank notes from circulation will depress growth in the short term. But we expect a relatively swift recovery as replacement notes are issued, while the longer-term benefits of a larger formal sector should further increase potential growth and support market valuations.

5. What is the predominant monetary policy outlook around the world? How patient will the Fed be given the outlook for inflation, employment, nominal growth and financial conditions overseas? Describe some of the fiscal policy initiatives that could develop in 2017. What is the likelihood that the impact of potential global trade policy would outweigh any benefits from domestic-oriented fiscal stimulus in the U.S.?

After a sustained call by monetary policy leaders in

most advanced economies for fiscal policy to accelerate growth, fiscal policy makers in many advanced economies are answering the call. As monetary policy became more overburdened through 2016, it was evident it would not be sufficient to fully revive growth, inflation and inflation expectations. As we enter 2017, Japan appears to be most fully in the sweet spot of coordinated monetary and fiscal policies. The Japanese central bank took a bold step to sustain accommodative monetary policy and expansive fiscal policy through its yield curve control that caps the yield on Japan's 10-year government bonds at zero, effectively reducing the government's debt service burden in one move. The Bank of Japan now openly admits it is passing the baton to fiscal policy, and has cleared the way for Japanese fiscal authorities to pursue some 28 trillion yen of stimulus in a combination of Development Bank loans, infrastructure spending and payments to elderly and low-income citizens. In recent months, the coordination between the monetary and fiscal wings seems to be paying off, as consumption accelerates, the yen weakens and estimates of GDP growth pick up.

The U.S. appears to be in the early stages of entering that same sweet spot. The Fed's monetary policy still suggests a very gradual pace of tightening, albeit somewhat faster than the pace of one rate hike per year so far – the market thinks 2 – 3 hikes are in the cards for 2017. We anticipate that the Fed will continue to tolerate some overshooting in inflation, but not to the point of permitting inflation expectations to float substantially higher than prior long-term averages. The Fed will also recognize that overtightening target rates, or tightening too quickly, will raise the risk of either asset prices dropping or a recession. Against that backdrop of a slow but steady tightening, President-elect Trump is advocating for a fiscal policy that combines tax cuts, tax rate reform and spending on infrastructure and defense. This recipe for fiscal reflation could generate as much as \$500 billion in eventual infrastructure spending and \$450 billion directed toward the military and defense. Alongside spending increases, Trump has proposed tax cuts that could bring the corporate rate down from near 40% to 15% or 20% and consolidate the number of personal tax brackets from five to three, with the highest topping out at 33%, and eliminate the Alternative Minimum Tax for households and firms. Combining these tax cuts and spending increases with expectations for a lighter regulatory touch support our call for faster nominal growth and higher but not excessive inflation.

By contrast, Europe has not yet fully embraced the idea of additional stimulus, despite tepid progress on inflation. Monetary stimulus was extended through the end of 2017 but at a slower pace of purchases, while fiscal stimulus may not appear at all across European

Union members. Germany is resisting adding stimulus after a one-off stimulus package in 2016 to address the refugee/migrant crisis, while France and Italy are being held to European Commission demands to reduce their budget deficits to below 3% of GDP given the fragile state of fiscal balances there. The fiscal policy landscape is further complicated by the upcoming elections in the Netherlands in March, in France in April to June, and in Germany in October, all of which include an element of populist discontent with current administrations.

In addition, the Brexit decision and the Trump victory only further elevate the need for fiscal spending in Europe. The possibility of a drag on growth from the U.K.'s decision to exit the EU and Trump's potentially protectionist America first stance raise the risk of slower growth in Europe. Pressure to fully ensure Europe's defense following suggestions by Trump for the U.S. to step away from NATO could also increase the likelihood of military and defense spending increases, especially given that several key European nations have tapered defense budgets in recent years.

6. Can the bull run continue? What are the main market scenarios that can unfold in 2017, given the changing global landscape? What is your base case, your upside and downside cases? What are the main differences between 2016 and 2017?

The secular bull market in equities can continue as it enters the late stages of this cycle, and the cyclical bull market is taking the lead as we emerge from the mid-cycle slowdown witnessed over the last 12-18 months, supported by a turn in revenue and profit growth and fiscal policy turning supportive of economic growth for the first time in years. Importantly, fund flows over the last decade have been decisively into fixed income with almost no net new flows into equities. As interest rates normalize and move higher, fund flows into equities should increase and support the bull market. With economic data gradually improving during 2016, monetary policy still relatively easy, signs of deflationary forces abating, inflation gaining traction and corporate earnings improving, the bull market should be poised to continue into 2017 and 2018.

Our colleagues in BofAML U.S. Equity Research use a suite of indicators that imply a 2017 year-end target of 2,300 in the base case that reflects accelerating U.S. and global growth amid slightly higher oil prices that should help drive an acceleration of earnings growth (Exhibit 5). Its 2017 base case target aligns with the GWIM CIO 2017 S&P 500 target range of 2,300 – 2,700.

Exhibit 5: BofAML S&P 500 Target Models for Year-End 2017.

Model	Category	Time Horizon	2017 Target	Expected Return (Annualized)	Current Weight in Forecast
BofAML Fair Value	Fundamental / Valuation	Medium Term	2,050	-5.6%	40%
Sell Side Indicator	Sentiment	Medium Term	2,671	+19.5%	20%
Estimate Revisions	Fundamental / Sentiment	Short Term	2,337	+6.1%	20%
Long-term Valuation	Valuation	Long Term	2,412	+9.1%	10%
12-Month Price	Technical	Medium Term	2,428	+9.8%	10%
		S&P 500	2,300	+4.6%	

Note: Short-term=1-3 month; Medium-term=1 Year; Long-term=5+ Years. We maintain our official target based on increments of 50 points on the S&P 500.

Source: BofA Merrill Lynch U.S. Equity & U.S. Quant Strategy.

Data as of November 17, 2016.

A downside scenario to our base case could unfold if the policies of the new administration stall and the delays result in a soft period as the anticipated pro-growth policies do not show up in economic data and corporate earnings. Potential delays in pro-growth policies could disappoint markets and lead to the unwinding of equity valuations that already discount stronger growth for 2017. In addition, uncertainty from Trump's trade policies and potential protectionist action could prove a drag on global growth. Lastly, the pace of interest rate increases will be a determinant of equity returns—if bond yields rise too quickly, they could short circuit the current bull market. Likewise, U.S. dollar strength needs to be monitored closely. Too rapid a dollar appreciation could stall the bull market—we will watch these macro indicators closely.

There is also upside risk to the outlook as previously explained if global growth accelerates faster than expected, while inflation accelerates. This would be a tailwind for cyclical countries, industries, commodities and related companies. With corporate free cash flow at high levels, strong growth could trigger capital spending, stimulating growth even more. Furthermore, with the absence of significant global macro shocks, a slightly higher U.S. dollar, only a gradual increase in interest rates, and implementation of the new administration's stimulus and tax plans, GDP growth and corporate profits could exceed expectations, sending equity values even higher than our base case scenarios. In this scenario, a move toward 2700 as the bull case is likely particularly as positive sentiment continues to gather momentum.

7. What is your specific outlook on valuation and corporate profits? What are some of the specific short-term market-based themes? What could be the impact of the U.S. dollar, oil, and protectionist policies on earnings and equities?

Post-Brexit, global equities rose as economic activity improved and earnings revision ratios rose. The results

of the U.S. elections created the pivot that furthered the market's expectations of better growth in 2017 along with rising inflation. As a result, we've seen the S&P 500 rise by 3.7% in November as well as the yield on the 10-year Treasury bond rise by over 50 basis points. Japanese equities have moved sharply higher (in local currency), with Europe in positive territory as well. Emerging markets equities, having enjoyed a great year of outperformance until October, were hit hard in November, as a perfect storm of rising rates, a higher U.S. dollar and anti-trade sentiment came to the fore. The ongoing rotation from defensive to cyclical sectors has gained further strength. Sectors such as financials, industrials and energy have been bid higher by double-digit percentages at the expense of utilities, consumer staples and REITs.

On the earnings front, our expectation is that corporate profits will rise for most regions in 2017, helped by better nominal growth. This comes after several quarters, at least in the U.S., of declining profit growth. Earnings growth should be supported by a recovery in the resource sectors, especially energy, given the base effect, and from financials, especially banks, given our expectations for higher interest rates and a steeper yield curve. The technology and health care sectors continue to have long-term secular winds at their back and should produce mid- to high-single-digit earnings growth. All in all, our expectation is for solid growth for the S&P 500, with a range of \$129-\$138. Earnings growth should improve in Europe and emerging markets, as global growth ticks higher and oil prices rise, and in Japan, where we expect stronger domestic demand and a weaker currency to drive profits.

Valuations for U.S. stocks seem extended but should not deter the markets from moving higher. After bottoming in February at a P/E of 16.8x trailing 12-month earnings, the multiple has expanded to 20.6x as of December 5, which is higher than the 10-year average of 17x. Similar conclusions can be derived by looking at other common multiples, such as forward P/E and price-to-book ratios. We do not expect valuations to expand meaningfully from these levels, especially given the prospect of rising bond yields and of significant uncertainty to persist due to ongoing political risks. However, at these levels, equities can produce mid-single-digit positive returns on an annualized basis over the long term. In addition, we think that global equity valuations can absorb higher bond yields given elevated equity risk premiums and the brightening earnings outlook.

With respect to earnings and ultimately to sentiment and stocks, we remain focused on political and policy risks and their impact on the dollar and rates. The recent rally in U.S. stocks comes on the hope for policy

induced reflation in 2017 and beyond. As we move towards the middle of 2017, we should get a better sense of the outlook for corporate and personal taxes and infrastructure spending. If taxes are lowered and an infrastructure spending bill that surprises the market on the upside passes Congress, stocks (especially cyclicals and small caps) should outperform, as sales and earnings growth expectations will move significantly higher. The markets will remain hinged to Trump- and Ryan-speak to get clues on how much fiscal stimulus is plausible in the months and years ahead.

The pro-growth fiscal stance should be good for U.S. and global stocks, but upside could stall based on how the Fed's policy stance is perceived and how fast the dollar and interest rates rise. The Fed's policy of maintaining a slow pace of rate hikes may be complicated as reflation takes hold and it finds itself behind the curve. Breakout inflation or the perception of it could reverse investor sentiment and flows away from stocks. Furthermore, the trajectory for the dollar, interest rates and oil can impact earnings. A swiftly rising U.S. dollar would pressure profits at large and multinational companies and could put pressure on the global manufacturing sector. Higher rates, while good for the financial sector, can put pressure on the more levered segments of the stock market. Meanwhile, oil is a swing factor as far as earnings from the energy sector go because of its significant contribution to the overall profit growth expected for the S&P 500 in 2017.

Another significant risk for global equities will be the new administration's follow-through on anti-trade campaign rhetoric. We cannot dismiss this, given how central it was to Trump's campaign. If the President-elect moves to brand China a currency manipulator and follows through with tariffs, there would be a significant chance of retaliation and damage to confidence and margins, and heightened risks of stagflation rather than healthy inflation. This would result in a risk-off environment for equities as well.

8. Will corporate tax cuts lead to significantly higher earnings? Could this support a much higher market level?

Tax reform has been labeled a priority for the Trump administration and garners widespread support in Congress, raising expectations for its legislative passage. According to BofA Merrill Lynch Global Research, lower corporate tax rates could add \$8-\$11 to S&P 500 non-financials earnings per share (EPS) per year. However, removal of interest-rate deductibility and changes in the treatment of foreign profits could cut this benefit in half over time. Should this scenario unfold in 2017, it would mean an additional \$5-\$6 of EPS over time, with greater upfront benefits from the tax cut, followed by the end of interest-rate deductibility and its negative impact to earnings.

Starting points for negotiations may be found in Trump's campaign overtures, to be refined into a budget outline next year, and the Ryan/Brady Blueprint, a broad proposal released in June and authored by House Speaker Paul Ryan and House Ways and Means Chairman Kevin Brady. Among the notable deviating positions between both plans is the degree of any corporate tax cut and the ending of interest expense deductibility. From the current U.S. statutory corporate tax rate of 35%, Trump's plan would reduce it to 15%, while the blueprint proposes a reduction to 20%. With regards to interest deductibility, Trump's plan suggests this item may be optional, versus it being a mandatory requirement in the blueprint. In our view, an essential issue at stake between the competing plans is whether corporate tax reform is done in a way that does not notably reduce federal government revenue.

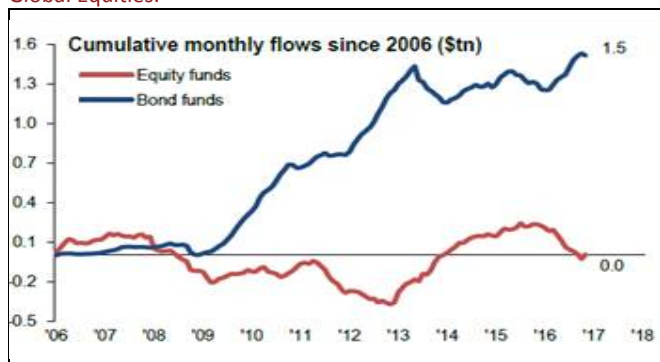
From an investor standpoint, it is important to stress that tax reform is difficult. Negotiations may result in setbacks, including smaller-than-expected tax cuts, the inclusion of interest deductibility additional unforeseen measures, or even delays. The ebb and flow of potentially difficult negotiations between Congress and the Trump administration may result in market volatility, while the details of compromise may end up limiting EPS growth and curtailing price-to-earnings multiple expansion.

9. What are sentiment, investment exposure and technical factors to be aware of heading into 2017?

Most of the world approached investing cautiously during the better part of 2016, generally favoring bonds over equities, and defensive equities over cyclical equities. In addition, as the U.S. election approached, global institutional cash levels reached a historic "buy signal" of 5%, especially as the U.S. equity market was 2% off its August peak. Sentiment is a funny thing—once everyone seems positioned the same way, the opposite outcome of what consensus expects often occurs. This time was no different—the election results led to a fast and furious sell-off overseas, but on Wall Street stocks initially sold off and then gradually rose throughout the rest of the day.

Today, most of the major equity market indexes are sitting at or near record highs. Interest rates, which had been gradually rising with stronger economic data, rose sharply and are higher today than they were in January. The rotation we've seen into pro-cyclical, pro-growth and pro-inflation segments of the market at the expense of bonds and cash has been vicious. While technical factors and market sentiment are largely indicating attractive returns going into 2017, there can be pauses and reversals given such quick moves across asset classes.

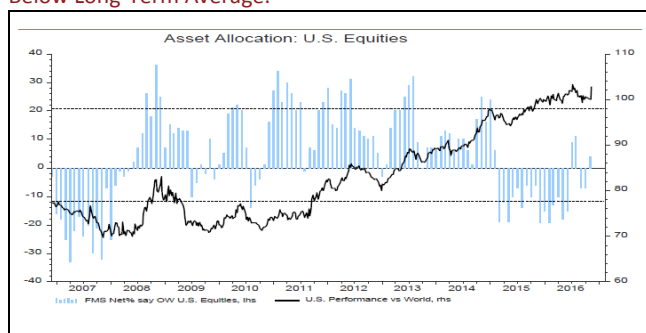
Exhibit 6: Inflows to Global Bonds Increased at the Expense of Global Equities.



Based on EPFR Global’s monthly dataset (more comprehensive coverage).
 Source: BofA Merrill Lynch Global Investment Strategy, EPFR Global.
 Data as of December 1, 2016.

Since the election, expectations have increased for improving global growth and higher inflation, and we’ve seen the largest month-over-month decline in cash levels since 2009. At the same time, we have not seen fund managers increase their equity positioning alongside this shift in sentiment. The percentage of global fund managers who are overweight equities, according to the BofA ML Global Research Fund Manager Survey (FMS), actually declined in November and is well below the long-term average. While we have yet to see signals for “The Great Rotation” from bonds to stocks, we do think current levels indicate that fund managers have room to raise equity allocations—a positive signal for equities. The BofA Merrill Lynch Global Research Sell Side Indicator, which measures strategist asset allocation recommendations and is a contrarian indicator, remains in “buy” territory despite pointing to a bounce in sentiment since the election. This is indicative of strong total returns for equities over the next 12 months.

Exhibit 7: Number of Fund Managers Overweight Equities is Well Below Long-Term Average.



Source: BofA Merrill Lynch Global Fund Manager Survey.
 Data as of December 1, 2016.

Technical analysis indicates the more cyclical sectors, including financials, industrials, energy and materials, have seen strength, while high-yielding stocks (also referred to as “bond proxies”), including utilities, REITs and staples, remain weak following the recent rise in interest rates. Financials and, to a lesser extent, industrials were very much underowned in portfolios, while bond proxies were the preferred equity investment. We will continue to monitor how investment flows change as bond yields rise, as we expect investors will rotate away from bonds and toward equities in the coming year, especially cyclical equities that should perform well in an environment of higher interest rates. Banks and other financials should transition from underowned to a preferred asset for investors.

For Europe and emerging markets, one technical indicator to watch is equity market breadth—which looks at the number of companies advancing relative to the number declining—to gauge how many stocks are participating in the market movement. Equity market breadth has been deteriorating as the strong dollar has been negatively impacting Europe and emerging markets. We remain cautious on Europe, as challenges remain, and cautiously optimistic on emerging markets. Japanese equities remain unloved, according to the FMS, which says allocations to Japanese equities are still below long-term averages.

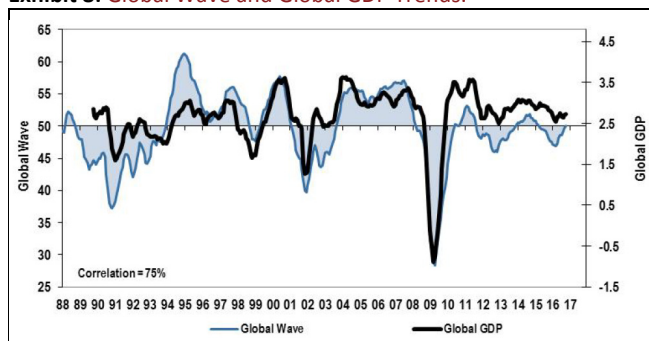
10. What is your overall tactical portfolio strategy for the year ahead?

Global Trends—Marching Forward

Over the past several months, several positive trends started pointing to stronger growth going forward. Two indicators that have shown strength are the Global Wave, a composite measure developed by BofA Merrill Lynch Global Research that quantifies trends in global economic activity, and Global Earnings Revision Ratios.

The Global Wave has improved for the fifth consecutive month, indicating a rotation towards cyclical regions and sectors as macroeconomic data continues to improve (Exhibit 8). Historically, the Global Wave has a strong track record of identifying multi-year trends in economic data and growth cycles.

Exhibit 8: Global Wave and Global GDP Trends.



Source: BofAML Global Quantitative Strategy, IBES, MSCI, Bloomberg, Worldscope, and ExShare.
Data as of November 30, 2016.

The recent improvement in Global Earnings Revision Ratios (ERR) has been particularly pronounced in the more cyclical sectors. Improvement in earnings is a key component of stronger global growth. During 2015, the U.S. was in an “earnings recession.” However, this year earnings began to grow again. The positive developments have taken place in the U.S., Europe, Japan and emerging markets. We have seen the most improvement in the earnings outlook in cyclical sectors, particularly financials. As we have exited the profits recession, companies are growing revenues, are contributing to global growth, and have stopped just cutting expenses to raise earnings.

The combination of these improvements supports our view of stronger sustainable growth in 2017.

Our expectation is for higher global growth and rising inflation heading into 2017. The Republican sweep in the U.S. elections raises the prospect of upside surprises to both growth and inflation expectations, i.e. from a secular stagnation mindset to one of fiscal reflation, although details on the policy outlook remain uncertain. This keeps us favorable on global equities over bonds and cash. Within equities, we remain slightly overweight U.S. large cap stocks and we raised U.S. small caps to overweight. We also raised our allocation to international developed equities to neutral, maintaining a preference for Japan over Europe. We keep our overweight to emerging market equities for now but with lower conviction.

We see further upside in large cap U.S. stocks in 2017 as earnings growth improves. Higher nominal economic growth should lead to better sales growth, which supports margins even as interest rates and wages rise. We do think episodic volatility will create risk-off instances through the year and high-quality, large cap equities should outperform on a relative basis during volatile periods. Small cap equities have rallied since the election and valuations are at a premium relative to large caps. Despite their rally, we think conditions will remain in place for small caps to tactically outperform

large caps in 2017 given President-elect Trump’s domestically focused pro-growth policies, including reduced regulations. Lower foreign sales exposure compared to large caps should help shield small caps from any protectionist measures on a relative basis and lower corporate taxes should benefit small caps more given their higher median tax rates.

We maintain our cyclical- and value-oriented theme in multi-asset and all-equity portfolios. However, we still believe exposure to dividend-growth investments versus the “bond proxies” in equities makes sense even as bond yields rise. Dividend growth mixed with more cyclical value factors is an effective combination in the environment that we are heading into, in our view. Bond proxies or those types of equities and industries that are higher-yielding (think utilities, telecoms, parts of REITs, some consumer staples areas) are likely to come under further pressure as bond yields rise in conjunction with higher inflation. We expect more value and cyclical positioned managers to perform better as they allocate more to industries that tend to benefit from the transition to a late-cycle phase, which includes the normalization of interest rates and increasing growth. These industries include banks, energy, consumer discretionary, and parts of the industrials and the technology sectors. This late-cycle move should also benefit active managers, as stock correlations tend to decline and intra-market dispersion rises.

We raise our conviction on international developed equities, with Japan preferred over Europe. We acknowledge that Japan’s economy has structural impediments to growth such as high debt levels and demographics. However, cyclically, growth there should accelerate on rising global activity, improving domestic demand and a weaker currency. The Bank of Japan’s recent monetary policy stance of fading negative deposit rates and targeting the yield curve has been well received by investors. Along with monetary policy, fiscal policy will be supportive of growth. For example, the government recently passed a second supplementary budget, comprising roughly JPY 7.5 trillion of spending. This should ensure that Japan’s fiscal stance turns expansionary next year.

European equities can produce positive returns, given that they are cheap and earnings could surprise on the upside driven by margin expansion and top line growth. However, we maintain a cautious stance, as the European political calendar is full for the next 12 months, with crucial votes in Germany and France and the triggering of Brexit looming in the first quarter. Investors are likely to demand a higher risk premium for European equities until the French elections in May 2017, given the likelihood that Marine Le Pen will make it to the second round of voting. A Le Pen victory could

likely bring the future of the EU and Euro into question, as she has talked about withdrawing from both. Our central case is that a center right president is elected in France and Angela Merkel is re-elected in Germany. The range of outcomes is wide in Europe and we prefer to wait for more clarity before being convinced that Europe can fend off this recent wave of populism and survive as a common economic unit.

We keep our overweight in emerging market equities for now, but risks have risen after the U.S. elections. We see positives in attractive valuations, especially relative to the U.S., recovering commodity prices and higher nominal growth that should lead to better earnings. However, the reflationary policies likely to be pursued by the Trump administration, such as infrastructure spending and lower taxes, could lead to further gains in the dollar and interest rates, acting as headwinds for EM assets. Furthermore, Trump's protectionist campaign rhetoric included threats to slap 45% tariffs on imports from China and to renegotiate NAFTA. This could have big implications for EMs. Mexico stands out as having the most to lose, although a number of other countries, particularly in emerging Asia, would also be hit hard by any unilateral trade barriers. We maintain an overweight based on our view that positives outweigh the negatives for now (Trump's anti-trade stance may moderate after he assumes office) and recommend being selective. We continue to expect strength in demand from the emerging market consumer, as incomes and spending power increase over the longer term.

11. Have we finally seen the bottom in rates, or are they “bottoming” as an ongoing process? What signs do we have that it is occurring now, after many false dawns? What are the pace and magnitude of rate rises likely to be, and what are the implications for various sectors within fixed income?

The most important fixed-income “event” of 2016 was not an event—it was a change in psychology, specifically the mindset of global central bankers. After years of pushing interest rates lower and—in many instances around the world—into negative territory, we believe that 2016 will mark an inflection point as the year that long-term, sustained negative rates were ultimately viewed by policymakers as a serious mistake that would not help global economic growth.

Negative rates are difficult for banks to pass through to customers, and therefore put a significant strain on the banking sector. A healthy, profitable financial sector is essential to the financing and everyday functioning of a developed economy. Furthermore, negative interest rates were viewed as unusual and, therefore, caused concern among consumers. By indirectly reducing longer-term rates, they caused savers to have to set

aside more now to meet future obligations. They also may have inadvertently increased consumer savings simply because they were viewed as a signal that “something was wrong,” as opposed to increasing consumption and investment, as central bankers would have hoped.

As Yogi Berra reminds us, “In theory, there is no difference between theory and practice. In practice, there is.” Belief in the theory of negative rates as a panacea for the global economy's ailments is over. This was evident in the Bank of Japan introducing “yield curve control,” keeping a positive yield spread and targeting a 10-year government bond rate of about 0%. The belief was notable by its absence in Fed Chair Janet Yellen's Jackson Hole speech; while she mentioned new, additional tools for combating deflation, negative rates were not one of them. The Fed has been more vocal recently about fiscal policy being an important complement to any monetary policy, which is unusual as a matter of standard Fed speak, but necessary in the current environment and a welcome development.

We believe the market has taken notice, and rates have bottomed. This is evident from the significant rise in longer-term U.S. Treasury yields, the higher real (inflation-adjusted) yield available on Treasury Inflation Protected Securities (TIPS) and—significantly—the difference between the two, which is referred to as the “breakeven” rate. At its lowest point this year, the 10-year Treasury yielded only 1.2% more than TIPS. This means that if inflation averaged above 1.2% for 10 years, TIPS would provide better returns than standard Treasuries. Since the Fed targets a 2% inflation rate, that was an extremely pessimistic assessment. Since then, 10-year breakevens have moved to almost 2%, the Fed's target. This change in inflation expectations is a real positive for the market, due to both the change in rhetoric by central bankers and the increased focus on fiscal stimulus (via tax cuts or additional spending) as an important complement to any monetary policy.

While the path to higher long-term rates may not be smooth and linear, the Fed's course of action for short-term rates should be slow and steady. We expect one to three Fed rate hikes in 2017. This is in line with market expectations of a hike in June and September, as well as about a 50% chance of a hike in December. Longer-term rates should follow suit, with the 10-year finishing 2017 in the range of 2.625% to 3.125%. We emphasize that this is a process, and we will exhibit volatility along the way, which can be mitigated by careful sector allocations.

Consequently, we are underweight fixed income in terms of overall asset allocation. Within fixed income, we are underweight Treasuries, short duration, and

prefer to have a portion of money dedicated to Treasuries to be invested in TIPS. We are overweight investment grade corporates, as providing solid risk-adjusted returns for relatively minimal credit risk. Municipals have recently become cheaper; while we expect we may see more volatility ahead, we are happy to be “paid to wait” before increasing allocations further. We are neutral on high yield; weakening fundamentals are tempered by relatively strong technicals and favorable high yield ratios relative to Treasury yields. High yield returns will be very muted over the medium and long term, though—in the low- to mid-single digits—and we expect our next move to be underweight versus overweight. Within high yield, an allocation to floating-rate leveraged loans is appropriate.

12. Is the bond market again experiencing 2013, when retail outflows caused one of the worst fixed income markets in recent memory?

Fixed income returns had one of their worst years in 2013. Interest rates rose dramatically due to the market’s abrupt realization that the Fed was not going to continue to expand its balance sheet indefinitely. Many parallels can be drawn between the current environment and that one. First, in May 2013, the 10-year Treasury rose approximately 50 basis points (bps), increasing from 1.6% to 2.13%. A similar move occurred this past November, as the 10-year Treasury increased from 1.7% to 2.4%. For both May 2013 and November 2016, fixed income returns were overwhelmingly negative, with both periods posting some of the worst monthly returns in over a decade. Importantly, the primary driver of negative returns in both markets was the overall rise in interest rates, not deteriorating credit concerns. As evidence, high yield securities—which are most susceptible to deteriorating credit profiles—significantly outperformed investment grade corporates in both periods. Lastly, in 2013 the municipal market was particularly hard hit, as retail investors headed for the sidelines to avoid further losses. The municipal performance in November 2016, affected by an expected reduction in 2017 tax rates, posted the worst performance on an absolute basis of all the major fixed income asset classes.

We make this comparison to help frame the current market and perhaps gain insight into the near-term market expectations. After the initial sell-off in May 2013, June did not fare much better. Outflows from retail investors—particularly in the municipal markets—continued to accelerate, causing rates to continue to rise. Typically, when a sell-off occurs, there is a period of follow-through caused by market participants attempting to react and rebalance portfolios in light of a potentially new market paradigm. This phenomenon may occur this time as well. In addition, the calendar

suggests that more near-term loss harvesting may occur, particularly with municipals.

As Mark Twain never actually said but still gets credit for: “History does not repeat itself, but it does rhyme.” All of these observations combine to create an interest rate environment that we expect will remain volatile in the near term, with an overall trend of higher rates as we move through 2017.

13. High yield has had a stellar return year-to-date. What are your expectations for this asset class, given our macro and equity market forecasts?

Year-to-date (through December 1), the Bloomberg Barclays U.S. Corporate High Yield Index has generated total and excess returns of 15% and 13.8%, respectively—the best-performing asset class within Fixed Income. This strong showing has occurred despite significant volatility. Earlier in the year, high yield (HY) and investment grade (IG) spreads approached post-crisis highs when commodity prices dropped and expected default rates accelerated. As commodity prices have recovered, however, HY spreads are now over 200 bps tighter year-to-date—and at 488 bps, well through longer-term averages. Not surprisingly—given the strong “risk-on” tone in the market – lower-quality, CCC-rated credit and higher-beta sectors such as energy and metals & mining have significantly outperformed the broader HY market.

For 2017, despite a more optimistic macro backdrop that should be supportive of HY spreads, our outlook remains tempered by relative valuations and deteriorating fundamentals. Given low starting spreads and yields, investors should prepare for lower-than-average, single-digit total returns over the longer term. Valuations appear even less attractive in the context of gross leverage well above prior cycle peaks. Accommodative central banks and low yields have led to a re-leveraging of corporate America. Although HY default rates could improve through 2017—the energy crisis of early 2016 drove annualized default rates to approximately 6%—heightened leverage now means that default rates will peak higher once the cycle turns and lending conditions tighten. This should lead to lower recovery rates, warranting higher risk premiums. That being said, yields are significantly above risk-free rates currently. High yield unsecured bonds yield approximately 3.5 times similar-maturity Treasuries. In a positive macro environment, where we expect growth to pick up, no recession on the horizon, and buyers to favor higher-yielding investments, this is a strong tailwind. This positive technical environment alleviates our fundamental concerns for the time being.

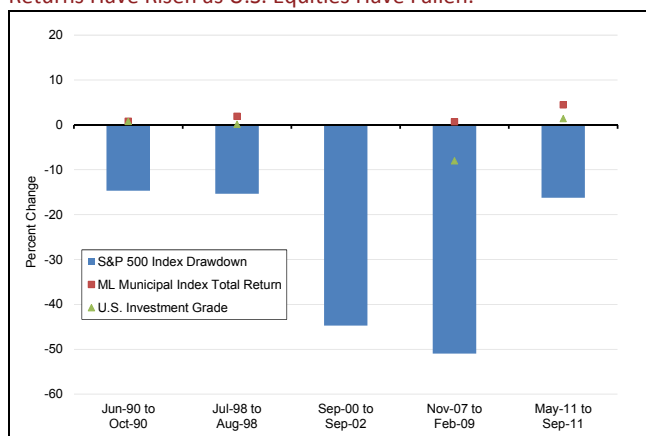
On balance, therefore, we remain neutral on high yield, with a preference towards up-in-quality and actively managed strategies. We expect our next move more

likely will be to underweight rather than overweight. Within high yield, we favor some allocation to bank loans, given their structural seniority, lower credit loss rates, positive exposure to rising short-term rates and the minimal yield give-up relative to corporate bonds currently.

14. What role should fixed income play in diversified portfolios going forward? Does it still make sense for a sizable portion, given our expectations for rising rates?

Even in a rising rate environment, fixed income is unquestionably essential to a diversified investment strategy. Bonds contribute two important factors to portfolios. First, they generate yield and a source of income—and hence return—regardless of market moves or price gyrations. Second, they are a diversifying asset that continues to exhibit both less volatility and a negative correlation to equities. Capital appreciation is simply a bonus, a nice but unexpected benefit that should not be relied upon. Bond investors have been spoiled over a 30-year bull market, and should not expect capital appreciation to be a major contributor to total returns going forward. Nevertheless, generating income and managing total risk in balanced portfolios are important themes as we see higher macro uncertainty and volatility in 2017, so fixed income is still key. Equities may help you dream well, but bonds will help you sleep tight.

Exhibit 9: Historically, U.S. Municipals and Investment Grade Total Returns Have Risen as U.S. Equities Have Fallen.



Source: Bloomberg, MPI, and GWIM Chief Investment Office. Data as of November 30, 2016.

High-quality fixed income dampens portfolio volatility, as U.S. investment grade issues and municipals provide effective diversification from equities. During the last five equity market drawdowns of more than 10%, total returns from high-quality municipal bonds (as measured by the BofA ML U.S. Municipal Master Index) were, in fact, positive (Exhibit 8). Meanwhile, U.S. investment grade total returns were positive in four of the five drawdowns.

We believe yield curves should continue to shift upward. The overall level of rates should not rise too much over the next 12 months, though. With the yield anchor being lifted and higher duration in bond markets, the asset class is vulnerable to negative price pressures. Investor repositioning may cause outflows as well. If this occurs, longer-duration bonds and lower-quality credits are more vulnerable. Importantly, however, we emphasize that while we see a more difficult total return environment for fixed income, it remains an important diversifier from equities. Additionally, investors should expect bonds to deliver solid risk-adjusted returns for the foreseeable future.

As we transition to a new cycle, rebalancing into higher yields over the next 12-18 months should help improve the level of cash flows versus the past several years of ultralow rates. Strategies to take advantage of the backup in yields while mitigating potential price declines include barbells and laddering in portions of the bond portfolio. Both approaches help shield portfolios from rising rates; the general idea is to capture higher yields by extending maturities as rates rise.

15. With a unified government—a Republican president and Republican majorities in both chambers of Congress—what is the potential for tax reform next year, and how might that affect tax-exempt municipal bonds?

Fixed income has sold off since Election Day, as the market priced in expectations of higher inflation. However, munis have fared particularly poorly for several reasons.

For one, unified government increases the chances for changes to the federal tax code. Republican tax plans call for lowering top marginal personal income tax rates (from 39.6% to 33%) and the elimination of the 3.8% Affordable Care Act (ACA) surtax on investment income. Changes in tax rates are subject to discussions in Congress, but any reduction would lower the value of the municipal bond tax exemption. We have already seen signs of reduced retail demand for munis, with large outflows from municipal bond mutual funds and ETFs.

Corporate tax rates would also be reduced under President-elect Trump’s tax plan, from 35% to 15%. Again, proposed tax rates may change, but lower rates would cause institutional investors such as banks and insurance companies to lighten up on their muni holdings, further reducing demand and placing additional upward pressure on muni yields.

In addition to lower tax rates, the market may be pricing in the possibility of more comprehensive tax reform proposals that could limit or eliminate the tax-

exempt status of munis. Comprehensive tax reform is far more difficult to implement than tax rate changes; Congress considered comprehensive tax reform, but was unable to reach consensus, in 2011. With the new unified government, such discussions could resume. However, even if comprehensive tax reform that limits the municipal bond tax exemption is passed, the details of the plan are an important consideration. For example, outstanding bonds may be “grandfathered,” which would be positive for the valuations of existing muni holdings.

Certain municipal sectors, such as hospital bonds, could come under credit pressure with the likely repeal of the ACA.

Tax loss selling through the end of 2016 may put additional upward pressure on muni yields. Year-end tax loss selling may be particularly heavy this year, because tax rates are expected to be lowered in 2017.

Declines in muni valuations since Election Day make them appear cheap relative to certain taxable fixed income sectors. However, we believe tax risk over the coming months could continue to pressure muni valuations. Given the unpredictability of how tax-reform plans will develop, we believe it would be premature for clients to make major changes to their municipal bond holdings at this point. We will continue to monitor the situation and make adjustments to our recommendations, as appropriate.

16. What are your thoughts on commodities, particularly oil and gold? Can an oil production cut really work, given the low-cost production dynamic with U.S. shale?

From a macro perspective, commodity prices tend to react consistently to the global manufacturing cycle and the state of monetary policy (with a lag). The rise in copper prices since January, for example, has coincided with the stabilization and then pickup in global cyclical momentum, as measured by global manufacturing survey data. We think this trend will continue and global growth will accelerate slightly in 2017.

Additionally, monetary policy remains reflationary, on balance, even with the Fed raising rates. This provides a decent anchor for demand for commodities, and we are maintaining our neutral weight in the asset class as a whole.

Similarly, we see some upside to oil prices. The combination of strong demand and the November 30 agreement to reduce production, enhanced by non-OPEC Russia contributing additional cuts, creates a credible scenario for inventory drawdowns and higher oil prices in 2017. It remains unclear how much the U.S. can ramp up production at prices slightly above \$50. So far, the 50% advance in the rig count from the trough has resulted in only a small gain in production.

Technological advances, learning by doing and excess capacity have caused a decline of about 30% in costs of production for oil and gas, mitigating some of the effect on production from the decline in investment. Globally, according to the International Energy Agency (IEA), cost declines explain two-thirds of the fall in investment spending, with the rest due to the drop in activity. Thus, the IEA expects some ramp-up in costs as activity increases. The availability of skilled labor is an expected constraint on U.S. production growth, adding upward pressure on oil prices. Overall, the IEA estimates that a price of around \$80 per barrel (in 2015 dollars) would be necessary to balance the oil market in 2020. The market dynamics and our 2017 oil price forecast of about \$50-\$70 per barrel are a first step in that direction.

Gold is mostly a speculative commodity, but there is some fundamental justification for owning gold when real yields are low or negative. From this perspective, the outlook is mixed. Real yields remain low but are picking up. For one thing, long rates in the U.S. are on an upward trend and the Fed is on track to raise rates this year and next. Related, the risk of deflation (often cited as a reason to own gold) has fallen considerably, while the potential for hyper-inflation is also low. Even though wage growth is picking up, inflation growth should remain modest for now. On the other hand, there is plenty of risk around U.S. macro forecasts. As geopolitical risk remains elevated. We continue to prefer holding a small position in gold only for diversification purposes, in line with long-term asset allocation guidelines, but we are tactically neutral.

17. Given the expectation for higher market volatility, what are your thoughts across the alternative investment universe?

Late cycle volatility, together with the continued impact of recent political events such as the U.S. election, the Italian referendum, and Brexit on global markets, should widen the opportunity set for alternative investment (AI) managers in 2017. AI typically performs best, particularly relative to traditional assets, when asset prices fluctuate and managers are provided with chances to profit on the long and short sides of trades.

Additionally, with the Fed tightening next year, volatility could pick up in both risk assets and areas of fixed income. We expect to see benefit across a wide array of AI strategies and believe allocations to AI could help portfolios in two ways—by generating idiosyncratic returns with limited market exposure, and through risk mitigation when compared to their traditional counterparts.

Higher interest rates could also lead to an environment of normalized correlation levels across markets and, when coupled with volatility, may create opportunities

for managers with flexible mandates and those who generate the lion's share of their returns from active management. Given where rates and valuations stand in traditional markets, flexible diversifying strategies such as global macro hold better promise now for delivering performance from both the long and short sides in a variety of asset classes. Private equity and private debt strategies should also benefit from robust corporate activity; we see favorable trends in M&A transactions, restructurings and mid-market lending.

Broadly speaking, volatility is good for AI and, after years of relative underperformance, we see the environment for active management, and hence alternative investments, improving in 2017.

18. Where do you see opportunity within alternative investments?

We remain neutral on hedge funds but believe allocations to these strategies could prove valuable in a higher-volatility environment. We currently emphasize managers with low to moderate levels of market exposure, and managers that generate a large portion of their return from asset selection. Our recommendation is for a diversified approach when investing in hedge fund strategies. Within private equity, we see opportunities in private credit, special situations and energy, as well as select opportunities in real estate. In all alternative categories, we look toward niche strategies that limit exposure to broad market currents.

19. Describe your top long-term themes and trends.

As we move deeper into the economic expansion, equity market returns should remain positive but are likely to moderate from the 12% annualized price gains of the past five years. However, we continue to expect investments centered on our five main mega themes of People, Government, Innovation, Earth and Markets to be important sources of performance differentiation relative to the broad equity indexes. Here are some of the key broad trends that we expect to shape the global economy and markets going into 2017.

People

Investors will look back on 2016 as the year of political surprises. From the growing support for fringe nationalist parties across mainland Europe, to the U.K. referendum vote to leave the European Union, to Donald Trump's presidential election victory in the U.S., electorates in the major Western economies are demanding change, and it is clear that a major populist shift is under way. It remains to be seen what new government policies, trading arrangements and geopolitical fault lines will emerge, but a key overarching theme going into 2017 will be the risk of more inward-looking, rather than outward-facing,

political leadership across the developed world. A subpar economic recovery from the 2008 recession is challenging the broad trend toward closer global integration. The ongoing eurozone crisis, low rates of labor force participation, strong resistance to new trans-Pacific and trans-Atlantic trade agreements, the rise of extremist parties across Europe, and particularly the major political shocks of 2016 in the U.K. and U.S. have all been causes and symptoms of the growing hostility to globalization among electorates. The key risks will be greater restrictions on trade, investment and immigration, as well as growing geopolitical stresses, both internationally and regionally.

Government

A major offshoot of the shifting political climate is likely to be increased government activism in the developed economies. Two of the main campaign platforms for the incoming U.S. administration were increased fiscal support and less regulation in areas such as energy and banking. On the spending side, President-elect Trump's transition team has proposed tax credits for private sector contractors with the aim of funding up to \$1 trillion of investments in airports, roads and bridges. At the same time, lower tax rates for corporations and households across all income brackets have been put forward. Whether or not these proposals gain Congressional approval or can meet their stated aims remains to be seen. But with the U.K. and Japan also planning to increase spending on transportation and communications infrastructure, the clear policy bias will be toward pro-growth fiscal policy. Regulatory changes in the U.S. are likely to have a mixed impact across sectors that will also bear close watching as specific policies are enacted. Banks, for example, could be helped by the easing of some Dodd-Frank rules, while large portions of the health care sector may stay under pressure on efforts to repeal the ACA and reduce drug prices.

Innovation

We continue to view the digital era of today in parallel with past periods of major technological change, which have typically been measured in decades rather than months or years. The Boston Consulting Group and World Economic Forum project that the digital economy will account for 7.1% of GDP (\$6.6 trillion) across the G-20 countries by 2020, a near-doubling from 4.1% in 2010. And we expect several technology trends to drive this growth. The number of connected objects globally—from medical devices to industrial machinery, cars, planes and public infrastructure—is expected to more than double by 2020, generating vast amounts of data that can be tracked and analyzed to cut business costs, improve customer service and design new products. Global sales of industrial robots

rose 15% last year, and the combination of falling system costs and improving functionality (such as machine vision, remote data processing and higher-precision gripping) is expected to produce double-digit annual increases over the remainder of the decade. Autonomous vehicle technology is also improving, with two U.S. companies becoming the first in the world to offer driverless motor vehicle service this year and several projecting commercial viability over the next five years. Next-generation virtual reality systems are gaining more attention, as new high-end headset manufacturers entered the market earlier this year. It should also be remembered that while internet penetration in developed markets is over 80%, close to a staggering two-thirds of people in the fast-growing emerging world are still offline, meaning the majority of the world's population is yet to join the global networked economy.

Earth

The October ratification of the global climate accord struck in Paris a year ago provides a strong signal that the world has moved decisively into an era of emissions reduction. Whether countries meet their individual targets remains to be seen, but movement toward low-carbon activity should now be viewed as a trend that will persist at the global level over the long term. Despite concerns that the incoming administration could effectively withdraw the U.S. from its commitments under the agreement, we would still expect clean energy adoption to continue at the corporate and state levels as the cost of renewable power generation and storage technology falls. The Environmental Protection Agency now counts 784 organizations, including companies, universities and government departments, on its 100% Green Power

Users list, up from 736 a year ago, and a \$500 billion Silicon Valley internet firm recently announced it plans to join the list in 2017. U.S. progress on emissions reduction could be set back by new efforts to boost domestic fossil fuel production on federal lands, but this will require a sustained rise in energy prices, and could ultimately produce another supply glut that depresses future prices and future production. As implementation of the Paris agreement begins, we therefore see structural support for climate change mitigation and clean energy investment continuing into 2017.

Markets

We expect policy under the Trump administration to mark a major departure from policy under the Obama government. This, combined with a business cycle that may be entering its latter stages, should have a material impact across asset classes. The main market themes in this new environment are likely to be fiscal expansion, larger deficits, a greater risk of trade impediments, rising inflation and higher interest rates. Cuts to income and corporate taxes, combined with an increase in infrastructure spending, should be tailwinds for economic growth, but could see Treasury yields continue to break higher on budget and inflation risk. As a result, we expect investors to increasingly shift away from fixed income and defensive bond proxy equity sectors such as telecoms and utilities. Smaller-capitalization, more domestically oriented equities should outperform given pro-growth domestic policy, likely strength in the U.S. dollar and the risk of new barriers to cross-border trade and investment. Banks should also benefit from a steepening of the yield curve. Following a decades-long shift toward freer trade, lower inflation and lower interest rates since the 1980s, it remains to be seen how persistent these trends will be. But, we expect cycle- and policy-led deflation to be a key theme across markets going into 2017.

ECONOMIC AND MARKET FORECASTS (AS OF DECEMBER 16, 2016)

	Q2 2016	Q3 2016 E	Q4 2016 E	2015	2016 E	2017 E
Real global GDP (% y/y annualized)				3.1	3.0 – 3.1	3.5 – 4.0
Real U.S. GDP (% q/q annualized)	1.4	3.2	2.5 – 3.0	2.6	1.6	2.0 – 3.0
CPI inflation (% y/y)*	0.7	0.9	1.3	0.1	1.3	2.0 – 3.0
Core CPI inflation (% y/y)**	2.1	2.2	2.2	1.8	2.2	2.0 – 3.0
Unemployment rate, period average (%)	4.9	4.9	4.7	5.3	4.9	4.5
Fed funds rate, end period (%)**	0.37	0.37	0.62	0.37	0.62	0.87 – 1.37
10-year Treasury, end period (%)	1.49	1.60	2.5	2.27	2.5	2.62 – 3.12
S&P 500, end period***	2099	2168	2200 – 2300	2044	2200 – 2300	2300 – 2700
S&P operating earnings (\$/share)	29	30	30 – 32	118	120 – 122	129 – 138
\$/€, end period	1.10	1.12	1.05	1.09	1.05	1.0 – 1.10
¥/\$, end period	103	101	118 – 120	120	118 – 120	115 – 125
Oil (\$/barrel), end period	48	48	50 – 55	37	50 – 55	50 – 70

Percent calendar-year average over calendar-year average annualized unless stated. E = Estimate.

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

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

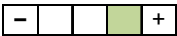

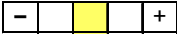



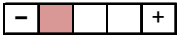
***Our 2017 S&P 500 end period forecast: 2300 is Base Case using a five factor framework from BAML Research. 2700 is the bull case with pro-growth policies initiated and a higher earnings number. Please review the numbers in the upfront 2017 year-ahead.

Past performance is no guarantee of future results.

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

Source: Global Wealth and Investment Management Investment Strategy Committee.

ASSET ALLOCATION TABLE (AS OF DECEMBER 16, 2016)

ASSET CLASS	ALLOCATION	WEIGHTING*
Cash	Positioning	We are neutral.
	Valuation	<ul style="list-style-type: none"> Low yields.
Equities	Positioning	We are overweight equities. Portfolios are being repositioned for higher nominal growth and rising interest rates. This rotation should continue throughout 2017. 
	Emphasis	<ul style="list-style-type: none"> We are overweight U.S. large caps, U.S. small caps and emerging market equities.
	Valuation	<ul style="list-style-type: none"> Valuations favor equities over fixed income.
U.S. Large Caps	Positioning	We are slightly overweight large caps. 
	Emphasis	<ul style="list-style-type: none"> Value.
	Valuation	<ul style="list-style-type: none"> Slightly overvalued but attractive relative to fixed income.
U.S. Mid Caps	Positioning	We are neutral mid caps. 
	Emphasis	<ul style="list-style-type: none"> Beneficiaries of relatively stronger U.S. economy.
	Valuation	<ul style="list-style-type: none"> Neutral.
U.S. Small Caps	Positioning	We are overweight small caps. 
	Emphasis	<ul style="list-style-type: none"> Beneficiaries of relatively stronger U.S. economy.
	Valuation	<ul style="list-style-type: none"> Neutral.
International Developed	Positioning	Downside risk to growth and inflation from bank stress and political uncertainty. Major elections in 2017 and negative interest rate policy offset highly accommodative monetary stance and improving global economy. 
	Emphasis	<ul style="list-style-type: none"> Favor Japan on a relative basis.
	Valuation	<ul style="list-style-type: none"> Neutral.
Emerging Markets	Positioning	Valuations are attractive for long-term investors. Beneficiaries of the pickup in global cyclical momentum. Favor reform-oriented countries and consumer spending. 
	Emphasis	<ul style="list-style-type: none"> Asia remains our favored region within the emerging world, and we maintain our preference for India on a country basis.
	Valuation	<ul style="list-style-type: none"> Attractive for long-term investors.
Fixed Income	Positioning	We are underweight fixed income, as it is less attractive compared to asset classes such as equities. 
	Emphasis	<ul style="list-style-type: none"> Slightly short duration is warranted balancing higher short-term rates in the U.S. and expectations for inflation with overwhelming demand for fixed income globally. We continue to prefer credit over Treasuries, with an emphasis on investment-grade corporates, particularly banks sector, and municipals. An allocation to Treasury Inflation-Protected Securities (TIPS) should be considered where appropriate. In the currently higher-volatility market, an allocation to Treasuries for liquidity and relative safety is advised. Given U.S. dollar strength, we are avoiding non-dollar sovereign bonds. We recommend active management to improve potential returns in a rising-rate environment. A barbell strategy of owning bonds with both longer and shorter maturities should perform better than bulleted strategy.
	Valuation	<ul style="list-style-type: none"> Expensive overall.

ASSET CLASS	ALLOCATION	WEIGHTING*
U.S. Investment-Grade	Positioning	Barbelled with respect to the curve. Slightly short duration.
	Emphasis	<ul style="list-style-type: none"> • U.S. Treasuries/Agencies • U.S. Investment Grade Credit • U.S. Collateralized • U.S. Municipals
	Valuation	<ul style="list-style-type: none"> • Yields, while off the bottom, are still historically low on investment-grade bonds and poised to continue to rise. • Some allocation to Treasuries recommended to provide liquidity and relative safety.
International	Positioning	We are underweight.
	Emphasis	<ul style="list-style-type: none"> • Given the strength of the U.S. dollar, we are avoiding non-dollar sovereign bonds.
	Valuation	<ul style="list-style-type: none"> • Expensive vs. U.S.-dollar-denominated alternatives.
High Yield	Positioning	We are neutral.
	Emphasis	<ul style="list-style-type: none"> • We recommend managed solutions that are higher in credit. Within high yield, an allocation to leveraged loans is advised.
	Valuation	<ul style="list-style-type: none"> • Fair to rich, expect a high degree of volatility.
Commodities	Positioning	We are neutral commodities.
	Emphasis	<ul style="list-style-type: none"> • We expect a slight upward track as the global expansion gains more traction.
Hedge Funds	Positioning	We are neutral hedge funds but recognize that an allocation to hedge fund strategies could prove valuable in a higher-volatility environment.
	Emphasis	<ul style="list-style-type: none"> • We currently emphasize hedge fund strategies that have low to moderate levels of market exposure and those managers that can generate a large portion of their return from asset selection.
Private Equity	Positioning	We advise using a staged approach, gaining vintage-year and global diversification over time.
	Emphasis	<ul style="list-style-type: none"> • We see potential opportunities in special situations/opportunistic and private credit strategies.
Real Estate	Positioning	While we anticipate continued positive performance from core real estate, we may be approaching cyclical highs and as such remain neutrally positioned.
	Emphasis	<ul style="list-style-type: none"> • We see compelling opportunities within the opportunistic space.

*Tactical qualitative investment strategy weightings are relative in nature versus the strategic weightings for a fully diversified portfolio. Weightings are based on the relative attractiveness of each asset class. Tactical strategy weightings are for a 12-to-18-month time horizon.

Because economic and market conditions change, recommended allocations may vary in the future. Asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns. All sector and asset allocation recommendations must be considered in the context of an individual investor's goals, time horizon and risk tolerance.

Not all recommendations will be suitable for all investors.

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.

Source: Global Wealth & Investment Management Investment Strategy Committee.

TOTAL RETURNS (% , U.S. DOLLAR TERMS AS OF DECEMBER 7, 2016)

	YTD	6 MONTHS	LAST 12 MONTHS
Equity Indexes			
S&P 500	11.95	7.28	10.31
Dow Jones Composite	15.18	10.48	13.28
NASDAQ	9.10	9.41	7.18
Russell 2500	18.67	12.07	16.42
Russell 2000	21.77	16.50	18.99
UK (FTSE100)	-1.58	-3.07	-3.37
Japan (TOPIX)	4.24	6.05	4.10
MSCI World	7.94	4.43	6.55
MSCI EAFE	0.82	-0.01	-0.15
Hang Seng	7.99	9.57	6.58
Euro Stoxx 50	-1.09	-1.28	-3.61
Emerging Market	11.84	5.47	10.34
Asia ex-Japan	9.95	6.37	9.69
DJ US Select REIT Index	5.04	0.70	7.78
U.S. Size and Style			
U.S. Small Cap	20.82	12.87	18.68
U.S. Mid Cap	14.61	8.29	12.71
U.S. Value	16.43	9.59	15.33
U.S. Growth	7.00	4.83	4.97
Global Sectors			
Consumer Discretionary	4.84	5.11	2.32
Consumer Staples	-0.11	-6.78	-0.51
Energy	27.68	8.78	25.96
Financials	14.26	16.92	12.15
Healthcare	-8.24	-8.25	-7.05
Industrials	13.46	8.07	11.62
Information Technology	13.95	11.07	10.75
Materials	27.54	12.95	25.27
Telecommunications	3.37	-5.52	2.76
Utilities	3.71	-6.25	5.30
Bonds			
10-Year Treasury	0.43	-4.99	0.14
2-Year Treasury	0.72	-0.17	0.60
TIPS	5.17	-0.29	4.54
Municipals	0.31	-2.71	0.91
Corporate Bonds (Merrill Lynch Corporate Bonds)	5.67	-0.44	4.70
High-Yield Bonds	16.42	6.81	14.14
Emerging Market Bonds	11.55	2.62	10.35
Foreign Exchange			
U.S. Dollar	-1.04	5.96	-1.04
British Pound	-13.96	-9.91	-15.58
Euro Stoxx 50	3.43	1.64	4.05
Japanese Yen	7.67	-2.76	10.08
Swiss Franc	0.38	1.58	1.01
Australian Dollar	2.28	4.89	1.61
Canadian Dollar	5.08	-2.20	1.83
Hedge Funds			
Global Hedge Fund Index	2.10	2.43	1.39
Hedge Fund Equal Weight	3.49	3.03	2.87
Commodities			
CRB Index	8.59	-0.65	7.21
Gold	10.58	-5.64	9.53
Oil	12.58	-5.18	7.91

Source: Bloomberg.

Data as of December 7, 2016.

Past performance is no guarantee of future results.

INDEX DEFINITIONS (IN U.S. DOLLAR TERMS)

Indexes are unmanaged, and an investor cannot invest directly in an index.

Asia ex Japan — MSCI Index is a capitalization-weighted index that monitors the performance of stocks from the Pacific region.

Barclays Capital Aggregate Index represents securities that are U.S. domestic, taxable, and dollar-denominated. The index covers the U.S. investment-grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indexes that are calculated and reported on a regular basis.

Barclays Capital Global High-Yield Index provides a broad-based measure of the global high-yield fixed income markets. The Global High-Yield Index represents that union of the U.S. High-Yield, Pan-European High-Yield, U.S. Emerging Markets High-Yield, CMBS High-Yield, and Pan-European Emerging Markets High-Yield Indexes. The Global High-Yield Index is a component of the Multiverse Index, along with the Global Aggregate Index. The Global High-Yield Index was created on January 1, 1999, with index history backfilled to January 1, 1990.

Consumer Discretionary — S&P Global 1200 Consumer Discretionary Sector Index encompasses those industries in the S&P Global 1200 Index that are most sensitive to economic cycles, such as automobiles, household durable goods, textiles & apparel and leisure equipment & facilities. The index is market-cap-weighted, free-float-adjusted outside the U.S.

Consumer Staples — S&P Global 1200 Consumer Staples Index comprises companies in the S&P Global 1200 Index whose businesses are less sensitive to economic cycles, such as manufacturers and distributors of food & beverage and producers of nondurable household goods and food & drug retailing. The index is market-cap-weighted, free-float-adjusted outside the U.S.

CRB Index — The Reuters CRB Commodity Price Index is an arithmetic average of commodity futures prices with monthly rebalancing.

DJ EURO STOXX 50 is a capitalization-weighted index of 50 European blue-chip stocks from those countries participating in the Economic and Monetary Union (EMU). The equities use free-float shares in the index calculation.

DJ Wilshire REIT Float — The Dow Jones Wilshire REIT Index measures U.S. publicly traded real estate investment trusts. It is a subset of the Dow Jones Wilshire Real Estate Securities Index. It is weighted by full market cap as well as float-adjusted market cap and is quoted in U.S. dollars.

Dow Jones UBS Commodity Index is designed to be a highly liquid and diversified benchmark for commodities as an asset class. The DJAIG Index is composed of futures contracts on 19 physical commodities.

Dow Jones Composite is a price-weighted average of 30 blue-chip industry-leader stocks.

Emerging Market — MSCI Index of daily Total Return.

Energy — S&P Global 1200 Energy Sector Index comprises companies in the S&P Global 1200 Index that are dominated by the construction or provision of oil rigs, drilling equipment and other energy services or engaged in the exploration, refining and transport of oil, gas and other fuels. The index is market-cap-weighted, free-float-adjusted outside the U.S.

Financials — S&P Global 1200 Financials Sector Index consists of companies in the S&P Global 1200 Index involved in activities such as banking, mortgage finance, specialized finance, asset management and custody, corporate lending, financial investment, real estate and REITs. The index is market-cap-weighted, free-float-adjusted outside the U.S.

Global Hedge Fund Index — The HFRX Global Hedge Fund Index is designed to be representative of the overall composition of the hedge fund universe. It comprises eight strategies: convertible arbitrage, merger arbitrage, equity hedge, equity market neutral, relative value arbitrage, event-driven, distressed securities and macro. The strategies are asset-weighted based on the distribution of assets in the hedge fund industry.

Hang Seng Index is a capitalization-weighted index of 33 companies that represent approximately 70% of the total market capitalization of the Stock Exchange of Hong Kong. The components of the index are divided into four subindexes: Commerce and Industry, Finance, Utilities, and Properties.

Healthcare — S&P Global 1200 Healthcare Sector Index encompasses companies that manufacture healthcare equipment and supplies or provide healthcare-related services and companies involved in research, development, production and marketing of pharmaceuticals and biotech products. The index is market-cap-weighted, free-float-adjusted outside the U.S.

Hedge Fund Research Inc. (HFRI) Fund of Funds Index is an equally weighted index consisting of domestic and offshore hedge funds of funds. The HFRI Indexes are based on information self-reported by hedge fund managers that decide, on their own, at any time, whether or not they want to provide, or continue to provide, information to HFR Asset Management, L.L.C. (“HFR”). Results for funds that go out of business are included in the index until the date that they cease operations. Therefore, these indexes may not be complete or accurate representations of the hedge fund universe and may be biased in several ways.

HFRI Global Macro Index is a subset of funds included in the broader HFRI Index. Global macro managers may carry long and short positions in any of the world’s major capital or derivative markets. These positions reflect their views on overall market direction as influenced by major economic trends and/or events. The portfolios of these funds may include stocks, bonds, currencies and commodities in the form of cash or derivatives instruments. Most funds invest globally in both developed and emerging markets.

HFRI Relative Value Index is a subset of funds included in the broader HFRI Index. Relative value arbitrage attempts to take advantage of relative pricing discrepancies between instruments including equities, debt, options and futures. Managers may use mathematical, fundamental or technical analyses to determine misvaluations. Securities may be mispriced relative to the underlying security, related security, groups of securities or the overall market. Many funds use leverage and seek opportunities globally. Arbitrage strategies include dividend arbitrage, pair trading, options arbitrage and yield curve trading.

Industrials — S&P Global 1200 Industrials Sector Index includes companies whose business is dominated by one of the following activities: manufacture and distribution of capital goods, including aerospace and defense, construction, engineering and building products, electrical equipment and industrial machinery. The index is market-cap-weighted, free-float-adjusted outside the U.S.

Information Technology — S&P Global 1200 Information Technology Sector Index covers technology software and services, technology hardware & equipment and semiconductors & semiconductor equipment manufacturers. The index is market-cap-weighted, free-float-adjusted outside the U.S.

Japan (TOPIX) is a capitalization-weighted index of all companies listed on the First Section of the Tokyo Stock Exchange.

Materials — S&P Global 1200 Materials Sector Index comprises a breadth of commodity-related manufacturing industries, including companies that manufacture chemicals, construction materials, glass, and related packaging products, metals, minerals and mining companies and producers of steel. The index is market-cap-weighted, free-float-adjusted outside the U.S.

MSCI ACWI (All Country World Index) is a free-float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets.

MSCI ACWI FM (Frontier Markets) is a free-float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets. MSCI covers 24 developed, 21 emerging and 31 frontier markets. If there is no designation (such as ‘EM’ or ‘AC’) before a regional or composite index, the index consists of developed markets only.

MSCI EAFE is a stock market index that is designed to measure the equity market performance of developed markets (Europe, Australasia, Far East), excluding the U.S. and Canada.

MSCI World Index is a free-float-weighted equity index.

NASDAQ 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.

National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index is a market-value-weighted index which measures the performance of investment-grade nonagricultural income-producing properties.

Oil — Bloomberg West Texas Intermediate Cushing Crude Oil Spot Price is usually at parity with the front-month Nymex crude oil contract, with the exception of its three-day delivery scheduling period after the front-month contract expires, also known as a roll.

Russell 1000 Growth® Index includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000® Index is a subset of the Russell 3000® Index that measures the performance of the 1,000 largest capitalization companies of the U.S. equity universe.

Russell 1000® Value Index includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values.

Russell 2000® Index is a subset of the Russell 3000® Index that measures the performance of the 2,000 smallest companies of the U.S. equity universe.

Russell 2000® Growth Index includes those Russell 2000 companies with higher price-to-value ratios and higher forecasted growth values.

Russell 2000® Value Index includes those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.

Russell 3000® Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

Russell Midcap® Index represents the 800 smallest companies in the Russell 1000® Index.

Russell Midcap® Growth Index includes those Russell Midcap Index companies with higher price-to-book ratios and higher forecasted growth values.

Russell Midcap® Value Index includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values.

Russell Top 200® Index is a subset of the Russell 3000® Index that measures the performance of the largest 200 companies by market capitalization of the U.S. equity universe.

S&P 500® Index is a capitalization-weighted index of 500 stocks.

S&P SmallCap 600® Index is a subset of the S&P 1500 index of U.S. companies. It represents the smallest companies in this universe (those with market capitalization in the range of U.S. \$250 million to U.S. \$1.5 billion).

Telecommunications — S&P Global 1200 Telecommunications Services Sector Index contains companies that provide communications services primarily through a fixed-line, cellular, wireless, high-bandwidth and/or fiber-optic-cable network. The index is market-cap-weighted, free-float-adjusted outside the U.S.

U.S. Growth — MSCI Index in which the developed markets indexes with dividends reinvested provide an estimate of total return that would be achieved by reinvesting one-twelfth of the annual yield reported at every month-end. The series with gross dividends reinvested takes into account actual dividends before withholding taxes, but excludes special tax credits declared by the companies.

U.S. Midcap — MSCI Index represents the universe of medium-capitalization companies in the U.S. equity market. This index targets 450 companies.

U.S. Small Cap — MSCI Index represents the universe of small-capitalization companies in the U.S. equity market.

U.S. Corporate Health Index is an equal-weighted, normalized index consisting of loan charge-offs, corporate spreads and the following ratios for the nonfinancial corporate sector: debt/equity, profits/assets and liquidity/assets.

U.S. Value — MSCI Index in which the developed markets indexes with dividends reinvested provide an estimate of total return that would be achieved by reinvesting one-twelfth of the annual yield reported at every month-end. The series with gross dividends reinvested takes into account actual dividends before withholding taxes, but excludes special tax credits declared by the companies.

UK (FTSE 100) is a capitalization-weighted index of the 100 most highly capitalized companies traded on the London Stock Exchange.

Utilities — S&P Global 1200 Utilities Sector Index encompasses those companies in the S&P Global 1200 Index that are considered electric, gas or water utilities, or companies that operate as independent producers and/or distributors of power. The index is market-cap-weighted, free-float-adjusted outside the U.S.

Wilshire 5000 Index includes all publicly traded stocks headquartered in the U.S. and holds over 7,000 stocks.

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The GWIM Investment Strategy Committee (GWIM ISC) is responsible for developing and coordinating recommendations for short-term and long-term investment strategy and market views encompassing markets, economic indicators, asset classes and other market-related projections affecting GWIM.

This publication is designed to provide general information about economics, asset classes and strategies. It is for discussion purposes only, since the availability and effectiveness of any strategy are dependent upon each individual's facts and circumstances. Always consult with your independent attorney, tax advisor and investment manager for final recommendations and before changing or implementing any financial strategy.

Other Important Information

Past performance is no guarantee of future results.

All sector and asset allocation recommendations must be considered in the context of an individual investor's goals, time horizon and risk tolerance. Not all recommendations will be suitable for all investors.

Equity securities are subject to stock market fluctuations that occur in response to economic and business developments.

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.

Tax-exempt investing offers current tax-exempt income, but it also involves special risks. Single-state municipal bonds pose additional risks due to limited geographical diversification. Interest income from certain tax-exempt bonds may be subject to certain state and local taxes and, if applicable, the alternative minimum tax. Any capital gains distributed are taxable to the investor.

Investments in high-yield bonds (sometimes referred to as "junk bonds") offer the potential for high current income and attractive total return, but involve certain risks. Changes in economic conditions or other circumstances may adversely affect a junk bond issuer's ability to make principal and interest payments.

International investing involves special risks, including foreign taxation, currency risks, risks associated with possible differences in financial standards and other risks associated with future political and economic developments.

Global investing poses special risks, including foreign taxation, currency fluctuation, risk associated with possible differences in financial standards and other monetary and political risks.

Investing in emerging markets may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility.

Stocks of small and mid cap companies pose special risks, including possible illiquidity and greater price volatility than stocks of larger, more established companies.

For investments in ABS, MBS, and CMOs generally, when interest rates decline, prepayments accelerate beyond the initial pricing assumptions, which could cause the average life and expected maturity of the securities to shorten. Conversely, when interest rates rise, prepayments slow down beyond the initial pricing assumptions, and could cause the average life and expected maturity of the securities to extend, and the market value to decline.

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. Tangible assets can fluctuate with supply and demand, such as commodities, which are liquid investments unlike most other tangible investments.

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.

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.

Alternative investments are intended for qualified and suitable 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. Alternative investments are speculative and involve a high degree of risk.

An investment in a hedge fund involves a substantially more complicated set of risk factors than traditional investments in stocks or bonds, including the risks of using derivatives, leverage and short sales, which can magnify potential losses or gains. Restrictions exist on the ability to redeem units in a hedge fund. Hedge funds are speculative and involve a high degree of risk.

Treasury bills are less volatile than longer-term fixed income securities and are guaranteed as to timely payment of principal and interest by the U.S. government.

Dividend payments are not guaranteed. The amount of a dividend payment, if any, can vary over time.

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

Breakdown reflects ratings from Standard & Poor's, Moody's and/or Fitch Ratings. For additional information on ratings, please see www.standardandpoors.com, www.moodys.com, and/or www.fitchratings.com.

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