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# The training wheels come off the bike

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## It really *is* different this time

Finding yield without taking on risk will remain difficult. Returns on cash, traditionally a good refuge during times of rising bond yields, will probably stay near zero. And defensive stocks, despite their higher dividend yields, may suffer negative total returns if yields rise further. Investors may need to look to some unconventional places for yield like cyclical stocks whose dividends are likely to rise.

## Asset allocation shift from bonds to stocks

We have made minor shifts in asset allocation across most of our risk profiles, raising the allocation to stocks and lowering the allocation to bonds.

## Technology comes to the gym

With America's focus on fitness/wellness and maintaining active, healthier lifestyles, performance athletic wear has become mainstream. Even within this simple industry, technology is changing competitive dynamics and helping drive customer demand.

## Guest column: China: stability is still the policy keyword

The interbank liquidity squeeze in China during June is finally over. But market concerns on China's growth outlook and on the health of the financial system are yet to be alleviated.


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## Second quarter review

The second quarter was one to remember across nearly all major financial markets. Stocks generally moved higher, and bonds and commodities sharply lower.

Emerging Market equities were hit hard in the second quarter, underperforming DM equities by 7.3%. From the peak in early May through late June, EM equities plunged 16%.

Japanese equities displayed a solid Q2 performance and hold the lead among global equity markets YTD.

Within US markets, Small caps outperformed across both style segments in the second quarter, with Small-cap Value (+4.4%) recording the best returns. YTD, Value holds the lead across both size segments.

Among US sectors, despite declining 1.3% in June, the S&P 500 was still up for the quarter and continued to outperform nearly all other asset classes. Healthcare (+20.3%), Consumer Discretionary (+19.8%) and Financials (19.5%) hold the lead YTD, while Materials (+2.9%) and Tech (+6.4%) lag.

Fixed income markets were rattled in the second quarter on worries that the Fed would soon taper its asset purchases. While all bond sectors posted negative returns, TIPS and long-term Treasuries suffered the most. EM debt also posted large losses, attributable in part to weak data out of China.

In FX markets, the yen came down by 5.3% in the second quarter while the US dollar gained 2.6%, and is now up 7.4% for the year-to-date.

Commodities continued their downward slide in the quarter, led by a 22.7% decline in gold.

# Financial markets recap

Total returns (%)

| | | As of 30 June 2013 | | | |
|---|---|---|---|---|---|
| Asset class | 2012 | 1 mo | 3mo | 12mo | YTD |
| **Equity Indices (%, US dollar terms)** | | | | | |
| S&P 500 | 16.0 | -1.3 | 2.9 | 20.6 | 13.8 |
| NASDAQ Comp | 17.7 | -1.4 | 4.5 | 17.8 | 13.4 |
| FTSE 100 | 15.2 | -5.2 | -2.1 | 12.1 | 0.6 |
| TOPIX | 8.1 | 1.5 | 4.1 | 21.0 | 15.5 |
| Hang Seng | 27.7 | -5.7 | -4.6 | 10.9 | -5.9 |
| DJ Euro Stoxx 50 | 20.2 | -5.6 | 2.6 | 21.8 | -0.4 |
| MSCI EAFE | 17.9 | -3.5 | -0.7 | 19.1 | 4.5 |
| MSCI Emerging Markets | 18.6 | -6.3 | -8.0 | 3.2 | -9.4 |
| **Size & Style (%, US dollar terms)** | | | | | |
| Russell 2000 | 16.3 | -0.5 | 3.1 | 24.2 | 15.9 |
| S&P 500 Citigroup Growth | 14.6 | -1.7 | 2.5 | 16.8 | 12.0 |
| S&P 500 Citigroup Value | 17.7 | -0.9 | 3.4 | 25.0 | 15.7 |
| S&P 600 Citigroup Growth | 14.6 | -0.3 | 3.4 | 22.1 | 15.8 |
| S&P 600 Citigroup Value | 18.2 | 0.0 | 4.4 | 28.5 | 16.6 |
| **S&P 500 Sectors (%, US dollar terms)** | | | | | |
| Consumer Discretionary | 23.9 | 0.9 | 6.8 | 31.4 | 19.8 |
| Consumer Staples | 10.8 | -0.3 | 0.5 | 17.5 | 15.2 |
| Energy | 4.6 | -2.0 | -0.4 | 17.6 | 9.8 |
| Financials | 28.8 | -1.6 | 7.3 | 35.4 | 19.5 |
| Health Care | 17.9 | -0.7 | 3.8 | 27.8 | 20.3 |
| Industrials | 15.3 | -1.3 | 2.8 | 22.3 | 13.8 |
| Information Technology | 14.8 | -3.6 | 1.7 | 7.7 | 6.4 |
| Materials | 15.0 | -4.3 | -1.8 | 11.1 | 2.9 |
| Telecom Services | 18.3 | 1.9 | 1.0 | 12.3 | 10.5 |
| Utilities | 1.3 | 1.0 | -2.7 | 6.2 | 9.9 |
| **BofA Merrill Lynch Global Research Bond Indices (%, US dollar terms)** | | | | | |
| 10-Year Treasury | 4.2 | -2.6 | -4.6 | -4.2 | -4.9 |
| 2-Year Treasury | 0.3 | -0.1 | -0.1 | 0.3 | 0.0 |
| TIPS | 7.3 | -3.8 | -7.4 | -5.2 | -7.9 |
| Municipals* | 7.3 | -3.2 | -3.3 | 0.1 | -2.8 |
| US Corporate Bonds | 10.4 | -2.8 | -3.4 | 1.8 | -3.3 |
| US High Yield Bonds | 15.6 | -2.6 | -1.4 | 9.6 | 1.5 |
| Emerging Market Corporate Bonds | 15.8 | -3.6 | -4.2 | 4.2 | -4.0 |
| Emerging Market Sovereign Bonds | 17.5 | -4.2 | -4.4 | 2.9 | -6.5 |
| Preferreds | 13.6 | -2.7 | -2.4 | 4.4 | 0.4 |
| **Foreign exchange** (%, in local currencies)** | | | | | |
| US dollar | 1.5 | 0.0 | 2.6 | 7.4 | 7.4 |
| British pound | 2.9 | 0.2 | 0.4 | -3.2 | -3.8 |
| Euro | 0.9 | 0.1 | 2.6 | 6.8 | 3.8 |
| Yen | -11.0 | 1.7 | -5.3 | -19.9 | -12.0 |
| **Commodities** (%, US dollar terms)** | | | | | |
| CRB Index | -3.4 | -2.2 | -7.0 | -3.0 | -6.6 |
| Gold | 7.1 | -11.0 | -22.7 | -22.7 | -26.3 |
| WTI Crude Oil | -7.1 | 5.0 | -0.7 | 13.7 | 5.2 |
| Brent Crude Oil | 3.8 | 2.2 | -7.4 | 4.8 | -9.4 |
| **Alternative Investments† (%, US dollar terms)** | | | | | |
| Hedge Fund - CS Tremont[1] | 5.4 | 0.4 | 3.0 | 10.6 | 5.4 |
| Hedge Fund - HFRI Fund of Funds[1] | 3.1 | 0.6 | 2.3 | 8.4 | 4.8 |
| Private Equity - Cambridge Assoc.[2] | 9.2 | NA | 3.5 | 13.8 | NA |
| Private Real Estate - NCREIF TR[3] | 7.8 | NA | 2.6 | 10.5 | 2.6 |

Notes: *Not tax adjusted. **BoE calculated effective FX indices. [1]Data as of 5/31/2013; CS AUM-weighted, HFRI equal-weighted [2]Quarterly data as of 12/31/2012 [3]Quarterly data as of 3/31/13†AI data not comparable to other asset classes because of reporting delays, lack of standardized reporting, and survivorship and self selection biases. Crude oil prices are spot in USD.
Source: S&P, MSCI, Bloomberg, FactSet, BofAML Bond Indices (US Treasury Current 10yr, Current 2yr, Inflation-Linked; Muni Master, US Corp Master, US HY Master II Index; EM Corporate Plus Index; EM External Debt Sovereign Index; US Preferred Stock, Fixed Rate).

# It really *is* different this time

**Martin Mauro**
Fixed Income Strategist

**Cheryl Rowan**
Portfolio Strategist

Finding yield without taking on risk will remain difficult. We believe that intermediate and long-term yields will rise further in the coming 18 months. But returns on cash, traditionally a good refuge during times of rising yields, will probably stay near zero. And defensive stocks, despite their higher yields, may suffer negative total returns if yields rise further. Investors may need to look to some unconventional places for yield like cyclical stocks whose dividends are likely to rise.

## The training wheels come off the bike

Market movements during the past two months demonstrated the importance of the support from the Federal Reserve.

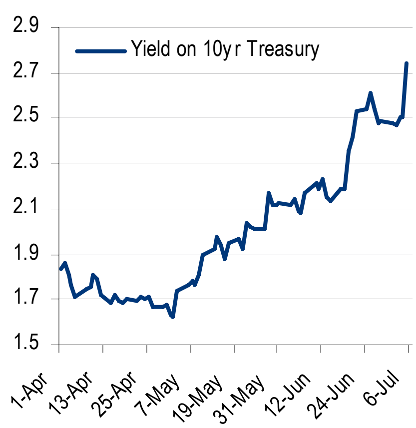
Fed Chair Bernanke's statements initially jolted the markets, but stocks eventually crawled back.

Bond yields have been surging since early May with the growing expectation that the Fed may soon scale back on its $85 billion in monthly purchases of securities. The selloff kicked into higher gear on June 19 when Fed Chair Bernanke outlined a tentative timeframe for the Fed to curtail its purchases. Bernanke stated that if the economy improved as the Fed expects, its securities purchases would be reduced later this year, and ended entirely by the middle of next year. The next trigger for higher yields was the June employment report, which appeared strong enough to justify the expectations that the Fed will begin tapering its purchases.

Intermediate and long-term rates could rise, but short-term rates are likely to stay near zero until well into 2015.

The potential for the Fed to reduce and eventually eliminate its bond purchases is akin to taking the "training wheels off the bike." When the Fed stops, investors will be left to pedal on their own. The price declines in commodity markets took away some of the demand that was driven by the view that Fed purchases would ultimately be inflationary. Stocks initially sold off, but regained their footing when investors became more optimistic about the economy. Since the 10-year Treasury yield bottomed at 1.63% on May 2, the return on the S&P 500 has been +2.6%, while the return on the 10-year Treasury has been -8.5%

Chart 1: Soaring yields




Source: BofA Merrill Lynch Global Research, Bloomberg

Emerging market (EM) stock and bond markets were pummeled on the combination of higher Treasury yields and signs of slowing economic growth in China. Michael Hartnett, chief investment strategist, believes that the bad news from China has been largely discounted. But he sees the risk of a further unwind of EM debt positions, forcing EM equity investors to exit their winning positions in consumer stocks. The capitulation that leads to a buying opportunity might not occur until investors are forced to sell their winners. See The Thundering Word, 04 July 2013. Ting Lu, our China economist, discusses recent developments and his growth outlook in our Guest column, on pages 10-11.

### Our rate expectations

Priya Misra, our rates strategist, recently raised her forecast for the yield on the 10-year Treasury to 3.0% at the end of this year, and 4.0% at the end of next year. The yield is presently about 2.65%.

## This bond bear might not growl like the others

Many investors do not remember what a bear market in bonds is like, and in some ways that is just as well. History tells us that cash provides decent returns when bond yields rise, but that may not be the case this time, at least not for a while. Rates on money funds and other cash instruments are likely to stay near zero for another couple of years.

The reason is that, as Fed officials have recently stressed and as the recent statements from the Federal Open Market Committee spell out, the Fed expects to keep short term rates near zero for a "considerable time" after the securities purchases end. Specifically, the FOMC intends to keep the federal funds rate near zero for "at least as long as the unemployment rate remains above 6.5%", provided inflation remains well behaved. The unemployment rate was 7.6% in June, and inflation is running about one percentage point *below* where the Fed wants it to be. Based on the criteria that the FOMC has laid out, our economists believe that short-term rates will remain near zero until the middle of 2015.

Cash generated positive returns in prior bond bear markets, but that might not be the case now.

### What worked in the 1990s down markets will not work now

The worst bond bear market of the past 25 years extended from October 1993 to November 1994, punctuated by a surprise Fed rate hike on February 4, 1994. Treasury yields also rose steadily from October 1998 to January 2000. The1998 to 2000 rise in Treasury yields began with the undoing of the flight to quality during the Asian financial crisis, and was helped along by the boom in technology industries.

Table 1 shows the returns on selected bond and stock market sectors during both of those periods. In the bond world, cash was the best place to be. While most bonds suffered losses, the return on three-month Treasury bills was 4.0% in 1993-1994 and 6.2% in 1998-2000. The Fed raised the federal funds rate by three percentage points in the 1994 cycle, and 1.75 percentage points during the 1998-2000 cycle. Returns on cash were high to begin with, and the Fed rate hikes made them higher. But for now, if we are right about the Fed, returns on cash will stay near zero for about another two years.

Table 1: Returns during bond bear markets

| | Oct '93- Nov '94 | Oct '98-Jan '00 |
|---|---|---|
| Range on 10-yr Tsy yield | 5.2% - 8.0% | 4.2% - 6.8% |
| Bond market | | |
| 3 mo Tsy | 4.0% | 6.2% |
| 10 yr Tsy | -13.6% | -12.6% |
| 30 yr Tsy | -20.9% | -21.6% |
| Investment Grade corporates | -6.7% | -3.1% |
| High yield corporates | 0.4% | 5.1% |
| Munis | -8.6% | -8.2% |
| S&P 500 | 1.6% | 48.7% |
| Telecom stocks | -10.2% | 40.8% |
| Utilities | -18.5% | -2.8% |

Source: BofA Merrill Lynch Global Research, Bloomberg

## Positioning in bonds

Bond ideas: low quality, short-duration ladders

Following the recent widening in credit spreads, we recently reduced our already below-market duration, and raised our allocation to high yield for investors fitting both the Moderate and Aggressive risk profiles. We include senior loan securities as part of the high yield allocation.

For income seeking investors, we recommend short- to intermediate-term maturities, centering on about five years.

Table 1 shows that lower-quality securities did best during the down markets. That is because of the yield advantage that these securities have, and because better economic growth makes investors more comfortable in taking credit risk.

High yield is not appropriate for conservative investors. For them, we suggest short-term portfolio laddering – staggering short term maturities. For instance, begin with a one-, three- and five-year maturity. As each security matures, replace it with the longest maturity in the ladder. The yield on such a combination will be low, but it should be better than cash for funds not needed for liquidity purchases.

Portfolio laddering for conservative investors, high yield and senior loans for those willing to take credit risk.

The likelihood that short-term rates will remain near zero will make some potential bond market hedges less effective. For example, coupon rates on securities that are tied to LIBOR will probably not rise until the federal funds rate rises. For securities that are paying their "floor" rates, such as many senior loans, the wait could be even longer. Still, the appeal of senior loans is that their prices are less sensitive to rising rates.

## Stocks

### Look for both income and income growth

How the stock market responds to rising interest rates depends on why rates are rising and the related fundamental health of equities. Recent stock market performance has been bolstered by signs of better economic growth. Despite the reaction of the bond market to Bernanke's recent comments, the equity market is encouraged by signs from industries like housing and automobiles that things are getting better. Sectors of the market that are considered to be more cyclical, like technology and industrials, should be able to do well in the environment we foresee. But rising bond yields are likely to pose a threat to traditional defensive sectors of the market – utilities, telecommunications, consumer staples and parts of health care.

Rising rates affects sector performance in the stock market.

The last column of Table 2 shows the returns in different sectors of the stock market in the five days after Bernanke's remarks. The declines were spread almost uniformly across sectors. Compare that with the first two columns, which show market performance during two previous market declines, when higher rates were not a factor. At that time, the traditional defensive sectors outperformed.

Table 2: Market sectors after recent pullbacks (total returns)

| | 04/29/11-06/15/11 | 04/02/12-06/01/12 | 06/18/13-06/24/13 |
|---|---|---|---|
| S&P 500 | -6.9% | -9.6% | -4.7% |
| Consumer Staples | -1.8% | -3.2% | -4.1% |
| Health Care | -1.2% | -5.9% | -4.0% |
| Telecommunications | -3.6% | 5.9% | -4.9% |
| Utilities | -0.9% | 1.6% | -3.9% |
| Consumer Discretionary | -6.6% | -7.7% | -4.4% |
| Energy | -10.3% | -13.7% | -4.9% |
| Financials | -10.1% | -15.3% | -5.1% |
| Industrials | -8.6% | -10.1% | -5.2% |
| Information Technology | -8.6% | -12.8% | -5.2% |
| Materials | -8.9% | -11.7% | -5.2% |

Source: BofA Merrill Lynch Global Research; shaded section denotes defensive market sectors

"Defensive stocks" generally do well over long periods, but not during rate-driven market declines.

The bottom section of Table 1 on the previous page shows something similar for the stock market during the two periods of sharply rising bond yields. Stocks managed to show gains in both those periods, but utilities underperformed dramatically, with negative returns in both periods. The telecommunications sector had negative returns in 1993-94. The positive returns in 1998-2000 were driven by the surge in technology stocks.

Defensive sectors usually perform well over long periods, but not during periods of rising yields. One reason that defensive equities underperform when interest rates are rising is that bonds then offer better yields that make equity dividend yields seem less attractive. Another reason is that rising rates often accompany stronger economic growth. In those instances, investors are usually better rewarded in cyclical growth stocks rather than defensive stocks.

Table 3: Dividend yields in S&P sectors

| | |
|---|---|
| S&P 500 | 2.1% |
| Telecommunications | 4.4% |
| Utilities | 4.1% |
| Consumer Staples | 3.0% |
| Materials | 2.4% |
| Energy | 2.2% |
| Industrials | 2.2% |
| Healthcare | 1.9% |
| Information Technology | 1.8% |
| Financials | 1.7% |
| Consumer Discretionary | 1.5% |

Source: BofA Merrill Lynch Global Research, S&P

In contrast, defensive stocks usually outperform when overall returns are flat or negative, such as in 2011, when the price return on the S&P was zero. In 2012, when the price return on the S&P was 13.4%, defensive shares underperformed as a whole, although telecommunications shares did well.

For some time, our US Equity Strategist Savita Subramanian has favored stocks with high dividend *growth* over those that offer just high dividend *yields*. Such stocks allow investors to more fully participate in a rising equity market than the defensive sectors. Savita recommends overweight positions in the information technology, industrials, and energy sectors.

## Strike a balance

Many investors are drawn to higher yielding stocks today in order to compensate for the low yields found in bonds and cash. Table 3 shows that the defensive sectors (shaded) have appreciably higher dividend yields than the growth or cyclical sectors of the stock market. The tradeoff is that growth and cyclical sectors have better potential for capital gains, and, in many cases, dividend growth.

We think that investors need to strike a balance. Maintaining a diversified portfolio of higher yielding stocks makes sense to us, particularly for investors who look to equities as a source of income, since we expect cash rates to remain near zero for another two years.

But investors should be aware that these “defensives” might not live up to their billing if rates rise substantially. Investors seeking a diversified list of stocks with good dividend growth potential should look at our Equity Income & Growth Portfolio – found on page 21.

## Asset allocation shift from bonds to stocks

We have made minor shifts in asset allocation across most of the risk profiles, raising the allocation to stocks and lowering the allocation to bonds. The changes comport with our view that bond yields will rise from here, and equities should outperform fixed income. For investors with a 12-18 month time horizon, our asset allocation recommendations are now as follows:

Table 4: RIC Asset allocation changes (July 2013)

| | Conservative | | Moderately Conservative | | Moderate | | Moderately Aggressive | | Aggressive | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Prev. | New | Prev. | New | Prev. | New | Prev. | New | Prev. | New |
| Stocks | 24% | 24% | 44% | 45% | 65% | 68% | 75% | 80% | 85% | 88% |
| Bonds | 53% | 53% | 48% | 46% | 33% | 30% | 23% | 19% | 13% | 11% |
| Cash | 23% | 23% | 8% | 9% | 2% | 2% | 2% | 1% | 2% | 1% |

Source: BofA Merrill Lynch Global Research

Also, on July 1, we changed our fixed income allocation, reducing what was already a below market duration, and shifting some allocation from emerging markets to domestic high yield and Treasuries. The new allocations are on Table 9. For more details see The Fixed Income Digest (July '13): Time to catch your breath.

# American innovation

## Technology comes to the gym

A few months ago we introduced evidence, initially published by our US Equity Strategy team, that American companies across a wide variety of industries are opening paths toward higher levels of efficiency and solving problems with their skill in innovation.

This month, we continue our series focusing on industries that are particularly innovative – and highlighting stocks that play leading roles within those industries.

Performance fitness products used to be reserved for professional athletes. Now with America's focus on fitness/wellness and maintaining active, healthier lifestyles, performance athletic wear has become mainstream. Even within this simple industry, technology is changing competitive dynamics and helping drive customer demand.

Nike has pushed the innovation envelope since its beginning in the 1970s – from its waffle-trainer running shoes in the 1970s to its air-filled soles in the 1980s to today's Flyknit manufacturing process and FuelBand fitness tracker. Similarly, Under Armour got its start as the first company with a moisture-wicking compression undershirt, and innovation continues to be part of the company's foundation.

### Flyknit – state-of-the-art sneaker manufacturing

Sneaker-making technology has not materially changed in several decades; however, Nike has developed a new, revolutionary sneaker-making process that it calls Flyknit. The Flyknit technology weaves the upper part of a sneaker together in a specially built machine. Nike developed its Flyknit technology to make a comfortable, lightweight running sneaker, but it also sees the potential to reduce waste, cut labor costs, reduce production and shipping time, and the possibility to add personalization.

Nike' Flyknit sneaker manufacturing technology has the ability to reduce waste, cut labor costs, reduce production and shipping time, and the potential to add personalization.

Nike has spent more than five years developing its latest sneaker technology. The idea for Flyknit came from trying to replicate the fit and feel of a sock. But the problem with a sock is that it has no structure or support. So Nike hired computer programmers and engineers who studied the knitting machines that make socks and sweaters. They created a 15-foot computer programmed knitting machine that weaves the upper part of the sneaker. The knitting software instructs the machine to precisely alter the knitting process to add stability, support and style to the sneaker.

In traditional shoemaking, machines cut out specific pieces, which workers then sew together. The Flyknit technology cuts out this step, which is the most labor-intensive part of the process. The Flyknit process also reduces waste by eliminating multiple cuts and materials. For example, the upper part of Nike's Lunar1 Flyknit sneaker has just one piece, compared to the 36 pieces that are in the upper part of the Air Pegasus running sneaker. Nike says this makes production quicker with less labor. It also reduces waste by over 60%, which helps Nike's sustainability initiatives, and could support higher margins longer term. Since the Flyknit technology significantly reduces the labor necessary to make sneakers, longer term it could allow Nike to source from more locations, reducing shipping costs and delivery time to market.

The technology so far is focused on making lightweight running sneakers, which represent over 30% of the $6.5 billion US running shoe market and is Nike's largest product category.

### Inspired by Stealth Bomber

Under Armour's ColdGear Infrared applies ceramic-infused ink to fabric to allow body heat to be transferred and retained better.

Under Armour has been a leader in introducing new products that make athletes perform better. One new product line is called ColdGear Infrared, which is designed to keep athletes warm for longer periods of time. The technology, which was inspired by the Stealth Bomber's use of ceramics, works by taking ceramic-infused ink and applying it to the fabric, allowing body heat to be transferred and retained better throughout the product. The technology does not affect the feel of the fabric on the body, does not add weight, and does not affect moisture control. Under Armour has incorporated this technology into its cold weather gear including hats, gloves, pants, jackets, fleece, mock turtlenecks and leggings.

## "Just track it"

Another athletic innovation is in fitness electronics with the relatively new Nike FuelBand and the Armour39 wearable chest strap from Under Armour.

Under Armour recently introduced its first fitness electronic device, the Armour39 performance monitor.

Though Under Armour has continually introduced ground-breaking products in athletic apparel, it is a newcomer in athletic electronics. The company's first electronic product is the Armour39, which is a performance monitoring chest strap that measures heart rate, calories, and intensity. The chest strap wirelessly connects to an iPhone app or a watch that Under Armour sells separately. While heart rate monitors have been around for years, the proprietary metric that measures workout intensity, called WILLpower, is unique. WILLpower is an algorithm that measures workout duration, heart rate, intensity, calories burned, and even workout position and gives a score from 0 to 10. The idea is to score an individual's workout intensity and motivate him/her to score higher in future workouts.

Nike is encouraging third-party developers to make apps for its FuelBand activity tracker.

Nike has a similar product called FuelBand, but instead of tracking a specific workout, the FuelBand is designed to track activity throughout the entire day. The FuelBand is a wristband with an accelerometer that measures all movement, including counting steps, calories burned, and total active time. The activity is then translated into "NikeFuel" points. Similar to Under Armour's WILLpower, Nike's Fuel point tracking is designed to be a motivational tool. The user can set a daily goal and the wristband will give progress updates throughout the day.

The wristband can upload the user's data to Nike's website or an iPhone app, where it can store historical data. Nike is also encouraging third-party software developers to make apps for the FuelBand, which it hopes will make the device more indispensable to users.

The U.S. athletic product demand trends remain favorable and should maintain momentum into 2014, driven by a continued shift at retailers favoring technical athletic footwear and apparel. Both Nike and Under Armour have strong product pipelines, driven by their focus on innovation, and should be key beneficiaries of this trend.

Table 5: Athletic innovation stocks in the BofAML universe

| Symbol | Company | BofAML Rating | Price | Market Cap ($Mil) |
|---|---|---|---|---|
| NKE | Nike Inc. | B-1-7 | 63.64 | 56,870 |
| UA | Under Armour Inc. | C-1-9 | 61.22 | 6,432 |

Source: BofA Merrill Lynch Global Research

# Guest Column

## China: stability is still the policy keyword

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The interbank liquidity squeeze in China during June is finally over, with the overnight Shibor (interbank lending rate) back to 3.3% now from the spike of 13.4% on 20 June. But market concerns about China's growth outlook and on the health of the financial system are yet to be alleviated. The interbank market drama, which could have been easily avoided, convinced some that the new Chinese government led by Premier Li Keqiang is using "shock-therapy" to treat China's money and debt issues, and that may lead to an economic hard landing. We believe that is not the case. The message seems clear that the new leaders value growth and financial market stability and policy continuity. The State Council will likely employ a practical approach to clean up the existing financial messes and control risks. One important implication is that the chance of a growth hard landing could be quite small.

### Government calls for stability after the interbank turmoil

To guide market expectations, on 5 July, the State Council issued a statement (the Statement) on how to better use finance to support economic restructuring and upgrading. It came along with an official interpretation by China's Bank Regulatory Commission (the Interpretation). It shows that the State Council will decisively remedy the mishandling of the interbank market and will further alleviate the markets' fear of the illusive monetary policymaking in the past month.

The new government leaders appear to value economic growth and financial market stability.

"Maintaining Stability" is highlighted many times in those documents, implying that that the new State Council led by Premier Li Keqiang was caught by surprise on the interbank liquidity crunch in June and vowed to prevent similar disruptions in the financial sector. The Interpretation emphasized that "prudential monetary policy" means no easing despite the economic growth slowdown and no tightening despite relative fast money growth in the past. This is, so far, the clearest statement on Li's government's gradualist exit strategy of the past monetary stimulus. We believe this Statement is also a reaction to the PBoC's mishandling in June and a response to hawkish demand for severe tightening. We believe this approach is the most appropriate for the economy.

### Premier Li did not engineer the interbank liquidity squeeze

Some analysts believed that the interbank liquidity squeeze was planned and firmly under control of the omnipotent Premier Li. In these optimists' views, Mr. Li aimed to get a clean start by exposing those problems, especially rapidly accumulated debt and high money growth left by his predecessor, and he achieved this goal by engineering the interbank liquidity crunch.

We have sympathy for some of these views, but in our view the reality is not that rosy. We believe the interbank liquidity squeeze was not engineered by Premier Li, who is still in the middle of consolidating his power base. In his first couple of years, Premier Li, who is responsible for running the Chinese economy, still needs to maintain growth stability and policy continuity. If, for whatever reasons, there is a rapid rising risk of social, economic and financial instability, we believe he will try to take measures to return to normal, simply because his team is not confident and powerful enough to use crisis to achieve their goals.

### The government wants to maintain growth stability

The Statement emphasized meeting reasonable funding demands for important projects under construction, actively supporting important infrastructure projects such as railways and supporting urban infrastructure projects and social housing. We interpret that as the government wants to maintain growth stability. Surely there is no need for major stimulus at present, as growth may be close to the potential rate, which is trending down. But in case there is a high risk of a hard landing, we are confident that Premier Li will take measures to increase aggregate demand to stabilize growth.

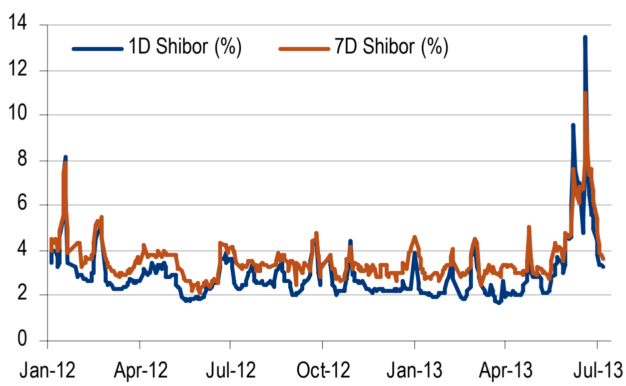
We see only a small chance of a hard landing.

A related implication is that the chance of a growth hard landing is quite small. We understand that a number of issues could be challenging, such as local government debt and shadow banking in China's economic system, but these problems are not fatal, and a careful exit strategy could prevent the Chinese economy from being hit by a hard landing. There may be some temptation to engineer a hard landing to disclose many of China's ills, and then take the opportunity to cure them. In reality, however, conservative new leaders in their first couple of years in office are unlikely to employ such a risky strategy because of the unique political backdrop in China.

## What caused the credit crunch?

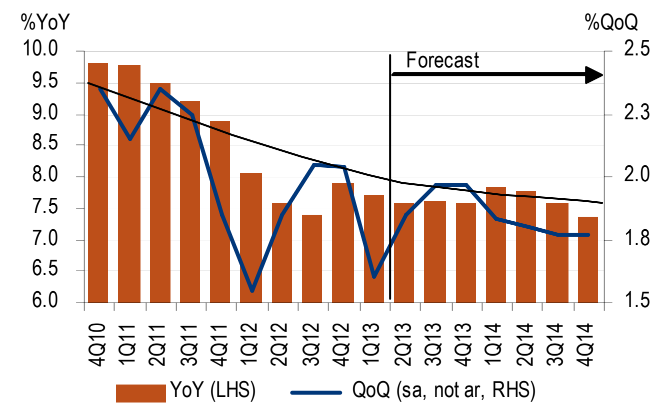
There were many factors behind the surging Shibor rates in June including capital outflow, quarter-end demand for cash to meet loan-to-deposit ratio requirements, quarter-end expiration of bank wealth management products that are used for bond purchases, et al. But the interbank liquidity squeeze was fully avoidable because if it wishes to, the PBoC could practically provide unlimited liquidity to ease every squeeze. What was the PBoC aiming to achieve by taking a tough stance? There seem to be competing theories to explain it: (1) the government was seriously concerned about the overly rapid credit growth facilitated by shadow banking, so it decided to hike Shibor and squeeze interbank lending to slow credit growth; (2) the PBoC squeezed interbank liquidity to punish banks that had aggressively used short-term interbank funding for longer-term investments.

Chart 2: Shibor spiked in June




Source: CEIC, BofA Merrill Lynch Global Research.

Chart 3: We believe the new leaders value growth stability




Source: CEIC, BofA Merrill Lynch Global Research.

Factors and motivations behind the latest interbank liquidity squeeze might be complicated, but overall we believe the interbank credit crunch engineered by Chinese regulators could do much more harm than good to the Chinese economy. It appears now politicians learned that dealing with banks in breach of regulations should be done by improving prudential regulations rather than engineering an interbank credit crunch which could potentially backfire should banks lose mutual trust.

# RIC asset class views

Table 6: Research Investment Committee asset class views

| Asset class | RIC view (+ / = / –) | Comments |
|---|---|---|
| Equity Markets | | |
| US Equities | + | Fed tapering schedule suggests that US economy on improving trend; growth/cyclicals should take over leadership |
| Consumer Discretionary | = | Favor housing or auto-related stocks; increasingly selective among retailers as sector has gotten more expensive |
| Consumer Staples | = | Defensive with good div. yields and global reach but many valuations are stretched; look for unexploited stocks |
| Energy | + | Benefits from quest for US energy independence; be selective among producers as-forecast is for lower oil prices |
| Financials | = | Appears that spreads are likely to widen; favor higher quality banks and insurers |
| Healthcare | = | Obamacare, looming govt. cutbacks keep us neutral; pharmaceuticals good income source, biotechs have M&A appeal |
| Industrials | + | Benefits from cyclical recovery with many high quality stocks. US manufacturing well positioned |
| Info Technology | + | Sector has lagged yet operating margins and balance sheets are strong; expect more cash return to shareholders |
| Materials | = | Weak commodity prices, low inflation and China slowdown weigh on earnings & stocks—stick to chemicals & fertilizers |
| Telecom | – | Good div. yields but not much room for div. growth any more; poor risk/reward tradeoff according to US Strategy |
| Utilities | – | Div. yields still well above Treasuries, but rising rates narrows that gap; stocks lag in economic recovery |
| | | |
| Growth | + | Slow earnings growth recovery and low inflation environment continue to favor growth stocks; cyclical growth is cheap |
| Value | = | Look for value stocks with growth characteristics in Technology, Industrials and Energy |
| | | |
| Small cap | + | Small caps positively correlated with rising interest rates; should benefit from improved economic growth and M&A |
| Large cap | + | Beneficiaries of fund flows into US equities/ETFs; look for cyclical growth and div. growers to outperform |
| | | |
| | | |
| Europe (ex. UK) | = | ECB committed to providing liquidity--odds of rate cut improved; should see shift from defensives to value/financials |
| United Kingdom | = | Data suggest economy broadly improving; BoE appears to be keeping rates low with policy statement; favor financials |
| Japan | + | BoJ committed to QQE framework with focus on stimulating growth and ending deflation; like banks and domestic plays |
| Asia Pac (ex. Japan) | = | Valuations attractive, preference is for cyclical yield vs. defensives; Australia has unique challenges |
| Emerging Markets | = | Bad news is priced in, but too early to buy aggressively; China slowdown on track; Latam earnings not yet bottoming |
| | | |
| | | |
| Fixed income markets | | |
| Treasuries | – | Income is low, and yields are likely to rise. |
| Agencies / MBS | – | Vulnerable to a tapering in Fed purchases, benefiting from improved GSE profitability, but yields are too low. |
| TIPS | = | Inflation protection desirable, even though yields are low. |
| US IG Corporates | + | Preferable to Treasuries for conservative investors. We favor lower quality, and intermediate maturities. |
| US HY Corporates | + | Yield spreads have widened, duration is lower than in other sectors. |
| Preferred securities | – | Duration risk too high for sector as a whole. |
| Non-US DM sovereigns | – | Yields are low and currency translation should work against $ based investors. |
| EM $ Sovereigns | = | Risks from rising US Treasury yields and slowing growth in EM nations. |
| EM Local crncy Sovereigns | - | Same risks as for $ denominated, plus near-term risk of weaker currencies. |
| | | |
| | | |
| Gold | = | Near-term range of $1,000/oz and $1,500/oz. |
| Oil | = | Year end price target of $103/bbl for Brent crude. But downward pressures longer term due to increased supply. |
| US dollar | + | Greenback should strengthen against most developed and EM countries. |
| | | |

Source: BofA Merrill Lynch Research Investment Committee

## Notes to RIC views

Ratings designations are as follows: (+) favorable view; (=) neutral view; (-) unfavorable view. Ratings reflect the Research Investment Committee's view for an investment time horizon of 12-18 months. Typically, the RIC view will agree with regional/product strategists, but at times there may a difference of opinion based on investor suitability or time frame.

# Fixed Income, Econ, Commodities, Currencies: views & risks

Table 7: Regional Equity Strategist views & associated risks

| Views | Risks |
|---|---|
| **Global Economics** *(Ethan Harris, Alberto Ades)* | |
| ■ Europe remains mired in recession, contracting 0.6% in '13. Risks remain skewed to the downside.<br>■ The ECB stands ready to back Euro area countries with its OMT program if any countries request help and sign an MoU.<br>■ US growth will likely strengthen in the fourth quarter. We expect the Federal Reserve to announce QE tapering in December. | ■ Downside risks: US fiscal tightening, slow progress on structural and fiscal reforms in Europe, and a soft recovery in China.<br>■ Upside risks: US housing market rebound, stronger US labor market recovery. |
| **Global Rates** *(Priya Misra, Ralf Preusser, John Wraith)* | |
| ■ US: Our new forecasts for the 10 year Treasury yield are 3.0% at the end of 2013 and 4.0% at the end of 2014.<br>■ Europe: Now that the ECB has adopted its own form of forward guidance we expect to see EUR rates de-correlate further from the US, with the front-end more anchored going forward. This will also lend support to carry trades in semi-core sovereigns.<br>■ UK: We anticipate that the MPC under new Governor Mark Carney will introduce some form of rate guidance over the next couple of months, and expect short yields to fall back towards the level they were at prior to the sell off that began in mid-May. We do not expect QE to return for the foreseeable future, absent a major negative shock in the UK or Eurozone. | ■ US: The risk to our long is a convexity led sell-off or continued outflows from bond funds. However, given the macro back drop of the Fed's forward guidance this should be less of a risk to the front end of the curve.<br>■ Europe: The EUR curve will trade directionally with the US, suggesting steepeners as a hedge against a further US-led sell-off.<br>■ UK: There has been a clear improvement in various data releases over the past month or two. If these intensify, the Bank may be happy to proceed without guidance, and short rates could drift higher in that event. |
| **Global Commodities** *(Francisco Blanch)* | |
| ■ Commodity demand should be modestly supported by global economic growth of 3% this year, but we remain concerned by the lack of growth momentum in EMs.<br>■ Soft demand and rising supplies could lead to a small surplus in Brent crude oil markets over the next 18-24 months; we forecast an average 2H13 price of $103/bbl, $105/bbl in 2014. In NA, energy supplies are surging and we see a risk of WTI prices dropping to $50/bbl over next 24mo.<br>■ Gold prices remain challenged by a lack of technical and fundamental support. | ■ A deeper-than-expected Euro area recession, increased Middle East tensions, faster-than-expected US fiscal tightening, and a China hard-landing scenario.<br>■ From a geopolitical perspective, the return of Iran's idled oil output, or a further loss, could be a major swing factor for Brent. |
| **Global Credit** *(Hans Mikkelsen, Oleg Melentyev)* | |
| ■ The macro backdrop for corporate credit in 2013 remains positive. We remain overweight high grade and high yield corporate bond spreads and favor US HY and European IG over US IG.<br>■ Short term macro risks - including the US fiscal tightening and Europe - are fading. While increasing interest rates are typically positive for credit spreads, the recent increase was too rapid leading to spread widening.<br>■ High beta sectors (i.e., Financials and Cyclicals) should outperform as they have more spread cushion to offset higher interest rates. We prefer lower quality positioning in HY. | ■ The biggest risk to US IG is the possibility of wider credit spreads following massive fund outflows, should interest rates continue to rise rapidly.<br>■ HY has capacity to offset most initial interest rate increases now, but that would change if rates were to rise by more than a nominal amount.<br>■ We look for companies to add leverage to the detriment of bondholders – especially in the higher quality industrial segment. |
| **Municipals** *(Municipal Strategy Group)* | |
| ■ Tax revs are improving. Housing recovery will be meaningful to local govts that have been stressed<br>■ Munis are not poised to rally much more, but negative net supply is providing a support level; stable Fed rate outlook supports a focus further out to the intermediate range.<br>■ Defaults and bankruptcies trended lower in 1Q2013. We expect this to continue. | ■ Puerto Rico has a $2bn budget gap expected for FY2013, which ended 30 June. Gov. Padilla just signed a FY2014 budget that includes several tax measures. Recovery in the Commonwealth's economy remains a focus.<br>■ Credit spreads are especially tight in HY. Anticipate spread widening in the lower rate, higher risk segments.<br>■ Possible changes to the tax exempt status of muni bonds. |
| **Global FX** *(David Woo, Alberto Ades)* | |
| ■ Look for the USD to strengthen against G10 on worries around China, Europe and Fed tapering, with further downside to risky & commodity currencies.<br>■ Continue to expect EUR-USD lower, with an end-13 1.25 target; and we maintain our USD-JPY target to 105 for 2013 YE.<br>■ Any EMFX appreciation will only be gradual in near term after the sharp sell-off following the rise in UST yields and USD. Recommend buying MXN, BRL and ILS and look to sell INR, CZK and TRY. | ■ A surprise resolution to the European crisis provides further upside risk to our view, while a country exit would cause the euro to fall further.<br>■ USD-JPY has upside risk from the participation in yen selling from domestic investors in Japan or positive macro shocks in the US that would push up growth and yields.<br>■ Better US data could increase expectations of Fed tapering, sending EMFX lower. |

Source: BofA Merrill Lynch Research Investment Committee

# Global equity markets: views & risks

Table 8: Regional Equity Strategist views & associated risks

| Views | Risks |
|---|---|
| **Global Equities *(Michael Hartnett)*** | |
| ■ The MSCI All-Country World Index year-end target for 2013 is 370.<br>■ The slow but steady recovery in bank credit and the labor market argues for ongoing monetary stimulus and a bullish core asset allocation in 2013. But 2013 will likely prove the high-watermark of the high liquidity era.<br>■ We favor cheap cyclical areas of equity markets, particularly US banks and Japanese and European stocks. | ■ Downside risks: crash in bonds, relapse in US real estate, or an FX war spurred by recession fears.<br>■ Upside risks: policy stimulus works to create much stronger than expected growth in 2013. |
| **United States *(Savita Subramanian)*** | |
| ■ 2013 year-end S&P 500 target is 1600, which is 14.5x our 2013 EPS of $110.<br>■ We recommend taking advantage of attractive valuations via four flavors of growth: 1) Dividend Growth; 2) Cyclical Growth; 3) Global Growth; and 4) Stable Growth (Quality).<br>■ Pro-cyclical sector preferences: OW Tech, Industrials & Energy, UW Utilities & Telecom. | ■ No bottom in China growth, re-emergence of tail risks from Europe, global recession. |
| **Europe *(John Bilton)*** | |
| ■ Healing consumer and improving manufacturing sentiment in Europe confirms a recovery in the economic growth in 2H13. With recent accommodative language from the central banks and likelihood of another rate cut before year-end, EU stocks would gain from the reflationary environment in the continent.<br>■ A modest earnings growth and a nominal re-rating will allow Eurostoxx 50 to reach 3100 on 12m view, DAX to 9200 and FTSE 100 to 7100. Offering 10-16% upside.<br>■ Themes: 1) Stocks exposed to domestic EU economies as they offer value and improving earnings trends 2) Avoid expensive GEM exposed stocks primarily consumer oriented. | ■ China slowing before European issues are sufficiently stabilized.<br>■ EU austerity measures begin to dominate ECB's reflationary bias. |
| **Japan *(Naoki Kamiyama)*** | |
| ■ Target level of TOPIX is 1,350 (next 12 months), which is 15.5x our FY03/15 EPS of ¥87. Our target and EPS estimate are based on currency forecast of 105.<br>■ BoJ can improve overall market sentiment to reduce risk premium. Strong leadership is expected to continue after upper house election in July.<br>■ Positive for autos and financials; negative for defensives. | ■ US employment trend and Fed's communication to the market.<br>■ Further slow down in China. |
| **Asia-Pac ex-Japan *(Nigel Tupper)*** | |
| ■ Asia Pacific ex-Japan was the second worst performing region in June, falling 6.3% and underperforming MSCI AC World by 3.2%. This is the fourth consecutive month that the Asia Pacific ex-Japan has underperformed.<br>■ With a PE of 10.5x and a PB 1.6x, valuations in the Asia Pacific ex-Japan region remain attractive. When the PE ratio has been at this level, Asia Pacific ex-Japan equities have historically returned 21% on average in the subsequent 12 months.<br>■ As the cycle improves, we recommend investors rotate away from expensive High Quality into inexpensive Low Quality, and from Defensive Yield to Cyclical Yield. | ■ Asia Pacific ex-Japan equities have rallied 6.2% over the last 12 months. However, this rally has not been earnings-based, but rather has been a re-rating. In order for us to have more confidence in markets rallying further we need to see an earnings recovery.<br>■ Seasonality studies have shown that equities struggle to provide positive absolute returns from May to October. This suggests that there may be more attractive entry points. |
| **Emerging Markets *(Michael Hartnett)*** | |
| ■ Hawkish Fed commentary and China's credit crunch have been big headwinds for EM equities, which underperformed DM in 1H13 by the most since the fallout from the Asia Crisis in 1998.<br>■ The relative valuation of EM versus DM equities is 3 standard deviations below its 5 year average, the cheapest level since October 2008.<br>■ Our tactical trading rules argue for near-term bounce in cheap and unloved EM equities. But investors looking for cyclical entry point should wait for policy makers to ease, or for weaker USD. | ■ EM debt crash, social unrest, signs of rising inflation.<br>■ A further unwind in EM debt positions could force EM equity investors to sell their beloved consumer stocks, which have been big winners in recent years. |

Source: BofA Merrill Lynch Research Investment Committee

# Asset allocation for individual investors

- The tables below represent asset allocation recommendations by investor profile (Conservative – Aggressive).
- Strategic allocations are long-term, 20-30 year benchmarks developed by Merrill Lynch Global Wealth Management.
- Core allocations have a 12-18 month horizon, and are provided by the BofA Merrill Lynch Global Research Investment Committee.

## Asset allocation for US clients

**Tier 0 (highest liquidity):**
Highest liquidity needs with none of the portfolio invested in less liquid alternative asset categories. Tier 0 clients can also reference the Tier 1 strategic allocations if fulfilling the Alternative Assets allocation with liquid forms of alternative investments (including non-traditional funds).

Table 9: Strategic and core allocations without alternative assets (Tier 0 liquidity)

| | Conservative | | Moderately conservative | | Moderate | | Moderately aggressive | | Aggressive | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Strat. | Core | Strat. | Core | Strat. | Core | Strat. | Core | Strat. | Core |
| Traditional Assets | | | | | | | | | | |
| Stocks | 20% | 24% | 40% | 45% | 60% | 68% | 70% | 80% | 80% | 88% |
| Bonds | 55% | 53% | 50% | 46% | 35% | 30% | 25% | 19% | 15% | 11% |
| Cash | 25% | 23% | 10% | 9% | 5% | 2% | 5% | 1% | 5% | 1% |
| Alternative Assets | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% |

**Tier 1 (higher liquidity):**
Up to 10% of the portfolio may be unavailable for 3-5 years.

Table 10: Strategic allocations with alternative assets (Tier 1 liquidity)

| | Conservative | Moderately conservative | Moderate | Moderately aggressive | Aggressive |
|---|---|---|---|---|---|
| Traditional Assets | | | | | |
| Stocks | 20% | 40% | 55% | 65% | 70% |
| Bonds | 50% | 45% | 30% | 20% | 10% |
| Cash | 25% | 10% | 5% | 5% | 5% |
| Alternative Assets | | | | | |
| Real Assets* | 1% | 1% | 2% | 2% | 6% |
| Hedge Fund Strategies | 4% | 4% | 8% | 8% | 9% |
| Private Equity | 0% | 0% | 0% | 0% | 0% |

* *"Real Assets" defined to include commodities, TIPs and Real estate, including REITS.*; Figures may not sum to 100 because of rounding.

**Tier 2 (moderate liquidity):**
Up to 20% of the portfolio may be unavailable for 3-5 years.

Table 11: Strategic allocations with alternative assets (Tier 2 liquidity)

| | Conservative | Moderately conservative | Moderate | Moderately aggressive | Aggressive |
|---|---|---|---|---|---|
| Traditional Assets | | | | | |
| Stocks | 15% | 35% | 50% | 55% | 55% |
| Bonds | 50% | 45% | 25% | 20% | 10% |
| Cash | 25% | 10% | 5% | 5% | 5% |
| Alternative Assets | | | | | |
| Real Assets* | 3% | 3% | 7% | 7% | 10% |
| Hedge Fund Strategies | 6% | 6% | 8% | 8% | 8% |
| Private Equity | 1% | 1% | 5% | 5% | 12% |

* *"Real Assets" defined to include commodities, TIPs and Real estate, including REITS.*; Figures may not sum to 100 because of rounding.

**Tier 3 (lower liquidity)**
Up to 30% of the portfolio may be unavailable for 3-5 years.

Table 12: Strategic allocations with alternative assets (Tier 3 liquidity)

| | Conservative | Moderately conservative | Moderate | Moderately aggressive | Aggressive |
|---|---|---|---|---|---|
| Traditional Assets | | | | | |
| Stocks | 15% | 35% | 40% | 50% | 40% |
| Bonds | 45% | 40% | 25% | 15% | 10% |
| Cash | 25% | 10% | 5% | 5% | 5% |
| Alternative Assets | | | | | |
| Real Assets* | 3% | 3% | 9% | 9% | 11% |
| Hedge Fund Strategies | 10% | 10% | 14% | 14% | 14% |
| Private Equity | 2% | 2% | 7% | 7% | 20% |

* *"Real Assets" defined to include commodities, TIPs and Real estate, including REITS.*; Figures may not sum to 100 because of rounding.

Notes: The Strategic Profile Asset Allocation Models with Alternative Assets were developed by Merrill Lynch Global Wealth Management for private clients. The Strategic allocations are identified by Merrill Lynch Global Wealth Management and are designed to serve as guidelines for a 20-30 year investment horizon. The Core allocations are provided by the BofA Merrill Lynch Global Research Investment Committee. The Merrill Lynch Global Wealth Management models allocate assets among specified asset classes and, within each class, reflect broad investment diversification. The models offer benchmarks for traditional asset class allocation (stocks, bonds and cash), as well as models for allocations among traditional and alternative asset classes reflecting portfolios targeting varying liquidity levels. The models are designed to provide allocation benchmarks based on risk/return profiles. Merrill Lynch Global Wealth Management defines liquidity as the percentage of assets, by invested value, within a portfolio that can be reasonably expected to be liquidated within a given time duration under typical market conditions. Given the less-liquid nature of certain alternative assets, BofA Merrill Lynch Global Research does not make Core allocation recommendations for portfolios that include these asset classes. Merrill Lynch Global Wealth Management clients should consult with their financial advisor about these allocations.

## Fixed-income allocation for US clients

Table 13: Combined municipal and taxable recommended sector allocations by Investor Profile

| | Conservative | | | Moderate** | | | Aggressive | | |
|---|---|---|---|---|---|---|---|---|---|
| | Federal tax bracket | | | | | | | | |
| Sector | <25%* | 28% | 39.6% | <25%* | 28% | 39.6% | <25%* | 28% | 39.6% |
| Munis | 0% | 45% | 50% | 0% | 58% | 63% | 0% | 75% | 80% |
| Treasuries & CDs | 40% | 22% | 20% | 32% | 13% | 12% | 31% | 7% | 6% |
| TIPS | 3% | 2% | 2% | 4% | 2% | 2% | 4% | 1% | 1% |
| Agencies (GSEs) | 35% | 19% | 17% | 0% | 0% | 0% | 0% | 0% | 0% |
| Mortgages | 2% | 1% | 1% | 23% | 10% | 9% | 19% | 5% | 4% |
| Corporates | 20% | 11% | 10% | 24% | 10% | 9% | 22% | 6% | 4% |
| Preferreds | 0% | 0% | 0% | 1% | 1% | 0% | 1% | 0% | 0% |
| High Yield* | 0% | 0% | 0% | 9% | 4% | 3% | 12% | 2% | 2% |
| International: Developed Markets | 0% | 0% | 0% | 3% | 1% | 1% | 3% | 1% | 1% |
| International: Emerging Markets USD | 0% | 0% | 0% | 2% | 1% | 1% | 4% | 1% | 1% |
| International: Emerging Markets Local | 0% | 0% | 0% | 2% | 1% | 1% | 4% | 1% | 1% |
| TOTALS | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |
| TAXABLE-Maturity | | | | | | | | | |
| 1-4.99 years | 100% | 100% | 100% | 56% | 56% | 56% | 56% | 56% | 56% |
| 5-14.99 years | 0% | 0% | 0% | 40% | 40% | 40% | 37% | 37% | 37% |
| 15+ years | 0% | 0% | 0% | 4% | 4% | 4% | 7% | 7% | 7% |
| TOTALS | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |
| TAX EXEMPT-Maturity | | | | | | | | | |
| 1-4.99 years | 100% | 100% | 100% | | 10% | 10% | | 10% | 10% |
| 5-9.99 years | | | | | 50% | 50% | | 30% | 30% |
| 10-14.99 years | | | | | 20% | 20% | | 30% | 30% |
| 15+ years | | | | | 20% | 20% | | 30% | 30% |
| TOTALS | 100% | 100% | 100% | | 100% | 100% | | 100% | 100% |

* Including tax-deferred accounts like IRAs and 401(k)s. ** The Moderate Category applies to the "Moderately Conservative", "Moderate", and "Moderately Aggressive" Profiles.

Changes from last month are highlighted in bold.

Source: BofA Merrill Lynch Global Research

## US Equity sector allocation models

Table 14: Portfolio Strategy team's US equity sector weightings by investor profile

| | Weight in S&P 500 | Conservative | Moderately conservative | Moderate | Moderately aggressive | Aggressive |
|---|---|---|---|---|---|---|
| Consumer Discretionary | 12.2% | 10.0% | 6.0% | 11.0% | 12.0% | 13.0% |
| Consumer Staples | 10.5% | 22.0% | 15.0% | 12.0% | 8.0% | 4.0% |
| Energy | 10.5% | 12.0% | 12.0% | 10.0% | 12.0% | 13.0% |
| Financials | 16.7% | 12.0% | 14.0% | 15.0% | 7.0% | 7.0% |
| Health Care | 12.7% | 15.0% | 11.0% | 11.0% | 17.0% | 18.0% |
| Industrials | 10.2% | 11.0% | 12.0% | 14.0% | 18.0% | 14.0% |
| Info Technology | 17.8% | 6.0% | 8.0% | 16.0% | 23.0% | 25.0% |
| Materials | 3.3% | 0.0% | 2.0% | 2.0% | 3.0% | 3.0% |
| Telecom Services | 2.8% | 3.0% | 10.0% | 3.0% | 0.0% | 3.0% |
| Utilities | 3.3% | 9.0% | 10.0% | 6.0% | 0.0% | 0.0% |
| | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

Source: BofA Merrill Lynch Research Portfolios, S&P; S&P 500 Sector Weights are as of 28 June 2013; weights may not add up to 100% due to rounding.

## A closer look at asset allocation for US clients: size, style and international

The tables below present in-depth size and style recommendations for US clients using the stocks, bonds and cash weights from the most liquid (Tier 0) liquidity profile on the previous page.

Table 15: Strategic and core allocations without alternatives

| | Conservative | | Moderately conservative | | Moderate | | Moderately aggressive | | Aggressive | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Strategic | Core | Strategic | Core | Strategic | Core | Strategic | Core | Strategic | Core |
| Stocks | 20% | 24% | 40% | 45% | 60% | 68% | 70% | 80% | 80% | 88% |
| Lg. Cap Growth | 8% | 11% | 16% | 21% | 23% | 30% | 25% | 33% | 27% | 34% |
| Lg. Cap Value | 12% | 12% | 16% | 16% | 23% | 23% | 25% | 25% | 21% | 21% |
| Small Growth | 0% | 0% | 2% | 2% | 2% | 2% | 3% | 3% | 6% | 6% |
| Small Value | 0% | 0% | 2% | 1% | 2% | 1% | 3% | 2% | 6% | 5% |
| Intl: Developed | 0% | 0% | 3% | 3% | 8% | 8% | 11% | 11% | 16% | 16% |
| Intl: Emerging | 0% | 1% | 1% | 2% | 2% | 4% | 3% | 6% | 4% | 6% |
| | | | | | | | | | | |
| Bonds | 55% | 53% | 50% | 46% | 35% | 30% | 25% | 19% | 15% | 11% |
| Tsys, CDs & GSEs | 35% | 41% | 27% | 17% | 13% | 11% | 6% | 7% | 2% | 4% |
| Mortgage Backed | 14% | 1% | 13% | 11% | 9% | 7% | 6% | 4% | 4% | 2% |
| IG Corp & Preferred | 6% | 11% | 10% | 12% | 9% | 8% | 9% | 5% | 5% | 3% |
| High Yield | 0% | 0% | 0% | 4% | 2% | 3% | 1% | 2% | 2% | 1% |
| International | 0% | 0% | 0% | 3% | 2% | 2% | 3% | 1% | 2% | 1% |
| | | | | | | | | | | |
| Cash | 25% | 23% | 10% | 9% | 5% | 2% | 5% | 1% | 5% | 1% |

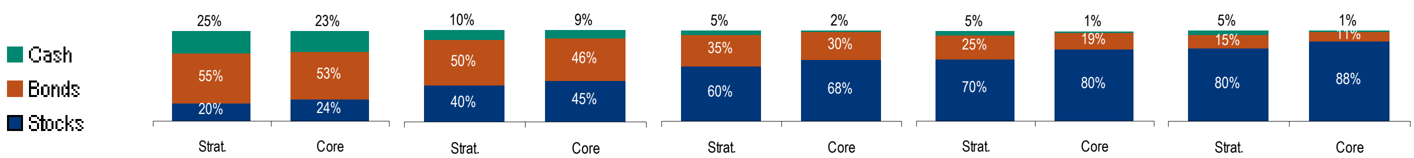



Table 16: Stocks – by size and style

| | Conservative | | Moderately conservative | | Moderate | | Moderately aggressive | | Aggressive | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Strategic | Core | Strategic | Core | Strategic | Core | Strategic | Core | Strategic | Core |
| Large cap growth | 40% | 46% | 40% | 47% | 38% | 44% | 35% | 41% | 33% | 39% |
| Large cap value | 60% | 50% | 40% | 36% | 38% | 34% | 35% | 31% | 26% | 24% |
| Small growth | 0% | 0% | 4% | 4% | 4% | 3% | 4% | 4% | 8% | 7% |
| Small value | 0% | 0% | 4% | 2% | 4% | 1% | 4% | 3% | 8% | 6% |
| International: Developed | 0% | 0% | 10% | 7% | 13% | 12% | 18% | 14% | 20% | 18% |
| International: Emerging | 0% | 4% | 2% | 4% | 3% | 6% | 4% | 8% | 5% | 7% |

Source: BofA Merrill Lynch Global Research

Table 17: Bonds -- by sector

| | Conservative | | Moderately conservative | | Moderate | | Moderately aggressive | | Aggressive | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Strategic | Core | Strategic | Core | Strategic | Core | Strategic | Core | Strategic | Core |
| Tsys, CDs & GSEs | 65% | 78% | 55% | 36% | 40% | 36% | 25% | 36% | 15% | 35% |
| Mortgage Backed | 25% | 2% | 25% | 23% | 25% | 23% | 25% | 23% | 25% | 19% |
| IG Corp & Preferred | 10% | 20% | 20% | 25% | 25% | 25% | 35% | 25% | 40% | 23% |
| High yield | 0% | 0% | 0% | 9% | 5% | 9% | 5% | 9% | 10% | 12% |
| International | 0% | 0% | 0% | 7% | 5% | 7% | 10% | 7% | 10% | 11% |

Source: BofA Merrill Lynch Global Research

Notes: Figures may not sum to 100 because of rounding
The Investor Profile Asset Allocation Model was developed by Merrill Lynch Global Wealth Management for private clients. The Strategic allocations are identified by Merrill Lynch Global Wealth Management and are designed to serve as guidelines for a 20-30-year investment horizon. The Core allocations are provided by the BofA Merrill Lynch Global Research Investment Committee and reflect the group's outlook over the next 12-18 months.

## Asset allocation for global clients

The Asset Allocation for Global Clients is designed to reduce "home country bias" and introduce a currency perspective. Core recommendations are based on qualitative views from our BofAML Global Research strategists, translated into recommendations with a quantitative optimization model. Strategic allocations are based on market cap weights for the MSCI All-Country World and BofAML Global Fixed Income Markets Indices (12/31/2010). Both allocations are for individual investors.**

**Tier 0 (highest liquidity):**

Highest liquidity needs with none of the portfolio invested in less liquid alternative asset categories. Tier 0 clients can also reference the Tier 1 strategic allocations if fulfilling the Alternative Assets allocation with liquid forms of alternative investments (including non-traditional funds).

Table 18: Strategic and core allocations without alternatives (Tier 0 liquidity)

| | Conservative | | Moderately conservative | | Moderate | | Moderately Aggressive | | Aggressive | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Strat. | Core | Strat. | Core | Strat. | Core | Strat. | Core | Strat. | Core |
| Global Equities | 20% | 24% | 40% | 45% | 60% | 66% | 70% | 78% | 80% | 90% |
| North America | 8% | 10% | 19% | 22% | 28% | 32% | 32% | 37% | 37% | 43% |
| Europe (ex UK) | 4% | 5% | 7% | 8% | 11% | 12% | 13% | 15% | 15% | 17% |
| UK | 2% | 2% | 4% | 4% | 5% | 5% | 6% | 6% | 7% | 7% |
| Japan | 2% | 2% | 3% | 4% | 5% | 7% | 6% | 7% | 7% | 8% |
| Pac Rim (ex Japan) | 1% | 1% | 2% | 1% | 3% | 2% | 4% | 3% | 4% | 3% |
| Emerging Markets | 3% | 4% | 5% | 6% | 8% | 9% | 9% | 11% | 10% | 12% |
| Global Fixed Income | 55% | 56% | 50% | 47% | 38% | 32% | 28% | 20% | 18% | 8% |
| Govt Bonds | 34% | 34% | 30% | 26% | 24% | 18% | 18% | 11% | 10% | 1% |
| Inv. Grade Credit | 8% | 8% | 8% | 8% | 6% | 6% | 4% | 4% | 3% | 3% |
| High Yield Credit | 2% | 2% | 2% | 2% | 1% | 1% | 1% | 1% | 1% | 1% |
| Collateralized Debt | 11% | 12% | 10% | 10% | 7% | 7% | 5% | 5% | 4% | 4% |
| Cash (USD) | 25% | 20% | 10% | 8% | 2% | 2% | 2% | 2% | 2% | 2% |
| Global Real Assets* | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| Global Hedge Fund Strat | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% |
| Global Private Equity | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% |

**Real Assets include commodities, TIPs, Real estate, incl. REITS;* Figures may not sum to 100 because of rounding; collateralized debt includes MBS

**Tier 1 (higher liquidity):**

Up to 10% of the portfolio may be unavailable for 3-5 years.

Note: The RIC does not provide core allocations to Alternative Investments due to their less liquid nature. Recommended allocations in these categories reflect strategic allocations.

Table 19: Strategic and core allocations with alternatives (Tier 1 liquidity)

| | Conservative | | Moderately conservative | | Moderate | | Moderately aggressive | | Aggressive | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Strat. | Core | Strat. | Core | Strat. | Core | Strat. | Core | Strat. | Core |
| Global Equities | 18% | 22% | 38% | 43% | 56% | 62% | 66% | 74% | 73% | 80% |
| North America | 8% | 10% | 18% | 21% | 26% | 30% | 30% | 35% | 34% | 39% |
| Europe (ex UK) | 3% | 4% | 7% | 8% | 10% | 12% | 12% | 14% | 14% | 16% |
| UK | 2% | 2% | 3% | 3% | 5% | 5% | 6% | 6% | 6% | 5% |
| Japan | 2% | 2% | 3% | 4% | 5% | 6% | 6% | 7% | 6% | 7% |
| Pac Rim (ex Japan) | 1% | 1% | 2% | 1% | 3% | 2% | 3% | 2% | 4% | 3% |
| Emerging Markets | 2% | 3% | 5% | 6% | 7% | 8% | 9% | 11% | 9% | 10% |
| Global Fixed Income | 52% | 53% | 50% | 47% | 32% | 26% | 22% | 14% | 10% | 3% |
| Govt Bonds | 32% | 32% | 30% | 26% | 20% | 14% | 14% | 7% | 6% | 0% |
| Inv. Grade Credit | 8% | 8% | 8% | 8% | 5% | 5% | 3% | 3% | 2% | 2% |
| High Yield Credit | 2% | 2% | 2% | 2% | 1% | 1% | 1% | 1% | 0% | 0% |
| Collateralized Debt | 10% | 11% | 10% | 10% | 6% | 6% | 4% | 4% | 2% | 1% |
| Cash (USD) | 25% | 20% | 7% | 5% | 2% | 2% | 2% | 2% | 2% | 2% |
| Global Real Assets^* | 1% | 1% | 1% | 1% | 2% | 2% | 6% | 6% | 12% | 12% |
| Global Hedge Fund Strat^ | 4% | 4% | 4% | 4% | 8% | 8% | 4% | 4% | 3% | 3% |
| Global Private Equity^ | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% | 0% |

*^The RIC does not make core allocations to these categories due to their long term, less liquid nature Strategic benchmark weights are reflected in both columns*

**Real Assets include commodities, TIPs, Real estate, incl. REITS;* Figures may not sum to 100 because of rounding; collateralized debt includes MBS

Notes: Merrill Lynch Global Wealth Management's Strategic Profile Asset Allocation Models were developed for private Merrill Lynch Global Wealth Management Clients. The Strategic allocations are identified by Merrill Lynch Global Wealth Management are designed to serve as guidelines for a 20-30 year investment horizon. The Core allocations are provided by the BofA Merrill Lynch Global Research Investment Committee. The Merrill Lynch Global Wealth Management models allocate assets among specified asset classes and, within each class, reflect broad investment diversification. The models offer benchmarks for traditional asset class allocation (stocks, bonds and cash), as well as models for allocations among traditional and alternative asset classes reflecting portfolios targeting varying liquidity levels. The models are designed to provide allocation benchmarks based on risk/return profiles. Merrill Lynch Global Wealth Management defines liquidity as the percentage of assets, by invested value, within a portfolio that can be reasonably expected to be liquidated within a given time duration under typical market conditions. Given the less-liquid nature of certain alternative assets, BofA Merrill Lynch does not make Core allocation recommendations for portfolios that include these asset classes. Merrill Lynch Global Wealth Management clients should consult with their financial advisor about these allocations.

**BofAML Global Research also publishes a tactical Global Asset Allocation for institutional investors, distinct from the RIC's Core Asset Allocation for Global Clients, published herein. The institutional Core Global Asset Allocation, published weekly, is based on the same views and framework, but is designed for institutional investors with a 3-6 month time horizon.

## Asset allocation for global clients (continued)

**Tier 2 (moderate liquidity):**
Up to 20% of the portfolio may be unavailable for 3-5 years.

Note: The RIC does not provide core allocations to Alternative Investments due to their less liquid nature. Recommended allocations in these categories reflect strategic allocations.

Table 20: Strategic and core allocations with alternatives (Tier 2 liquidity)

| | Conservative | | Moderately conservative | | Moderate | | Moderately aggressive | | Aggressive | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Strat. | Core | Strat. | Core | Strat. | Core | Strat. | Core | Strat. | Core |
| Global Equities | 14% | 18% | 35% | 40% | 45% | 51% | 51% | 59% | 53% | 63% |
| North America | 6% | 8% | 16% | 19% | 21% | 25% | 24% | 29% | 24% | 30% |
| Europe (ex UK) | 3% | 4% | 6% | 7% | 8% | 10% | 9% | 11% | 10% | 12% |
| UK | 1% | 1% | 3% | 3% | 4% | 4% | 4% | 4% | 5% | 5% |
| Japan | 1% | 1% | 3% | 4% | 4% | 5% | 4% | 5% | 4% | 5% |
| Pac Rim (ex Japan) | 1% | 1% | 2% | 1% | 2% | 1% | 3% | 2% | 3% | 2% |
| Emerging Markets | 2% | 3% | 5% | 6% | 6% | 7% | 7% | 9% | 7% | 9% |
| Global Fixed Income | 51% | 52% | 48% | 45% | 33% | 27% | 27% | 19% | 15% | 5% |
| Govt Bonds | 31% | 31% | 30% | 26% | 21% | 15% | 17% | 10% | 9% | 0% |
| Inv. Grade Credit | 8% | 8% | 7% | 7% | 5% | 5% | 4% | 4% | 2% | 2% |
| High Yield Credit | 2% | 2% | 2% | 2% | 1% | 1% | 1% | 1% | 1% | 1% |
| Collateralized Debt | 10% | 11% | 9% | 9% | 6% | 6% | 5% | 5% | 3% | 3% |
| Cash (USD) | 25% | 20% | 7% | 5% | 2% | 2% | 2% | 2% | 2% | 2% |
| Global Real Assets^* | 2% | 2% | 2% | 2% | 4% | 4% | 4% | 4% | 8% | 8% |
| Global Hedge Fund Strat^ | 6% | 6% | 6% | 6% | 9% | 9% | 4% | 4% | 6% | 6% |
| Global Private Equity^ | 2% | 2% | 2% | 2% | 7% | 7% | 12% | 12% | 16% | 16% |

*^The RIC does not make core allocations to these categories due to their long term, less liquid nature Strategic benchmark weights are reflected in both columns.*
**Real Assets include commodities, TIPs, Real estate, incl. REITS;* Figures may not sum to 100 because of rounding; collateralized debt includes MBS

**Tier 3 (lower liquidity):**
Up to 30% of the portfolio may be unavailable for 3-5 years.

Note: The RIC does not provide core allocations to Alternative Investments due to their less liquid nature. Recommended allocations in these categories reflect strategic allocations.

Table 21: Strategic and core allocations with alternatives (Tier 3 liquidity)

| | Conservative | | Moderately conservative | | Moderate | | Moderately aggressive | | Aggressive | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Strat. | Core | Strat. | Core | Strat. | Core | Strat. | Core | Strat. | Core |
| Global Equities | 12% | 16% | 32% | 37% | 41% | 47% | 47% | 55% | 46% | 52% |
| North America | 5% | 7% | 14% | 17% | 19% | 23% | 22% | 27% | 21% | 25% |
| Europe (ex UK) | 2% | 3% | 6% | 7% | 8% | 10% | 9% | 11% | 9% | 11% |
| UK | 1% | 1% | 3% | 3% | 4% | 4% | 4% | 4% | 4% | 3% |
| Japan | 1% | 1% | 3% | 4% | 3% | 4% | 4% | 5% | 4% | 5% |
| Pac Rim (ex Japan) | 1% | 1% | 2% | 1% | 2% | 1% | 2% | 1% | 2% | 1% |
| Emerging Markets | 2% | 3% | 4% | 5% | 5% | 6% | 6% | 8% | 6% | 7% |
| Global Fixed Income | 48% | 49% | 48% | 45% | 27% | 21% | 21% | 13% | 7% | 1% |
| Govt Bonds | 30% | 30% | 30% | 26% | 17% | 11% | 13% | 6% | 5% | 0% |
| Inv. Grade Credit | 7% | 7% | 7% | 7% | 4% | 4% | 3% | 3% | 1% | 1% |
| High Yield Credit | 2% | 2% | 2% | 2% | 1% | 1% | 1% | 1% | 0% | 0% |
| Collateralized Debt | 9% | 10% | 9% | 9% | 5% | 5% | 4% | 4% | 1% | 0% |
| Cash (USD) | 25% | 20% | 5% | 3% | 2% | 2% | 2% | 2% | 2% | 2% |
| Global Real Assets^* | 3% | 3% | 3% | 3% | 6% | 6% | 7% | 7% | 15% | 15% |
| Global Hedge Fund Strat^ | 9% | 9% | 9% | 9% | 16% | 16% | 11% | 11% | 14% | 14% |
| Global Private Equity^ | 3% | 3% | 3% | 3% | 8% | 8% | 12% | 12% | 16% | 16% |

*^The RIC does not make core allocations to these categories due to their long term, less liquid nature Strategic benchmark weights are reflected in both columns.*
**Real Assets include commodities, TIPs, Real estate, incl. REITS;* Figures may not sum to 100 because of rounding; collateralized debt includes MBS

Notes: The Strategic Asset Allocation Model was developed by Merrill Lynch Global Wealth Management. The Strategic allocations are identified by Merrill Lynch Global Wealth Management and are designed to serve as guidelines for a 20-30 year investment horizon for Merrill Lynch Global Wealth Management clients The Core allocations are provided by the BofA Merrill Lynch Global Research Investment Committee and reflect their outlook over the next 12-18 months.

Table 22: Sector Weightings (Sectors listed in order of preference)

| Sector | Weight in S&P 500 | BofAML Weight (+ / = / -) | Comments | Industry Preferences/Themes |
|---|---|---|---|---|
| Information Technology | 17.8% | + | ■ Cash rich - dividend, buyback, capex play<br>■ Attractive valuation - greatest implied upside on forward P/E of any sector<br>■ Highest foreign exposure, secular and cyclical growth, lower EPS volatility vs. history<br>■ Stock pickers industries: Tech hardware and software<br>■ Risks: Consensus overweight, govt. spending cuts (Comm. Eqpt.) | Mega-cap tech |
| Industrials | 10.2% | + | ■ Highest percentage of high quality stocks<br>■ GDP-sensitive, capex exposure, global exposure<br>■ Risks: Defense stocks at risk from govt. spending cuts, high European exposure | Industrial conglomerates<br>Machinery<br>Avoid defense stocks |
| Energy | 10.5% | + | ■ Attractive valuation: only sector besides health care with implied upside on relative P/B, P/OCF and fwd. P/E<br>■ Benefits from US domestic energy advantage<br>■ Cyclical recovery play, foreign exposure<br>■ Risks: oil price volatility | Domestic refiners<br>Energy equipment & services |
| Health Care | 12.7% | = | ■ Large cap pharmaceuticals are our preferred yield play (cheap, underowned)<br>■ Attractive valuation: only sector besides energy with implied upside on relative P/B, P/OCF and fwd. P/E<br>■ Obama's re-election/health care reform: benefits hospitals, Medicaid managed care, labs, and PBMs<br>■ Risks: Most government spending exposure of any sector | Pharmaceuticals |
| Consumer Staples | 10.5% | = | ■ Contrarian - underowned by fund managers<br>■ High quality, dividend yield, and dividend growth potential (lower payout ratio than utilities/telecom)<br>■ Higher foreign exposure and less government risk than the other defensive sectors<br>■ Risks: inflation, upside surprise to profits growth | Avoid Tobacco on valuation |
| Consumer Discretionary | 12.2% | = | ■ Household durables (contains homebuilders) and specialty retail (contains home improvement stores) beneficiaries of improvement in housing market<br>■ Risks: higher oil prices, consumer deleveraging, continued high unemployment | Select specialty retail<br>Select household durables |
| Financials | 16.7% | = | ■ Benefits from US cyclical recovery / housing recovery<br>■ Old leadership rarely becomes new leadership, high beta<br>■ Attractively valued on relative P/B, but remains expensive vs. history on relative fwd. P/E<br>■ Risks: regulatory reform, litigation, stress in European financial system, US recession | Mega-cap financials |
| Materials | 3.3% | = | ■ Poor risk-reward vs. other non-financial cyclicals (high beta but lower LTG)<br>■ Risk: no bottoming in China growth (more leveraged to improvement in China than Industrials, which is also highly exposed to improvement in Europe as well as EM). | Chemicals<br>Avoid metals & mining until more signs of improvement in China |
| Utilities | 3.3% | – | ■ Most expensive sector vs. history on relative fwd. P/E, no growth, high payout ratios (little room to raise dividends)<br>■ High dividend yield, underowned by fund managers, hedge against macro uncertainty, purely domestic | |
| Telecom | 2.8% | – | ■ Expensive (trading near all-time-highs on relative fwd. P/E), high payout ratios (little room to raise dividends)<br>■ Highest dividend yield, hedge against macro uncertainty, low intra-stock correlations | |

*Weights in S&P 500 as of 6/30/2013. May not add to 100% due to rounding.
Source: BofA Merrill Lynch US Equity & US Quant Strategy

# Core Portfolio

The Equity Core Portfolio attempts to achieve capital gains over a 1-2 year time horizon by combining tactical sector weighting decisions from our US Equity Strategy team with stock selections that offer attractively valued growth potential. For a complete description and current holdings, please see the following; Equity Core Portfolio Spotlight.

# Highlighted Portfolio of the Month

## Income & Growth Portfolio

The primary objective of the Income & Growth Portfolio is to utilize a total return approach with a cross-section of stocks that combine income and dividend growth for inflation protection, and earnings growth for wealth accumulation. Stock selection should involve less volatility than assumed by the pure growth investor and may have a lower yield than sought by the pure income investor. No minimum yield is required, but the stocks must provide a regular secure dividend.

Income & Growth Portfolio

| | | | Price | | | | |
|---|---|---|---|---|---|---|---|
| Sectors/Target Weights | Symbol | Proposed Weight | Close 7/5/2013 | Average Cost | Yield † | QRQ Rating | Footnote |
| *Information Technology (16%)* | | | | | | | |
| Visa | V | 3% | 190.79 | $99.90 | 0.69% | B-1-7 | Bbijopsvw |
| IBM | IBM | 3% | 194.93 | $209.26 | 1.95% | B-2-7 | BObgijopsvw |
| Accenture | ACN | 3% | 73.64 | $75.24 | 2.20% | A-2-7 | Bbijopsvw |
| Oracle | ORCL | 4% | 31.19 | $29.16 | 0.45% | B-1-7 | BObgijopsv |
| ADP | ADP | 3% | 70.75 | $68.56 | 2.46% | B-1-7 | Bbijopsvw |
| *Financials (15%)* | | | | | | | |
| Wells Fargo | WFC | 3% | 42.07 | $29.90 | 2.85% | B-1-7 | BObgijopsvw |
| ACE Limited | ACE | 2% | 90.12 | $48.69 | 2.26% | B-1-7 | Bbijopsvw |
| T. Rowe Price | TROW | 3% | 75.37 | $72.22 | 2.02% | B-1-7 | Bbjopw |
| Amer Express | AXP | 4% | 76.31 | $43.85 | 1.21% | B-1-7 | BObijopsvw |
| Citigroup | C | 3% | 48.53 | $38.42 | 0.08% | B-1-7 | BObgijopsv |
| *Industrials (14%)* | | | | | | | |
| Caterpillar Inc | CAT | 3% | 82.14 | $75.93 | 2.92% | B-2-7 | Bbijopsvw |
| Honeywell | HON | 4% | 80.06 | $46.16 | 2.05% | B-1-7 | BObijopsvw |
| FedEx Corp. | FDX | 3% | 98.96 | $104.90 | 0.61% | B-1-7 | Bbgijopsvw |
| United Tech | UTX | 4% | 96.53 | $69.10 | 2.22% | B-1-7 | BObijopsvw |
| *Consumer Staples (12%)* | | | | | | | |
| Diageo | DEO | 4% | 117.48 | $90.59 | 1.88% | A-1-7 | BObijopsv |
| Costco | COST | 4% | 111.76 | $59.47 | 1.11% | B-1-7 | Bbgijopsvw |
| CVS/Caremark | CVS | 4% | 58.64 | $35.78 | 1.53% | B-1-7 | Bbgijoprsvw |
| *Consumer Discretionary (11%)* | | | | | | | |
| The Home Depot | HD | 3% | 78.29 | $50.97 | 1.99% | A-1-7 | BObgijopsvw |
| Comcast Corp | CMCSA | 3% | 41.70 | $32.33 | 1.87% | A-1-7 | #BObgijopsv |
| McDonald's Corp | MCD | 3% | 99.86 | $59.88 | 3.08% | B-1-7 | Bbgijopsvw |
| Nike | NKE | 2% | 63.64 | $40.83 | 1.32% | B-1-7 | Bbgijopsvw |
| *Health Care (11%)* | | | | | | | |
| Covidien | COV | 4% | 58.27 | $48.71 | 1.78% | B-1-7 | Bbijopsvw |
| McKesson Corp. | MCK | 3% | 115.73 | $90.65 | 0.69% | B-1-7 | Bbgijopsvw |
| Thermo Fisher | TMO | 4% | 85.42 | $71.60 | 0.70% | A-1-7 | Bbgijopsvw |
| *Energy (10%)* | | | | | | | |
| Valero | VLO | 3% | 33.85 | $36.73 | 2.36% | B-1-7 | Bbijopsvw |
| Marathon | MRO | 4% | 35.62 | $31.02 | 1.91% | B-1-7 | Bbijopsvw |
| Schlumberger | SLB | 3% | 74.09 | $61.73 | 1.69% | B-1-7 | Bbijopvw |
| *Utilities (6%)* | | | | | | | |
| American Water Works | AWK | 3% | 40.29 | $22.70 | 2.78% | A-1-7 | Bbgijopsvw |
| Dominion | D | 3% | 56.25 | $56.48 | 4.00% | A-1-7 | Bbgijopsvw |
| *Telecomm. Services (3%)* | | | | | | | |
| America Movil | AMX | 3% | 21.05 | $22.98 | 1.61% | B-1-7 | BObijopsv |
| *Materials (2%)* | | | | | | | |
| Monsanto | MON | 2% | 98.71 | $86.90 | 1.52% | B-1-7 | Bbgijopsvw |
| *Cash (0%)* | | 0% | | | | | |
| | | 100% | | | 1.77% | | |

†: Yields are estimated based on historical information. There is no assurance that the yield will remain the same or increase. Yields may decrease. Yields do not reflect transaction costs/fees or taxes and may be affected by currency fluctuations.
One or more analysts responsible for selecting the securities held in the Research Portfolios own such securities: Honeywell. Source: Bloomberg, BofA Merrill Lynch Global Research

# Stock lists

## US 1 List (methodology)

Table 23: US 1 List (as of 5 July 2013)

| Ticker | Company | Rating | Date added | Price when added | Price as of 5 Jul | Footnotes |
|---|---|---|---|---|---|---|
| AGN | Allergan | B-1-7 | 05/28/13 | 99.71 | 84.35 | Bbgijopsvw |
| APC | Anadarko Petro | C-1-7 | 07/03/12 | 69.05 | 88.38 | BObijopsvw |
| CHKP | Check Point | C-1-9 | 11/12/12 | 44.59 | 51.45 | Bbijos |
| EMN | Eastman Chemical | B-1-7 | 04/15/13 | 65.59 | 72.01 | BObijopsvw |
| EQIX | Equinix | B-1-9 | 06/04/13 | 198.03 | 185.67 | Bbgijopsvw |
| ESRX | Express Scripts | B-1-9 | 09/17/12 | 62.60 | 62.95 | BObijpsvw |
| F | Ford Motor | C-1-7 | 08/28/12 | 9.34 | 16.70 | BObgijopsv |
| FDX | FedEx Corp. | B-1-7 | 02/04/13 | 103.39 | 98.96 | Bbgijopsvw |
| FOXA | 21st Century Fox | B-1-7 | 06/28/13 | 28.79 | 30.39 | Bbijopsv |
| GILD | Gilead | B-1-9 | 02/25/13 | 42.09 | 53.32 | Bbijopsvw |
| KLAC | KLA-Tencor | C-1-7 | 10/01/12 | 47.30 | 56.47 | Bbijopsvw |
| KRFT | Kraft Foods Group | B-1-7 | 10/01/12 | 44.10 | 55.24 | BObijopvw |
| MMM | 3M | B-1-7 | 02/19/13 | 104.18 | 111.54 | Bbijopsvw |
| NWL | Newell | C-1-7 | 10/15/12 | 20.21 | 26.12 | Bbijopsvw |
| OZM | Och-Ziff | C-1-7 | 08/07/12 | 8.40 | 10.66 | Bbijopvw |
| PETM | PetSmart | B-1-7 | 02/04/13 | 63.58 | 68.43 | Bbijopvw |
| PXD | Pioneer | C-1-7 | 06/18/13 | 154.65 | 152.55 | Bbgijopsv |
| QCOM | QUALCOMM | C-1-7 | 11/12/12 | 61.63 | 60.95 | Bbijopsvw |
| SIRI | Sirius XM Radio | C-1-9 | 10/15/12 | 2.80 | 3.38 | Bbgijopsv |
| SPR | Spirit AeroSys-A | C-1-9 | 04/29/13 | 20.15 | 21.91 | Bbijopsv |
| SWKS | Skyworks | C-1-9 | 11/19/12 | 20.66 | 21.85 | Bbijopsw |
| UA | Under Armour | C-1-9 | 06/25/13 | 57.50 | 61.22 | Bbijopsvw |
| URBN | Urban Outfitter | C-1-9 | 09/10/12 | 39.48 | 41.04 | Bbjp |
| VVUS | Vivus, Inc. | C-1-9 | 01/07/13 | 14.87 | 12.38 | Bbijpsw |
| WMT | Wal*Mart Stores | A-1-7 | 09/17/12 | 73.99 | 75.21 | Bbgijopsvw |

Note: We last modified this portfolio on 2 July 2013. Please see the original report for details, including price objectives and investment rationale. Please see Footnote Key at the back of this report. One or more members of the US 1 Committee (or a household member) owns stock of one or more companies on the US 1 list. Source: BofA Merrill Lynch Global Research

## Endeavor, the Small Cap US Buy List (methodology)

Table 24: Endeavor stocks (as of 5 July 2013)

| GICS sector | Company | Symbol | BofAML opinion | Price as of 5 July | Mkt value (US$ mn) | MLSCR Model scores (100=best; 1=worst) Aurora | MLSCR Model scores (100=best; 1=worst) Enhanced contrarian | Date added | Price on add date | Footnotes |
|---|---|---|---|---|---|---|---|---|---|---|
| Consumer Disc. | AMERICAN AXLE & MFG HOLDINGS | AXL | C-1-9 | 19.62 | 1,468 | 98 | 100 | 8/9/2010 | 10.37 | BObgijopsvw |
| Consumer Disc. | JACK IN THE BOX INC | JACK | C-1-9 | 40.50 | 1,790 | 91 | 88 | 7/9/2012 | 27.62 | Bbijpsvw |
| Consumer Disc. | SONIC AUTOMOTIVE INC -CL A | SAH | C-1-7 | 21.70 | 1,149 | 88 | 90 | 10/11/2011 | 13.23 | Bbgijopsvw |
| Consumer Disc. | STANDARD PACIFIC CORP | SPF | B-1-9 | 7.85 | 1,689 | 100 | 100 | 6/14/2013 | 8.96 | Bbgijopsv |
| Consumer Staples | SUSSER HOLDINGS CORP | SUSS | C-1-9 | 50.00 | 1,066 | 90 | 76 | 7/5/2011 | 16.04 | Bbijopsvw |
| Energy | ROSETTA RESOURCES INC | ROSE | C-1-9 | 44.78 | 2,370 | 71 | 84 | 6/14/2013 | 45.46 | Bbgijopsv |
| Financials | CORESITE REALTY CORP | COR | C-1-7 | 31.75 | 679 | 98 | 95 | 5/14/2012 | 24.65 | Bbgijpsvw |
| Health Care | HEALTH MANAGEMENT ASSOC | HMA | C-1-9 | 15.50 | 4,016 | 84 | 94 | 7/14/2009 | 5.00 | Bbijps |
| Health Care | PHARMERICA CORP | PMC | C-1-9 | 13.42 | 399 | 95 | 97 | 1/19/2009 | 16.21 | Bbijpvw |
| Health Care | MEDASSETS INC | MDAS | C-1-9 | 17.73 | 1,080 | 83 | 88 | 1/11/2013 | 18.60 | Bbijopsvw |
| Health Care | WELLCARE HEALTH PLANS INC | WCG | C-1-9 | 56.86 | 2,470 | 36 | 66 | 3/9/2012 | 67.81 | Bbijpvw |
| Industrials | TAL INTERNATIONAL GROUP INC | TAL | B-1-7 | 42.07 | 1,424 | 65 | 84 | 9/19/2011 | 27.84 | Bbgijopsvw |
| Industrials | ALASKA AIR GROUP INC | ALK | C-1-9 | 52.28 | 3,685 | 73 | 91 | 10/11/2011 | 30.89 | Bbijopsv |
| Industrials | TRIUMPH GROUP INC | TGI | C-1-7 | 80.90 | 4,055 | 97 | 97 | 10/16/2007 | 40.08 | Bbijops |
| Information Tech | FEI CO | FEIC | C-1-7 | 73.54 | 2,841 | 63 | 55 | 5/14/2012 | 45.56 | Bbijopsvw |
| Information Tech | MENTOR GRAPHICS CORP | MENT | C-1-7 | 19.57 | 2,204 | 78 | 82 | 5/14/2012 | 14.05 | Bbijopsv |
| Information Tech | CADENCE DESIGN SYSTEMS INC | CDNS | C-1-9 | 15.11 | 4,276 | 81 | 95 | 7/5/2011 | 10.60 | Bbijopsvw |
| Materials | BERRY PLASTICS GROUP INC | BERY | C-1-9 | 22.80 | 2,579 | 94 | 98 | 6/14/2013 | 23.44 | Bbgijopsv |
| Materials | GRAPHIC PACKAGING HOLDING CO | GPK | C-1-9 | 8.32 | 2,891 | 94 | 89 | 5/18/2011 | 5.30 | Bbgijopsvw |
| Telecom. Services | LEAP WIRELESS INTL INC | LEAP | C-1-9 | 7.33 | 579 | 61 | 95 | 3/9/2012 | 10.00 | BObijpsvw |

Please see Footnote Key at the back of this report. Source: BofA Merrill Lynch Small Cap Research

## US High Quality & Dividend Yield Screen (methodology)

Table 25: High Quality and Dividend Yield Screen (July 2013)

| Date Added | Ticker | Name | Sector | ROE (%) | Debt/ equity | Yield (%) | Quality | Market val ($ mn) | Cost Price | Price (US$) | QRQ | FCF/ DIV | Footnotes |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 4/1/2012 | ADP | ADP | Information Technology | 21.4 | 0.0 | 2.4 | A | 33,412 | 55.19 | 68.86 | B-1-7 | 2.1 | Bbijopsvw |
| 11/1/2011 | BAX | Baxter | Health Care | 33.5 | 0.8 | 2.4 | A+ | 37,541 | 54.98 | 69.27 | B-1-7 | 1.9 | Bbgijopsvw |
| 1/2/2013 | EMR | Emerson | Industrials | 19.6 | 0.5 | 3.0 | A+ | 39,207 | 54.86 | 54.54 | B-2-7 | 1.9 | Bbgijopsvw |
| 7/1/2013 | GPC | Genuine Parts | Consumer Discretionary | 21.7 | 0.3 | 2.6 | A | 12,098 | | 78.07 | A-2-7 | 2.1 | Bbijopsvw |
| 3/1/2013 | JNJ | Johnson & Johnson | Health Care | 16.3 | 0.2 | 2.8 | A+ | 241,171 | 76.70 | 85.86 | A-2-7 | 1.7 | Bbijopsvw |
| 6/3/2013 | KO | Coca Cola | Consumer Staples | 26.7 | 1.1 | 2.6 | A+ | 178,640 | 41.42 | 40.11 | A-1-7 | 1.7 | BObijopsv |
| 10/1/2012 | LLTC | Linear Technology | Information Technology | 50.1 | 0.9 | 2.7 | A- | 8,593 | 31.82 | 36.84 | B-1-7 | 1.9 | Bbijopsw |
| 2/2/2009 | MCD | McDonald's Corp | Consumer Discretionary | 36.6 | 0.8 | 3.0 | A | 99,252 | 58.02 | 99.00 | B-1-7 | 1.3 | Bbgijopsvw |
| 5/3/2010 | MDT | Medtronic | Health Care | 19.4 | 0.6 | 2.0 | A | 52,055 | 43.69 | 51.47 | A-1-7 | 3.6 | Bbgijopsvw |
| 10/1/2012 | MMM | 3M | Industrials | 26.0 | 0.3 | 2.2 | A+ | 75,473 | 92.42 | 109.35 | B-1-7 | 2.5 | Bbijopsvw |
| 8/1/2011 | MSFT | Microsoft Corp | Information Technology | 22.6 | 0.2 | 2.5 | A- | 288,364 | 27.40 | 34.545 | B-2-7 | 2.3 | Bbgijopsvw |
| 2/1/2013 | PG | Procter & Gamble | Consumer Staples | 17.5 | 0.5 | 2.9 | A+ | 211,012 | 75.92 | 76.99 | A-1-7 | 2.0 | Bbgijopsvw |
| 4/1/2012 | PAYX | Paychex | Information Technology | 33.7 | 0.0 | 3.6 | A | 13,290 | 30.99 | 36.51 | A-2-7 | 1.3 | Bbijopvw |
| 6/3/2013 | TGT | Target Corp. | Consumer Discretionary | 17.3 | 0.9 | 2.1 | A+ | 44,188 | 71.51 | 68.86 | B-2-7 | 1.7 | Bbijopsvw |
| 2/1/2013 | UTX | United Tech | Industrials | 20.2 | 0.9 | 2.2 | A+ | 85,440 | 89.84 | 92.94 | B-1-7 | 3.3 | BObijopsvw |
| 12/3/2012 | WMT | Wal-Mart Stores | Consumer Staples | 24.5 | 0.8 | 2.2 | A+ | 244,080 | 72.02 | 74.49 | A-1-7 | 2.2 | Bbgijopsv |
| 2/1/2012 | XOM | ExxonMobil | Energy | 27.7 | 0.1 | 2.5 | A+ | 401,730 | 83.74 | 90.35 | A-1-7 | 2.6 | Bbijopsvw |
| | | | Average | 25.6 | 0.5 | 2.6 | | 121,502.7 | | | | 2.1 | |
| | | | S&P 500 benchmarks: | 14.4 | 1.1 | 2.0 | | | | | | | |

Note: All data as published on 7/1/2013. Calculations are based on data from the last 12 months. Financials stocks are excluded because they typically have very high Debt/Equity ratios that have nothing to do with their capital structure. We calculate the benchmark S&P 500 ROE by taking the average of the aggregate ROE (S&P 500 EPS ÷ by book value per share) and the median ROE. Disclaimer: These stocks have been selected according to the specified screening criteria and do not constitute a recommended list. Investors looking for a high quality dividend yield oriented investment can consider this analysis as one part of their decision making process, but should also consider other factors including fundamental opinions, financial risk, investment risk, management strategies and operating and financial outlooks. Source: BofA Merrill Lynch Global Research, BofA Merrill Lynch US Quantitative Strategy, FactSet, S&P

## International Low Volatility & Dividend Yield Screen (methodology)

Table 26: International Low Volatility & Dividend Yield Screen (July 2013)

| Ticker | Company | Country | Sector | Market value | Price | LT debt / equity | Gross Div. yield[1] | 5yr annualized div. growth | QRQ | Footnote |
|---|---|---|---|---|---|---|---|---|---|---|
| ABB | ABB | Switzerland | Industrials | 50,045 | 21.62 | 43.2 | 3.4 | 9.4 | B-1-7 | Bbijopsv |
| AEM | Agnico Eagle Mines Ltd. | Canada | Materials | 4,605 | 26.64 | 24.3 | 3.1 | 36.1 | B-1-7 | Bbijopsv |
| BHP | BHP Billiton Ltd-Spon ADR | Australia | Materials | 142,797 | 56.32 | 37.0 | 4.0 | 15.3 | A-1-7 | Bbijopsv |
| CM | Canadian Imperial Bank of Commerce | Canada | Financials | 28,088 | 70.23 | 38.2 | 5.2 | 1.6 | B-2-7 | Bbgijopsv |
| CAJ | Canon | Japan | Info Tech | 44,814 | 33.60 | 0.1 | 4.5 | 11.8 | A-1-7 | Bbijopsv |
| NVS | Novartis | Switzerland | Health Care | 191,382 | 70.72 | 19.9 | 3.4 | 9.6 | A-2-7 | Bbijopsv |
| NTT | NTT | Japan | Telecom | 69,706 | 26.34 | 30.8 | 3.2 | 16.8 | A-1-7 | BObgijopsv |
| DCM | NTT DoCoMo | Japan | Telecom | 67,352 | 15.43 | 6.3 | 4.1 | 9.0 | A-2-7 | Bbijopsv |
| PSO | Pearson | United Kingdom | Consumer Disc. | 14,903 | 18.23 | 35.2 | 5.1 | 2.6 | A-2-7 | Bbijopsv |
| RIO | Rio Tinto | United Kingdom | Materials | 76,875 | 39.90 | 42.4 | 4.6 | 4.0 | B-1-7 | BObijopsv |
| RY | Royal Bank of Canada | Canada | Financials | 83,227 | 57.61 | 18.5 | 4.1 | 4.1 | B-1-7 | Bbgijopsv |
| SNY | Sanofi | France | Health Care | 135,978 | 51.07 | 18.7 | 3.5 | 2.0 | A-1-7 | Bbgijopsv |
| BNS | Scotiabank | Canada | Financials | 62,915 | 52.50 | 27.8 | 4.3 | 4.3 | B-1-7 | BObgijopsv |
| SI | Siemens AG | Germany | Industrials | 88,303 | 100.23 | 53.9 | 3.9 | 11.2 | A-1-7 | Bbijopsv |
| SLF | Sun Life Financial Inc. | Canada | Financials | 18,067 | 29.94 | 29.2 | 4.6 | 0.5 | B-2-7 | Bbijopsv |
| TU | TELUS Corporation | Canada | Telecom | 19,475 | 29.79 | 74.3 | 4.5 | 8.5 | B-1-7 | Bbijov |
| TD | The Toronto-Dominion Bank | Canada | Financials | 73,247 | 79.27 | 27.6 | 3.8 | 6.3 | B-1-7 | BObijopsv |
| TRI | Thomson Reuters | Canada | Consumer Disc. | 27,019 | 32.58 | 35.6 | 4.0 | 3.7 | B-1-7 | Bbgijopsv |
| VOD | Vodafone Group Plc | United Kingdom | Telecom | 139,220 | 28.78 | 40.3 | 7.3 | 1.0 | A-1-7 | Bbijopsv |

This is a screen and not a recommended list either individually or as a group of stocks. Investors should consider the fundamentals of the companies and their own individual circumstances / objectives before making any investment decisions.
[1]Investors should be aware that foreign governments sometimes withhold a percentage of dividends paid to US shareholders, which may adversely impact an investor who is following the list and may affect the yield received when compared to the stated yield for a security. Source: BofA Merrill Lynch Global Research

Note: Please be aware that links on this page are directed to lists that are updated as of the date of this publication. There may have been updates to one or more lists. Financial Advisors should check for the latest available constituents.

# Research portfolios and stock lists

## Stock lists

Regional Focus or 1 Lists are best investment ideas chosen from among our Buy-rated stocks.

US
Japan
Europe
Asia-Pacific

**Technical Titans List**

Designed to identify common stocks that are attractive based on technical analysis, the objective of this list is to capture short to intermediate-term (3-6 month) price appreciation, but positions can be held longer term.

**Growth 10 / Value 10**

Consist of 10 stocks each, chosen by the highest five-year EPS growth rate (Growth 10) or lowest trailing 12-month P/E ratio (Value 10) after quantitative screening criteria.

## Stock portfolios

### US Large Cap Equity

Five portfolios offerings are available to match each of the client profiles of Capital Preservation, Income, Income & Growth, Growth and Aggressive Growth. These match the risk profiles of conservative, moderately conservative, moderate, moderately aggressive and aggressive, respectively. A sixth portfolio called the Core Portfolio is designed to reflect weighting decisions of our US equity strategy team. Each of these portfolios employs a combination of top-down sector weightings and bottom-up stock selection focusing on the 10 GICS sectors.

Holdings
Primer

### US Mid-Cap Equity

Launched in April 2010, this portfolio invests in stocks between $2-12 billion that are selected using a combination of fundamental, quantitative and portfolio management tools, and is built on the GICS sector framework.

Holdings
Primer

### International Equity

This portfolio consists of ADRs and US-listed shares of non-US companies representing all major regions outside the US: Europe/Middle East/Africa, Asia, Latin America and Canada, and is built on the GICS sector framework.

Holdings
Primer

# Global economic, interest rate, FX forecast summaries

Table 27: Global economic forecasts (as of 5 July 2013)

| | GDP growth, % | | | | CPI inflation*, % | | | | ST interest rates**, % | | | | Exchange rate*** | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2011 | 2012 | 2013F | 2014F | 2011 | 2012 | 2013F | 2014F | Current | 2012 | 2013F | 2014F | CCY pair | Spot rate | 2011 | 2012 | 2013F |
| Global and Regional Aggregates | | | | | | | | | | | | | | | | | |
| Global | 3.8 | 3.1 | 3.0 | 3.7 | 4.3 | 3.1 | 2.9 | 3.3 | 2.41 | 2.56 | 2.50 | 2.69 | | | | | |
| Global ex US | 4.4 | 3.3 | 3.3 | 4.0 | 4.6 | 3.4 | 3.2 | 3.7 | 3.06 | 3.19 | 3.11 | 3.34 | | | | | |
| Developed Markets | 1.4 | 1.2 | 1.0 | 1.9 | 2.6 | 1.9 | 1.4 | 1.7 | 0.37 | 0.46 | 0.36 | 0.38 | | | | | |
| G5 | 1.4 | 1.1 | 0.9 | 1.8 | 2.7 | 2.0 | 1.4 | 1.7 | 0.29 | 0.38 | 0.30 | 0.32 | | | | | |
| Emerging Markets | 6.3 | 4.9 | 4.8 | 5.4 | 6.0 | 4.3 | 4.3 | 4.7 | 4.69 | 4.59 | 4.50 | 4.77 | | | | | |
| Europe, Middle East and Africa (EMEA) | 2.4 | 0.6 | 0.5 | 1.5 | 4.0 | 3.3 | 2.6 | 2.6 | 2.15 | 2.40 | 2.08 | 2.18 | | | | | |
| European Union | 1.6 | -0.3 | -0.2 | 0.9 | 2.9 | 2.6 | 1.6 | 1.5 | 0.64 | 0.90 | 0.56 | 0.59 | | | | | |
| Emerging EMEA | 5.0 | 2.9 | 2.3 | 3.1 | 5.9 | 4.7 | 4.5 | 4.6 | 5.81 | 5.94 | 5.28 | 5.42 | | | | | |
| PacRim | 5.8 | 5.4 | 5.5 | 5.8 | 4.7 | 3.0 | 2.9 | 3.8 | 3.13 | 3.28 | 3.11 | 3.35 | | | | | |
| PacRim ex Japan | 7.0 | 6.1 | 6.1 | 6.5 | 5.6 | 3.6 | 3.4 | 4.0 | 3.81 | 3.89 | 3.67 | 3.92 | | | | | |
| Emerging Asia | 7.2 | 6.2 | 6.3 | 6.7 | 5.7 | 3.7 | 3.4 | 4.1 | 3.86 | 3.90 | 3.71 | 3.97 | | | | | |
| Americas | 2.6 | 2.4 | 1.9 | 2.9 | 4.2 | 3.2 | 3.1 | 3.2 | 2.03 | 2.00 | 2.28 | 2.49 | | | | | |
| Latin America | 4.5 | 2.9 | 2.7 | 3.6 | 6.9 | 6.1 | 7.2 | 7.2 | 7.31 | 6.78 | 7.72 | 8.36 | | | | | |
| G5 | | | | | | | | | | | | | | | | | |
| US | 1.8 | 2.2 | 1.7 | 2.7 | 3.2 | 2.1 | 1.6 | 1.7 | 0.10 | 0.13 | 0.13 | 0.13 | | | | | |
| Euro area | 1.5 | -0.5 | -0.6 | 0.5 | 2.7 | 2.5 | 1.4 | 1.3 | 0.50 | 0.75 | 0.50 | 0.50 | EUR-USD | 1.28 | 1.30 | 1.32 | 1.25 |
| Japan | -0.6 | 1.9 | 1.8 | 1.7 | -0.3 | -0.1 | 0.1 | 2.3 | 0.10 | 0.05 | 0.05 | 0.05 | USD-JPY | 101 | 77 | 87 | 105 |
| UK | 1.0 | 0.3 | 1.1 | 2.1 | 4.5 | 2.8 | 2.7 | 2.3 | 0.50 | 0.50 | 0.50 | 0.75 | EUR-GBP | 0.86 | 0.83 | 0.81 | 0.83 |
| Canada | 2.5 | 1.7 | 1.5 | 2.1 | 2.9 | 1.5 | 0.8 | 1.3 | 1.00 | 1.00 | 1.00 | 1.25 | USD-CAD | 1.06 | 1.02 | 0.99 | 1.04 |

Notes: Global and regional aggregates are based on the IMF PPP weights unless stated otherwise. Countries within each region are ordered according to these weights.

* Annual averages. The HICP measure of inflation is used for Euro area economies. ** Central bank target rate, year-end, where available, short-term rates elsewhere.

Note: US short-term rate forecast for 2012 year-end is 0-0.25%. Midpoint used in table above for global and regional aggregation purposes.

Source: BofA Merrill Lynch Global Research

## Methodology: US 1 List

The US 1 List represents a collection of our best investment ideas that are drawn primarily from US fundamental equity research analysts' "Buy" recommendations. To be included in the list, stocks must be listed in the US and must have an average daily trading volume of at least $5mn in the six months preceding their selection for the list. Once selected, a stock will remain on the list for 12 months unless the US 1 Committee removes the stock in connection with a downgrade or otherwise. At the end of the 12-month period, the Committee may extend a company's inclusion on the list for another 12 months if it continues to meet the US 1 criteria.

The list will generally consist of between 20 and 30 equally weighted stocks, but not fewer than 15 stocks. It will be rebalanced to achieve equal weighting in connection with the addition and deletion of any stock. Sector weighting in the selection process is considered. However, the US 1 list is not required to reflect the weights of the S&P 500 or any other index.

A US 1 Index will be established to track the performance of the list. The Index will be calculated on both a price-return (without the reinvestment of dividends) and a total-return basis and will be available on Bloomberg at (MLUS1PR <Index>) and (MLUS1TR <Index>), respectively.

## Methodology: Endeavor List

Endeavor is a concentrated list of approximately 15 to 20 smaller cap stocks that represents the strategic views of BofA Merrill Lynch Small Cap Research. The Endeavor list includes those smaller cap stocks that are most compelling using a multi-disciplinary process. Candidates for the Endeavor buy list carry a favorable view by a BofA Merrill Lynch Fundamental Analyst and are attractively ranked by our Aurora (growth) or Enhanced Contrarian (value) quantitative models.

## Methodology: US High Quality & Dividend Yield Screen

We list a screen of preferred securities that meet specified selection criteria and have relatively high yields for their credit rating and industry sector. The US High Quality & Dividend Yield Screen is not a recommended list.

### Screening criteria

We combined our two secular themes through the following criteria. In our view, these screening factors were likely to uncover higher-quality companies that offered relatively secure dividend yield. The stocks are selected from the S&P 500.

- S&P Common Stock Rank of A+, A, or A-. The S&P Common Stock Rankings are our main measure of quality. These rankings are based primarily on the growth and stability of earnings and dividends over a 10-year period.
- Return on Equity (ROE) greater than the average S&P 500 ROE.
- Debt/Equity lower than the S&P 500.
- Dividend yield greater than the S&P 500.
- BofA Merrill Lynch Research Investment Opinion indicates Buy or Neutral as well as the likelihood that the dividend will remain the same or be increased (ie, a dividend rating of "7").
- The ratio of the last 12 months' free cash flow to dividends must be greater than 1.0.

## Methodology: International Low Volatility & Dividend Yield Screen

We list a screen of preferred securities that meet specified selection criteria and have high yields relative to their index. The International Low Volatility & Dividend Yield Screen is not a recommended list.

This monthly screen selects low volatility and high dividend yield stocks from the universe of non-US stocks that have ordinary shares or ADRs that trade on the NYSE or NASDAQ, are covered by BofA Merrill Lynch Global Research, and are constituent members of the MSCI AC World ex-USA Index. The screen uses the following criteria to uncover low volatility companies that offer relatively secure dividend yield.

- BofAML Investment Rating indicates Buy or Neutral.
- BofAML Volatility Risk Rating is A-low or B-medium.
- BofAML Income Rating is 7, which indicates the dividend is expected to remain the same or be increased.
- The dividend yield is greater than the MSCI AC World ex-USA index.
- The debt/equity ratio is less than the MSCI AC World ex-USA index.
- The 5-year annualized dividend growth rate is >0%.

## Footnote key

/#/ One or more analysts responsible for covering the securities in this report owns such securities.
/b/ MLPF&S or one of its affiliates acts as a market maker for the equity securities recommended in the report.
/g/ MLPF&S or an affiliate was a manager of a public offering of securities of this company within the last 12 months.
/i/ The company is or was, within the last 12 months, an investment banking client of MLPF&S and/or one or more of its affiliates.
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# Link to Definitions

## Consumer & Retail

Click here for definitions of commonly used terms.

## Macro

Click here for definitions of commonly used terms.

# Important Disclosures

Investment Rating Distribution: Consumer Products Group (as of 30 Jun 2013)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|---|---|---|---|---|---|
| Buy | 28 | 49.12% | Buy | 27 | 96.43% |
| Neutral | 14 | 24.56% | Neutral | 11 | 78.57% |
| Sell | 15 | 26.32% | Sell | 11 | 73.33% |

Investment Rating Distribution: Textiles/Apparel Group (as of 30 Jun 2013)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|---|---|---|---|---|---|
| Buy | 14 | 56.00% | Buy | 11 | 78.57% |
| Neutral | 4 | 16.00% | Neutral | 4 | 100.00% |
| Sell | 7 | 28.00% | Sell | 5 | 71.43% |

Investment Rating Distribution: Global Group (as of 30 Jun 2013)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|---|---|---|---|---|---|
| Buy | 1679 | 49.21% | Buy | 1259 | 74.99% |
| Neutral | 832 | 24.38% | Neutral | 616 | 74.04% |
| Sell | 901 | 26.41% | Sell | 591 | 65.59% |

* Companies that were investment banking clients of BofA Merrill Lynch or one of its affiliates within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster* |
|---|---|---|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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