The Weekly Letter

Chief Investment Office • NOVEMBER 24, 2015

- **Thematics Matter:** In recent years, the market has been driven by strong macro factors such as low interest rates and easy monetary policy, with most risk assets moving higher. Going forward, we expect equities to provide moderate returns and experience higher volatility. We therefore emphasize the importance of being selective within different asset classes and looking for specific long-term thematic opportunities. We advise investors to apply core and satellite exposures to diversify across investment themes.
- **Markets in Review:** Equities rose for the week, with the S&P 500 up 3.3% and international developed markets, as represented by the MSCI EAFE Index, up 2.5%. Bonds were roughly flat on the week, with the 10-year Treasury yield at 2.26% compared 2.27% in the prior week. Commodities ended the week down 1.2%, as WTI crude oil fell 0.9% to $40.39 per barrel and gold fell 0.5% to $1,078 per ounce.
- **Looking Ahead:** In the U.S., third-quarter GDP is expected to be revised up, and the University of Michigan Sentiment index is expected to increase. In the eurozone, the M3 money supply is expected to be up for October.

Thematics Matter

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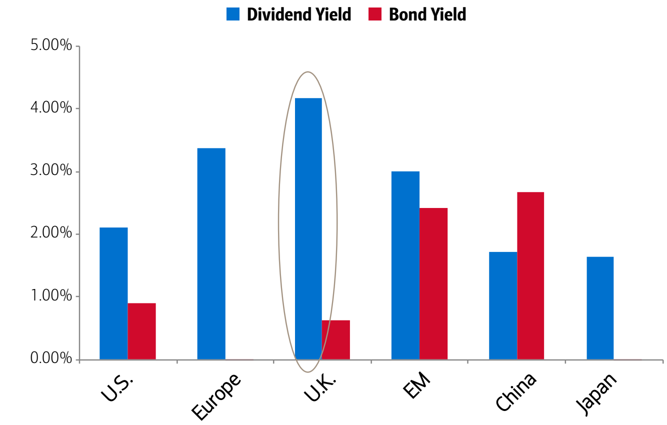
Have it your way—investor preferences that are driving market opportunities

Driven by a lower tolerance for risk in the aftermath of the global financial crisis, an aging population, and a "lower for longer" interest rate environment, investors have had an insatiable appetite for income in recent years. We think this appetite for income is unlikely to abate and is already manifesting itself in the markets. For example, many European government bonds are offering negative returns.

For investors with income needs, we think equities with high dividend yields can be part of the solution. High-quality European equities, for example, remain an attractive source of diversified income, with the broad index dividend yield currently at 3.2%, versus 2.1% for the S&P 500 (see Exhibit 1). Within European equities, there are select opportunities with even higher dividends such as the United Kingdom (4.2%), which is a developed economy that also has an independent central bank and a relatively stable currency compared to the rest of Europe.

Exhibit 1: Selectivity among European equities can offer additional diversified sources of income compared to US equities and global fixed income



Source: Bloomberg, MLWM Investment Management & Guidance. Dividend Yield is trailing 12 month dividend yield and bond yield is the current yield to maturity on 2-year government bonds. Data as of November 19, 2015.

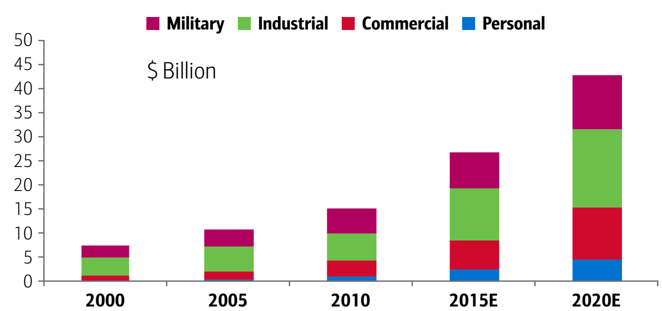
Furthermore, investors hunting for yield in a specific sector may want to look at opportunities in global Telecom. The sector is yielding 3.5% globally and 5.2% in the U.S., while valuation looks attractive compared to the S&P 500.

Another key investor preference is the adoption of social impact investing, particularly among millennial investors. According to a U.S. Trust survey, millennials view their investment decisions as a way to express their social, political or environmental values. Over 70% of those surveyed preferred to invest in companies that have a positive social or environmental impact and indicated that it was possible to achieve a market rate of return in social investments.

Rise of the machines—the “tech economy” is leading new sources of growth through robotics

The integration of robotics and automated “smart” solutions continues to have a strong impact on several industries. According to a recent BofA Merrill Lynch (BofAML) Global Research report, the robot technology market is expected to grow 9-11% by 2020, with global spending on robotics reaching $43 billion by then (see Exhibit 2). This growth hits many segments of the market, but two key sectors where this disruptive technology has immediate applications are Health Care and Defense.

Exhibit 2: Opportunities to implement the robotics trend exist across several segments of global economy



Source: BofA Merrill Lynch Global Research, MLWM Management & Guidance.

According to the same BofAML Global Research report, the global market for medical robotics and equipment is expected to grow to $18 billion by 2022. Key drivers include growing demand for health care IT and robotic surgeries, and the introduction of advanced treatment technologies. Additionally, the global market for telemedicine—the delivery of health-related services via information and communications technology—is expected to reach more than $34 billion by 2020, with growth stemming from global aging trends and increasing per capita health care expenditures in North America and Emerging Markets.

The Defense sector globally has been increasing its adoption of robotics and unmanned vehicles in recent decades, and it is expected to continue to do so (see Exhibit 2). This is driven by the advantages they bring in terms of safety, accuracy, speed, flexibility and cost. Global spending on broader military robots and their systems is expected to reach $7.5 billion by 2018. Similar to overall defense spending, the U.S. is the leader in global defense robotics, while strong growth is expected to come from Japan, South Korea, China, and India.

Gray matters — aging demographics are stimulating demand in key areas of the economy

Established companies and startups alike are offering a variety of products and services to capitalize on the increased spending of an aging population. This could spell opportunities for investors in a variety of sectors, particularly travel, leisure, hotels and restaurants, as baby boomers gear up for retirement.

Additionally, as would be expected from an aging population, consumer expenditures will shift toward increased consumption of health care products and services. We expect these expenditures to also flow through to retail drugstores and pharmacies as these businesses try to transform themselves into one-stop health care shops focused on overall wellness.

The demand for incremental health care services means many seniors consider assisted living arrangements either in their existing (or downsized) homes or, increasingly, in newly built facilities. The aging population is also reshaping the assisted living industry through such setups as home-based assisted living.

Beyond 2015, this longevity trend will influence the housing market as well. According to BofAML Global Research strategist Sarbjit Nahal, 83% of seniors in the U.S. say they want to stay in their homes as they grow older. Spending more years in their homes should translate into more years spending on their homes. Their share of home renovation spending, already accounting for 50% of total home improvement spending, stands to grow larger as this demographic increases.

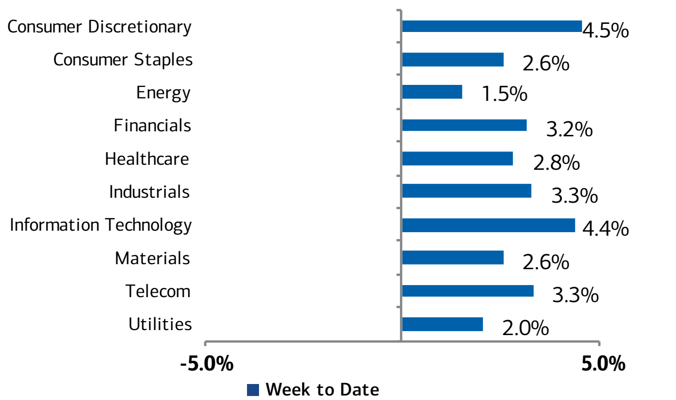
Portfolio Strategy: Among the multitude of investable themes in today’s market, we highlight several based on investor preferences—markets, innovation and people. In times of market uncertainties, we welcome positioning for longer-term investment themes such as longevity, the internet of things, cybersecurity, robotics and water management—to name a few. Within equities, we reiterate our preference for U.S. stocks and currency-hedged positions in Europe and Japan.

Markets in Review

Trailing Economic Releases

- U.S. CPI rose 0.2% month-over-month (MoM) for October, from a 0.2% decline in September. Excluding food and energy prices, core CPI rose 0.2%, in line with September's 0.2% gain, mainly driven by higher medical care prices. This implies an annual rate of 1.8%, slightly below the Fed's 2% target.
- U.S. industrial production fell 0.2% MoM for October, the third consecutive monthly decline. Manufacturing production was a bright spot, with a 0.4% MoM increase. The largest drags were in utilities and mining, which dropped 2.5% and 1.5% MoM, respectively.
- The Bank of Japan kept its policy to increase the monetary base by 80 trillion yen annually unchanged.

S&P 500 Sector Returns (as of last Friday's market close)



Equities

		Total Return in USD (%)		
	Level	WTD	MTD	YTD
DJIA	17,245.2	3.5	1.2	2.3
Nasdaq	4,927.9	3.6	1.2	8.9
S&P 500	2,023.0	3.3	0.7	3.4
S&P 400 Mid Cap	1,406.1	2.9	0.3	1.0
Russell 2000	1,146.5	2.5	1.2	-1.3
MSCI World	1,654.3	3.0	0.0	1.4
MSCI EAFE	1,712.2	2.5	-0.8	1.3
MSCI Emerging Mkts	821.1	2.7	-0.5	-9.9

Fixed Income

		Total Return in USD (%)		
	Yield (%)	WTD	MTD	YTD
ML U.S. Broad Market	2.41	0.2	-0.5	0.7
U.S. 10-Year Treasury	2.28	0.2	-1.0	0.7
ML Muni Master	2.36	0.5	0.2	2.5
ML U.S. Corp Master	3.51	0.2	-0.5	0.0
ML High Yield	8.04	-0.5	-2.3	-2.1

Commodities & Currencies

		Total Return in USD (%)		
	Level	WTD	MTD	YTD
Bloomberg Commodity	164.0	-1.2	-6.9	-21.9
Gold Spot[1]	1,077.9	-0.6	-5.6	-9.0
WTI Crude $/Barrel[1]	40.4	-0.9	-13.3	-24.2

Level	Current	Prior Week End	Prior Month End	2014 Year End
EUR/USD	1.06	-1.18	-3.27	-12.00
USD/JPY	122.8	0.2	1.8	2.5

Source: Bloomberg. [1]Spot Price Returns. **All data as of last Friday's close. Past performance is no guarantee of future results.**

Looking Ahead

In the U.S., third-quarter GDP is expected to be revised up, and the University of Michigan Sentiment index is expected to increase. In the eurozone, the M3 money supply is expected to be up for October.

Upcoming Economic Releases

- On Tuesday, third-quarter GDP is expected to be revised up to a seasonally adjusted 2.1% QoQ, from the preliminary estimate of 1.5%. Inventories are expected to be the primary driver, as stronger-than-anticipated September data revealed less inventory drawdown than initially assumed.
- On Wednesday, the University of Michigan Sentiment index is expected to increase to 93.6 in the final report for November from 93.1 in the preliminary report. The strong October employment report is likely to boost consumer confidence.
- On Thursday, the eurozone M3 money supply is expected to be up 4.9% YoY for October—in line with the prior month.

BofA Merrill Lynch Global Research Key Year-End Forecasts

S&P Outlook	2015 E
S&P 500 Target	2,000
EPS	$117.50
Real Gross Domestic Product	**2015 E**
Global	3.1%
U.S.	2.5%
Euro-Area	1.7%
Emerging Markets	4.0%
U.S. Interest Rates	**2015 E**
Fed Funds	0.25-0.50%
10-Year T-Note	2.35%
Commodities	**2015 E**
Gold	1,122
WTI Crude Oil	$50.00

All data as of last Friday's close.

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