

Capital Market Outlook

FOR CLIENTS OF INSTITUTIONAL INVESTMENTS AND PHILANTHROPIC SOLUTIONS

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Week of April 30, 2012

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In Brief

Better-than-expected earnings results have caused us to raise our profits outlook.

- **Improving economic fundamentals suggest that profits will continue to surprise to the upside.** Margins have room to expand further. This makes equities look increasingly undervalued
- **A tale of two Chinas.** After nearly two weeks of travel in China speaking with local firms and U.S.-based foreign affiliates, in addition to various professors and university students, we find that the general consensus on the Middle Kingdom is the following: near-term fears of an economic hard landing in China are overblown. However, there are mounting concerns at the micro level and rising worries over how (if) China will transition from a middle-income country to a high-income country. In contrast to near-term optimism, the Middle Kingdom's medium-term picture is less clear.

Economic Outlook

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Profits outlook moving higher

The surge in corporate sector profitability has been a surprising and often baffling development over the past two years given the pervasive gloominess surrounding world economic growth prospects. Heightened uncertainty about U.S. growth and the specter of worsening Eurozone financial conditions last summer

caused analysts and business leaders to rapidly lose faith in the outlook for profits, as reflected in the sharp drop in measures of CEO confidence, a large decline in the earnings revisions ratio, weakening earnings guidance, and a decline in earnings estimates.

With aggressive European Central Bank (ECB) liquidity injections eventually containing the Eurozone financial

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crisis and solid U.S. growth underpinnings becoming more evident, much-too-gloomy expectations started to reverse. The Conference Board CEO confidence index rebounded sharply by early 2012, and earnings revisions and guidance for 2012 profits started to improve rapidly in recent weeks.

First-quarter profit announcements and guidance are confirming the improved outlook for growth. Company reports have exceeded expectations, with about 70% of the roughly 60% of the S&P 500 companies that have reported so far beating estimates. Across the board, upside profit surprises have been mainly due to higher-than-expected profit margins, with profits beating expectations by more than sales. Also, outsized beats have been mainly reported in cyclical sectors and more domestically oriented stocks, which is not surprising given the high relative level of positive economic data surprises in the U.S. in the first quarter (in part caused by abnormally mild winter weather). Importantly, the financial sector has also reported encouraging results so far, reflecting a rise in loan volumes, a decline in loan losses, and a turnaround in corporate transaction activity. In fact, according to UBS analysts, financial sector credit valuation adjustments are obfuscating an even more pronounced performance improvement in the first quarter.

As a result of the strong start to the earnings reporting season, analysts have boosted their 2012 first-quarter and annual estimates for all sectors except utilities during the past month. The consensus for S&P500 operating earnings per share is \$97 for this quarter (+8% year over year) and \$106 for 2012 (+10% year over year). For 2013, estimates are for another gain of about 13% to \$119 per share.

With profits already at record levels in 2011 (\$96 per share), critical questions about how long this profits bonanza will last and what that implies for equity prices abound. Such questions are always difficult to answer. Sometimes, however, they are more difficult than others. Indeed, margins are very high, profits are at record levels, unit labor costs have started to increase during the past year, and uncertainty clouds loom over the Eurozone, China and the U.S. That said, our analysis suggests that equities are pricing in much weaker profit levels, so even if profits start to decline some or consolidate at current levels for a couple of years, equities would still be a good value for investors with a longer time horizon. What's more, for a number of reasons, we believe that profits could continue to surprise to the upside for a while longer. These include:

1. Assuming a sensible solution to the fiscal "time bomb" set to explode on January 1, 2013, the U.S. economy should continue to expand by 2% to 3% this year and

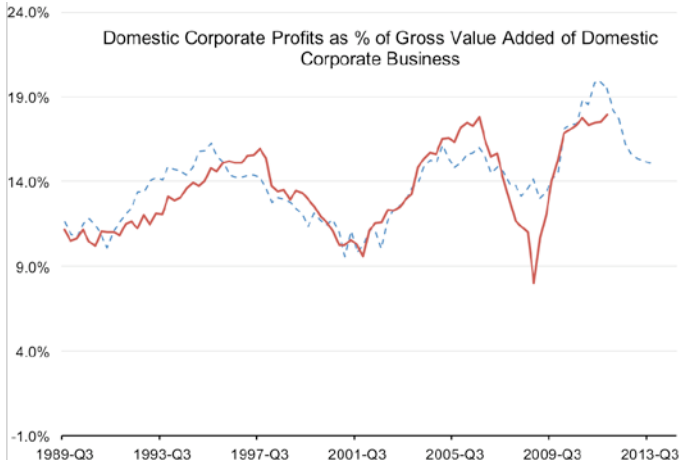
next, led by the private sector. Growth should accelerate next year as the state and local government sector levels off and housing increasingly contributes to growth. Corporate sector output tends to outpace gross domestic product (GDP) growth in expansions and should thus continue to advance at about 5% to 6% in nominal terms in 2012 and 2013.

2. Leading indicators point to sustained economic expansion and more profits growth. The shift in the mix of growth, from business investment to more housing investment, for example, would prolong the expansion and keep profits growing.
3. Even if economic growth continues, profits could decline if expenses grow faster than revenues. However, profit margins are likely to keep surprising to the upside. As shown in Exhibit 1, based on our models, margins overshot to the downside during the recession and are poised to overshoot on the upside in coming quarters.
 - **First**, the U.S. expansion is driven by not only pent-up demand for consumer and business durable goods, but also by extremely stimulative monetary policy. Real interest rates are deeply negative, which tends to be positive for corporate profit margins, as shown in Exhibit 2. In fact, as the chart suggests, the inverse relationship between real interest rates and profit margins is not only cyclical. Declining real federal fund rates have driven the uptrend in profit margins since the early 1980s. Also related, the surge in money supply growth since late 2010 suggests an acceleration in profits growth if their past correlation is any indication. So does the still-steep yield curve. On this basis, higher margins would not be surprising.
 - **Second**, in a low inflation environment, companies are forced to become more efficient in the allocation of their capital because pricing power is generally weaker. More efficiency implies more profitability. At the same time, and reinforcing the relationship between low inflation and high profitability, there is less noise in the price signal, which allows a more efficient allocation of capital. So companies have to and can allocate their resources much more efficiently than in a high and rising inflation environment such as in the 1970s. This implies less waste, less inefficiencies and more profitability. While profit margins will eventually revert to a mean, that mean is likely to be higher in this environment, similar to the low-inflation period of the 1950s and 1960s.
 - **Third**, capital deepening has increased substantially over time, allowing labor expense to shrink as a share of revenues.

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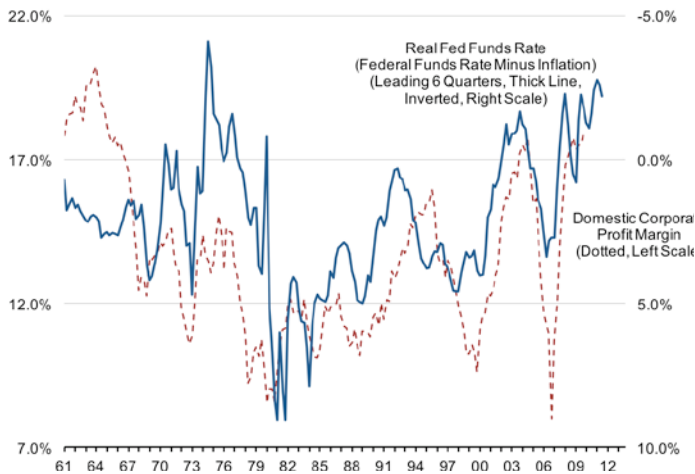
■ Fourth, companies have not been overinvesting in labor and capital since the recession ended. High levels of uncertainty about tax and regulatory policy have prompted businesses to add labor cautiously. Our work indicates that labor cost growth is likely to remain in check. Also, while business investment surged during the past year and a half, it is slowing from its double-digit year-over-year growth pace as a result of reduced pent-up demand and moderating profits growth. Based on the past relationship between investment growth and changes in depreciation expenses, the latter are unlikely to cut into profits in coming quarters. Interest payments are also unlikely to become a drag on profits anytime soon given low corporate sector borrowing growth and low interest rates.

EXHIBIT 1: PROFIT MARGINS UNDERPERFORMED DURING THE RECESSION. OVERSHOOT LIKELY THIS YEAR TO GET BACK ON TREND



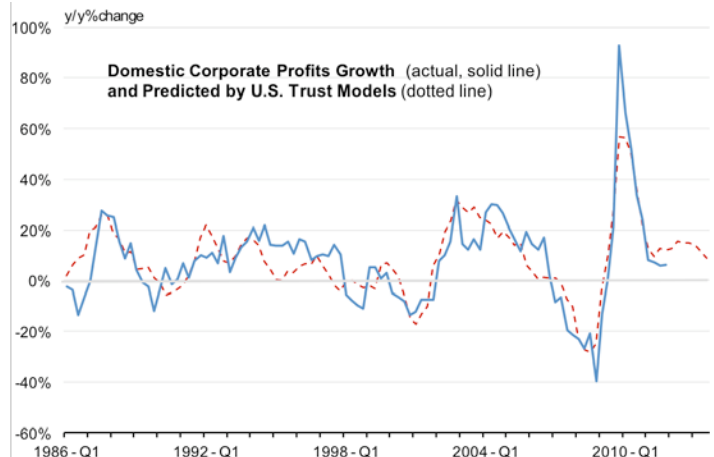
Sources: Bureau of Economic Analysis/Haver Analytics; U.S. Trust Macro Strategy Team. Dotted line represents U.S. Trust model through 2013-Q4. Data as of April 24, 2012.

EXHIBIT 2: NEGATIVE REAL INTEREST RATES LEAD PROFIT MARGINS HIGHER



Sources: Federal Reserve Board; Bureau of Economic Analysis/Haver Analytics. Data as of April 27, 2012.

EXHIBIT 3: MONEY SUPPLY GROWTH, CAUTIOUS EXPANSION OF LABOR AND CAPITAL, AND EXPANDING ECONOMIC ACTIVITY POINT TO STILL-GROWING PROFITS IN COMING QUARTERS



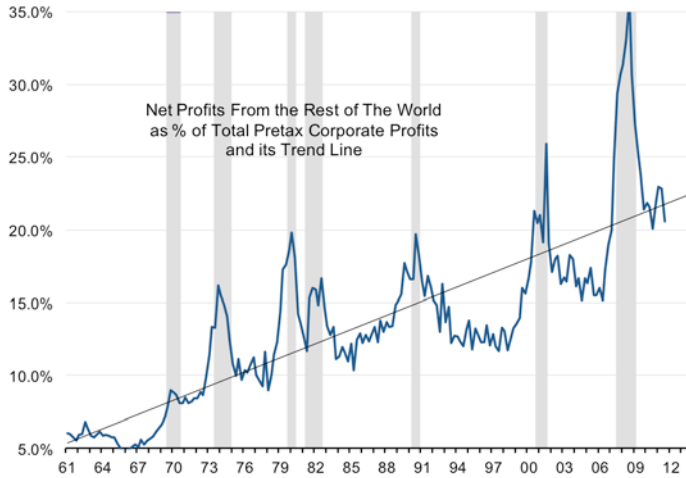
Sources: Bureau of Economic Analysis/Haver Analytics; U.S. Trust Macro Strategy Team. Forecast through late 2013. Data as of April 27, 2012.

Putting it together, domestic profits before tax as measured by gross domestic product (GDP) accounts could increase another 8% to 12% this year as economic activity expands further and margins likely reach even higher levels;

Domestic profits now represent 80% of overall profits as U.S. businesses increasingly benefit from faster profit growth overseas (the share is 60% for the S&P 500 given the high international exposure of large multinationals, with profits from the Eurozone estimated at about 20% of total profits). While we expect the foreign profit share to remain on a secular uptrend, it does tend to decline cyclically. This has also been the case during this cycle, not least due to the lag between the U.S. and foreign growth cycles and the tendency for the dollar to appreciate in times of weakening economic conditions (Exhibit 4). Foreign profits growth decelerated sharply by the end of 2011 and is likely to grow only slightly, if at all, in coming quarters because of the Western European recession and additional likely gains in the dollar. That said, a preponderance of U.S. exports go to large “core” Eurozone countries, which are less impacted by the crisis than the periphery. Also, the International Monetary Fund sees still-strong emerging market (EM) growth of around 6% ahead. Pent-up demand for consumer, industrial and high-tech products in the context of high levels of employment, strong credit growth, a mining and energy boom, and renewed policy stimulus as inflation appears to have peaked in most EMs, suggest that profits of large U.S. multinationals are likely to continue to benefit from this source of growth. This suggests that total profits could advance by 7% to 10% this year and 4% to 8% next year. Given positive first quarter earnings surprises, we

now assume operating earnings per share (EPS) of \$97 to \$101 this year but believe that the risks are to the upside given the results from our models showing about \$100 to \$105 EPS this year and about \$110 next year.

EXHIBIT 4: FOREIGN PROFIT SHARE ON A SECULAR UPTREND BUT CYCLICAL DECLINE



Sources: Federal Reserve Board; Bureau of Economic Analysis/Haver Analytics.
Data as of April 27, 2012.

The exact pace of profits growth remains to be seen. However, with equities, particularly large caps, undervalued at current profit levels and normalized profits set to continue to advance to fresh records, even if profits consolidate around current levels over the next three years, the S&P 500 index should move higher. Any further profit growth from current levels would only make equities that much more attractive over this horizon. Large cap growth stocks remain the most attractive given underpriced growth potential, strong balance sheets, and significant scope for dividend growth. Combined with their massive share of total market capitalization, the undervaluation of large cap growth stocks suggests that a large shift up in market indexes is likely as these companies become more fairly valued.

Economic Reports in Brief

Jonathan W. Kozy

Vice President and Senior Research Analyst

Highlights: The headline GDP figure masks the underlying strength in the private sector. Real final sales to private domestic purchasers (consumption plus fixed investment) grew 2.7% in the first quarter. New home sales data, pending homes sales data (for existing homes), and home price data released last week all support the case that the housing recovery is gaining momentum. The four-week moving average of initial unemployment claims, a leading indicator, moved higher for the third straight week. It is not unusual for the data to be volatile this time of year, but the weakness is worth monitoring.

Gross Domestic Product and Personal Income: Real GDP grew at a 2.2% pace (quarter/quarter, annualized) in the first quarter, but private sector spending was even better. Real final sales to private domestic purchasers (consumption plus fixed investment) grew 2.7% for the quarter even with a 0.6 pps drag from structures spending. Looking further at the details, real consumer spending on durable goods grew 15.3% for the quarter on the back of 28.8% growth in spending on motor vehicles and parts. The biggest detractor from GDP growth was federal government spending (-0.46 percentage points (pps) contribution). The federal government “consumption” model continues to shift away from goods and services consumption (which would add to GDP) toward transfer and entitlement spending. Inventories added 0.6 pps to overall growth and residential investment spending contributed 0.4 pps, with the help of warmer weather. Real business equipment and software spending growth is slowing, as we expected, but not collapsing. In our view, capital expenditures (capex) should still contribute to overall gross domestic product throughout 2012, with stronger growth expected in the second half.

Federal Reserve Data: The Chicago Fed’s National Activity Index, a weighted average of 85 indicators of national activity, fell 0.36 points to -0.29. The more reliable three-month average fell 0.32 points to 0.05 and suggests economic activity is still running above trend, albeit slightly. While the index is mostly being weighed down by depressed but improving housing data, all four components fell for the month. The “employment, unemployment, and hours” is still above trend and was the biggest contributor. On a more positive note, regional manufacturing survey data are still consistent with positive cyclical momentum but the leading components were mixed. For example, the Federal Reserve Bank

of Richmond’s manufacturing survey rose 7 pps to 14%. Shipments, new orders and employment were all higher. Looking ahead, manufacturers surveyed about their business prospects for the next six months were slightly less optimistic about new orders and capital expenditures, but were significantly more optimistic about employment. While slightly lower for the month, capex expectations still point toward at least trend-like levels of business investment spending.

Durable Goods: Durable goods orders were well below expectations in March but shipments, which are included in GDP (see above), finished the quarter strong. Orders were down 4.2% in March, well below Bloomberg consensus estimates for a 1.7% decline. There was broad-based weakness, but the decline was primarily driven by a 47.6% decline in nondefense aircraft and parts. Nondefense capital goods, excluding aircraft or “core” orders, were also down 0.8% for the month, led by declines in machinery and metals. Still, we would not write off second quarter capex just yet. We still expect a positive contribution to GDP, albeit a small one. The rebound in shipments in March was evident in the GDP report. “Core” shipments, a good proxy for current quarter equipment and software capex, rose 2.6%, mostly due to a 6.5% gain in machinery shipments. We would also note, with regard to first quarter capex, that the semiconductor book-to-bill ratio was up for the sixth straight month in March.

Housing Data: The Pending Home Sales Index, which tracks contracts that have been signed and are awaiting closing, rose 4.1% in March from an upwardly revised 97.4 in February. The increase was well above consensus forecasts for a 1.0% rise. The index is at its highest level since April 2010, when activity was boosted by the home buyer tax credit. For the month, data were strongest in the West and South regions. New homes sales continue to trend higher even as distressed properties come on the market at bargain prices. New home sales fell 25,000 in March to 328,000 units but were above consensus expectations for 319,000 units. Notably, the prior two months were revised higher by a total of 51,000 units, resulting in the fourth consecutive quarterly increase in new home sales. The number of new single-family homes for sale reached another record low at 144,000, down from a peak of 572,000 in July 2006. Generally speaking, the trend in national home prices is also improving. The S&P/Case-Shiller 20-City Home Price Index (HPI) was

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near expectations in February, rising 0.15% for the month (not seasonally adjusted) but falling 3.5% over the last 12 months. Given the plethora of home price indexes out there, we thought it would be useful to summarize all the data on housing prices from the recent reports in the table below (Exhibit 5). Distressed sales and refinances continue to weigh on overall prices as seen by the relatively better performance of the CoreLogic ex-distressed index and the FHFA index. The S&P Case-Shiller and CoreLogic indexes are based on three-month moving averages, so it is not surprising that signs of improvement are lagging versus other measures of home prices.

Employment Data: For the week ending April 21, initial claims for unemployment insurance, a leading indicator, fell 1,000 to 388,000, but the four-week moving average rose 6,250 to 381,750. The headline number was worse than Bloomberg consensus estimates for 375,000. Continuing claims for unemployment insurance also rose.

Consumer Confidence: Consumer confidence appears to be in a holding pattern. The Conference Board’s measure of consumer confidence fell 0.3 points to 69.2 in April. The “present situation” index was up 0.5 points while the “expectations” index fell 2.4 points, with all three subcomponents (expected business conditions, expected personal income, and employment outlook) moving lower. The “present situation” component, meanwhile, is at its highest level since September 2008. Separately, the “labor market differential,” or percentage of consumers who think jobs are plentiful minus the percentage who believe that jobs are currently hard to get rose 2.6 points to a still-depressed -29.1. This is the highest reading since November 2008. The University of Michigan’s confidence measure, on the other hand, rose 0.4 points to 76.4. The “expectations” component reached its highest level since September 2009.

EXHIBIT 5: MONTHLY HOME PRICE INDEXES (THROUGH FEBRUARY)

	1-Month Change (%)	3-Month Change (%)	6-Month Change (%)	12-Month Change (%)
CoreLogic HPI incl distressed sales NSA	-0.8	-2.8	-5.9	-2.0
CoreLogic HPI incl distressed sales SA	0.3	0.6	-0.9	-1.9
CoreLogic HPI excl distressed sales NSA	0.7	0.4	-2.4	-0.8
CoreLogic HPI excl distressed sales SA	0.9	1.7	0.4	-0.9
S&P Case-Shiller Composite 20 NSA	-0.8	-2.9	-6.1	-3.5
S&P Case-Shiller Composite 20 SA	0.2	-0.4	-2.5	-3.5
FHFA (Purchase Only) NSA	0.6	-1.3	-1.9	0.4
FHFA (Purchase Only) SA	0.3	0.0	0.0	0.5
Average	0.2	-0.6	-2.4	-1.5

Sources: CoreLogic; S&P; FHFA/Haver Analytics.
 FHFA=Federal Housing Finance Agency, S&P=Standard & Poor’s, SA=Seasonally Adjusted, NSA=Not Seasonally Adjusted.
 Data through April 24, 2012.

Market Strategy*

Joseph P. Quinlan

Managing Director & Chief Market Strategist

A tale of two Chinas

After nearly two weeks of travel in China speaking with local firms and U.S.-based foreign affiliates, in addition to various professors and university students, I found the general consensus on the Middle Kingdom to be the following. First, near-term fears of an economic hard landing in China (real GDP growth below 6%) are overblown; the macro backdrop remains relatively positive. Second, there are, however, mounting concerns at the micro level and rising worries over how (if) China will transition from a middle-income country to a high-income country. In contrast to near-term optimism, the Middle Kingdom's medium-term picture is less clear.

The good news

This is a tale of two Chinas. Among the majority of constituents I spoke with, there was an overriding sense of confidence that China's near-term prospects remain relatively robust and that the nation will easily remain one of the strongest economies in the world this year. Underpinning this conviction: rising personal consumption, the infrastructure build-out of China's interior, and single-digit export growth.

The real estate market has cooled this year, but in many parts of China's vast interior construction cranes and crews work day and night — and on the weekends, erecting more highways, trains and housing units. Remember, only half of China's population lives in urban areas, yet the percentage of people living in cities is expected to steadily climb over the next two decades. According to the World Bank, the nation's urban population will grow at the equivalent of more than one Tokyo each year for the next two decades.

In terms of consumption, rising real wages and employment have put more income in the pockets of Chinese workers (migrant workers enjoyed an 11% increase in real wages last year), allowing households to increase their savings and spending. And spending they are, with personal consumption expenditures in China rising 10% in 2011. A similar level of growth is expected again this year. Boosting spending has been decent job growth, with the government reporting that 3.3 million new jobs were created in the first quarter of this year. While official unemployment statistics need to

be taken with a grain of salt, for what it's worth, China's unemployment rate stood at 4.1% at the end of 2011. Given the ever-increasing number of cars on China's roads, and the near cult-like status of owning any product made by Apple, the Chinese are not afraid of consuming. Indeed, the nation emerged as the second largest buyer of luxury products last year.

The outlook for exports is more problematic, with China's trade surplus in 2011 shrinking to its lowest since 2006. On this topic, many of the Chinese I spoke with were more fixated on Europe than the U.S., and for good reason. The European Union (EU) now ranks as China's largest export market, surpassing the U.S. in 2007. The Chinese, like most of the world, do not have much confidence in near-term growth prospects in Europe. Not that folks in China were unconcerned with the U.S. To the contrary, many Chinese expressed fears that the mainland would yet become a scapegoat for whatever ails the U.S. economy in the upcoming election. The EU and the U.S. combined account for roughly half of China's total exports.

Europe has placed a drag on China's export growth, although many of the people I spoke with thought the pull on trade would be made up by consumption and investment at home. Also providing a measure of comfort, China has more fiscal space than other nations and is poised, if need be, to not only increase public sector spending but also cut interest rates to stimulate growth in 2012 and 2013.

Summarizing, one story in China is of continued real economic growth, with moderating inflation, albeit the new norm in China is for real growth in the 7% to 8% range this year. The general consensus was that 10%+ annual growth in China was a thing of the past, which really didn't seem to bother most people I spoke with. More worrisome to many in China were micro and medium-term challenges.

The not-so-good news

The tone of many conversations shifted when the topic turned to more micro or company-specific topics.

Front and center for local firms and U.S. foreign affiliates operating in China: the effect of rising real wages and

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

the appreciation of the Chinese currency on corporate profits and China's global competitiveness. Add in the fact that China's labor force is set to peak in the next few years (2015, by most estimates), and the so-called China price is heading in one direction: up. And that has U.S. companies worried.

Indeed, according to recent survey from the American Chamber of Commerce in China, 90% of those companies surveyed believe the global competitiveness of China is on the decline, with many U.S. firms citing problems finding qualified management and non-management personnel. China may have a massive labor force, but there remains a dearth of skilled labor capable of stepping into a middle-management position with a foreign affiliate of a global multinational. Meanwhile, on the shop floor, average wages in China's factories rose by roughly 20% last year, forcing many Chinese producers to close shop or shift production to interior China or to lower-cost Southeast Asia. Last year, 21 of China's 31 provinces raised the minimum wage by an average of nearly 22%.

Another bone of contention — the urban-rural income divide and rising income inequality, which many highlighted as a key government challenge over the next few years. To this point, despite strong rural income growth, rural incomes have been eroded by rising food inflation over the past year, while according to the latest statistics, average incomes in urban areas are some 3.1 times higher than rural areas. This divide is politically toxic and represents a key challenge to China's goal of a 'harmonious' society.

Financial sector liberalization, more dynamic growth in services, more oversight of state-owned enterprises, the rising ranks of unemployed college graduates, an insufficient number of skilled workers, a rapidly aging population — all of these items were mentioned as potential barriers to future growth and key hurdles to clear if China is going to move from middle-income status to high-income status.

Many of the people I spoke with in China expect the nation to reach this lofty goal — but not without some turbulence and challenging times. The nation remains as optimistic as ever about the future, with optimism among China's college generation most palpable. This cohort has grown up in an age of affluence, or in a nation that has expanded by an average of 10% per annum their entire lives. No wonder they are optimistic.

But among midlevel managers and university professors, the optimism surrounding China's future was a tad more guarded. Everyone believes China is on the right path — but that this path is fraught with new risks and challenges that will test the resiliency and character of one of the world's most important economies.

Portfolio Positioning

Investment Strategy Committee

Portfolio strategy and asset allocation

- Solid economic data, steady profits and central bank liquidity support have provided a tailwind for equity markets recently. We believe it is still too early in the calendar year for the “policy cloud” to rain on the market’s parade. Our year-end target of 1350 was based on an early-year positive trend that could extend S&P 500 gains to 1375 before pulling back in the summer as earnings-per-share (EPS) growth slows down, European financial stress persists and political transitions enter the equation. If equities pull back, a resumption of the positive trend during the second half of the year would most likely be based on better prospects for financials and residential real estate. This, of course, assumes the geopolitical equation remains relatively stable as well.
- As the S&P 500 hovers around our year-end target of 1350 for this year, we would advise removing some equity market risk in our portfolios. We recently lowered our overall equity allocation from overweight to neutral relative to the strategic targets across all of our all-asset portfolio models and would advise reallocating to high-yield and cash/short-duration fixed income. Importantly, rebalancing should be measured and should occur over the course of weeks, not on any single day.
- Within the domestic equity asset class, we remain overweight large caps due to their greater exposure to global growth and are at a neutral weight in small cap and mid cap equities.
- We continue to expect the U.S. market to outperform the Eurozone and Japanese markets, as macroeconomic headwinds are more severely restraining growth and profits in those regions. Thus, we remain underweight international developed equities. We have adjusted emerging market equities slightly lower, but we remain overweight relative to strategic benchmarks, mainly based on value.
- We remain underweight fixed income. Within fixed income, we continue to prefer credit over Treasuries, with an emphasis on investment-grade and high-yield corporate bonds, mortgage-backed securities (MBS), and specific non-U.S., non-European sovereign bonds for their yield and currency advantages. Within fixed income-only models, we would recommend shifting some percentages from Treasuries and agencies to corporate high-yield credit.
- We remain neutral weight commodities as an asset class. The fundamental forces behind the commodity bull market remain intact, including strong global growth trends in emerging markets and lower-than-normal real interest rates across the globe. However,

in the near term, commodities are vulnerable to the recession “winds” blowing from Europe and a cyclical slowdown in China. We will look for more attractive valuation levels to increase our tactical weightings.

- Our macro view implies that the dollar has ended its downtrend against other major (rich country) currencies and even has potential to rise substantially against the euro and yen. Commodity currencies (Canada and Australia) remain the most likely to prove an exception. The macro view (global rebalancing) provides the most scope for emerging Asian currencies to rise against the dollar.
- Global rebalancing should create significant opportunities for long/short, distressed debt, and event-driven managers in the hedge fund space. We remain neutral weight with a focus on managers of diversified strategies who invest in liquid securities, understand the drivers of balance sheet repair around the world, and use leverage responsibly.
- We are neutral on private equity and recommend vintage year diversification among managers who have a strong track record in the full private equity cycle over multiple market cycles, from fundraising to deal sourcing to exit.
- We remain underweight real estate as an asset class, given our preference for other assets.
- In the event that we experience a sizable drawdown in equities toward midyear, we will revisit the fundamentals within the context of our most up-to-date investment strategy thought leadership (and forecasts) and assess whether tactical asset allocation changes are necessary.

Macro strategy

- There is growing evidence that a global recession has been averted and our basic global outlook seems to be on track for 2012. A confluence of factors have come together to reignite momentum in global trade and manufacturing over the past few months. In addition, financial stress indicators have been improving and monetary policy has reversed course in emerging markets and remains highly accommodative in the U.S.
- The U.S. is leading the rest of the world. Unlike the situation in most other countries, and especially that in Europe, U.S. manufacturing is rising from a low point set during the fall crisis that was still in growth territory. While there are clearly subpar areas in the recovery to date, they remain concentrated in the obvious areas: government and housing. Outside of these healing areas, the economy is performing much more normally despite the entrenched pessimism.

ECONOMIC AND MARKET FORECASTS (AS OF APRIL 27, 2012)

	Q4 2011	Q1 2012 e	Q2 2012 e	2011	2012 e	2013 e
Real Global GDP (% y/y annualized)				3.8	3.0 - 4.0	3.5 - 4.5
Real U.S. GDP (% q/q annualized)	3.0	2.2	2.0 - 3.0	1.7	2.0 - 2.5	2.5 - 3.5
CPI inflation (% y/y)*	3.1	3.3	2.8 - 3.2	3.1	2.0 - 3.0	1.5 - 2.5
Core CPI inflation (% y/y)*	1.7	2.2	1.8 - 2.2	1.7	1.0 - 2.0	1.0 - 2.0
Unemployment rate, period average (%)	8.7	8.3	8.0 - 8.3	9.0	8.0	7.0 - 7.5
Fed funds rate, end period (%)	0.12	0.12	0.12	0.12	0.12	0.12
10-year Treasury, end period (%)	1.88	2.21	2.0 - 2.5	1.88	2.0 - 2.5	2.0 - 3.0
S&P 500, end period	1258	1408	1350 - 1400	1258	1300 - 1400	1350 - 1450
S&P operating earnings (\$/share)	24	24.9	25 - 26	96.5	97 - 101	101 - 106
\$/€, end period	1.30	1.33	1.25 - 1.30	1.30	1.15 - 1.25	1.10 - 1.20
¥/\$, end period	77	83	80 - 85	77	78 - 83	85 - 90
Oil (\$/barrel), end period	99	103	100 - 110	99	85 - 120	85 - 120

Percent calendar year average over calendar year average annualized unless stated. "e" = Estimate.

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

Past performance is no guarantee of future results.

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

Source: U.S. Trust Investment Strategy Committee.

ASSET ALLOCATION TABLE (AS OF MARCH 26, 2012)

ASSET CLASS	ALLOCATION	WEIGHTING*
Cash	Positioning We remain overweight in cash as we remove some equity risk in our portfolios.	OVERWEIGHT
Equities	Positioning We are maintaining a neutral weight in equities.	NEUTRAL
	Emphasis <ul style="list-style-type: none"> ■ We prefer U.S. equities over non-U.S.-developed equities. Exceptions are commodity currency countries (Canada and Australia). ■ We remain overweight large cap U.S. equities and are neutral weight small cap and mid cap U.S. equities versus our policy benchmarks. ■ We have adjusted emerging market equities slightly lower, but we remain overweight relative to strategic benchmarks. 	
Fixed Income	Positioning We remain underweight fixed income compared to asset classes such as equities.	UNDERWEIGHT
	Emphasis <ul style="list-style-type: none"> ■ We continue to prefer spread products over Treasuries with an emphasis on investment-grade and high-yield corporate bonds, as well as mortgage-backed securities. 	
Commodities	Positioning The fundamental forces behind the commodity bull market remain intact, including strong global growth trends in emerging markets and lower-than-normal real interest rates across the globe.	NEUTRAL
	Emphasis <ul style="list-style-type: none"> ■ We favor a diversified mix of commodity exposure. 	
Hedge Funds	Positioning We are maintaining a neutral weight in hedge funds on a strategic basis.	NEUTRAL
	Emphasis <ul style="list-style-type: none"> ■ We favor long/short strategies, distressed strategies and global macro. 	
Private Equity	Positioning Use a staged approach gaining vintage-year and global diversification over time.	NEUTRAL
	Emphasis <ul style="list-style-type: none"> ■ From a sector perspective, we are optimistic on credit strategies, secondary funds, and infrastructure. 	
Real Estate Funds	Positioning We remain underweight real estate given our preference for other assets.	UNDERWEIGHT
	Emphasis <ul style="list-style-type: none"> ■ We prefer opportunistic and value sectors, given adverse market conditions. 	

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

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

Alternative investments such as derivatives, hedge funds, private equity funds and funds of funds can result in higher return potential, but also higher loss potential. Changes in economic conditions or other circumstances may adversely affect your investments. Before you invest in alternative investments, you should consider your overall financial situation, how much money you have to invest, your need for liquidity and your tolerance for risk.

Source: U.S. Trust Investment Strategy Committee.

U.S. EQUITY INDEXES (TOTAL RETURN, PERCENT CHANGE)

	CLOSE 4/27/2012	LAST WEEK	MTD	YTD	LAST 12 MONTHS	TRAILING 12-MO. P/E	GROSS DIV 12-MO. YLD.
Dow Jones Indstrl Avg.	13,228.31	1.56	0.27	9.13	7.09	13.39	2.48
S&P 400 MidCap	999.40	2.39	0.59	14.16	0.30	18.57	1.36
S&P 500	1,403.36	1.83	-0.24	12.31	5.79	14.27	1.98
S&P 600 SmallCap	462.02	2.61	-0.25	11.71	2.57	21.26	1.32
Nasdaq Composite	3,069.20	2.30	-0.67	18.18	8.13	17.48	1.01
Russell 1000	776.78	1.85	-0.16	12.73	5.18	14.69	1.93
Russell 1000 Growth	665.50	1.99	0.34	15.08	8.20	16.82	1.45
Russell 1000 Value	685.58	1.71	-0.67	10.37	2.17	12.98	2.43
Russell Midcap	1,098.50	1.94	0.14	13.11	0.95	17.81	1.63
Russell Midcap Growth	504.03	1.92	0.48	15.07	1.50	20.52	1.03
Russell Midcap Value	1,102.41	1.95	-0.20	11.18	0.27	15.71	2.23
Russell 2000	825.47	2.69	-0.51	11.86	-2.45	30.30	1.56
Russell 2000 Growth	477.22	2.86	-0.67	12.52	-2.62	32.64	0.74
Russell 2000 Value	1,082.45	2.51	-0.35	11.20	-2.26	28.28	2.38

U.S. EQUITY SECTORS (TOTAL RETURN, PERCENT CHANGE)

10 GLOBAL INDUSTRY CLASSIFICATION STANDARD SECTORS	INDEX WEIGHT	LAST WEEK	MTD	YTD	LAST 12 MONTHS	TRAILING 12-MO. P/E	GROSS DIV 12-MO. YLD.
Consumer Disc.	11.23	2.78	1.81	18.05	15.66	18.11	1.47
Consumer Staples	10.84	-0.09	0.58	6.15	13.26	16.68	2.84
Energy	11.12	2.21	-1.46	2.36	-8.35	10.85	1.91
S&P 500	100.00	1.83	-0.24	12.31	5.79	14.27	1.98
Financials	14.70	2.14	-1.80	19.85	-2.94	12.76	1.70
Health Care	11.35	0.73	-0.14	8.91	9.63	13.07	2.15
Industrials	10.56	1.62	-0.24	11.05	-0.56	14.42	2.23
Info. Tech.	20.38	2.44	-1.02	20.21	15.69	15.38	0.98
Materials	3.46	1.00	-0.16	11.01	-5.62	14.25	2.21
Telecom Services	2.88	4.37	4.75	6.93	6.07	19.88	5.19
Utilities	3.48	1.71	1.65	0.00	13.39	14.08	4.13

INTERNATIONAL MARKETS (TOTAL RETURN, PERCENT CHANGE)

	CLOSE 4/27/2012	LAST WEEK	MTD	YTD	LAST 12 MONTHS
MSCI AC World	140.68	1.21	-0.94	10.83	-4.46
MSCI EAFE	3,874.10	0.85	-1.69	8.99	-10.81
MSCI Europe	4,367.55	1.13	-1.50	9.00	-14.00
MSCI Pacific	4,025.94	0.35	-2.09	8.94	-4.17
MSCI EM	399.13	-0.14	-1.86	11.96	-13.04
MSCI AC Asia ex Japan	315.94	-0.32	-0.99	12.59	-11.47

**CURRENCY SPOT RETURN PERFORMANCE AGAINST THE U.S. DOLLAR
(PERCENT CHANGE)**

CURRENCY	CLOSE 4/27/2012	LAST WEEK	MTD	YTD	LAST 12 MONTHS	90-DAY BOND YLD.
Australian Dollar	1.05	0.88	1.21	2.57	-3.69	3.77
Brazilian Real	1.89	-0.82	-3.23	-1.11	-17.02	8.66
Canadian Dollar	0.98	1.22	1.87	4.17	-3.13	1.07
Swiss Franc	0.91	0.28	-0.43	3.50	-3.50	0.00
Euro	1.33	0.27	-0.66	2.27	-10.37	0.02
British Pound	1.63	0.88	1.61	4.65	-2.18	N/A
Japanese Yen	80.27	1.56	3.24	-4.19	2.35	0.10
South Korean Won	1,135.10	0.39	-0.18	1.53	-4.90	3.38
Singapore Dollar	1.24	0.87	1.62	4.77	-0.64	0.25

Past performance is no guarantee of future results.

Sources: Bloomberg; FactSet; U.S. Trust Market Strategy Team.

Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index.

U.S. GOVERNMENT BONDS (GENERIC, CHANGE IN YIELD)

	YIELD 4/27/2012	LAST WEEK	YEAR- TO-DATE	LAST 12 MONTHS
90-day T-bill	0.09	0.01	0.07	0.03
Two-year Treasury	0.26	-0.03	0.01	-0.39
Five-year Treasury	0.82	-0.04	-0.01	-1.24
10-year Treasury	1.96	-0.03	0.07	-1.43
10-year TIPS (real)	-0.34	-0.05	-0.22	-1.11

BOND INDEXES (BARCLAYS CAPITAL, TOTAL RETURN, PERCENT CHANGE)

	YIELD TO WORST 4/27/2012	LAST WEEK	MTD	YTD	LAST 12 MONTHS
Corporate & gov't	1.81	0.18	1.25	1.33	8.88
Broad corporate	3.29	0.24	1.24	3.35	9.42
Non-investment grade	7.12	0.73	0.89	6.28	6.01
Treasury bills	0.11	-0.01	0.01	0.02	0.09
Treasury notes and bonds	1.02	0.18	1.38	0.07	9.24
Agencies	0.92	0.08	0.64	0.60	4.63
Mortgages	2.60	0.03	0.61	1.18	6.05
Municipals	2.47	0.15	1.11	2.88	11.65
Global gov't, ex-U.S.	1.82	1.20	1.17	0.97	3.01
U.S. Aggregate	2.08	0.13	1.03	1.33	7.86
Global Emerging Markets	5.24	0.57	1.03	6.98	9.16
Global Aggregate, ex-USD	2.12	1.08	0.94	2.12	2.13

COMMODITIES (PRICE RETURN, PERCENT CHANGE)

DOW JONES-UBS COMMODITY INDEX & THE UNDERLYING COMMODITIES	LAST WEEK	YTD	LAST 12 MONTHS
Natural Gas	8.49	-31.30	-55.37
Wheat	4.33	-5.28	-28.63
Corn	3.73	-5.41	-9.74
Copper	3.20	10.71	-10.37
Soybeans	3.04	21.72	8.68
RBOB Gasoline	2.02	16.06	1.82
Dow Jones Commodity Index*	1.76	-0.01	-18.72
Nickel	1.66	-3.26	-32.03
Heating Oil	1.37	11.09	-3.61
Gold	1.34	5.93	9.12
Aluminum	1.25	4.36	-23.18
Crude Oil	1.01	5.48	-6.55
Zinc	0.72	10.60	-8.91
Cotton	0.24	-0.09	-13.93
Lean Hogs	-0.92	-9.32	-8.84
Silver	-0.97	12.19	-31.57
Soybean Oil	-1.33	4.67	-5.98
Coffee	-1.37	-23.99	-40.73
Sugar	-1.58	-5.98	-8.02
Live Cattle	-2.25	-9.41	-6.11

(*Total return index)

Index Definitions

SECURITIES INDEXES ASSUME REINVESTMENT OF ALL DISTRIBUTIONS AND INTEREST PAYMENTS. INDEXES ARE UNMANAGED AND DO NOT TAKE INTO ACCOUNT FEES OR EXPENSES. IT IS NOT POSSIBLE TO INVEST DIRECTLY IN AN INDEX.

The Barclays Bond Indexes are used as performance benchmarks in each respective category of U.S. debt issuances.

The Barclays Capital U.S. Aggregate Index is an unhedged market capitalization-weighted index of the total U.S. investment grade bond market.

The Barclays Capital U.S. Corporate High Yield Bond Index is an unmanaged, market value-weighted index, which covers the U.S. non-investment grade fixed-rate debt market. The index is composed of U.S. dollar-denominated corporate debt in industrial, utility and finance sectors with a minimum \$150 million par amount outstanding and a maturity greater than 1 year.

The Bloomberg International Debt Index represents open-end, international debt funds domiciled in the U.S.

The BofA Merrill Lynch US 3-Month Treasury Bill Index consists of a single issue purchased at the beginning of the month and held for a full month. At the end of the month that issue is sold and rolled into a newly selected issue. The issue selected at each month-end rebalancing is the outstanding Treasury Bill that matures closest to, but not beyond, three months from the rebalancing date. To qualify for selection, an issue must have settled on or before the month-end rebalancing date. While the index will often hold the Treasury Bill issued at the most recent 3-month auction, it is also possible for a seasoned 6-month Bill to be selected.

The BofA Merrill Lynch 10-15 Year US Treasury Index is a subset of The BofA Merrill Lynch US Treasury Index including all securities with a remaining term to final maturity greater than or equal to 10 years and less than 15 years.

The BOVESPA – BOVESPA is a total-return index weighted by traded volume and comprises most liquid stocks traded on the Sao Paulo Stock Exchange.

The Chicago Board Options Exchange OEX Volatility Index (VIX) reflects a market estimate of future volatility, based on the weighted average of the implied volatilities of eight OEX calls and puts – the nearest in and out of the money call and put options from the first- and second month expirations.

The Commodity Research Bureau (CRB) Commodity Index is a measure of price movements of 22 sensitive basic commodities whose markets are presumed to be among the first to be influenced by changes in economic conditions. The commodities used are in most cases either raw materials or products close to the initial production stage which, as a result of daily trading in fairly large volume of standardization qualities, are particularly sensitive to factors affecting current and future economic forces and conditions.

The Commodity Research Bureau (CRB) Food Index is a measure of price movements of basic foodstuffs whose markets are presumed to be among the first to be influenced by changes in economic conditions.

The Conference Board Leading Economic Index (LEI) – Leading Indexes generally signal activity/output in the coming 3-6 months. Relevant indicators include manufacturers' new orders, average weekly hours, vendor performance, initial unemployment insurance claims, building permits, money supply (M2), consumer expectations, stock market prices, and interest rate spreads.

The Dow Jones Commodity Index is composed of futures contracts on 19 physical commodities. It reflects the return on fully collateralized future positions. It is quoted in USD.

The Dow Jones Industrial Average Index, the most widely used indicator of the overall condition of the stock market, is a price-weighted average of 30 actively traded blue-chip stocks as selected by the editors of The Wall Street Journal.

The Dow Jones U.S. Select Aerospace & Defense Index measures manufacturers, assemblers and distributors of aircraft and aircraft parts primarily used in commercial or private air transport, and producers of components and equipment for the defense industry, including military aircraft, radar equipment and weapons. The index is weighted by float-adjusted market capitalization.

The Euro STOXX 50 (price) Index is a free-float market capitalization-weighted index of 50 European blue-chip stocks from those countries participating in the European Monetary Union.

The FactSet World Aggregate Indexes are time-series composite indexes based on proprietary country, region, sector, and industry classification.

Indexes are all based in dollars.

The J.P. Morgan EMBI Global Index tracks total returns for traded external debt instruments in the emerging markets.

The Morgan Stanley Capital International (MSCI) Australia Index is a broad-based index that tracks the performance of Australian stocks.

The Morgan Stanley Capital International (MSCI) Canada Index is a broad-based index that tracks the performance of Canadian stocks.

The Morgan Stanley Capital International (MSCI) Emerging Asia Index is a capitalization weighted index that monitors the performance of stocks from the emerging Asia region.

The Morgan Stanley Capital International Europe, Australasia, Far East (MSCI EAFE) Index is a capitalization-weighted index that tracks the total return of common stocks in 21 developed-market countries within Europe, Australasia and the Far East.

The Morgan Stanley Capital International (MSCI) Europe Index is a broad-based index that tracks the performance of European stocks.

The Morgan Stanley Capital International (MSCI) Pacific Index is a free float-adjusted market capitalization-weighted index designed to measure equity market performance of developed markets in the Pacific region.

The MSCI AC (All Country) Asia ex Japan Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of Asia, excluding Japan.

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

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of May 30, 2011, the MSCI Emerging Markets Index consists of the following 21 emerging market country indices: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand and Turkey.

The Mumbai Sensex – The Mumbai Stock Exchange Sensitive Index is a cap-weighted index.

The Nasdaq Composite Index is a market capitalization price-only index that tracks the performance of domestic common stocks traded on the regular Nasdaq market as well as National Market System-traded foreign common stocks and American Depositary Receipts.

The OITP (Other important trading partners) index is a weighted average of the foreign exchange values of the U.S. dollar against a subset of currencies in the broad index that do not circulate widely outside the country of issue. The weights are derived by rescaling the currencies' respective weights in the broad index so that they sum to 1 in each sub-index.

The Philadelphia Federal Reserve Bank Business Outlook Index. The survey panel consists of 150 manufacturing companies in Federal Reserve District III (consisting of southeastern PA, southern NJ and Delaware.) The diffusion indexes represent the percentage of respondents indicating an increase minus the percentage indicating a decrease.

The Reuters/Jeffries CRB Index is an arithmetic average of commodity futures prices with monthly rebalancing.

The RTSI – The Russian Trading System Index is a capitalization-weighted index that is calculated in U.S. dollars.

The Russell 1000 Growth Index measures the performance of those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 1000 Index consists of the largest 1000 companies in the Russell 3000 Index. This Index represents the universe of large capitalization stocks with a base value of 130.00 as of December 31, 1986.

The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization. The index was developed with a base value of 135.00 as of December 31, 1986.

The Russell 1000 Value Index measures the performance of those Russell 1000 Index companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 2000 Growth Index measures the performance of those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 2000 Value Index tracks the performance of those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values.

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

The Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index.

The Russell MidCap Value Index measures the performance of those Russell Midcap companies with lower price-to-book ratios and lower forecasted growth values. The stocks are also members of the Russell 1000 Value Index.

The Shanghai Composite – The Shanghai Stock Exchange Composite Index is a capitalization-weighted index.

The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization U.S. stocks.

The Standard & Poor's (S&P) 500 Financials Index is a capitalization-weighted index that tracks the Financials sector of the S&P 500, as denoted by the GICS.

OTHER IMPORTANT INFORMATION

Past performance is no guarantee of future results.

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

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

Investing in fixed income securities may involve certain risks, including the credit quality of individual issuers, possible prepayments, market or economic developments and yields and share price fluctuations due to changes in interest rates. When interest rates go up, bond prices typically drop, and vice versa.

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

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

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

There are special risks associated with an investment in commodities, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes, and the impact of adverse political or financial factors.

Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates, and risks related to renting properties, such as rental defaults.

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

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

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

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