Global
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Asset allocation for 2011

Bank of America Merrill Lynch

US Investment Strategy Committee
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Maintain 65% equity, 30% bond, 5% cash allocation

We see little reason to change our current asset allocation for individual investors of 65% equities, 30% bonds, and 5% cash but recommend some tactical changes to our regional, size and style allocations.

The "3 P's" say overweight equities, underweight bonds

We believe equities will outperform bonds in 2011, driven by the "3 P's": policy, positioning, production.

Increase high yield exposure, reduce investment grade

Within fixed income portfolios, the RIC recommends increasing the allocation to high yield bonds funded through a two percentage point reduction in the allocation to investment grade bonds. We forecast 10% returns from high yield bonds in 2011 compared to just 2.5% from investment grade.

Overweight Growth, but up allocation to Large Cap Value

The RIC continues to favor growth stocks due to scarce growth, international exposure and valuation. We reduce our underweight position in large cap value. Our US Equity Strategy Team believes Financials – which make up a third of the value index – can offer stronger returns in 2011, albeit with higher risk.

Overweight international equities, but less bullish

The RIC remains overweight international stocks, but has reduced the overweight by two percentage points. A strengthening US dollar is likely to drive more investment flows to the US equity market in 2011. The long-term case for emerging markets remains very good, but large investor positioning and rising inflation in EM may hinder fresh flows to the region. Japan is a tempting contrarian investment, but lacks a convincing fundamental story. Germany is the only real strong story in Europe.

Click the image above to watch the video

Refer to important disclosures on page 16 to 18. Analyst Certification on Page 15. Link to Definitions on page 15.

2010 Review

2010 was a good year for many asset markets, as central bank liquidity in developed markets kept investors in "risk on" mode for much of the year.

During the first and fourth quarters, when the Fed was pursuing quantitative easing, US equities outperformed Emerging Markets. Overall for the year the S&P 500 outperformed the MSCI EM Index by 70bps in local currency terms.

Within US markets, small caps significantly outperformed large caps in 2010. Value outperformed growth in December for the first time since May, For the full year, large cap growth and value were tied (+15% each), although among small caps, growth outperformed.

Among US sectors, cyclicals led, with Consumer Discretionary (+27.7%), Industrials (+26.7%), and Materials (+22.2%) providing the strongest returns for the year. Defensive sectors lagged, with Health Care (+2.9%) and Utilities (+5.5%) offering the lowest returns.

Fixed income sectors lagged in the fourth quarter, but all had positive total returns for the year. In 2010 High Yield (+15.2%), Preferreds (+13.7%), and Emerging Markets (+12.5%) were the top performers as investors looked to riskier sectors for yield. Munis (+2.3%) were one of the worst performing fixed income assets in 2010 as BABs issuance and concerns over state and local budgets hurt returns.

Despite the Bank of Japan's efforts to curb the Yen's appreciation, it rose an astonishing 16.5% in 2010 while most other major currencies declined.

2010 was a strong year for commodities, with oil up 15.1% for the year. Gold was the best performing asset in 2010, returning 29.5%.

Financial Markets Recap

Table 1: Total return (%)

		As of 31 December 2010		
Asset class	2009	1 month	3 months	2010
Equity Indices (%, in local currencies)				
S&P 500	26.5	6.7	10.8	15.1
NASDAQ Comp	45.4	6.3	12.3	18.2
FTSE 100	27.3	6.8	6.9	12.6
TOPIX	7.6	4.5	8.5	1.0
Hang Seng	56.6	0.1	3.3	8.6
DJ Euro Stoxx 50	25.6	5.4	2.1	-2.8
MSCI EAFE	25.4	4.8	5.7	5.3
MSCI Emerging Markets	62.8	4.5	5.8	14.4
Size & Style (%, US dollar terms)				
Russell 2000	27.2	7.9	16.3	26.9
S&P 500 Citigroup Growth	31.6	5.2	11.0	15.1
S&P 500 Citigroup Value	21.2	8.2	10.5	15.1
S&P 600 Citigroup Growth	28.4	6.4	16.5	28.0
S&P 600 Citigroup Value	22.8	8.9	16.0	24.7
S&P 500 Sectors (%, US dollar terms)				
Consumer Discretionary	41.3	4.2	12.6	27.7
Consumer Staples	14.9	4.2	6.1	14.1
Energy	13.8	9.0	21.5	20.5
Financials	17.2	10.7	11.6	12.1
Health Care	19.7	4.5	3.6	2.9
Industrials	20.9	7.7	11.8	26.7
Information Technology	61.7	5.3	10.2	10.2
Materials	48.6	10.4	19.0	22.2
Telecom Services	8.9	7.8	7.3	19.0
Utilities	11.9	3.1	1.1	5.5
BofA Merrill Lynch Global Research Bond Indices (%, US dollar terms)				
10-Year Treasury	-9.7	-4.0	-5.6	7.9
2-Year Treasury	1.1	-0.2	-0.1	2.3
TIPS	10.0	-1.6	-0.9	6.3
Municipals*	14.5	-2.0	-4.5	2.3
Corporate Bonds	19.8	-0.9	-1.6	9.5
High Yield Bonds	57.5	1.8	3.1	15.2
Emerging Markets	27.2	-0.7	-2.0	12.5
Preferreds	20.1	0.0	-0.2	13.7
Foreign Exchange (%, in local currencies)**				
US Dollar	-5.6	-3.0	-1.2	-3.6
British Pound	8.8	-1.3	0.5	-0.8
Euro	-2.1	0.8	-2.6	-9.0
Yen	-5.6	1.8	3.2	16.5
Commodities (%, US dollar terms)**				
CRB Index	23.5	10.4	16.0	17.4
Gold	24.4	2.5	8.6	29.5
Oil	77.9	8.6	14.3	15.1
Alternative Investments† (%, US dollar terms)				
Hedge Fund - CS Tremont[1]	18.6	-0.2	5.2	7.8
Hedge Fund - HFRI Fund of Funds[1]	11.5	-0.1	3.7	3.4
Private Equity - Cambridge Assoc.[2]	13.8	NA	1.6	6.0
Private Real Estate - NCREIF TR[3]	-16.9	NA	3.9	8.1

Source: Standard & Poor's, MSCI, Bloomberg, FactSet, BofA Merrill Lynch Global Research bond indices. Notes: *Not tax adjusted. **BoE calculated effective FX indices. [1]Data as of 11/30/10; CS AUM-weighted, HFRI equal-weighted [2]Quarterly data as of 6/30/10 [3]Quarterly data as of 9/30/10 †AI data not comparable to other asset classes because of reporting delays, lack of standardized reporting, and survivorship and self selection biases.

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Asset allocation for 2011

In order to help our clients position their portfolios for 2011, this month's Research Investment Committee (RIC) report focuses on asset allocation. We see little reason to change our current asset allocation for individual investors of 65% equities, 30% bonds, and 5% cash[1] but recommend some tactical changes to our regional, size and style allocations as follows:

- Within equity portfolios, the RIC recommends increasing the allocation to US large cap value stocks funded through a two percentage point reduction in the allocation to international equities.
- Within fixed income portfolios, the RIC recommends increasing the allocation to high yield bonds funded through a two percentage point reduction in the allocation to investment grade bonds.

Winners and losers of 2010

The investment drivers of 2010 were low economic growth, low interest rates and high financial market liquidity. That combination drove investors out of cash and into assets providing high growth, high yield and to a lesser extent high quality. As a consequence some of the worst performing assets were those handicapped by low-quality balance sheets. G7 government bonds, US municipal bonds and European equities all underperformed. In contrast, some of the best performing assets in 2010 were those that provided growth and yield such as US small cap equities, emerging market equities and high yield bonds (Table 2).

Table 2: 2010 winners & losers

	$100 invested in 2010
Gold	$130
Small cap	$127
Emerging market equities	$120
Nasdaq	$118
Commodities	$117
US equities	$115
Growth	$115
Value	$115
US high yield bonds	$115
Japanese equities	$115
Global equities	$113
US Financials	$112
US IG corporate bonds	$110
Oil	$108
Treasuries	$106
European equities	$104
Municipals	$102
US Dollar	$102

Total returns compounded daily in USD; WTI Cushing Crude.
Indices used: Russell 2000; ML US High Yield Master Index; MSCI EM Index; S&P 500 Growth Index; S&P 500 Index; ML US Corporate Master Index; S&P 500 Value Index; MSCI Japan Index; ML US Treasury Master Index; CRB Index; ML Municipal Master Index; Dollar Index; MSCI Europe, MSCI ACWI; S&P 500 Financials Index.
Source: BofA Merrill Lynch Global Research bond indices, Bloomberg

More broadly, in 2010 equities and commodities outperformed bonds as a combination of ample liquidity and higher inflation expectations drove returns. Gold was the best performing major asset class thanks to a weak dollar and ongoing tail risk fears. Within equities, emerging markets outperformed, but US and Japanese markets beat Europe. Small outperformed large cap while growth and value performed equally well. Within fixed income, high yield outperformed investment grade bonds, which in turn outperformed Treasuries and municipal bonds, the latter suffering its worst quarterly losses in 4Q since Orange County filed for bankruptcy in 1994.

The RIC's base case

In the December RIC Report, we presented our base case for 2011 in some detail. Below we provide a quick summary of those views.

- The U.S. economy will continue to improve, albeit at a slow pace
- The rate of global economic growth will slow modestly from 2010
- Fixed income returns will fall to low single digits
- High quality munis in the US will provide decent returns in 2011
- Investment grade and high yield credit spreads will tighten further
- The cyclical bull market in global equities continues with returns of 10-15%
- The S&P 500 Index will reach 1400 in 2011, based on a $93 EPS estimate

[1] References to our numerical allocation weights are Tactical allocations for an individual investor, and use a Moderate investor as an example.

- Large-cap equities are forecast to outperform small-cap equities (with the exception of technology)
- The US dollar will strengthen against both the euro and the Japanese yen
- Commodity prices will rise once again, led by oil, copper and coal

In the table below we highlight some of the key BofA Merrill Lynch Global Research macro and market forecasts for 2011 and their comparisons with 2010 and 2009.

Table 3: Key BofA Merrill Lynch Global Research 2011 forecasts vs. 2009-2010 actual figures

	2009	2010	2011E
Global GDP	-0.7%	5.0%	4.3%
US GDP	-2.6%	2.9%	2.9%
Global CPI	1.7%	3.2%	3.4%
US CPI	-0.3%	1.6%	1.4%
10 yr Treasury yield	3.80%	3.30%	4.0%
Fed funds	0-0.25%	0-0.25%	0-0.25%
MSCI ACWI	299	331	375
S&P 500	1115	1258	1400
USD-EUR	1.43	1.34	1.20
WTI Crude Oil	$73/bbl	$83/bbl	$87/bbl
Gold	$974/oz	$1227/oz	$1425/oz

Notes: EUR and 10-year Treasury yield are year-end; Gold and oil are average for the full year; 2010 GDP and CPI figures are estimates; MSCI ACWI, S&P 500 are year-end figures in 2009-2010, 12-month targets in 2011.
Source: BofA Merrill Lynch Global Research

Tactical allocation for US clients

The RIC provides tactical asset allocation for individual investors based on a 12- to 18-month time horizon. This tactical allocation is set relative to Global Wealth Management's long-term strategic benchmark allocation, which is based on a 20- to 30-year time horizon. Asset allocation advice is provided for five client risk profiles from Conservative to Aggressive, but all references to asset allocation below use the Moderate Investor profile. Here, in the *RIC—Monthly Investment Overview* we discuss changes made to the asset allocation appearing in the full RIC. Please refer to the full RIC report for more detail and for the full asset allocation tables.

The RIC makes tactical asset allocation recommendations for individual investors. Elsewhere, BofA Merrill Lynch provides an institutional asset allocation which is based on the same views, but which has a shorter investment horizon.

The RIC's asset allocation

Table 4: Asset allocation for US clients

	Moderate Investor	
	Strategic	Tactical
Stocks	60%	65%
Bonds	35%	30%
Cash	5%	5%

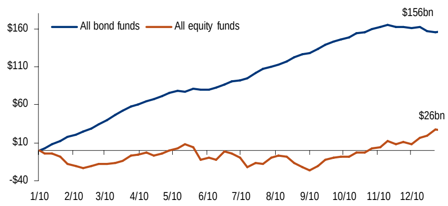
Source: BofA Merrill Lynch Investment Strategy

We maintain an asset allocation of overweight equities (65%), underweight bonds (30%) and neutral cash (5%) relative to GWM's long-term strategic benchmark of 60%-35%-5% (Table 4).

Within US taxable fixed income, we recommend the following allocation: 34% Treasuries, CDs & Government Sponsored Entities; 26% mortgage backed securities, 28% investment grade and preferred bonds, 7% high yield, and 5% international bonds.

Within equities, we recommend the following allocation: 40% Large Cap Growth, 36% Large Cap Value, 4% Small Cap Growth, 1% Small Cap Value, 14% Developed Market International, 5% Emerging Market International.

Chart 3: Cumulative investment by US individuals in bond and equity funds since 2009



Source: BofA Merrill Lynch Global Research, Lipper FMI

Changes this month

- Within bonds, we raise the allocation to high yield by 2 percentage points to 7% and reduce the allocation to investment grade to 28%
- We increase the allocation to US Large Cap Value by 2 percentage points to 36% and reduce the allocation to International: Developed and Emerging by 1 percentage point each.

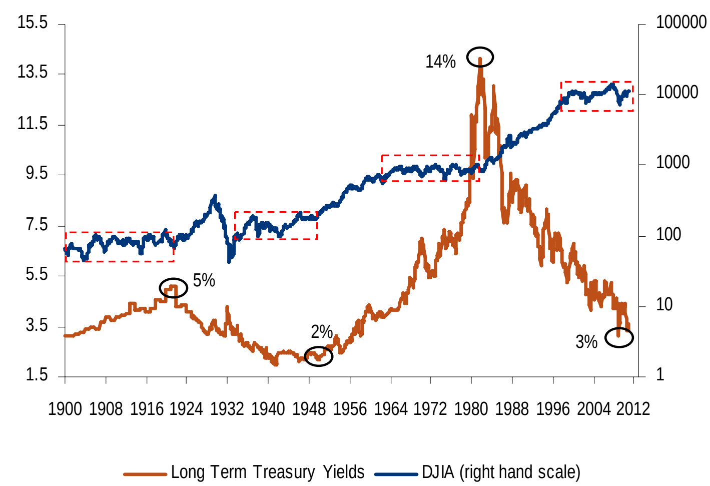
The "3 P's" say overweight equities, underweight bonds

We make no changes our tactical 65% allocation to equities, 30% allocation to bonds, and 5% allocation to cash for a moderate investor. We believe equities will outperform bonds in 2011, driven by the "3 P's": policy, positioning, production.

Policy: War against deflation is more positive for equities than bonds

Over the past few years, policy makers in developed markets have fought low growth and low inflation with a combination of monetary and fiscal stimulus. The RIC believes that the three weapons of quantitative easing, low taxes, and historically low interest rates will continue to provide support for global equities. The combination of pro-growth and anti-deflation policies has started to raise inflation expectations and that's better news for equities than bonds. And if bond yields have seen their secular lows, the long-term outlook for equities looks very bright (Chart 2).

Chart 1: Bear market in bonds = Bull market in equities

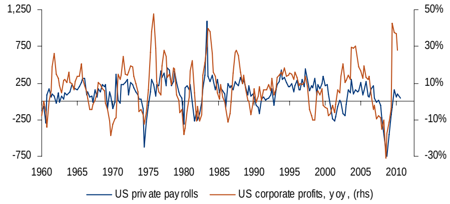


Source: BofA Merrill Lynch Investment Strategy, Haver, Bloomberg

Positioning: The great rotation from bonds to equities

While sentiment toward equities has picked up in recent weeks, individual investors have been overwhelmingly pro-fixed income and anti-equities over the last two years (Chart 1). In 2009 and 2010, fund flows into fixed income funds as a percent of assets under management totaled a massive 19% and 10%, respectively. The outperformance of equities over the same two-year period and the stark contrast between the health of the corporate and government balance sheets are likely to cause rotation out of bond funds into equity funds in 2011.

Chart 2: US payrolls have not caught up with corporate profit growth

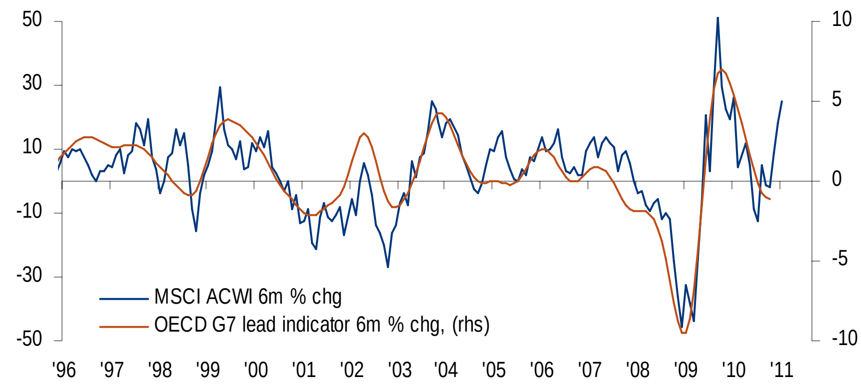


Source: BofA Merrill Lynch Global Equity Strategy

Production: Lead indicators of production and profits are rising

Leading indicators of global production are turning around after some weakness during the middle of 2010 (Chart 4, next page). Growth in developed market economies has started to improve and data appears to be back on trend. Meanwhile, emerging markets continue to be an important engine of global growth. A fully fledged bull market in equities and commodities is unlikely without a recovery in the US labor market (Chart 3) and a waning of the risks to European growth from the sovereign debt crisis. That said, bond markets are vulnerable to GDP upgrades, especially if those upgrades threaten to take US GDP growth above trend. Note that in year-on-year terms the US economy grew over 3% in 4Q for the first time since 3Q 2005.

Chart 4: Global equities have begun to discount better developed market economic data



Source: BofA Merrill Lynch Equity Strategy; Datastream

Table 5: Fixed Income allocation for US clients

	Moderate Investor	
	Strategic	Tactical
Overall allocation to bonds	35%	30%
Breakdown within bonds	100%	100%
Tsys, CDs & GSEs	40%	34%
Mortgaged Backeds	25%	26%
IG Corp and Preferreds	25%	28%
High Yield	5%	7%
International	5%	5%

Source: BofA Merrill Lynch Global Research

The RIC's fixed income allocations

The RIC maintains an underweight allocation to fixed income of 30% versus GWM's strategic weighting of 35%. Within fixed income the asset allocation advice is as follows:

- US Treasuries: maintain a 34% underweight position
- Mortgage-backed securities: maintain a slight 26% overweight position relative to GWM's strategic benchmark
- Investment grade corporate bonds: reduce the overweight from 30% to 28%
- High yield bonds: increase the overweight to 7% from 5%
- International bonds: maintain market weight of 5%

Underweight Treasuries

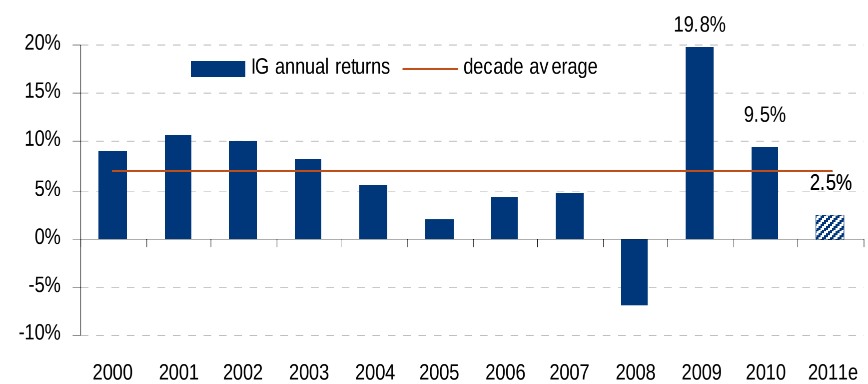
While we expect that low growth and low inflation will keep the Fed on hold until late in 2012, we expect Treasury yields to rise in 2011. US Rates Strategist Priya Misra forecasts the yield on the 10-year Treasury will rise to 4.0% by the end of this year from 3.3%, as the economy recovers and risk appetite slowly returns. This back-up in yields combined with continued high Treasury issuance will produce modestly negative returns for Treasury securities. The RIC recommends maintaining an underweight position in government bonds.

High yield over investment grade

The RIC believes high yield will be the best-performing segment within fixed income, outperforming Treasuries, investment grade corporate bonds, and municipals. We increase our high yield allocation to 7% and expect 10% returns in 2011 compared to just 2.5% for investment grade corporates. Credit Strategist Jeffrey Rosenberg recommends a down-in-quality credit portfolio as spreads will continue to narrow for lower quality securities in 2011. Combined with easy monetary policy and an improving economy, the lower cost of debt for high yield issuers should push high yield default rates to 2% – one of the lowest levels ever.

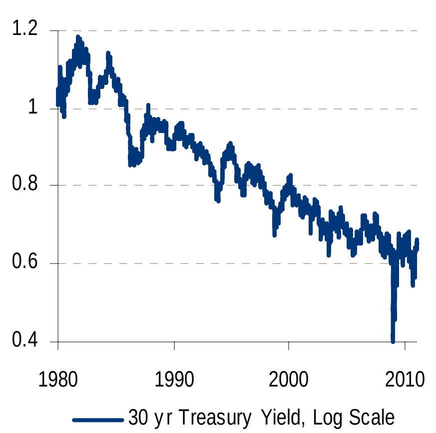
Investment grade corporate bond returns in 2011 will be lower than in recent years (Chart 6) and the RIC reduces our investment grade corporate bonds allocation from 30% to 28%. Similar to high yield, Marty Mauro, GWM Fixed Income Strategist, recommends investors consider lower quality securities. Liquidity conditions will continue to lend support to investment grade and push spreads tighter, but higher interest rates will offset some of the return in 2011.

Chart 6: Investment Grade corporate bond returns will be lower than in recent years



Source: BofA Merrill Lynch Global Research

Chart 5: Long-term Treasury yields are at historic lows, and are unlikely to go lower



Source: BofA Merrill Lynch Investment Strategy

A view on US municipal bonds

Fiscal strains and retiree funding challenges will pose lingering problems for US municipal issuers. According to Municipal Strategist John Hallacy, munis will face higher volatility in 2011 from both downgrades and the rare default. However, the RIC maintains that investors in the highest tax brackets can still benefit from a diversified portfolio of high quality municipal bonds. Marty Mauro points out that for investors in the highest tax brackets, munis can offer an after-tax yield of up to a 100bp over Treasuries. Please see the *In Focus* guest column appearing in the full RIC Report for a deep dive into the bull and bear cases for muni bonds over the year ahead.

Note the fixed income allocation for a Moderate US client, shown in Table 5, assumes a tax-deferred account, and therefore does not include an allocation to municipal bonds. For a fixed income allocation that includes municipal bonds by tax bracket, please refer to Table 23 in the full RIC Report.

Table 6: Equity allocation for US clients

	Moderate Investor	
	Strategic	Tactical
Overall equity allocation	60%	65%
Breakdown within equities	100%	100%
Large Cap Growth	38%	40%
Large Cap Value	38%	36%
Small Growth	4%	4%
Small Value	4%	1%
International: Developed	13%	14%
International: Emerging	3%	5%

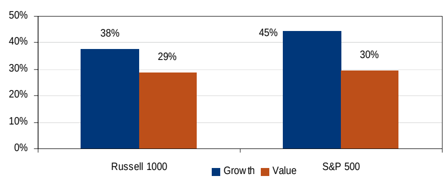
Source: BofA Merrill Lynch Global Research

The RIC's equity allocations

The RIC maintains an overweight allocation to equities of 65% versus GWM's strategic weighting of 60%. Within equities, the allocation advice is as follows:

- Large Cap Growth: maintain an overweight of 40%
- Large Cap Value: maintain underweight position, but raise the allocation to 36% from 34%
- Small Cap Growth: maintain neutral weight of 4%
- Small Cap Value: maintain a large underweight of just 1%
- International Developed: maintain overweight, but reduce allocation to 14% from 15%
- International Emerging: maintain overweight, but reduce allocation to 5% from 6%

Chart 7: Growth vs. Value foreign exposure



Source: BofA Merrill Lynch US Quantitative Strategy

Still bullish Growth, less bearish Large Cap Value

The RIC continues to recommend an overweight allocation to Growth. Combining Large and Small Growth components we recommend a 44% allocation vs the benchmark 42%. Although the RIC remains underweight Value across market-caps, we increase our allocation to Large Cap Value this month by two percentage points to 36% (benchmark 38%).

The RIC continues to prefer growth to value because we believe that growth will remain relatively scarce in coming years. Growth stocks also offer greater international exposure (Chart 7) and valuations are inexpensive relative to historical levels. According to US Quantitative Strategist Savita Subramanian US growth stocks currently trade at premium to value stocks of just 1.20, compared to the average since 1979 of 1.47, based on 12-month forward PE.

In addition, Chief US Equity Strategist David Bianco believes tech – which makes up 31% of the Russell 1000 growth index – will offer the best risk/reward in 2011. For stock ideas in this space, see Bianco's *Tech Titans*, which represent the top 10 tech earnings contributors in the S&P.

Bianco's Venti Financials list shows S&P 500 Financials companies with market cap > $20bn

Nonetheless, we pare our underweight to large cap value this month, as Bianco believes financials – which represent almost a third of the Russell 1000 Value Index – can offer stronger returns in 2011, albeit at higher risk. Our preference for financials is limited to the largest market cap stocks. Small Cap Strategist Steven DeSanctis notes that estimates for small cap financials continue to fall as the regional banks work to repair balance sheets.

Large cap cheap relative to small cap

Combining the growth and value components, we are net underweight small cap US stocks (5% vs the benchmark 8%) and equal weight large cap US stocks at 76% of the equity portfolio.

We were wrong in 2010 to be overweight large cap and underweight small cap. But the history of returns, high valuation, and low international exposure of small caps all argue that outperformance is unlikely to be replicated in 2011 according to DeSanctis.

For small caps, 2010 marked the second consecutive year of +20% annual returns. The only two other times this happened since 1979, in the subsequent third year small caps returned -7% and 2%. DeSanctis expects annual returns for small caps in the high single digits.

Small caps are now far more expensive than large caps. The small cap price to forward earnings ratio has climbed 2.7x above that of large caps. Small caps have been this much more expensive than large just 9% of the time since 1979.

Small caps tend to have less international exposure than large caps. Over the last five years, the Russell 2000 had on average just 20% of revenue coming from outside the US, compared to 34% for the S&P 500. Our economics team expects the world ex-US GDP to grow at 4.7%, compared to 2.9% for the US in 2011.

In contrast to DeSanctis' view on small caps, Bianco is very constructive on the large caps, and one of his favorite themes for 2011 is Big International Growth (BIG) stocks. Please see the US Equity Strategy Team's 2011 outlook for a screen of BIG stocks as well as other thematic and financial metric-driven preferred stock screens and baskets.

A word on mid caps

Mid caps led the market higher in 2010. While we don't break out mid caps specifically in our asset allocation we are asked to comment on them regularly. From an asset allocation perspective, Global Wealth Management investors should consider mid caps as a part of their large cap allocation.

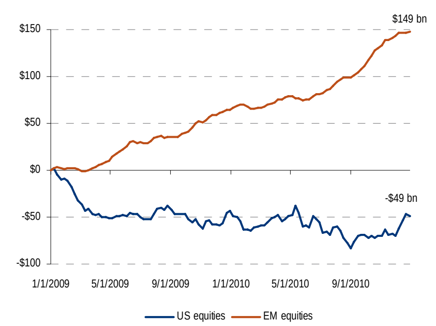
Over time, mid caps can deliver comparable returns as small caps with less risk. However, with strong recent performance, mid caps trade on a forward price to earnings multiple that is comparable to small caps and much higher than that of large caps. Also, we believe earnings growth expectations of over 30% are much too high and will need to be revised down.

Still overweight international equities, but less bullish

We remain overweight international stocks (19% vs the benchmark 16%), but trim both our international developed market and emerging market positions each by a percentage point this month. The RIC remains underweight US equities at 81% vs the benchmark 84%.

We maintain an overweight to international equities, but are less bullish than in 2010. Within international developed markets, the investment case is slightly less compelling this year: Germany is the only real strong story in Europe as sovereign debt issues continue to weigh on markets; Japan is a tempting contrarian investment – but lacks a convincing fundamental story; and a strengthening USD is likely to drive investment flows to US companies. The RIC believes that slow growth in the G7 will continue to drive capital to Emerging Markets (EM), but that healthy investor positioning in the region and rising inflation may slow the rate of that capital flow (Chart 8).

Chart 8: Cumulative flows into EM equities and out of US equities 2009-2010



Source: BofA Merrill Lynch Investment Strategy, EPFR Global

Currency Strategist David Woo believes that the US dollar will appreciate against the euro in 2011, ending the year at $1.20. According to Bianco, a stronger dollar will attract foreign investors into US stocks and should help to keep interest rates low.

While EM equities are still our favorite structural overweight, the RIC recognizes that US mega-cap multinationals can provide access to some of the same strong growth themes in EM at cheaper valuations. Bianco's sector calls echo the EM investment theme: he favors Tech, Energy, Industrials and Materials – all of which benefit from EM-led global growth, rising infrastructure expenditure, and a recovery on global business capex. Further, US equities are currently trading at 13X forward earnings, a 17% discount to their historic average while EM equities are trading at a modest premium to their long-term average.

Asset Markets: Base Case, Ideas, Risks

Table 7: RIC base case for global asset markets

Region/sector Analyst(s)	Convictions	Ideas & risks
Global Economy: Ethan Harris	■ Global growth likely to moderate. Boom in EM fades and DM economies muddle along ■ Pockets of inflation in EM, but either actual (Japan) or threatened (US & Euro zone) deflation in DM ■ Developed economies remain vulnerable, with crippled sectors and regions	■ Supports a gradual recovery in cyclical assets ■ Policy tightening in emerging markets (EM), but not developed markets (DM) ■ Periodic risk flares are likely
Global Equities: Michael Hartnett	■ MSCI All-Country World Index 12-month target 375 ■ Secular emerging market bulls; cyclical developed market bulls ■ Equity positives: policy, liquidity, positioning, EPS, relative valuation ■ Secular bull markets in equities that offer yield, growth, quality	■ Overweight US, Germany & EM (India, Brazil, Russia); Underweight China, Australia, & peripheral Europe ■ Own yield, growth and high quality Best of Breed stocks ■ Mega-Cap Multinationals; EM/Asia consumer remain core structural themes ■ Risks: Policy errors; deflationary double dip in asset prices; excess of deficits driving up interest rates; weak EM growth, high EM inflation
Global Rates: Bin Gao, John Wraith, Priya Misra, Ralf Preusser	■ 10 year US Treasury yield to decline early in 2011, but rise in 2H to end the year at 4% ■ US economy to grow at slightly above trend levels due to the fiscal stimulus. This allows the healing process to gather momentum. However, the path of recovery is subject to downside risks and policy makers face difficult choices. This should argue for a Fed on hold longer than the market expects, and greater uncertainty ■ Yield grab is major theme, which may support US agencies and mortgages but European investors have started to reassess peripheral sovereign risks. We expect peripheral spreads to remain under pressure ■ UK: Risk that fiscal tightening stifles growth in 1H11 and triggers a resumption of QE remains high, though for now the data remains relatively robust ■ Buy Australia 10y Government bond	■ In the US, starting 2011 with a long duration stance in 5s. Own 1 year forward 1y10y volatility and curve steepeners as risk premiums should rise. Finally, we like owning TIPS breakevens to position elevated inflation risk premium ■ Europe: O/W core countries such as Germany & the Netherlands, UW the periphery ■ UK: Inflation expectations may face upward pressure, as CPI is set to rise due to the VAT hike in January. The possibility of additional QE may unsettle investors from an inflation perspective ■ ECB may be unable to withdraw liquidity, buy receiver spreads on 10y EUR rates to position for a bull flattening relative to forwards
Global Commodities: Francisco Blanch	■ We see commodity prices moving broadly higher in 2011 on the back of robust growth in EM even if DM posts relatively weak growth ■ We see tighter money in EM and fiscal retrenchment in DM creating occasional short-term headwinds. But a robust EM consumer and growing government spending on infrastructure & social housing in China and other EM could support prices in 2011 ■ WTI and Brent crude oil prices should average $87/bbl and $88/bbl in 2011, respectively, and oil should hit $100/bbl sometime during the year	■ We see little upside to US natural gas prices as production continues to depress prices, but we remain bullish thermal coal in 2011 on rising EM production cost inflation ■ Increased demand and low inventories will likely push copper to a new record of $11,250/MT in 2011, while gold will complete its move to $1,500/oz in 2011 ■ Risks: our outlook is generally positive, but we see a number of converging risks arising for commodities. Investors should consider some downside protection
Global Credit: Jeff Rosenberg	■ We expect that favorable liquidity conditions will continue to drive spreads to tighter. Our targets are 120bp in HG and 470bp in HY by end-2011 ■ Total returns to HG will be lower in 2011 at 2.5% as rates rise. Ample liquidity leading to declining defaults and the need for yield imply continued investor preference for HY and we forecast around 10% total returns	■ Euro sovereign risk remains but should not rise to the level of systemic risk, allowing US credit markets to decouple ■ HG: O/W higher beta, lower quality bonds. HY: down in quality with preference for lower-rated single-Bs and CCCs. Financial bonds down to junior-most (trust-preferred) level ■ Risks: Largest risks to credit allocations continue to be a double dip recession and deflation, but the likelihood of that scenario has declined in the past few months
Global FX: David Woo, Daniel Tenengauzer	■ USD higher against the G3 as QE2 has passed and the USD to receive support from rising real rates and near term boost in US growth prospects ■ EUR lower: Now that QE2 has passed, markets have begun to focus on deteriorating sovereign fundamentals in peripheral Europe. EUR-USD 1.20 by end-2011 ■ Signs of a global growth soft landing and rising commodity prices should support commodity bloc currencies in the short term ■ Expect policy making in Brazil to trigger a weaker currency, closing the year above 1.80	■ Recommend buying USD vs. basket of short 50% EUR and short 50% JPY ■ Sell EURGBP: Elevated inflation and stronger-than-expected growth should reduce the probability of QE2 in the UK in the near term. In addition, the UK is embarking on a credible fiscal tightening program unlike Euroland which remains problematic.

Source: BofA Merrill Lynch Investment Committee

Global Equity Market Convictions: Ideas & Risks

Table 8: Global equity weightings by region

Region/sector Analyst(s)	Recommendation*	Convictions	Ideas & risks
North America: David Bianco	Overweight	■ 12-month S&P 500 target is 1400, which is 14x our 2012E EPS of $99 ■ S&P EPS growth is outpacing US GDP growth as S&P is not US GDP ■ Tactical overweight: energy, tech, materials, industrials ■ Strategic overweight: tech and mega-cap multinationals	■ BIG: Big International Growth Stocks ■ Highest risk/highest reward play is mega-cap financials ■ Best risk/reward play is technology ■ Best defensive play is consumer staples
UK: Gary Baker	Underweight	■ Macro data continues to surprise on upside with manufacturing optimism at 16yr high ■ 12 month target of 6500 on FTSE 100 ■ O/W resources, energy, banks, healthcare = all major FTSE constituents	■ Concern over the Irish bailout has pushed banks down to levels that are far too cheap – we are O/W the sector ■ Resource stocks enjoy strong operating fundamentals: booming demand & tight supply. Stay O/W as principal China play ■ Risks: the true impact of austerity not likely to be felt before 2Q11
Europe ex-UK: Gary Baker	Underweight	■ 12 mo. price target on SXXP is 300 assumes 12x EPS. Current valuation 10.8x 2011E makes market look cheap against history and vs. bonds ■ Expected profit margins in 2011 look a little ambitious but with record low gearing levels ROE looks secure c. +15% ■ O/W basic resources, banks, energy, pharma, telecom ■ U/W utilities, chemicals, staples	■ EU macro data in core still strong. Germany remains a standout: very strong with multi-year low unemployment and multi-year high business confidence ■ Peripheral financials have shaken confidence but we think the situation stabilizes without Spain asking for support ■ Risks: austerity biting into growth next year, policy misstep on inflation concerns accelerating desire to "normalize" policy measures
Japan: Masatoshi Kikuchi	Underweight	■ Forecasting the Nikkei to end 2010 at 10,500, peak at 12,000 in mid-2011 and fall back to 11,000 by end-2011 ■ Stocks should react to the prospect of earnings recovery in 2H FY3/12, higher dividends/share buybacks and voting exercises by domestic institutional investors ■ Higher US bond yields should be positive for Japanese stocks as they are highly correlated. Rising inflation in Asian countries may help Japan to get out of deflation	■ Raising precision/electronic components from Neutral to Overweight and non-bank financials from Underweight to Neutral and retain our Overweight calls on industrial electronics, auto & rubber and machinery ■ Positive risk scenario includes stronger-than-expected global economy in 2011 and inflation targeting policy by the BOJ ■ Negative risk scenario is the appreciation of the yen beyond 80 and the continued decline in valuation of Japanese stocks
Asia-Pac ex-Japan: Sadiq Currimbhoy	Neutral	■ Asia ex Japan at 2.1x P/B, and inflation is a key risk ■ Tightening throughout much of the region now. China inflation surprise continues to be the principle near term pressure ■ O/W consumer, telecoms, healthcare, tech, insurance; countries—India, Taiwan, Singapore ■ U/W industrials, materials, energy; countries—China, Australia, Philippines	■ Recommend structural exposure to the Asian consumer where margins continue to improve ■ Singapore looks structurally more positive as it increasingly becomes a service economy ■ Key macro risk: inflation ■ Key tail risk: protectionism
Emerging Markets: Michael Hartnett	Overweight	■ EM our favorite structural overweight ■ High growth, low inflation, infant credit cycles and low real rates globally are secular positives for EM ■ Shorter-term investors should be aware that valuations are no longer cheap	■ Long India, Brazil, Russia equities ■ Long Best of Breed in EM ■ Risks: for 2011 is that either an inflationary bubble occurs in EM (low rates, high liquidity) or US protectionism hurts global trade

Source: BofA Merrill Lynch Investment Committee

*Recommendations are relative to regional weightings in the MSCI All Country World Index

Top Convictions from Macro Research

A note to clients: many of the themes that appeared here through 2010 have been replaced for 2011. The RIC doesn't necessarily recommend selling any implementation idea no longer appearing in the table. Many of the themes have an investment thesis still intact; however, those previous themes don't reflect our top 10 best ideas for 2011.

Table 9: Actionable themes and investment ideas

Themes	Rationale	Investment ideas	What to avoid
The scarcity of yield	■ With low interest rates & ageing populations in the developed world, investors should continue to seek out yield in both fixed income and equity markets	■ High yield & EM bonds ■ MLPs & REITS (selectively) ■ For safe, high-dividend yielding equities, see our International High Quality and Dividend Yield Screen and US High Quality and Dividend Yield Screen published each month in the RIC Report. Please also see Cheryl Rowan's Income Portfolio.	■ Dividend yield traps ■ High dividend-yielding stocks with BofA Merrill Lynch QRQ rating of 8
Rising rates	■ We expect the Fed to be on hold until 4Q12, but believe investors should begin to plan in 2011 for an eventual rise in rates	■ Senior Loan Funds	■ Long duration fixed income assets
Fiscal retrenchment	■ Policy makers are likely to reduce budget deficits from current levels by raising taxes and/or reducing government spending	■ US state fiscal austerity will be a positive for bonds of high quality municipal issuers. ■ For investors in high tax brackets, higher quality GO bonds at the state level and essential purpose bonds at the state & local level.	■ Within munis, lower quality issuers, private issuer public purpose bonds, and heavily concentrated positions. Don't reach for yield in the muni space. ■ Within equities, industries heavily reliant on government spending such as Defense
EM & Asia consumer	■ EM & Asia consumers have healthy balance sheets & are at the start of a credit cycle ■ Market capitalization of consumer stocks in EM is low relative to population size.	■ Large cap multinationals in the US, Europe, and Japan that smartly deploy capital in EM to access consumption ■ Commodities, especially Energy and Natural Resources	■ Small cap EM consumer companies (many trading at high valuations) ■ Avoid concentrated positions in direct EM consumer plays
Returning shareholder value	■ Excess free cash flow, low borrowing rates, and greater corporate confidence in macro backdrop should spur capex, M&A and share repurchases among US corporations	■ Equities in technology & industrial sectors. See David Bianco's "Tech titans" "Picks, shovels, & wings" lists ■ For companies likely to return shareholder value, see "Leveraged recap" and "Dividend growth" lists	■ Within equities, avoid financials ■ Within bonds, avoid A-rated bonds of Industrials companies
Small cap tech	■ Great growth potential; relatively cheap valuation within the small cap universe; strong earnings revisions; substantial overseas exposure ■ Takeover candidates because of healthy balance sheets	■ Internet services sector over Semiconductors ■ See Steven DeSanctis' Theme Screen and the Endeavor portfolio published each month in the RIC report	
Germany	■ Solid growth helped by strong finances & a weak Euro ■ German business sentiment recently hit 20yr high; unemployment fell to 20yr low; rising wages	■ OW German equities ■ Within sectors, buy Autos, Machinery, Engineers, & Exporters	
Scarce resources	■ We expect robust commodity demand growth from EM & fundamentally constrained supply in 2011	■ Energy & Industrial Metals over Agriculture ■ Copper, oil, & equities of global commodities producers	■ Commodity price takers such as Utilities ■ Assets in abundant supply such as Treasuries
Active management	■ Fundamental stock selection strategies generally outperform after periods of high correlation. Correlations have already come down since 2Q10	■ Fundamental analysis of stocks with less sensitivity to their industry group or overall market: Materials, software, Tech Hardware & Equipment, and Consumer Services such as Hotels, Restaurants, Leisure & Education Services	■ Benchmark weightings ■ Stock picking in US sectors that tend to be driven more by macro views than company fundamentals: Transport, Insurance, Autos, Utilities
Hedging risk	■ In a risk-on/risk-off world, many asset prices move together when a tail risk strikes	■ Equity options; Buy EM tail risk protection ■ Put spreads on equity volatility can help reduce costs of hedges that go unused in periods of calm volatility	■ DM tail risk protection can be expensive

Source: BofA Merrill Lynch Global Research

Link to Definitions

Macro

Click here for definitions of commonly used terms.

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