

This report summarizes U.S. Trust's year-ahead investment outlook. To receive a more in-depth report or to discuss this information in light of your particular investment objectives, please contact your U.S. Trust advisor.

2010: The Pivotal Year

Building the Foundation for Recovery as the Bull Moose Treks On

We live in a world of constant and accelerating change. Short- and long-term economic trends are converging in an unusual and powerful way to create potential opportunities which we believe will take firmer hold in The Pivotal Year of 2010. Every year has its endings and beginnings, of course, but next year seems to have a larger-than-usual share: the end of the decade, the possible launch of a better-than-expected recovery, the roll-off of the Bush tax cuts, a potential new healthcare bill, the fiscal stimulus of last year finally having an impact, a potential shift in monetary policy, movement from a government-assisted economic recovery to a self-sustaining private-sector-led recovery, job losses to job gains, heavy reliance on the consumer to reliance on business spending, and many others.

Times of significant change can be times of meaningful opportunity. We are emphasizing areas which can benefit from a short-term, cyclical, repair-to-recovery phase as well as the long-term growth shift from the developed to the developing world.

IN THIS PIVOTAL YEAR, WE ARE FOCUSED ON:

- Portfolio positioning
- Opportunistic investments
- Risk management

WE CONTINUE TO EMPHASIZE:

- Late-cycle reflationary assets and equities
- Emerging market equities
- Growth equities over value
- Specific sectors: materials, energy, technology and industrials
- High-quality U.S. multinationals

BUILDING THE FOUNDATION FOR RECOVERY

In 2009 we closed out the first ascent of the journey to recovery through rescue and repair by way of government-led assistance and stimulus to thaw credit. We are now in the second ascent — a private-sector-led recovery driven by real job growth. This is why we believe 2010 is The Pivotal Year. We are transitioning from rescue and repair to recovery. The third ascent should bring us to a rebalanced global economy, with an expanded global infrastructure, a healthier U.S. economy and China emerging as the second-largest economy in the world. On the way, we should see job growth, a self-reinforcing recovery and Fed tightening. And throughout this process, we should see profits grow and a cyclical bull market that eventually retests prior highs by the end of 2011.

Specifically, if we do see the job growth we're expecting, the first half of 2010 could see a solid stock-market rally that approaches 1300 on the S&P 500. Beyond that, we'll look to move beyond recovery to actual expansion driven by improvements in

business equipment spending, mergers and acquisitions and a pickup in consumer demand — which could potentially set us up for continued gains in 2011.

WITH CHANGE, OPPORTUNITY

We don't mean to imply all blue skies ahead. Challenges remain, and we actively work to manage the risks associated with each. But we remain confident that solutions will emerge. The entrepreneurial drive, the ability to dream big, and the availability of far-reaching mechanisms (such as the internet) to transfer new ideas and desires into realities — are all alive and well. In the next decade, we expect new industries, new technologies and new jobs. We believe the

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— Chris Hyzy,
Chief Investment Officer,
U.S. Trust

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opportunities will be in areas of scarcity: natural resources, capital expenditures, growth, balance sheet health and quality yield. The demand for medical advances will likely continue rapidly. We believe infrastructure refurbishment will accelerate in all corners of the globe. Educational services will likely expand to provide the skilled workforce needed for new industries, and skilled labor should continue to command a premium over unskilled labor.

These are structural and longer-term opportunities. We believe they have already started to develop and expect them to take firmer hold in the pivotal year of 2010.

INVESTMENT OUTLOOK

We expect to see growth in equities and believe the market is underestimating the earnings power of U.S. companies in particular, creating an opportunity for investors.

Low-yielding fixed-income assets, the recovery in manufacturing and business investment, M&A activity and the mountain of cash on the sidelines should continue to provide a solid backdrop for equities in the near term. Fund flows to bond funds and emerging markets have significantly outpaced those to domestic equities, and we think the market is underestimating the earnings power of U.S. companies in particular.

Investors with excessive cash and fixed income allocations should continue to rebalance portfolios into longer-term assets now, before the economy and markets fully recover.

PORTFOLIO CONSIDERATIONS¹

Equities:

We are upgrading multinational large cap U.S. equities to overweight. High-quality U.S. multinational companies' fourth-quarter earnings should receive a huge lift from currency translation. Global demand for U.S. goods should also begin to gather momentum. Sectors we are watching with interest include two notable laggards — energy and industrials. We are also maintaining our overweight positions in materials and information technology. Additionally, we recently upgraded the healthcare sector to neutral weight and downgraded the financial and consumer discretionary sectors to underweight. At this point, most of the political fears have been priced into the healthcare sector and valuations are attractive, in our view.

¹ All sector recommendations must be considered by each individual investor to determine if the sector is suitable for their own portfolio based upon their own goals, time horizon, and risk tolerances.

OTHER IMPORTANT INFORMATION

Equity securities are subject to stock market fluctuations that occur in response to economic and business developments. 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. Global investing poses special risks, including foreign taxation, currency fluctuation, risk associated with possible differences in financial standards and other monetary and political risks. Investing in 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. 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. Alternative investments are intended for qualified and suitable investors only. Alternative investments involve limited access to the investment and may include, among other factors, the risks of investing in derivatives, using leverage and engaging in short sales, practices which can magnify potential losses or gains. Alternative investments are speculative and involve a high degree of risk. Commodities investments are highly volatile and are speculative. Commodities prices may be affected by overall market movements, changes in interest rates and other factors such as weather, disease, embargoes and international political and economic developments.

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We continue to overweight small and mid cap equities and emerging markets but remain selective, preferring countries likely to benefit from the U.S. and China leading the global economy out of recession (for example, Brazil, Singapore and Mexico).

Commodities:

We are maintaining our tactical overweight in tangible assets (commodities). We continue to emphasize commodity-linked economies and currencies (Canada and Australia), which tend to outperform the U.S. in an environment of relative commodity-price strength, which we expect as reflation efforts succeed and global growth surprises to the upside.

As far as gold is concerned, we would view an allocation to the metal at current levels as more of a hedge against a dollar collapse rather than a pure directional investment.

Cash and fixed income:

We remain underweight cash and fixed income. We continue to prefer investment-grade corporate bonds over Treasuries and international developed bonds.

Alternative investments:

Private Equity: Strategic M&A activity is picking up and is helping the private equity asset class recover.

Hedge Funds: The global convergence period should create significant opportunities for long/short, distressed debt and event-driven managers in the hedge fund space. We think this will take time, and patience is needed.

Real Estate: Unlike leading indicators for other sectors of the economy, those for commercial real estate activity remain weak. In our view, it is premature to be advocating an upgrade to the real estate asset class at this time.

Longer-term investment themes:

Broader themes we think have potential over the longer term include water, agricultural commodities, climate change, healthy lifestyles and aging, Asia's emerging market currencies, defense, the rise of the emerging market middle-class consumer, nuclear power, information technology and Africa.

“We've been saying it for some time now, but it deserves repeating: now is the time to actively examine and position investment portfolios for the recovery.”

— Chris Hyzy,
Chief Investment Officer,
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