

Outlook

January 2020



Long-term
perspective on
markets and
economies



2020 Outlook

Key takeaways:

MACRO

Stay balanced in this election year.

Patient investors can do well in election years. We looked at every election since 1932 and found that primary seasons are volatile, but markets have notched solid gains afterward. It may be better to stay invested than sit on the sidelines.

Recession in 2020? Not if the consumer stays this strong. In the U.S., it's a tale of two economies: Consumer strength should continue to offset the manufacturing slowdown caused by trade and policy uncertainty.

EQUITY

Consider upgrading your equity portfolio.

The best offense is a good defense. It's not too soon to prepare portfolios for rougher seas ahead as we face headwinds from an election year, a slowing global economy and late-cycle markets.

Look for sustainable dividends, not just "value" investments. The value label can be misleading because it's not always defensive. It's better to select companies that can sustain dividends when times get tough.

Think all the best stocks are in the U.S.? Think again. Over the last decade, most of the top 50 stocks were non-U.S., even though the U.S. index did better overall. It's about selecting companies, not indexes.

FIXED INCOME

Consider upgrading your bond portfolio.

It may be time to revisit your bond allocation. Given the late-cycle U.S. economy and weakness abroad, your fixed income allocation should be mostly Core bonds that can help mitigate stock market volatility.

Consider complements to high-yield corporates. High-income munis and emerging markets bonds have offered similar after-tax income potential – often with lower correlation to equities.

Municipal bonds continue to offer good relative value. Election years can spell volatility for munis. View setbacks as opportunities to add tax-advantaged income and equity diversification potential to your portfolio.

CE credit available

Earn one hour of CE credit from CFP and CIMA by watching our 2020 Outlook webinar and completing a short quiz at the following link:

www.cecreditcenter.com

Patient investors can do well in election years

Mark Twain once quipped, “If voting made any difference, they wouldn’t let us do it.” All kidding aside, as we head toward a pivotal U.S. presidential contest in November, it’s worth reminding investors that election results, historically speaking, have made essentially no difference when it comes to long-term investment returns.

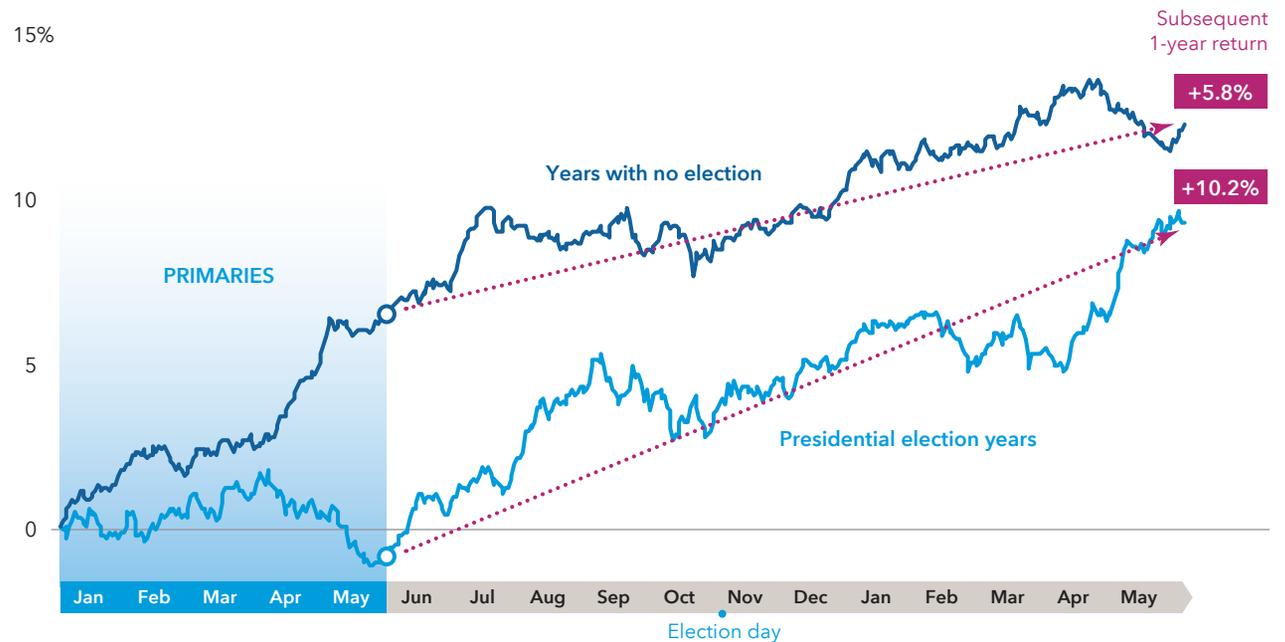
What has mattered is staying invested. Looking at election results back to 1932, U.S. stocks have trended up regardless of whether a Republican or Democrat won the White House. Investors who held on for at least a year were rewarded for their patience, though they had to withstand heightened volatility during the primaries.

Election-related volatility can in fact produce select opportunities. Pharmaceutical and managed care stocks have recently come under pressure amid political criticism of private sector health insurance. That, in turn, has resulted in some attractive company valuations for investors who believe that a government takeover of the nation’s health care system isn’t imminent.

“Investing during an election year can be tough on your nerves,” explains Capital Group portfolio manager Greg Johnson, “but it’s mostly noise and the markets carry on. Long-term equity returns are determined by the value of individual companies over time.”

Volatility during primaries is often followed by strong returns

S&P 500 Index average cumulative returns since 1932



SOURCES: Capital Group, RIMES, Standard & Poor’s. Includes all daily price returns from 1/1/32–11/30/19. Years without an election exclude all years with either a presidential or midterm election. Subsequent one-year return calculation begins on May 31 each year, a proxy for the end of primaries. Standard & Poor’s 500 Composite Index is a market capitalization-weighted index based on the results of approximately 500 widely held common stocks. Returns are in USD.

Policy and trade uncertainty drive global slowdown

Global economic growth is slowing, and there's no shortage of reasons why: a damaging U.S.-China trade war, political turmoil in Europe, violent protests in Hong Kong. The list goes on, creating a spike of uncertainty not seen since the 2008-2009 financial crisis. However, there are equal and opposite reasons to be cautiously optimistic about the outlook for 2020.

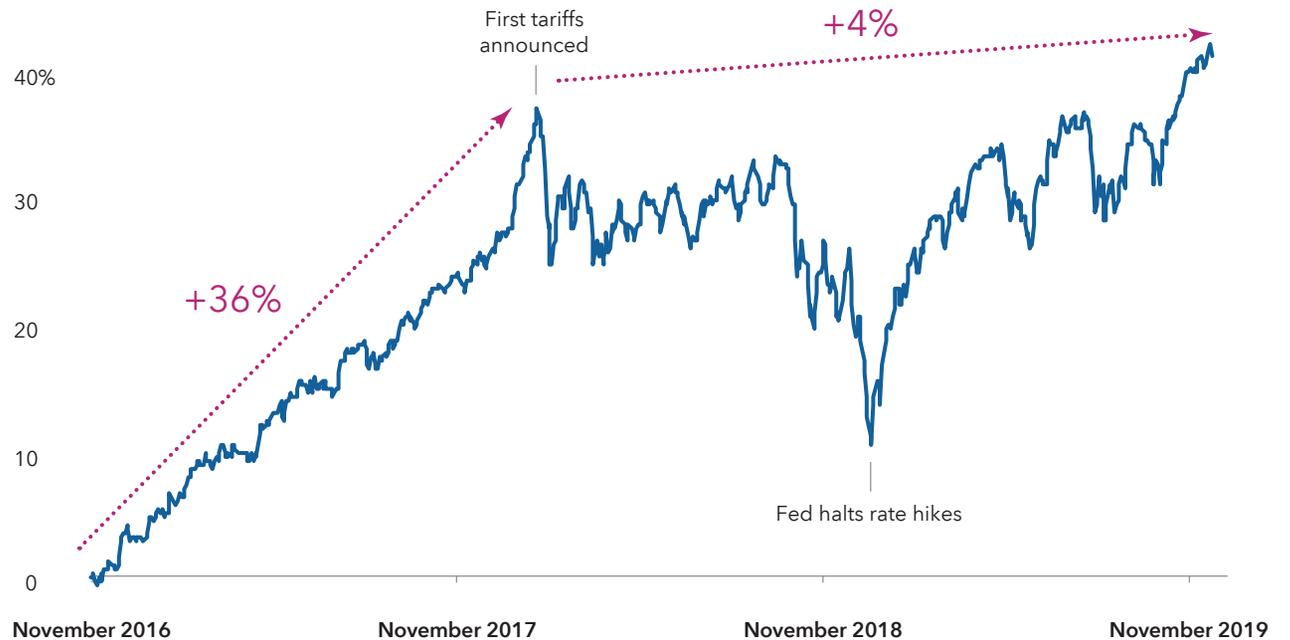
Powerful catalysts for change include a U.S.-China trade deal (even a limited one); a likely Brexit resolution in the U.K. (one way or the other); and an eventual return to normal levels of manufacturing activity as companies begin to invest again in a less uncertain world.

In the meantime, investors should remain focused on the long term and try not to get too caught up in the day-to-day headlines, says portfolio manager Jonathan Knowles, who has a front-row view of the global trade environment from Capital's Singapore office.

"The whole world is messy right now and we've just got to deal with it," Knowles says. "We're living in incredibly disruptive times – politically, economically and socially. Our job, as investors, is to find companies that will prosper no matter which way the macro winds are blowing."

Global stocks have been flat since the trade war began

MSCI ACWI cumulative return



SOURCES: MSCI, RIMES. As of 11/30/19. Returns are cumulative since the U.S. presidential election on 11/8/16. Returns are in USD.

To counter slowdown, central banks go lower for even longer

Global monetary policy took a sharp turn onto easy street in 2019 and never looked back. Reacting to rising tariffs and slowing economic growth, the U.S. Federal Reserve, European Central Bank and many others aggressively cut interest rates in a bid to boost growth and offset the damaging effects of a global trade war.

In other words, the “lower for longer” interest rate outlook remains as valid as ever. Policy rates are not likely to move higher in 2020, and the key question is: How low will they go? The answer may depend on whether the U.S. and China can reach a sustained trade-war truce.

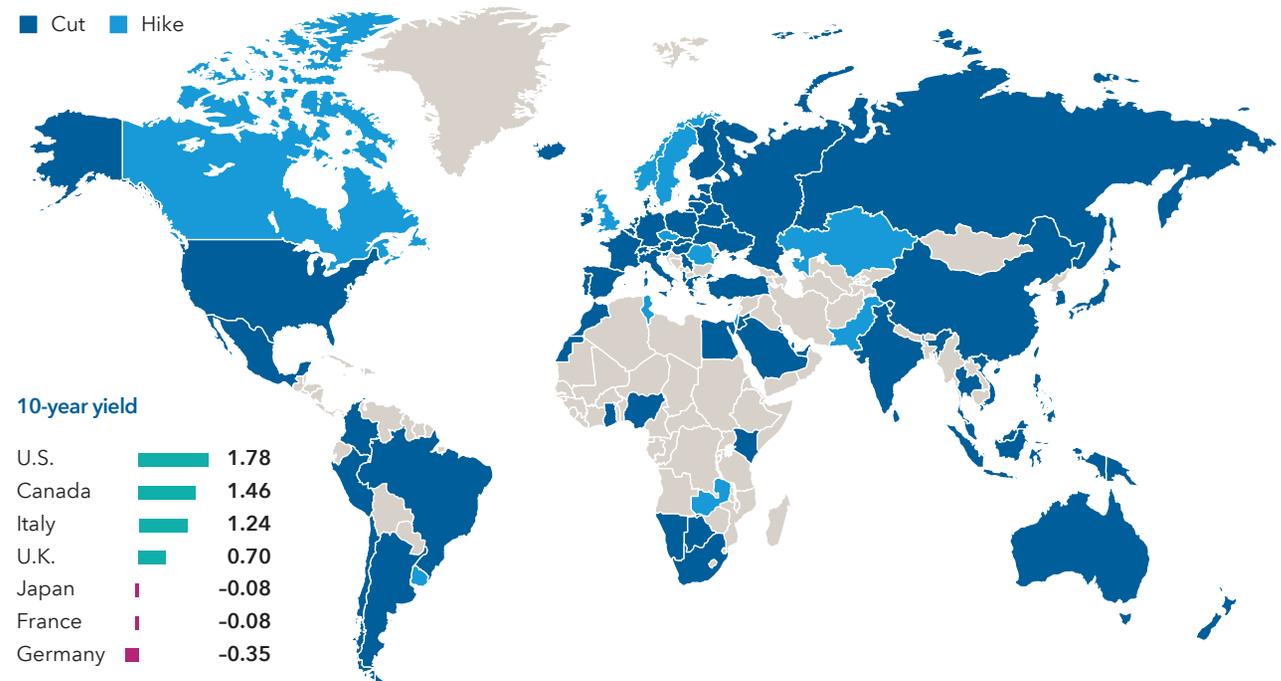
Easy monetary policy in the year ahead should provide a supportive environment for economic growth and equity prices. That doesn't mean conditions will be rosy, but it does make a U.S. or global recession unlikely in 2020, says Capital Group economist Darrell Spence.

“It takes a while for interest rate cuts to have an impact,” Spence explains. “The central bank actions we've seen this year won't really kick in until the first half of 2020. Whether that will be enough to offset the negative factors weighing on global growth remains to be seen.”

Major central banks ease monetary policy to boost growth and avoid recession

Latest central bank action

■ Cut ■ Hike



10-year yield

U.S.	1.78
Canada	1.46
Italy	1.24
U.K.	0.70
Japan	-0.08
France	-0.08
Germany	-0.35

SOURCES: FactSet, Refinitiv Datastream. As of 11/30/19. Yields are 10-year sovereign bond yields.

Is a recession likely in 2020? Not if the consumer holds up

Manufacturing has slowed across major economies ...

Manufacturing PMI



The trade tug of war between the U.S. and China has put pressure on manufacturing around the world – and Europe has been caught in the middle. Factory activity has been slowing across major economies, leaving companies hesitant to invest.

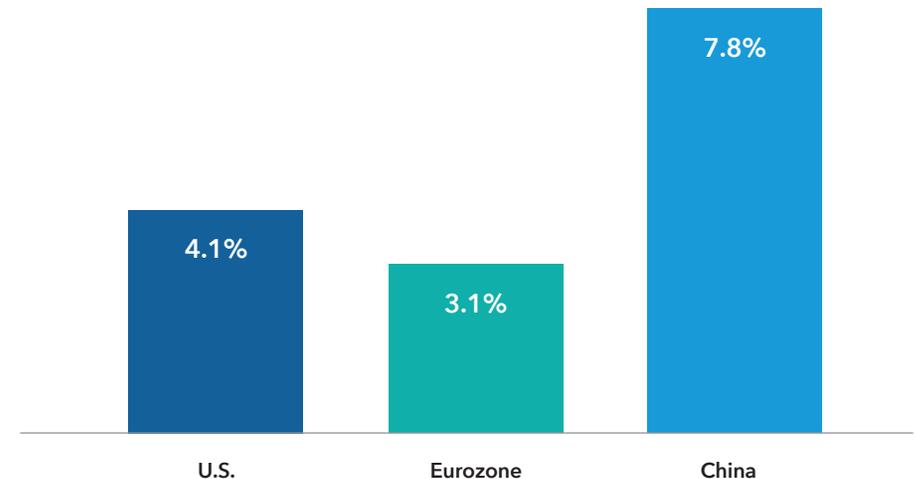
Nowhere has this been felt more acutely than in Europe, which is heavily dependent on global trade. Germany's auto sector, for example, has taken a

beating. Ironically, in the U.S., where manufacturing and export activity each account for about 12% of economic output, the impact has been more muted.

So, is a recession likely? "We are seeing a tale of two economies," says economist Darrell Spence. "While manufacturing has been weak, consumer fundamentals have been strong. As long as this remains the case, I don't expect a recession in the next year."

... but consumption has been solid

Retail sales growth (YoY)



Indeed, U.S. unemployment remains below 4%, wage growth has been solid and consumer spending healthy. Domestic demand has been reasonably solid in Europe and China as well. "Even if trade issues put further pressure on the economy, investors should remember that smart companies are fluid and can adapt to changing circumstances," says equity portfolio manager Alan Berro.

SOURCES: FactSet, Markit, Refinitiv Datastream. PMI as of 11/30/19. Retail sales as of 9/30/19.

Playing offense? Consider companies with pricing power

Storm clouds on the economic horizon will sometimes lead to rain, but well-managed innovative companies adapt to changing circumstances, giving them the potential to thrive regardless of the forecast.

Consider semiconductors: Once an industry with dozens of competitors subject to volatile boom-and-bust cycles, today the few remaining companies that specialize in chip manufacturing, including Taiwan Semiconductor and Intel, enjoy relatively smoother sailing.

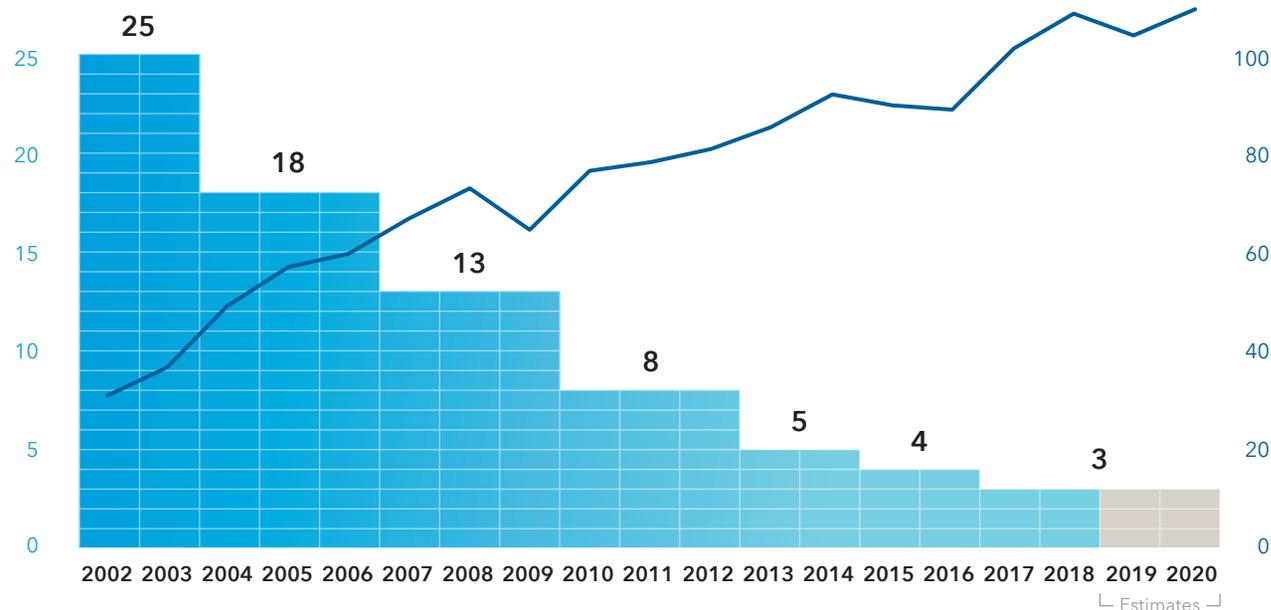
This consolidation has helped increase pricing power, scale and profit margins as it has coincided with a robust demand for specialized chips to power smartphones and fuel advances in artificial intelligence. "The need for these chips will likely expand," says equity portfolio manager Steve Watson. "And thanks to better discipline among the competitors, we have not seen prices collapse when demand has slowed. This pricing power can be even more impactful in a time of historically low rates."

Other sectors potentially benefiting from pricing power include the athletic footwear and apparel giants Nike and Adidas, who are capitalizing on rising demand in China and other markets; and online retail, where platform companies like Amazon and China's Alibaba can demand lower prices from suppliers and pass them on to consumers.

Semiconductor logic: Fewer companies plus soaring demand equals pricing power

30 Number of leading logic chipmakers

Sales (billions USD) 120



SOURCES: Capital Group, Intel, Statista, Inc., World Semiconductor Trade Statistics. Number of companies represents semiconductor companies capable of manufacturing the smallest chips available in each period. 2019 and 2020 are estimates.

Playing defense? Try upgrading with higher quality dividends

Trying to predict the timing of a recession is a fool's errand. As noted economist Paul Samuelson once declared, "The stock market has predicted nine of the last five recessions."

But it's never too soon for investors to consider whether their equity portfolios are well-balanced and positioned for downturns.

"I look for companies that can act defensively when volatility rises, but can participate if the market advances," says Joyce Gordon, a portfolio manager with four decades of investment experience. "I focus on dividend-paying companies with strong free cash flows and underlying earnings growth that have weathered previous bear markets."

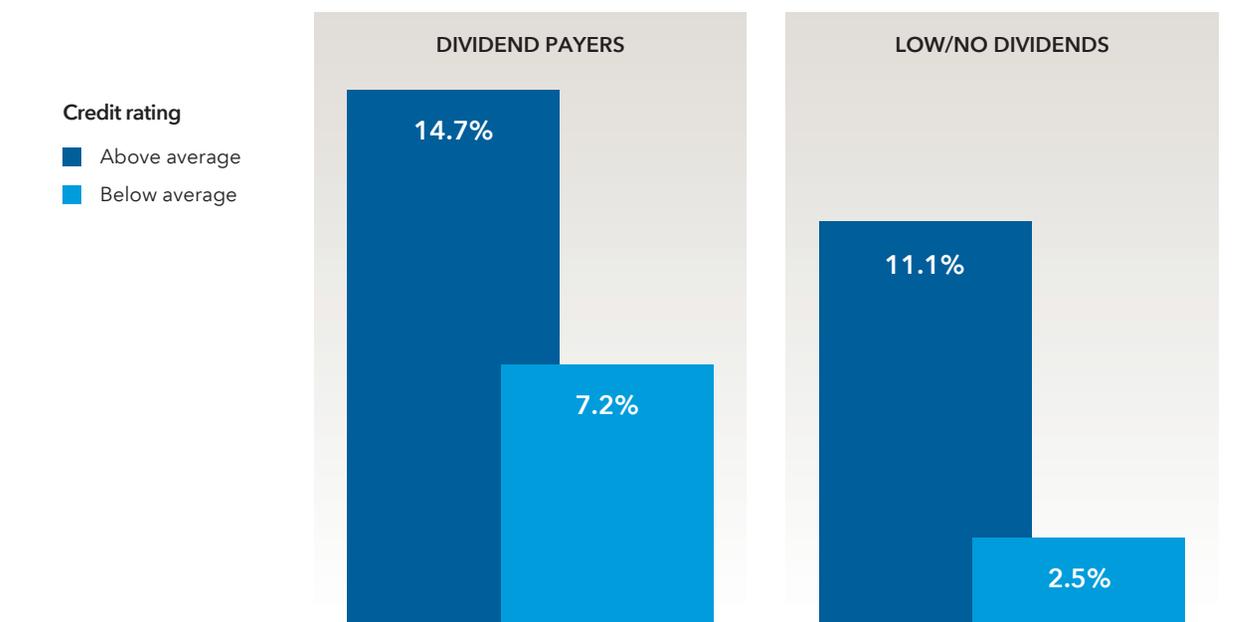
Between September 20, 2018, and November 30, 2019, a period of trade-related volatility, companies with above average credit ratings outpaced those with lower ratings. What's more, dividend payers with above average credit ratings outpaced those with lower credit ratings and companies that paid little or no dividends.

"I steer clear of companies that have taken on too much debt," notes Gordon. "Companies at the lower end of the investment-grade spectrum can struggle to fund themselves in a recession, increasing the risk that they might cut their dividends."

Companies with solid credit ratings that have paid meaningful dividends can be found across a range of sectors. Some examples include UnitedHealth, Microsoft, Procter and Gamble, and Home Depot.

Dividend payers with higher credit ratings have led the market since late 2018

Cumulative returns (9/20/2018-11/30/19)



SOURCES: Capital Group, FactSet, Morningstar. Includes all stocks in the S&P 500 Index for the entire period of 9/20/18-11/30/19. 9/20/18 was the market peak in 2018. "Low/no dividends" category includes all companies with a dividend yield less than or equal to 0.5%. Credit ratings are based on the lower of S&P and Moody's rating. "Above average" includes credit ratings A or higher. "Below average" includes credit ratings A- or lower. Companies with no credit rating are included in the "Below average" category. Companies without debt are included in the "Above average" category. Returns are in USD.

If you think all the best stocks are in the U.S., think again

International equities rose in 2019 but have now lagged the S&P 500 Index eight times in the past decade. Yet at the same time, the companies with the best annual returns each year are overwhelmingly located outside the U.S. In 2019, 37 of the top 50 stocks were based on foreign soil.

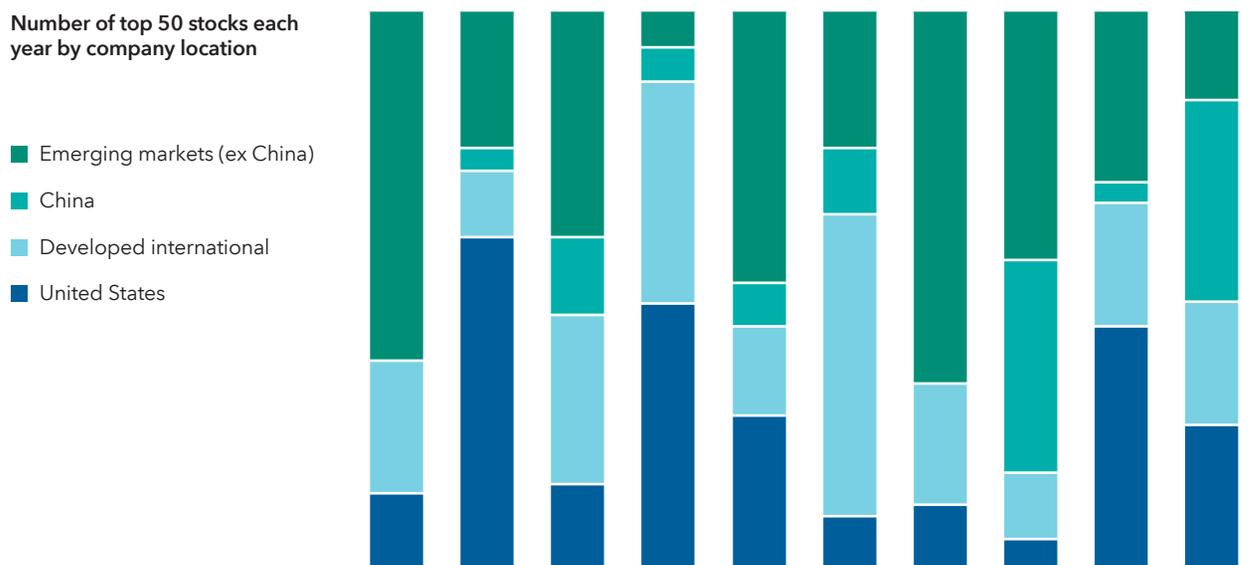
How can this be? It's all about opportunity. There are roughly three times as many investable foreign stocks as domestic. As an investor, why limit yourself to a quarter of the available pool when there are great companies located throughout the world?

In a year when political pressure has weighed on many U.S. health care companies, Japanese pharmaceutical giant Daiichi Sankyo was one of the top returning stocks. Likewise, Kweichow Moutai is far from a household name outside of China, but became the world's largest spirits company by market value after its stock nearly doubled in 2019 (through November 30).

When markets are uncertain, it's important to have some flexibility in portfolios. Consider selecting global funds that give managers the flexibility to choose from among the best companies, no matter where they are located.

74% of the top stocks since 2010 have been based outside the U.S.

Number of top 50 stocks each year by company location



Index return	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019 YTD
U.S.	15.1%	2.1	16.0	32.4	13.7	1.4	12.0	21.8	-4.4	27.6
Non-U.S.	11.2%	-13.7	16.8	15.3	-3.9	-5.7	4.5	27.2	-14.2	16.5

SOURCES: MSCI, RIMES. 2019 as of 11/30/19. Returns are in USD. Top 50 stocks are the companies with the highest total return in the MSCI ACWI each year. Returns table uses S&P 500 and MSCI ACWI ex USA indexes for U.S. and non-U.S., respectively. The MSCI ACWI ex USA is a free float-adjusted market capitalization-weighted index that is designed to measure equity market results in the global developed and emerging markets, excluding the United States.

International indexes don't tell the whole story

There are many reasons for lackluster non-U.S. returns over the last decade: a strong U.S. dollar, political turmoil and trade tariffs – just to name a few. But another factor is the way in which we typically measure international markets.

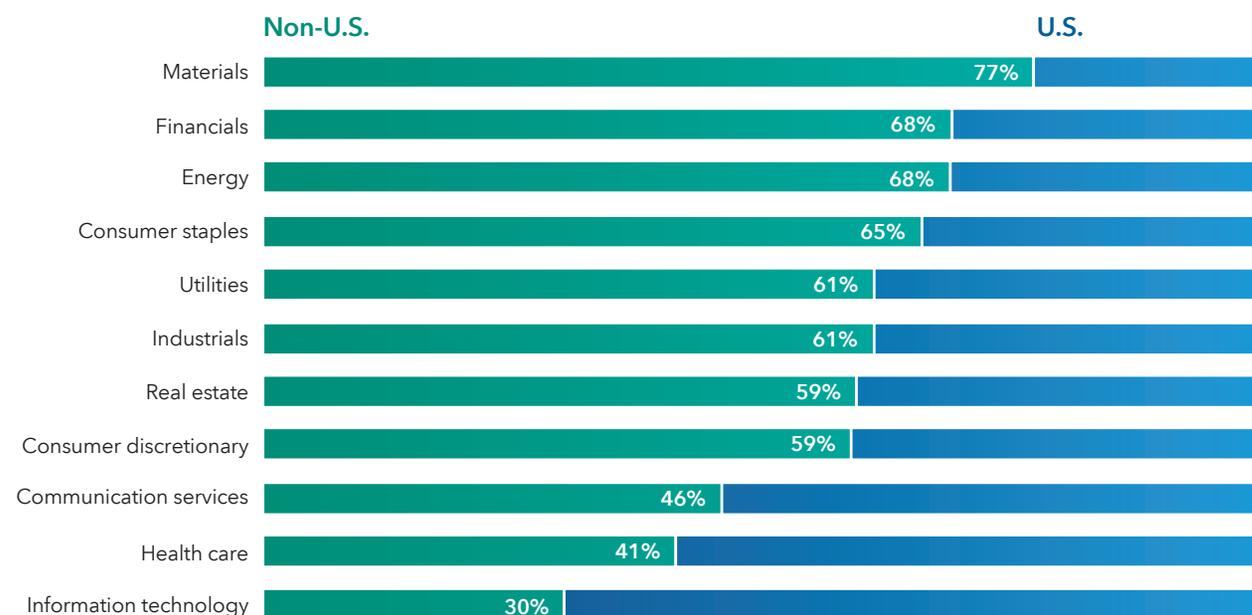
International indexes generally have a greater concentration of value-oriented stocks in “old economy” sectors such as materials, financials and energy. Contrast that with the U.S., where technology and health care dominate.

International markets may not be heavily weighted with high-flying tech stocks, but they have no shortage of market-leading companies. A significant part of the health care sector is U.S.-based, but large pharmaceutical companies Novartis, AstraZeneca and Novo Nordisk all call Europe home. Neighbors LVMH, Kering and Richemont own some of the world's most recognizable luxury brands. And in Asia, Murata and FANUC are on the cutting edge of robotics and factory automation.

Compared to U.S. stocks, international equities have also had higher average dividend yields and lower valuations. These are attractive characteristics for investors who prefer to be more defensive in a late-cycle environment. For example, Nestlé paid a 2.4% dividend as of November 30, 2019, and sells products that consumers crave regardless of economic conditions.

Non-U.S. indexes are more heavily weighted toward lower growth sectors

Regional exposure of each sector within MSCI ACWI



SOURCES: MSCI, RIMES. As of 11/30/19. The MSCI ACWI is a free float-adjusted market capitalization-weighted index that is designed to measure equity market results in the global developed and emerging markets, consisting of more than 40 developed and emerging market country indexes.

It's about companies, not countries

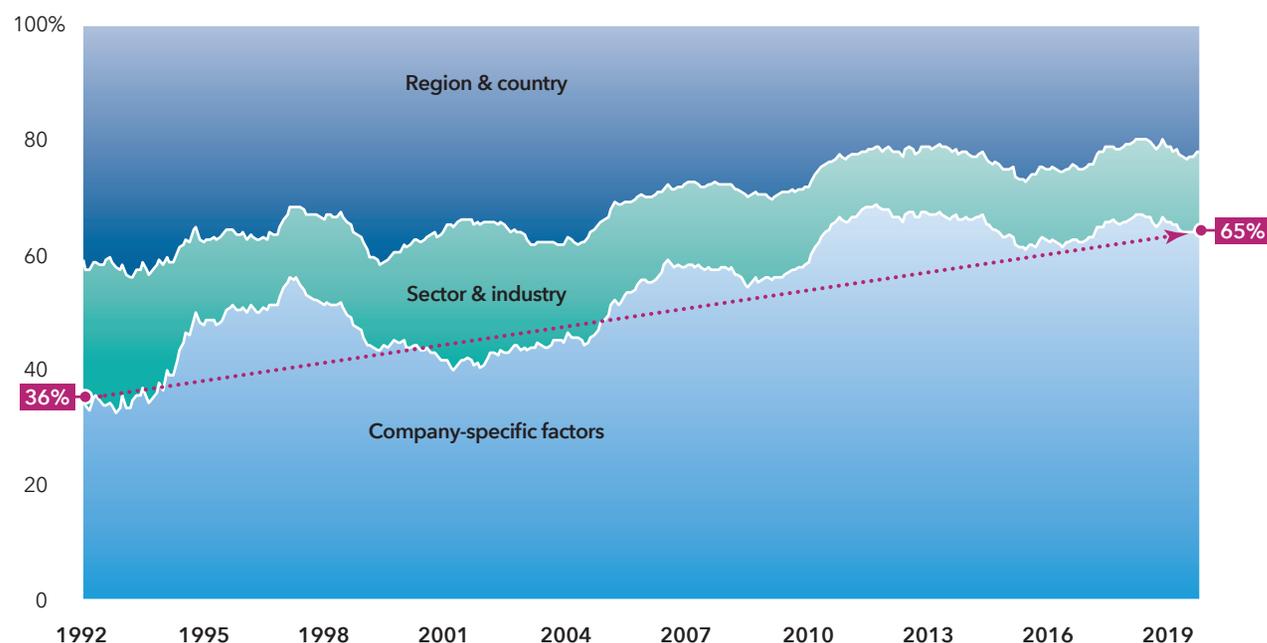
In some ways, international investing used to be much easier – dividing stock portfolios into geographic buckets was a simple way to achieve diversification. But globalization has made this less effective, so individual company characteristics have become more important than ever.

A study by Empirical Research Partners confirms this. In 1992, most of an emerging market (EM) company's return could be explained by its sector or region, and only 36% by the business itself.

"That was when investing in emerging markets was a relatively new concept, and the macro environment drove returns," says equity investment director David Polak. "EM companies were grouped together as a basket of higher growth but riskier assets. Today that's changed." As they have become more established on the global stage, 65% of their stock returns can now be explained by company-specific factors. "This is the same proportion found in developed markets. So, no matter where you invest, company fundamentals matter most," Polak emphasizes.

Country-specific issues will still influence business profits, but top companies are often able to overcome these external factors. This is where bottom-up research becomes essential – and can be the difference between investing in a company that succumbs to economic headwinds, or one that becomes the next big growth story.

Nearly two-thirds of EM returns can be attributed to company fundamentals



SOURCE: Empirical Research Partners. As of 11/30/19. Data shows the percentage of emerging markets' return that can be attributed to various factors over time, using regression analysis and a two-year smoothed average.

Core fixed income can offer balance when you need it most

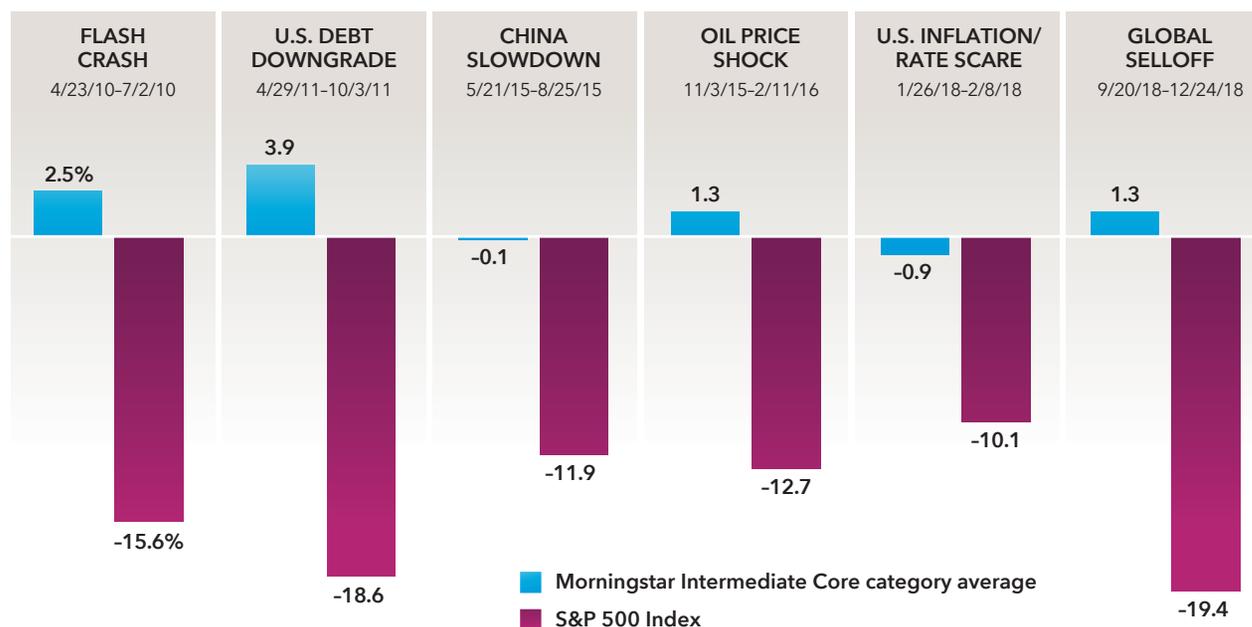
The lower for longer world profoundly changed investors' fixed income portfolios. Amid a widespread hunt for yield, many strategies regarded as core fixed income are not what they seem.

For years, we've cautioned investors to ensure their Core bond fund isn't overemphasizing income at the expense of equity diversification. Morningstar's April 2019 split of its \$1.6 trillion Intermediate-Term bond category provided some badly needed clarification on the matter.

Now, funds with less than 5% invested in high yield fall under the new Intermediate Core category. Most other funds were reassigned to Intermediate Core-Plus. Many of those funds seek higher income and show high equity correlation due to greater exposure to high yield. Morningstar's decision helps investors more easily distinguish strategies that may be more vulnerable in stock market declines from those which seek to offer a balance of the four key roles of fixed income: diversification from equities, income, capital preservation and inflation protection.

If you're seeking balance, consider a fixed income allocation that is mostly Core. Core-Plus could be a relatively modest exposure – perhaps held alongside high-income munis or emerging market debt. These asset classes (which can be volatile) have shown similar income potential to high yield – often with lower correlations to equities.

When you need core most: Cumulative returns (%) during recent market corrections*



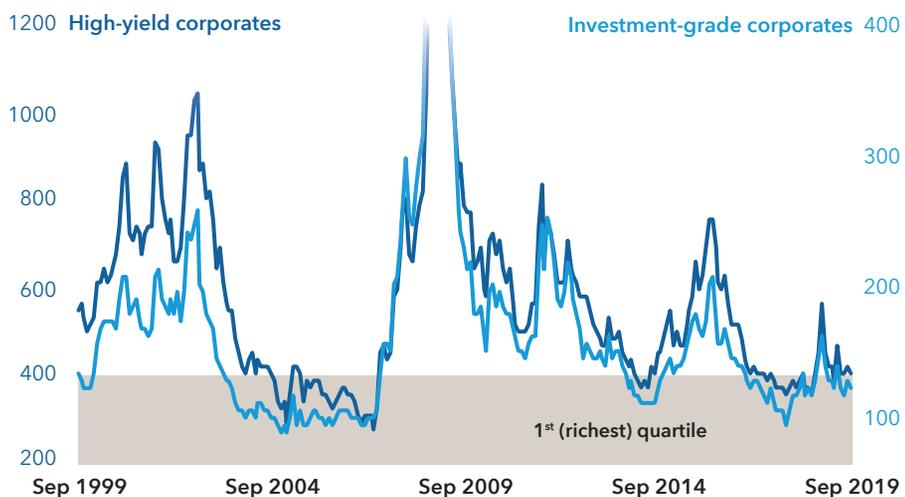
SOURCES: Capital Group, Morningstar, Standard & Poor's.

*Dates shown for market corrections are based on price declines of 10% or more (without dividends reinvested) in the unmanaged S&P 500 with at least 50% recovery persisting for more than one business day between declines. The returns are based on total returns in USD.

With corporates expensive, reaching for yield may not pay off

Credit valuations continue to look quite expensive

Range of credit spreads since 1999 divided into quartiles (bps)



Credit markets have been on a tear. The hunt for yield has put investment-grade and high-yield corporate bonds on track to notch double-digit gains in 2019. Will the good times continue?

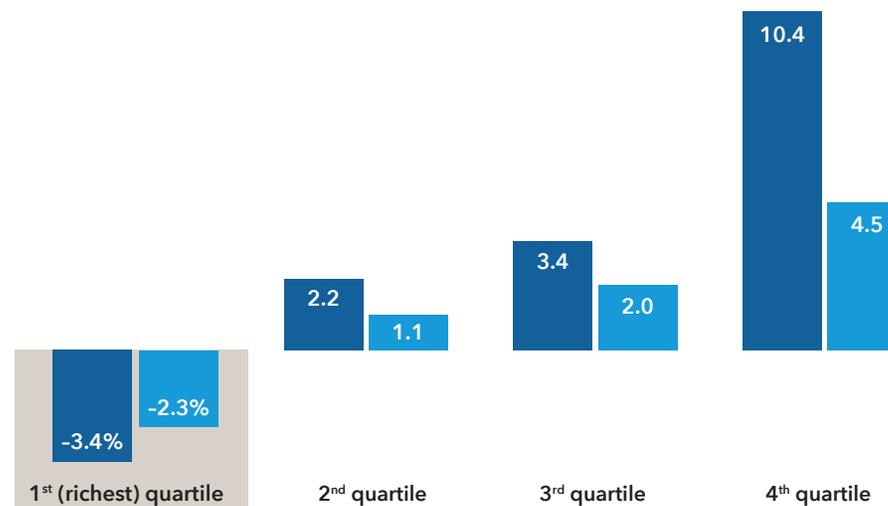
History shows that, with valuations at these levels, corporate credit has tended to lag or only modestly outpace U.S. Treasuries.

For investors, this suggests corporate credit may offer limited “extra” return potential for the risk entailed.

That’s important because many investor portfolios have a heavy exposure to credit that may leave them vulnerable in today’s late-cycle environment.

History suggests credit may lag or modestly lead Treasuries

Annualized two-year excess returns over Treasuries



Holding too much high yield is a particular concern. Rather than providing diversification, lower quality bonds have tended to suffer amid weak equity markets. If most of your portfolio’s fixed income is in a fund from Morningstar’s new Core-Plus category (see page 11), chances are you may be exposed to this vulnerability.

SOURCE: Bloomberg Index Services Ltd.: U.S. High Yield Corporates Index, U.S. Investment Grade Corporates Index and U.S. Treasury Index. Chart shows monthly spread data for high-yield and investment-grade credit from September 1999 through September 2019. 20-year monthly spread history (240 data points) is divided into quartiles. Returns are in USD.

Municipal bonds still offer value for income seekers

Because of the uncertainty around how tax and other fiscal policies will evolve, election years often spell volatility for the municipal bond market.

This time around, investors may also be uneasy if slower economic growth exposes troubled finances and creaking pension funds in certain states.

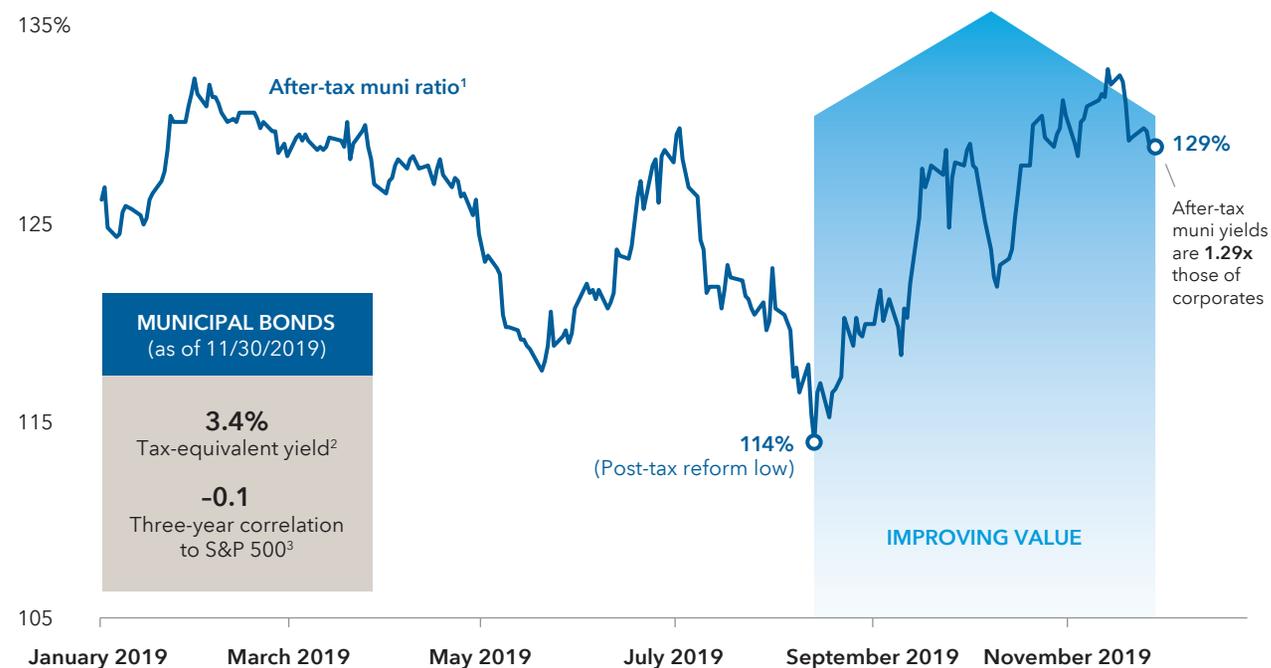
All that suggests the record-setting surge of investor money pouring into munis may recede. And yet, fundamentals should remain solid overall.

2020 may be the time to treat market setbacks as possible investment entry points and focus on longer term value.

Relative value compared to taxable bonds (measured by the so-called muni ratio) has improved, though there are still likely to be ups and downs. The ratio shows after-tax muni yields as a percentage of taxable bond yields. Put simply, higher ratios indicate that the after-tax income potential of munis meaningfully surpassed that of corporate bonds for taxpayers in higher (and middle, to a lesser extent) tax brackets.

Tax-advantaged income is just one benefit of the asset class. Investment-grade and high-yield municipal bonds also provide a potential source of equity diversification. With all that in mind, municipal bonds could be an option for investors looking to upgrade their portfolios.

Rising ratios signal improving value in municipal bonds relative to corporates



SOURCES: Capital Group, Bloomberg Index Services Ltd.

¹The muni ratio, through 11/30/19, expresses the after-tax muni bond yield as a percentage of taxable bond yield (for example: 100% indicates equal after-tax yields).

²Taxable-equivalent-rate assumptions are based on a federal marginal tax rate of 37%, the top 2019 rate. In addition, we have applied the 3.8% Medicare tax. A-rated bond yields based on components of the Bloomberg Barclays U.S. Aggregate Index for taxable bonds and the Bloomberg Barclays Municipal Bond Index for municipal bonds. Muni correlation reflects overall index.

³Correlation describes how closely changes in the returns of two assets mirror each other. A near-zero value indicates the assets are uncorrelated and may offer a diversifying effect when held together in a portfolio.

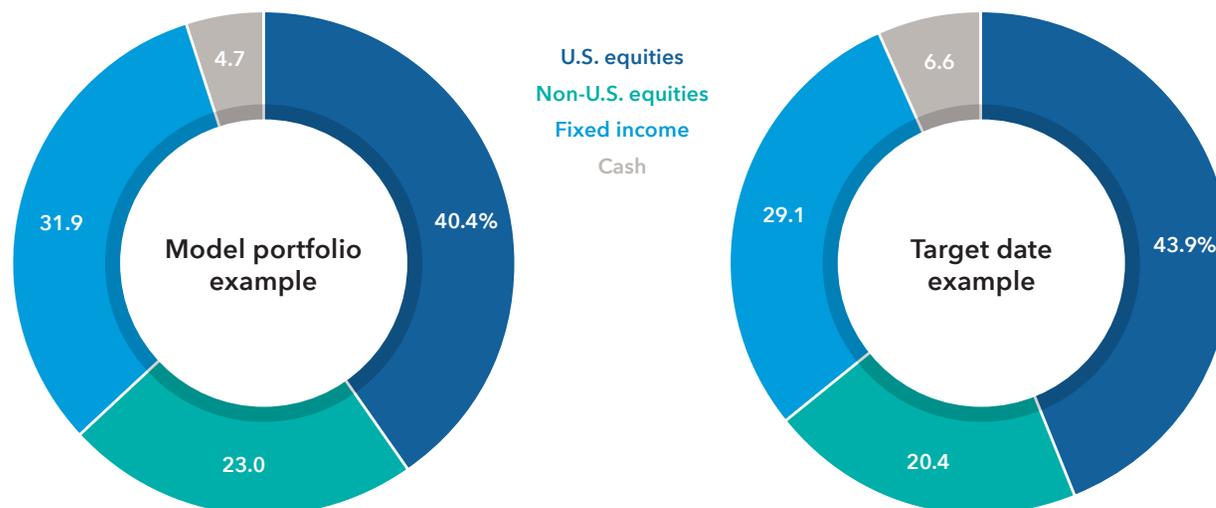
What's the best portfolio allocation for your objectives?

Election results and policy uncertainty can trigger short-term volatility. But over the longer term company fundamentals drive market returns. Investors should maintain broadly diversified portfolios that include a mix of stocks and bonds from around the world.

When it comes to economic cycles, it's better to be early than to be wrong. The current low rate, low inflation environment is a good time to focus on established dividend-paying companies with above-average credit ratings, as well as companies with pricing power. Maintain geographic flexibility, with managers that can reach beyond borders and asset classes in pursuit of the best opportunities.

In a late-cycle economy, investors may want to focus on bonds that offer a measure of stability and capital preservation. Consider a strong Core bond allocation that can offer resilience and diversification from equities. In a period of tight credit spreads and soaring corporate debt, invest selectively in corporate credit. Municipal bonds continue to offer relatively attractive after-tax income.

Sample portfolio allocations



SOURCE: Capital Group. As of 9/30/19. The model portfolio example is American Funds Moderate Growth and Income Model PortfolioSM. The target date example is American Funds 2030 Target Date Retirement Fund[®]. Although the target date funds are managed for investors on a projected retirement date time frame, the funds' allocation strategy does not guarantee that investors' retirement goals will be met. American Funds investment professionals manage the target date fund's portfolio, moving it from a more growth-oriented strategy to a more income-oriented focus as the fund gets closer to its target date. The target date is the year in which an investor is assumed to retire and begin taking withdrawals. Investment professionals continue to manage each fund for 30 years after it reaches its target date. Changes in the equity allocation within the underlying equity-income and balanced funds may affect the overall equity exposure in the target date funds.

2020 Outlook: Seek balance in portfolios this election year

Themes	U.S. equity The best offense is a good defense	International equity Better to be flexible than constrained	Taxable fixed income Better to know what you own	Tax-exempt fixed income Better to pay less in taxes
Key takeaways	Despite slower manufacturing and weak investment, the economy remains healthy thanks to a resilient consumer. Expect election- and trade-related volatility.	Global growth remains sluggish, but the outlook appears to be brightening thanks to easy monetary policy around the world.	Given the late-cycle economy in the U.S. and weakness around the world, your Core fixed income allocation should seek to provide resilience and diversification from equities.	Municipal bonds continue to offer after-tax income that is attractive relative to similar taxable bonds.
Investment implications	It's a good time to focus on dividend payers with above-average credit ratings as well as companies with pricing power.	Even in an era of U.S. market dominance, many of the best stocks can be found abroad. Consider adding global strategies that can pivot to opportunity around the world.	Consider a fixed income allocation that is mostly Core bonds that can offer resilience when stocks decline.	Consider shifting a portion of Core bond portfolios to municipals and explore high-income muni bonds as an option for enhanced income.
Select investments to consider	American Mutual Fund® A – AMRMX; F-2 – AMRFX; F-3 – AFMFX; R-6 – RMFGX Washington Mutual Investors FundSM A – AWSHX; F-2 – WMFFX; F-3 – FWMIX; R-6 – RWMGX	New Perspective Fund® A – ANWPX; F-2 – ANWFX; F-3 – FNPFX; R-6 – RNPGX New World Fund® A – NEWFX; F-2 – NFFFX; F-3 – FNWFX; R-6 – RNWGX	The Bond Fund of America® A – ABNDX; F-2 – ABNFX; F-3 – BFFAX; R-6 – RBFGX	The Tax-Exempt Bond Fund of America® A – AFTEX; F-2 – TEAFX; F-3 – TFEBX American High-Income Municipal Bond Fund® A – AMHIX; F-2 – AHMFX; F-3 – HIMFX

For high net worth investors, consider our separately managed account (SMA) strategies, which include our Capital Group U.S. Income and GrowthSM offering (which pursues a similar objective as Washington Mutual Investors Fund), Capital Group Global GrowthSM (which pursues a similar strategy to New Perspective Fund) and Capital Group International EquitySM.

Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from a financial professional and should be read carefully before investing.

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Market indexes are unmanaged and, therefore, have no expenses. Investors cannot invest directly in an index.

Bond ratings, which typically range from AAA/Aaa (highest) to D (lowest), are assigned by credit rating agencies such as Standard & Poor's, Moody's and/or Fitch, as an indication of an issuer's creditworthiness.

Investing outside the United States involves risks, such as currency fluctuations, periods of illiquidity and price volatility, as more fully described in fund prospectuses. These risks may be heightened in connection with investments in developing countries. The return of principal for bond funds and for funds with significant underlying bond holdings is not guaranteed. Fund shares are subject to the same interest rate, inflation and credit risks associated with the underlying bond holdings. Bond prices and a bond fund's share price will generally move in the opposite direction of interest rates. For tax-exempt bond funds, income may be subject to state or local income taxes. Income may also be subject to the federal alternative minimum tax (except for The Tax-Exempt Bond Fund of America). Certain other income, as well as capital gain distributions, may be taxable. Higher yielding, higher risk bonds can fluctuate in price more than investment-grade bonds, so investors should maintain a long-term perspective.

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