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Inside this issue

Tim Hai, CFA®, CAIA®
CIO and Sr. Portfolio Manager

Belleros Capital Management

The Passionate Investor

3Q2023 Market Review and Commentary

*Market Review **

- *Equity markets generally* ***outperformed*** *fixed-income markets with the S&P 500 falling 3.27% (including dividends; +13.07% YTD) and the Barclay's Capital U.S. Aggregate Bond index falling 3.23% (-1.21% YTD).*
- *Small caps* ***underperformed*** *large cap stocks (S&P 500) as the Russell 2000 small cap stock index returned -5.13% (2.54% YTD).*
- *Growth* ***underperformed*** *Value during the quarter but continued to outperform over the full year (as determined by the S&P 1500 broad market index which includes large, mid, and small capitalization stocks).*
- *International or developed, non-U.S. equity markets* ***outperformed*** *U.S. markets in local currency terms (-1.21%; +11.20% YTD) but trailed in U.S. dollars (MSCI EAFE**: -4.05%; +7.59% YTD).*
- *The MSCI Emerging Markets Index* ***outperformed*** *developed, non-U.S. equity markets (international) in both local currency terms (-1.29%; +4.40% YTD) and U.S. dollars (-2.79%; +2.16% YTD).*
- *Most U.S. market sectors were generally* ***negative*** *during the quarter.* ***Energy*** *(+12.22%; +6.03% YTD), and* ***Communication Services*** *(+3.07%; +40.43% YTD) stocks were most distinguishable given their strength.* ***Utilities*** *(-9.25%; -14.41% YTD) stocks were notable given their weakness.*
- *High yield bonds fell 0.17% during the quarter (+5.05% YTD). The U.S. corporate bond sector fell 3.24% during the quarter (-0.44% YTD). 10-Year U.S. Treasury yields climbed from 3.74% at the beginning of the quarter (3.87% at the beginning of the year) to 4.57% currently.*
- *The U.S. dollar rose relative to most other major currencies during the quarter, including the British Pound (-4.00%; +1.47% YTD), Japanese Yen (-3.24%; -13.10% YTD), and the Euro (-2.96%; -.080% YTD).*

** Unless otherwise noted, performances stated above reflect data provided by Standard and Poor's, Russell Investments, MSCI, and Barclay's Capital.*
*** The MSCI EAFE Index is a large capitalization, developed market benchmark that tracks non-U.S. or international equity markets.*

"Risk is not inherent in an investment; it is always relative to the price paid. Uncertainty is not the same as risk. Indeed, when great uncertainty – such as in the fall of 2008 – drives securities prices to especially low levels, they often become less risky investments."
— Seth Klarman

Company Description

Belleros Capital Management actively manages direct stock portfolios on a fully discretionary basis for institutional clients. Our primary goal is to help them outperform their benchmarks by exploiting short-term market inefficiency through a long-term investment strategy that produces investment portfolios that are differentiated in nature and is concentrated in its number of holdings. The strategy seeks to invest in the stocks of quality companies at a price that is sufficiently below our calculation of its intrinsic value. Additionally, the strategy is all capitalization in nature but tends to have a small and mid-capitalization bias that we believe is secular in nature.

Belleros Capital Management

Market Commentary

U.S. stocks ended the summer with a whimper as most indices struggled to break even. The S&P 500 fell 3.27% (+13.07% year-to-date ("YTD")) relative to last quarter's impressive 8.74% gain. Performance, though more broadly experienced, continued to be impacted in large part by a handful of the largest stocks as measured by market capitalization[1] ("cap") and continued to lack breadth[2] (read more HERE about the "Lucky Seven" stocks and "Bad Breadth" in the stock market's recent gains). The stocks of large cap companies as represented by the S&P 500 generally continue to contrast with the performance of smaller companies which were poorer to close the quarter (-5.13%). In fact, small cap stocks have been and continue to be in bear market territory[3] (-24.85% since November 2021). Recent weakness in these smaller stocks reflect increased recessionary expectations. The risk of an economic slowdown is believed by many to be more harmful to smaller companies (relative to larger ones) as lending costs rise and because of the lack of a more diversified global presence.

S&P 500 – Trailing 1-Year and 3Q2023 Performance

Source: FactSet

[1] Market capitalization is a measure of a company's size and refers to the number of its outstanding shares (stock) multiplied by its share price.
[2] Breadth (or market breadth) refers to the level diversity in the number of stocks participating in an upward or downward swing on a stock index or exchange.
[3] When stocks collectively fall more than 20% from their most recently reached highs.

Market Commentary…(Cont.)

Growth stocks trailed their value counterparts during the quarter but continued to outperform over the longer term. International and emerging market stocks outperformed U.S. stocks in local currencies but were mixed in U.S. dollar terms. The U.S. dollar strengthened relative to most other currencies as higher domestic interest rates attracted foreign investors. Energy stocks outperformed all other market sectors as contrived supply constraints implemented by Russia and Saudi Arabia helped push major crude oil benchmarks near $100 per barrel. Utility stocks struggled as investors continued to favor rising bond yields[4]. Credit markets including corporates and high yield bonds outperformed similarly as investors sought higher rates. Short-term interest rates continued to climb higher than the yield of bonds with longer maturities in response to further tightening by the Federal Reserve (the "Fed"; read more HERE about inverted yield curves and their meaning).

How Did We Get Here?

Macroeconomic threats have continued to batter stocks generally (and smaller stocks more acutely) for several years now. But many of these threats have been present for several years now and most stem from monetary and fiscal policy. The Fed was late in acknowledging an inflation problem that was at 40-year highs and was late in addressing it. When they did address it, they moved with extreme (some would say draconian) intensity to tighten monetary policy (11-straight increases to interest rates, including four 75 basis point ("bps") increases in a row). The Fed has threatened (for the better part of a year now) more increases to interest rates and the continuation of recently reached high level of interest rates for longer than the market expects. Belatedly, investment markets seem to finally be responding to and accepting of this. This is despite contradicting (at best) market signals about the strength of the economy and several looming threats to the economy. Fiscal policy from two administrations exacerbated the effects of monetary tightening as trillions of dollars were spent on COVID relief (some warranted, some less so) and more based on policy choices. Many critics suggest that the continuation of current monetary plans is not necessary and that a pause in rate hikes is the

[4] Both bonds and utility stocks offer yields that sometimes compete and cater to a similar investor pool. Prices for both investments may sometimes be inversely related in such a case.

"In the short run, the market is a voting machine but in the long run, it is a weighing machine."
— Benjamin Graham

Investment Philosophy

Market Efficiency (or Inefficiency)

Stocks are inherently volatile assets due to the sheer number of participants involved, the diversity of their motives, and the wide range of emotions they employ. Stocks are frequently prone to excessive volatility when emotions particularly run hot. We believe this excessive volatility is a sign of short-term stock market inefficiency. However, we believe the stock market is more efficient over the long-term as rational investment behavior reasserts itself. Similarly, excessive volatility causes the market prices of stocks to deviate from their intrinsic values.

As time progresses, the market prices of stocks generally return to their intrinsic values. We believe that stock market inefficiency as represented by excess volatility is exploitable and represents an opportunity for profit. In our experience, excessive volatility can and does extend to all manner of companies and stocks. Even the best companies and their stock can be affected by stock market inefficiencies and come to exhibit excess volatility, creating exploitable investment opportunity for the astute investor.

“We steer clear of the foolhardy academic definition of risk and volatility, recognizing, instead, that volatility is a welcome creator of opportunity”
— Seth Klarman

Investment Philosophy

The Main Source of Risk to Long-term Investors

Belleros Capital Management believes that the investment community’s definition of risk as volatility is inappropriate and generally does not apply to all participants. Although the effects of volatility can be particularly disastrous to investors that have near-term income or liquidity requirements, long-term investors can and should be less constrained by it. As opposed to gambling or speculation, we believe that investing is by definition a long-term strategy.

We believe that stock market volatility is a source of investment opportunity for long-term investors, especially when it is excessive. Investors with a strategy to benefit and exploit stock market inefficiencies and excessive volatility should therefore concern themselves with (and try to avoid) greater risks such as a permanent loss of capital, the risk of outliving one’s wealth, or the failure to meet their long-term investment and retirement goals.

How Did We Get Here?…(Cont.)

best policy. Our view has always been that monetary policy and its implementation has been a strong source of stock market volatility and inefficiency. Our conundrum is that that same volatility is also a large source of potential value add for our clients over the long term.

September Rain

September was an especially poor month for most stocks as it lived up to its billing as the “worst performing month” of the year (Read HERE to learn more about the September Effect). The S&P 500 (large caps) fell 4.77% while the Russell 2000 (small caps) fell 5.89% (see table below). Even the NASDAQ composite index of technology-related stocks fell 5.77%, though barely impinging upon its strong year-to-date push (+27.11%). As mentioned, an unprecedented number of macroeconomic factors (inflation, interest rates, fiscal policy, etc.) have influenced the stock market over the past several years and many of them still dictate market behavior today. An expected additional increase in interest rates over the next several months and/or the threat by the Fed to maintain the current level of (relatively high) interest rates for longer than many market participants have been expecting is causing volatility and a reassessment of risks. Bond market yields have risen dramatically over the past week/month as this threat becomes more realistic and accepted by investors. Bond prices are inversely related to interest rates and rising bond yields denote weakness in the bond markets as short-term interest rates move higher to anticipated levels as dictated by the Fed.

Bifurcated Performance*

	Sector	September	3Q	YTD	1-Year
S&P 500	Large Cap	-4.77	-3.27	13.07	21.62
Russell 2000	Small Cap	-5.89	-5.13	2.54	8.93
S&P 600	Small Cap	-6.00	-4.93	0.81	10.08
NASDAQ	Technology	-5.77	-3.94	27.11	26.11

Source: FactSet
** As of September 30, 2023*

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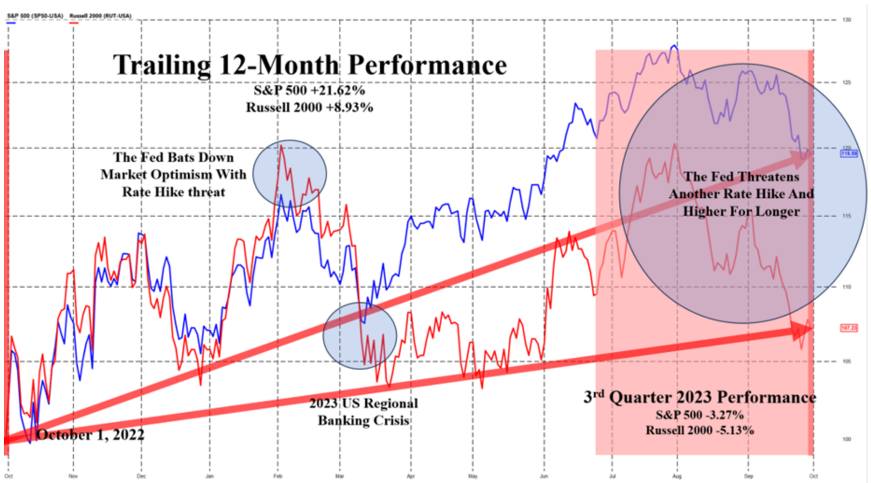
S&P 500 Versus Russell 2000 Performance



Source: FactSet

Still A Divided Market

Despite uniformly negative September returns, there still exists a wide gulf between the performance of large and small cap stocks during the short and longer term (see table and chart above). The S&P 500 and NASDAQ composite of technology-related stocks have both outperformed small caps largely because of a handful of large cap (mostly) technology stocks (see ***Recent Performance*** table below). The ***Percentage of Stocks*** table below demonstrates the lack of market breadth this year relative to the past. The number of stocks that have outperformed the index as a whole (29%), is well below the 10-year average which is closer to 50%. As mentioned previously, though market breadth has increased, investors continued to chase the Lucky Seven (see above reference) or Magnificent 7 stocks of recent fame. These stocks continue to be the biggest drivers of the S&P 500 index of large cap stocks. Narrow stock market gains in the past have been prone to retracement or price correction. Conversely, a stock market that is broader in participation is considered healthier and less prone to collapse.

"Wide diversification is only required when investors do not understand what they are doing." — Warren Buffett

Investment Philosophy

Diversification (or Not)

Belleros Capital Management believes the idea of portfolio diversification is counter-intuitive and works against our active management goals. The idea of diversification is meant to limit the impact of stock market volatility. We believe stock market volatility represents an investment opportunity that is exploitable. Therefore, limiting the opportunities we seek to exploit would seem rather perverse. Diversification is a sliding scale. Too little and you risk putting all your eggs in too few baskets; too much and your portfolio and expected return mimics the broader stock market (index).

We believe excessive diversification (in addition to high investment-related fees) is a main contributor to poor active management performance relative to passive/index investing. We believe investors who seek excess returns above and beyond what one could expect to receive from the broader stock market should choose an investment manager that minimizes fees and seeks to differentiate their investment portfolio to ward off the indexing-like characteristic of diversification.

"Owners of stocks, however, too often let the capricious and often irrational behavior of their fellow owners cause them to behave irrationally as well. Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to listen to pundits – and, worse yet, important to consider acting upon their comments."
–- Warren Buffett

Please contact us to learn more about our investment strategy and how we try to add value for our clients.

Recent Performance of the 10 Largest Stocks In The S&P 500*

Ticker Symbol	Company	Price	Market Cap	1Mo% Chg	3Mo% Chg	6Mo% Chg	YTD% Chg	12Mo%Chg
XOM	Exxon Mobil Corporation	119.11	476,780.25	9.12	13.01	11.19	7.99	34.04
LLY	Eli Lilly and Company	543.37	515,628.63	-1.90	18.46	60.93	48.53	62.50
TSLA	Tesla, Inc.	244.8	777,089.06	2.50	-4.46	29.39	98.73	-14.94
META	Meta Platforms Inc. Class A	302.475	777,738.02	4.21	6.02	50.73	151.35	113.60
BRK.B	Berkshire Hathaway Inc. Class B	357.39	779,282.22	0.52	6.95	18.22	15.70	31.50
NVDA	NVIDIA Corporation	429.866	1,061,112.00	-8.22	4.55	62.77	194.15	237.52
AMZN	Amazon.com, Inc.	125.805	1,289,793.13	-5.51	-2.51	29.38	49.77	6.61
GOOG/L	Alphabet Inc. Class A	132.085	1,671,140.94	0.82	9.91	30.74	49.71	32.02
MSFT	Microsoft Corporation	313.285	2,327,150.50	-3.22	-6.72	13.83	30.63	29.96
AAPL	Apple Inc.	170.62	2,666,731.25	-5.31	-9.84	8.23	31.32	13.87
			Average	-0.55%	4.11%	31.51%	66.16%	52.61%
			Median	0.52%	6.02%	29.39%	49.71%	32.02%

Source: FactSet
** As of September 30, 2023*

Percentage of Stocks Outperforming the S&P 500 Index*

Year	Percentage
2023*	29%
2022	57%
2021	48%
2020	33%
2019	46%
2018	45%
2017	43%
2016	51%
2015	47%
2014	52%
Average (2014-2022)	47%

Source: Bloomberg Finance L.P. and FactSet
** As of September 30, 2023*

Ursa Minor…At A Value

As shown in the ***Bifurcated Performance*** table above, small cap stocks as measured by the Russell 2000 have underperformed large cap stocks over the September, Third-quarter, year-to-date, and 1-year periods. Small cap stocks have also been mired in an (almost) 2-year bear market since November 2021 (-24.85%). The S&P 500 has fallen by 5.92% in comparison over the same period. The lengthy period of underperformance has pushed the relative value or worth of small caps stocks generally (as measured by the trailing P/E ratio[5]) to considerably cheaper levels compared to large cap stocks and history.

[5] P/E or the price/equity ratio is a measurement tool for valuing a company's stock that compares its current share price relative to its earnings on a per-share basis. The term "trailing" refers to the use of earnings recorded by the company over its past or trailing 12-month period. The P/E ratio can be compared historically or relative to other stocks with smaller values denoting a cheaper or undervalued investment.

Belleros
Capital Management

Valuation by Sector*

	Sector	Trailing P/E
S&P 500	Large Cap	21.0
Russell 2000	Small Cap	12.5

Source: FactSet
** As of September 30, 2023*

Small Cap Growth/Value Comparison*

		September	3Q	YTD	1-Year	Trailing P/E
Russell 2000 Growth	Small Cap Growth	-6.74	-7.32	5.24	9.49	18.59
Russell 2000 Value	Small Cap Value	-5.37	-2.96	-0.53	7.84	7.92

Source: FactSet
** As of October 2, 2023*

Ursa Minor…At A Value…(Cont.)

Small cap value stocks (as measured by the trailing P/E ratio) have also underperformed relative to their small cap growth stock peers. Despite relative strength over the past quarter, small cap value stocks have lagged behind their small cap growth stock peers over the longer term. Small cap value stocks also appear cheap historically.

A Framework For Adding Value

University of Chicago Booth School of Business professors Eugene Fama (a Nobel Laureate) and Kenneth French conducted extensive research in 1992 to explain the sources of stock market returns. Their study, now considered an integral part of investment curriculum in many college and university classrooms globally, found that small-cap stocks tend to outperform large cap stocks over a long term time period. Additionally, the study also found that value stocks tend to outperform growth stocks over the long-term. If their study reflects reality and continues to be valid in its assertions after 30 years, the current opportunity as evidenced by low levels of valuations in small cap value stocks may represent a source of potential value add for investors over the long term.

"Invest for the long haul. Don't get too greedy and don't get too scared."

— Shelby M.C. Davis

Please contact us to learn more about our investment strategy and how we try to add value for our clients.

Belleros Capital Management

"The best way to measure your investing success is not by whether you're beating the market but by whether you've put in place a financial plan and a behavioral discipline that are likely to get you where you want to go."

–– Benjamin Graham

Please contact us to learn more about our investment strategy and how we try to add value for our clients.

The Opportunity

It is no secret that small cap stocks are prone to macroeconomic forces. Recessionary pressures can jostle small caps because they are generally viewed as more susceptible to the extreme tails of an economic cycle. Rising interest rates can increase their cost of capital and the lack of a geographically diversified revenue/earnings stream can lead to volatility in their operating results. However, it has been a long-held view that although small cap stocks tend to collapse early in the economic cycle (like a canary in the coal mine), they are also said to be the first market segment to climb out of the correction as their operating results rebound and prospects rise. Given their poor relative returns of late and cheap valuation, value stocks may perhaps offer the most compelling opportunity over the long term after several years of under-whelming results.

Increasing Our Confidence Level

Although we agree that small cap value stocks potentially offer tremendous value based on historic performance and the current low levels of valuations as shown above, we would not rely on these facts alone nor the studies favoring their ability to outperform over the long term. However, we actively manage our clients' portfolios to add value over the long term (please refer HERE or to the adjoining columns to review our investment philosophy and strategy). This entails continually reviewing our investment opportunity set for what we perceive to be the best values available. To do this means we have to be selective and discerning in our job to pick the most suitable opportunities. Our work corroborates the data and studies above and suggest that (at least some) small cap value stocks do appear to offer good absolute value and good relative value historically and when compared to their peers (large cap and growth stocks).

Increasing Our Confidence Level…(Cont.)

To further increase our level of confidence, we utilize an investment strategy that defines the most important source of risk for investors as a ***permanent loss of capital*** – the actual loss of money. In our world, we believe that volatility, what academia and many of our peers consider as risk, matters less to a long-term investor that is seeking value add in his/her portfolio. We believe stock ***volatility*** represents inefficiency or noise in the marketplace that can be exploited as a long-term opportunity. They are ***on paper*** gains or losses that aren't yet realized and as such are subject to reversal (for good or bad). A permanent loss of capital on the other hand represents an actual monetary loss of value which cannot be recovered - it is permanent.

Our strategy then is defined by three tenets that seek to minimize the risk of a permanent loss of capital and thereby seek potential value add through the exploitation of volatility over the long term. These tenets include investing in ***good companies*** that offer a considerable margin of safety (i.e. ***value*** stocks that sell at a significant discount to intrinsic value) over a ***long-term time period***. All three tenets contribute to our goal of minimizing the risk of a permanent loss of capital and thereby potentially adding value over the long-term. Good companies are going concerns that have a lower risk of bankruptcy that can lead to a permanent loss of capital. Buying stocks at a considerable discount to intrinsic value also decreases the likelihood of a permanent loss of capital. Investing over a long-term time period allows the company enough time to right its ship and allow its stock price enough time to return to intrinsic value and avoid a permanent loss of capital.

Being an active manager also means continually reviewing our work, especially when things aren't going right for the stock. We continually review our investment thesis to determine if changes (and possibly a sale) is warranted. If warranted, and if we believe the weakness in the investment to be attributable to more market-related noise and not news fundamental to the company, or excessive in nature, we will defend the position by adding another position to the portfolio, thereby reducing our cost basis and increasing the potential rate of return in the holding. We may do so multiple times if we are confident in the holding. We believe a good amount of our ability to (potentially) add value comes from this exercise. Because we are not market timers, we allow the dollar cost averaging process described above to optimize our investments' potential rate of return.

Please contact us to learn more about our investment strategy and how we try to add value for our clients.

Closing Remarks

Perhaps the best advice we can offer investors is to avoid the urge to market time and to ***remain focused on your long-term goals - all the time*** - but especially during periods of market stress. Volatility is inherent in the stock market and can be excessive at times. This can unnerve the most disciplined investor. But volatility can also be a source of tremendous value add. This is extremely important if your goal is to outperform the broader stock market over the long term. Many (most, we would venture to say) investors and households need, indeed require their investment portfolio to work harder (add value beyond typical stock market returns) for them because they are behind in saving for their future and ***risk outliving their wealth*** (another major risk to avoid). Staying focused on the long-term and keeping one's emotions in check will help investors benefit from an ***eventual*** rebound. U.S. stocks have always rebounded from their lows and we see no reason why this would change. We recommend investors to be patient and avoid making investment decisions with emotions. We view performance over years (plural) and not in months, quarters, or year and we encourage investors to do the same. A long-term perspective will prevent investors from making emotional decisions that lead to real and permanent losses of capital and potentially significant opportunity costs in a market rebound. The last quarter of the year (and our favorite) is finally upon us. We are looking forward to pumpkin patches, hayrides, and family feasts. We'd be remiss not to mention Christmas trees. We wish everyone the best and look forward to hearing from you soon.

"The most important quality for an investor is temperament, not intellect."

-- Warren Buffett

Please contact us to learn more about our investment strategy and how we try to add value for our clients.

Investment Strategy

*We seek to exploit stock market volatility in the short-term through a **long-term**, active investment management strategy that seeks to purchase higher **quality** stocks with sustainable competitive advantages and economic moats, and at prices below our calculation of intrinsic value (otherwise known as "**value** investing"). These characteristics help us defend against what we believe is **the biggest risk in investing: a permanent loss of capital.** In addition, we intend to show our discipline and conviction in our investments by employing a concentrated portfolio mandate that is differentiated and allows us to focus on only the best investment candidates available. Further, we seek to show our conviction through our portfolio weighting scheme which skews exposure to the best investment candidate.*

- Active investment management
- Long-term investing
- Seek higher quality opportunities
- Value investing
- Minimizing permanent losses of capital
- High conviction
- Invest with confidence
- Disciplined approach
- Volatility is an opportunity
- Concentrated stock portfolio
- Differentiated from the index

"Risk is not inherent in an investment; it is always relative to the price paid. Uncertainty is not the same as risk. Indeed, when great uncertainty – such as in the fall of 2008 – drives securities prices to especially low levels, they often become less risky investments." — Seth Klarman

"We don't have to be smarter than the rest. We have to be more disciplined than the rest." — Warren Buffett

Biography

Tim Hai, CFA®, CAIA®

Chief Investment Officer and Senior Portfolio Manager

- 25 years of experience in the investment industry
- 11 years of equity portfolio management experience
- 6 years experience overseeing public equity and fixed-income assets for a $10 billion multi-employer pension plan
- 8 years exp. manager research and due diligence
- M.B.A. - Loyola College of Maryland, 2000
- B.S. Finance – University of Maryland, College Park, 1996

Tim has 25 years of diversified investment experience that includes the research and direct investment management of stocks and bonds for high net worth and small business clients. Additionally, Tim has experience in manager research and due diligence, having helped oversee and manage a $10 billion institutional pension fund. Tim had direct oversight of the pension fund's equity and fixed-income investment portfolios that were managed by outside investment managers. Tim had specific oversight over the pension fund's $1.2 billion concentrated managers program that sought to extract value add from some of the country's best investment managers through a mandate that required high conviction and a limited number of stock positions.

Tim received his B.S. in Finance from the University of Maryland, College Park and his MBA from Loyola College of Maryland. More recently, he also completed coursework in international investing and currency management with the Oxford International Investment Programme at the Said Business School at the University of Oxford, United Kingdom. Tim holds the Chartered Financial Analyst ("CFA") and Chartered Alternative Investment Analyst ("CAIA") designations. He is a member of the CFA Institute and the CFA Society Washington, DC. He is also a member of the Washington, DC Chapter of the CAIA Association.

Disclosures

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Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that future performance of any specific investment or investment strategy (including the investments and/or investment strategies recommended or undertaken by Belleros Capital Management, made reference to directly or indirectly by Belleros Capital Management, or indirectly via a source to an unaffiliated third party), will be profitable or equal the corresponding indicated performance level(s). Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will either be suitable or profitable for a client or prospective client's investment portfolio. Historical performance results for investment indices and/or categories generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the payment of which would have the effect of decreasing historical performance results. *For Professional Use Only*