MARKET OUTLOOK

SPRING 2021

HOWE & RUSLING

ON OUR MINDS

Spring has sprung—weather-wise, spirit-wise, and market-wise. A mere quarter ago, the world was peaking with pandemic deaths, the nation's capital was under heavy guard, and a Senate election was in the balance. One would think the market would be at an impasse from uncertainty. However, the Volatility Index (known also by its street name, the "fear index") was holding steady, like an idling DeLorean. Sure, to most of us the world was in shambles from a pandemic that still lingers and threatens, but the markets were returning "**back to the future**."

The world just wants to get back to the future, the future before COVID. However, despite vaccinations on the rise and progress towards herd immunity, we are not fully out of the woods. Pockets of the US are still struggling with the virus, and Europe and Brazil are lockdown centers, largely from low vaccination levels. However, the markets have tended to do what they do best: look forward. The markets, for good or bad, attempt to sift through the human emotion that clouds many investor decisions. Therefore, while daily life constantly presents questions, the markets filter through the emotion and look at data. Specifically, the data is pointing to a possible exit from the pandemic and a return to the future before the pandemic.

As Fed Chair Jerome Powell recently stated, "We're seeing an economy that seems to be at an inflection point… from widespread vaccination and strong fiscal and monetary policy support." However, without blinking, he also stated COVID is still a major threat. This inflection point has been in the making for almost five months now, and the markets have continued to respond with their forward-looking mechanism.

This forward-looking has been in both the fixed income and equity markets, and while pundits continue to go to their dated playbooks and try to apply yesterday's theories to today's realities, markets are constantly changing as they foresee, and adapt to, a new world. On top of virus worries, every day we hear fears about inflation, excessive stock valuations, deficits, or easy money, and every day we hear yesterday's solution. While we will be the first to admit the past is critical to help interpret the present, the solutions of the past usually are more rhetorical than realistic.

As we look forward, every day is different. Our future might not be what we expect, and it might be better than we think, but there will be bumps in the road (and we hate to report: bumps will always be there, regardless of an infrastructure plan or not!). Progress takes time, and there will be unplanned events, but in our minds, as time keeps moving, we are slowly getting back to the future.

Thank you as always for your belief in our ability to advise, and on behalf of all of us at Howe & Rusling, and especially our Macroeconomic Team, please enjoy our Spring 2021 Market Outlook.

Greg Farrell, VP, Senior Portfolio Manager & Macroeconomic Team Chair

THE PAST GUIDES THE FUTURE

FIXED INCOME

We are very fond of mentioning that the fixed income markets are the market makers. While equities grab the glamour, fixed income rarely hits the evening news headlines. However, this past winter, the Federal Reserve Chair commented that the Fed did not see inflation as a problem and had no intention of raising interest rates in the foreseeable future (at least to 2022, and maybe beyond). The fixed income markets, in a semi-glamour grab, had their own opinion of inflation and the state of the improving economy. On several trading days during the quarter, and always the day following comments from the Fed Chair, the 10-year Treasury made some abrupt moves up.

In a cause-and-effect scenario, when rates move up, bond prices drop. This is Macroeconomics 101. If you hold a bond with a lower rate, and rates are rising, who wants to buy your tired old-rate bond when there is a new and improved model out in the market? As in any transaction, you lower the selling price to attract a buyer. Think of buying a car when the new year models come out. If there are no updates to the car you are looking to buy, and hypothetically speaking the price of the new model (2021 model) is the same as last year's model (2020), what would you do? Likely 9 out of 10 buyers would buy the new (2021) model. This leaves the 2020 model sitting on the lot, and therefore the car dealer usually "discounts" last year's model to entice you to buy. The same is true with bonds; if you must sell a lower interest rate bond (say 2% coupon rate), and this year's model is offering a 2.25% coupon rate, the only way you will likely get a buyer is if you lower your asking price. It should be noted this simple case scenario applies to investors who own individual bonds. If you own a bond fund, the same happens on a much grander scale, as every second of the trading day someone who owns the fund is selling to raise cash, and someone is buying. The indirect challenge with bond funds is if you need cash, you just need to accept what the market is offering. If you own individual bonds, and presumably they have staggered maturities (laddering), you might have a bond maturing soon that will redeem at face value.

Back to the real world and off the car lot, while interest rate movement affects price, the only reason the price drops is from selling. Usually selling is not to raise money to buy a car; selling is happening as the investor is looking to either lock in a gain or preserve capital value. Therefore, on a historical basis, when the bond market sells off, the proceeds typically find their way into the equity markets.

However, as shown in the chart below, this past quarter the stock market could not handle all the bond sale proceeds, as the S&P 500 is over weighted with growth stocks (we will discuss this later in the Outlook). Looking at the blue arrows on the chart, they are pointing to sharp rises in the 10-year Treasury rate (gold line) and then a corresponding drop in the S&P 500 (gray line). Growth stocks, more than other style stocks, tend to drop in price with interest rate rises. Without a lot of deep explanation here, the premise is growth stocks are bought with the theory they will increase in value, typically based upon innovation. Therefore, investors pile into these stocks, with the idea someday they will cash in big. The more funds invested in the growth stock, the more pressure there is to create earnings down the road. When interest rates rise, this is an operational cost (higher rates) that will affect future earnings. Just as happened this winter, when the 10-year Treasury spiked up, growth stocks lost value as some holders of growth stocks sold their positions. These sellers enjoyed the ride, but they saw limits now on future growth from increased operational costs associated with higher interest rates.

10-YEAR TREASURY RATE V. S&P 500 LEVEL

We should point out that interest rates, from a historical basis, are still very low. However, as we have mentioned, the past is a guide, not a predictor. If you look over the past ten years (circled), rates have been range-bound, much like after other recessionary periods. Therefore, while there has been much press about interest rates, Federal Reserve policy in the near term will keep rates relatively in line, and we do not see any dramatic ill-effects to both the bond and equity markets in the coming year. We believe rates will rise somewhat, contributing to bond price volatility. This is a function of the eventual back to the future prognosis, coupled with increased inflation concerns (more below), but in relative terms, we believe rates will still be manageable (even for growth stock firms).

10-YEAR TREASURY RATE

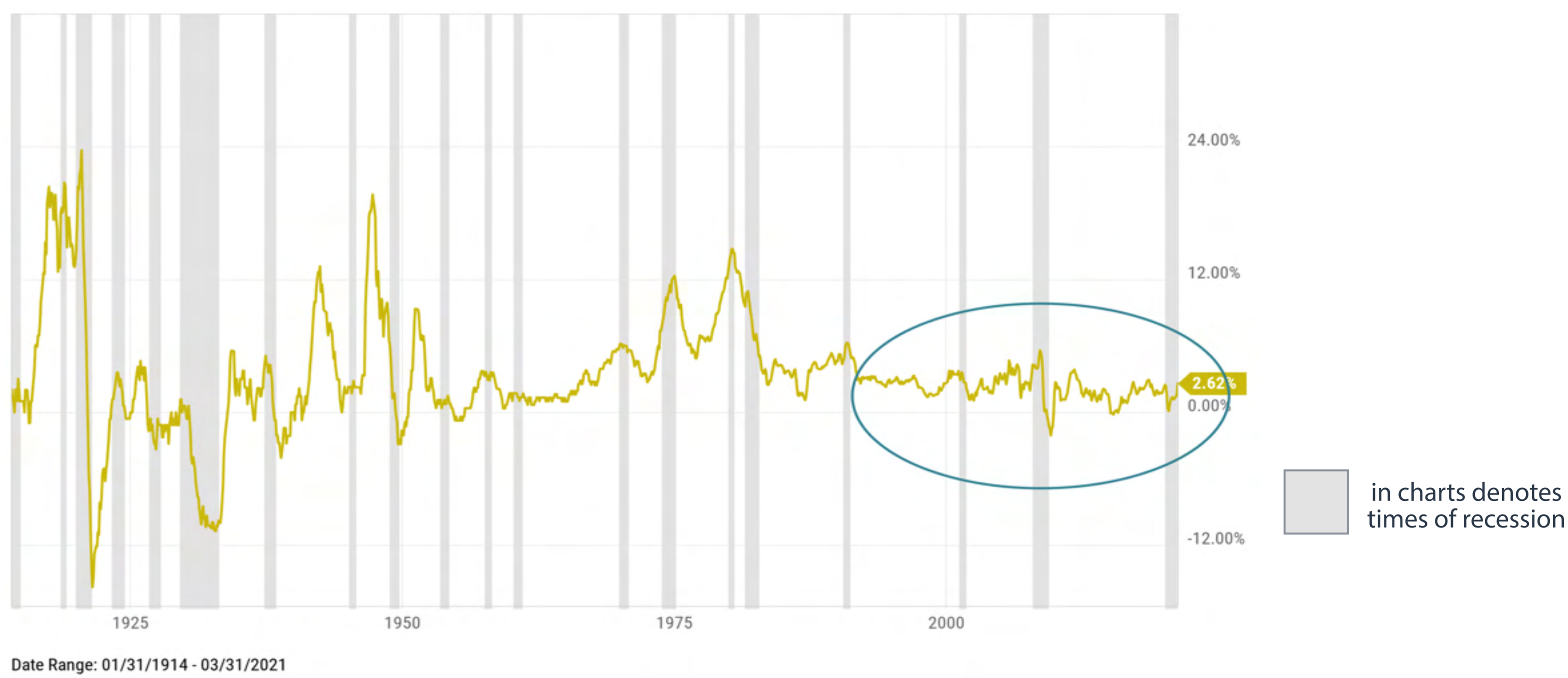
INFLATION & UNEMPLOYMENT

These topics of inflation and unemployment flow easily from interest rate conversations since the Federal Reserve is a key architect in their standing as foundations of the overall economy. All three have an interconnected cause-and-effect relationship. This present environment is interesting relative to inflation. When we were in lockdown (and again, some countries are still there), we really were not worrying about inflation, as we were not spending—no travel or commuting expenses, entertainment was very limited, services were curtailed as no one could come to your home or office, and many retail stores closed. As we stated in our Winter Outlook, savings were at all-time highs—and not just a mere increase from a previous high, but at astronomical levels. This was a combination of not spending, but also for a large segment of the population, continued income from government unemployment benefits as well as stimulus checks. As most economists thought, this cash needs to go somewhere, and when that happens, inflation is a concern.

We have a few thoughts in this area. Regarding inflation, let us first look at history—specifically, over 100 years of the US economy as shown in our US Inflation Rate chart. While the conversation of late has been runaway inflation, and sensational stories want to jump back to the 70s and early 80s, recent history would likely dispel these "bad news sells" theories. Without question we do have statistical inflation, defined as year over year, but remember that no one was spending at this time last year. Granted, excess cash from savings and fiscal policy distributions, coupled with a reopening economy, are triggering spending. However, spending alone does not cause inflation. Inflation is too much money chasing too few goods. We have seen in certain areas of the economy a lack of supply that has caused several goods to have price increases—notably lumber (which will eventually work its way to your facial tissues) and semi-conductors (which are in everything) are in limited supply. It has been said autos have more semi-conductors than steel, and the auto industry is seeing both supply and demand pressure (supply, as some plants have temporarily closed until the semi-conductor supply rectifies itself, and demand from stimulus payments as down payments).

It just goes to reason that when manufacturing plants shut down, and raw materials are limited from being harvested, all these basics of supply require human activity, which was on hiatus throughout the pandemic. This is cost-push inflation, which eventually solves itself as production catches up to demand, but it is starting to push into the economy. Interestingly, a CEO from a major tool and parts supplier candidly stated in response to a question about inflation that he would like to see a little—to raise prices. This comment, while blatantly frank, somewhat tells the tale of inflation (or lack thereof) over the past 30 years. While we are seeing cost-push inflation, the world has become your supplier, not just the general store down the road. When the price of something increases from $9 to $10, consumers can now price shop from the comfort of their palm, also saving gas and time. That $9 price is out there, and you can see the product as soon as tomorrow on your doorstep. The point is that globalization and technology have and will limit inflation.

US INFLATION RATE

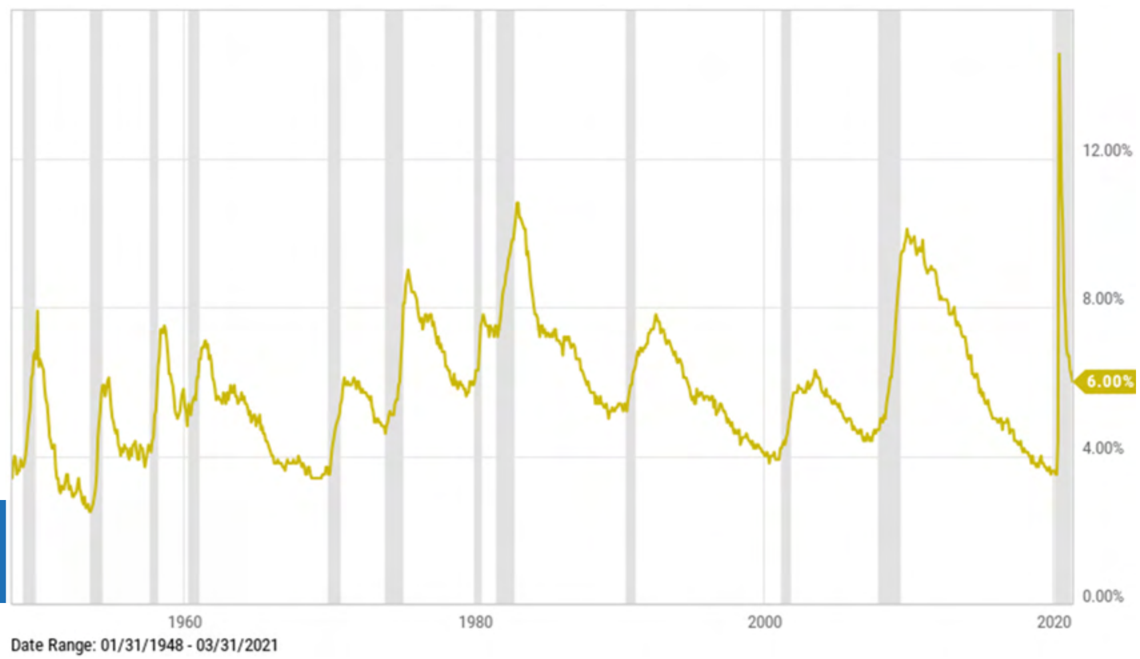


As mentioned in the reference to auto down payments, money in pockets does not last long. However, given a recession caused by a lockdown pandemic, a good portion of that money will find its way to the areas of the economy hurt the most (travel and entertainment), which will distract from broad inflation. However, this industry now faces a different challenge (as if it had not been challenged enough in the past 12 months). Labor is a critical component of the leisure and hospitality industry, and labor is in short supply (and not just in the hospitality industry).

This last statement almost seems beyond reason when we hear about high unemployment and associated continued benefits related to those displaced by the pandemic. However, there are always unintended consequences of public policy, which can only be seen after the fact. While the unemployment rate is getting back in line (per the chart), former employees in the hospitality industry (and other direct facing services as well as lower wage scale earners) have been making choices.

One of those choices is not returning to the industry, as they fear they might not have job stability; hence they are looking elsewhere. Another choice can be tackling the challenge of home schooling from shut-down schools in major metro centers and throughout the country, coupled with unavailable proper child supervision as daycares are packed (and that was the case pre-pandemic for infants and toddlers). Finally, another choice for some is to stay home and collect the benefit. While the extended benefit has truly helped the working parent, and those totally displaced, it has extended to all, and now a fair number of employers are suffering from a shortage of workers.

US UNEMPLOYMENT RATE



As mentioned, these two economic factors, inflation and employment, have strong reliance upon the Federal Reserve monitoring. The Fed Chair has categorically indicated they will allow inflation to run "hotter" than normal, and this was a decision the Fed put into formal action last fall. In the past when inflation hit 2%, over several months, it would employ monetary constraints. In the nearer term, we will certainly see higher inflation from the above-described scenarios, as the Federal Reserve seems resolved to allow for this cost-push inflation to remedy itself.

However, in the interaction between inflation and employment, high levels of employment can also be a catalyst for inflation, primarily from wages rising from demand and supply (too few laborers to fill positions). A target level of 4% unemployed was normally seen as "full" employment and a reactionary point for the Federal Reserve to tighten policy. With its statement last fall, from observation of low employment numbers pre-pandemic, it did not see this traditional cause-and-effect scenario of wage pressure and inflation. Hence, while employment (unemployment) still has some time before it reaches the 4% level, the Fed believes it has some room to play before tighter observation of inflation from wage pressure. With this said, there are benefits through the CARES Act which have provided income to the unemployed beyond traditional models, so monitoring will be different.

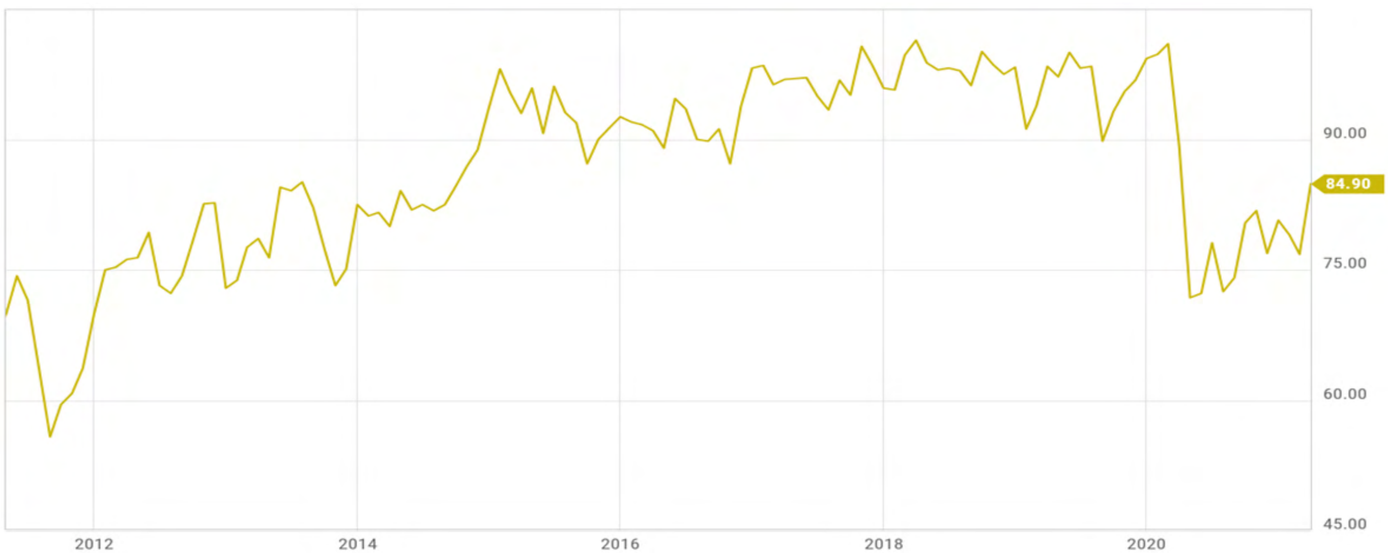
SENTIMENT, CONFIDENCE, PRICES, HOUSING, & THE DOLLAR

As we slowly get back to the future, we are treated to constantly improving reports from all areas of the economy. Normally, these gauges give some small glimpse into changing attitudes and trends in both consumer and manufacturing spending, and over time, can be used as signals. Among these gauge reports are sentiment indexes, confidence reports, and prices paid reports.

SENTIMENT

As would not be surprising, consumer sentiment is up from a year ago, with a reading of 84.90 for March, but not yet at pre-pandemic levels of 101 in February 2020. The index is based on random samples of US households measuring their sentiment in personal finances, business conditions, and other topics. The index still has some room to grow into the future.

US INDEX OF CONSUMER SENTIMENT

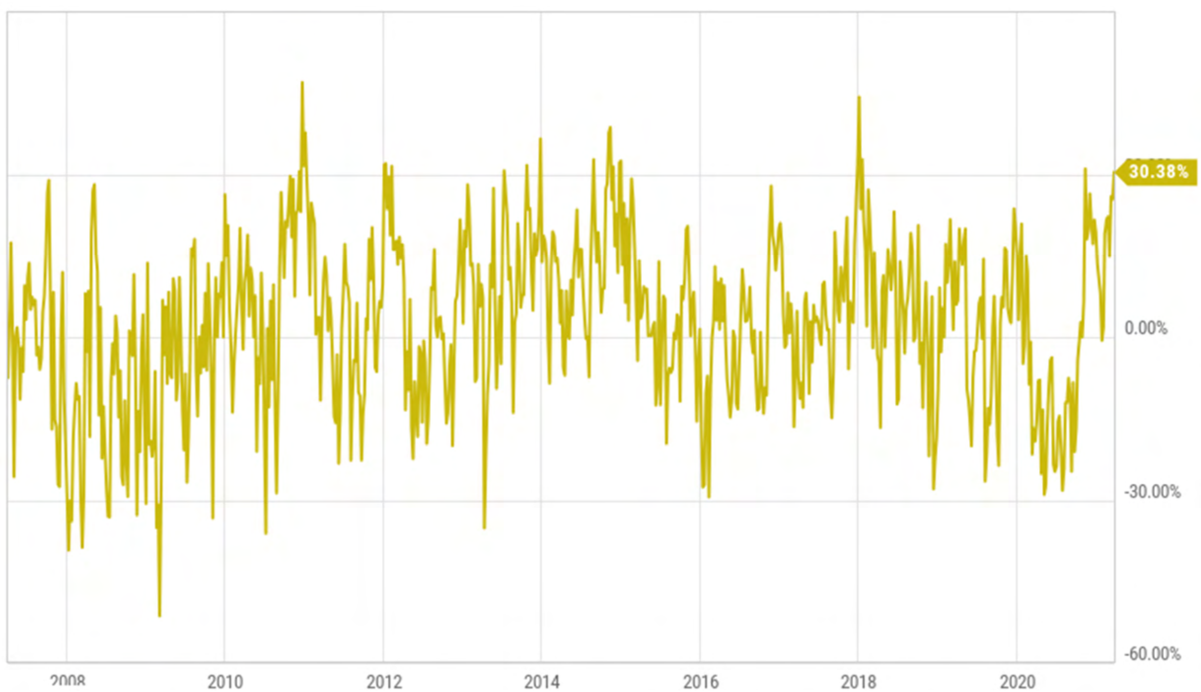


CONFIDENCE

Coupled with sentiment readings can also be data from the Conference Board, a non-profit of over 1,000 businesses, which measures both business and consumer confidence. In March, consumer confidence had read at 109.7, the best since March 2020, at 118.8. Likewise, the Institute for Supply Management (ISM) issues a monthly business indicator from surveys of purchasing managers called the PMI which is a leading indicator. For March, the index was at 64.7. Any reading above 50.0 is a positive reading and suggests confidence in the economy.

Additionally, on the confidence front, we use the Bull-Bear Spread as a reading of investor sentiment. When one looks at this chart below, the head can start to spin, but this should not be surprising as investments involve emotion and speculation. This bullish reading is not surprising, but the wide margin does "bear" watching (we couldn't resist!). However, to show how much confidence can wane, at the end of January 2021, the spread was at 0%, meaning investors had no opinion which way the market was leaning.

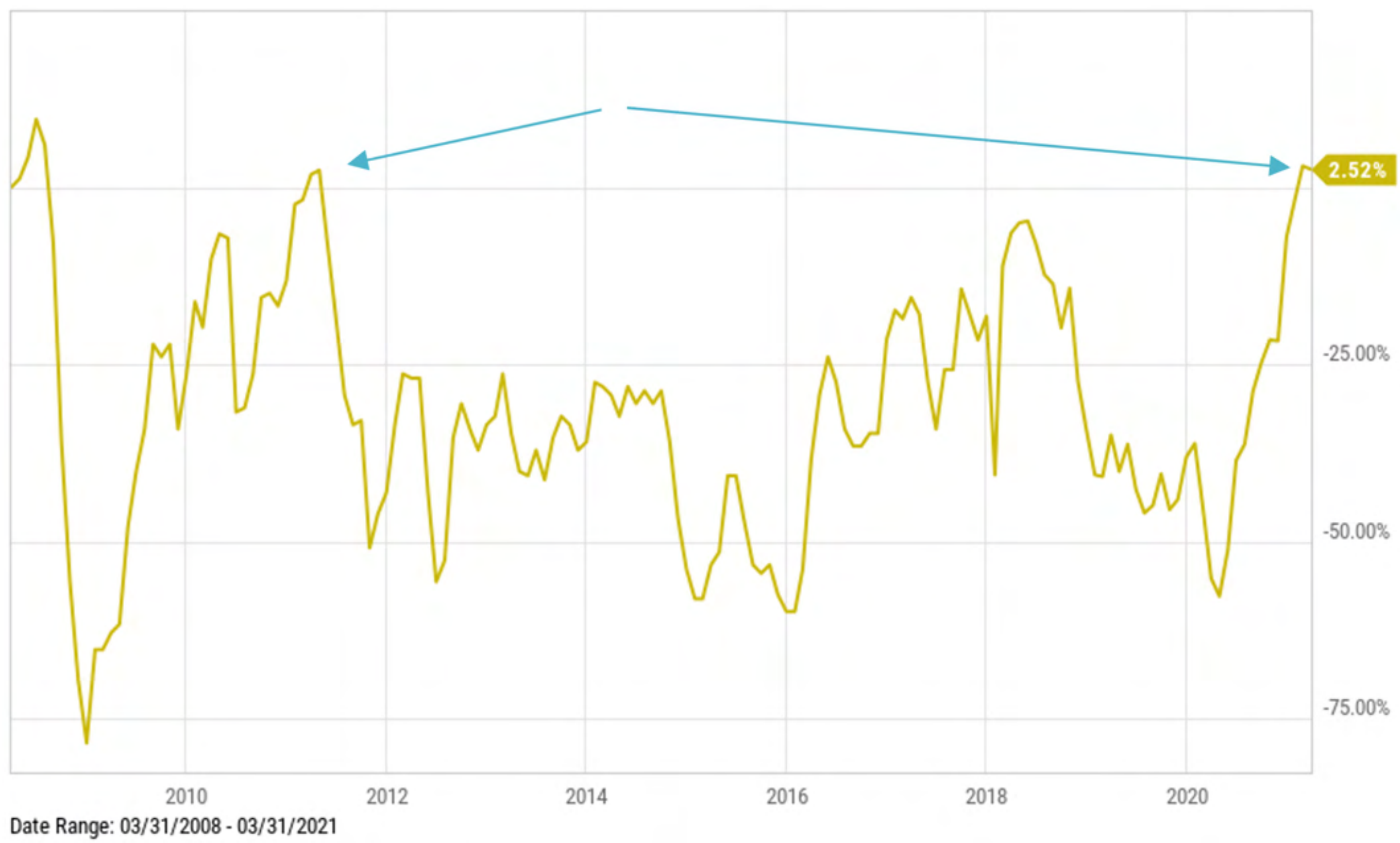
US INVESTOR SENTIMENT BULL-BEAR SPREAD



PRICES

Additionally, ISM surveys managers to measure prices paid by manufacturers (for basic goods to manufacture their products). While there has been a big jump in prices paid in recent months, since the start of the Great Financial Crisis, overall prices have only grown 2.52%. Coincidentally, the reading was exactly the same on 3/31/2021 as it was 10 years ago, March 2011, just after the recovery period from the Great Financial Crisis. This tells us it might not be time to panic yet.

US ISM MANUFACTURING PRICES PAID INDEX (% CHANGE)



HOUSING

Finally, we wanted to address housing, which seems to be grabbing a lot of press. Housing obviously is an important part of the overall economy. We hear every day, "Home prices are on the rise", followed with, "Are we in a bubble?" However, we must dig deeper to understand the figures.

While the chart has several data points, focus in on the gold & dark blue lines: US Existing Home Inventory vs Median Sales Price. These two tell the story, as we are in a classic supply and demand model—prices are up based on limited inventory. While New Permits jump around (light gray line), they are up over the past 10 years. However, inventory of existing homes is the biggest driver of price. Even with rising permits of new builds, inventory cannot keep up with scrappage, caused by several factors including knockdowns, fires, floods, tornadoes, or hurricanes. Just in the past 10 years, inventory of existing homes for sale is down 66%, from 3.2 million units to 1.03 million as of 3/31/2021.

With pandemic-driven migration out of urban areas, and more work from home policies, demand is likewise increasing. When a couple moves from NYC to Pittsburgh, their purchasing price point (from higher city rent) might be higher than the general market, so this likewise contributes to price increases. This scenario is likely to continue for some time, as it is very hard to replace inventory.

EXISTING HOME SALES V. INVENTORY V. NEW BUILD STARTS

Date Range: 03/31/2011 - 02/28/2021

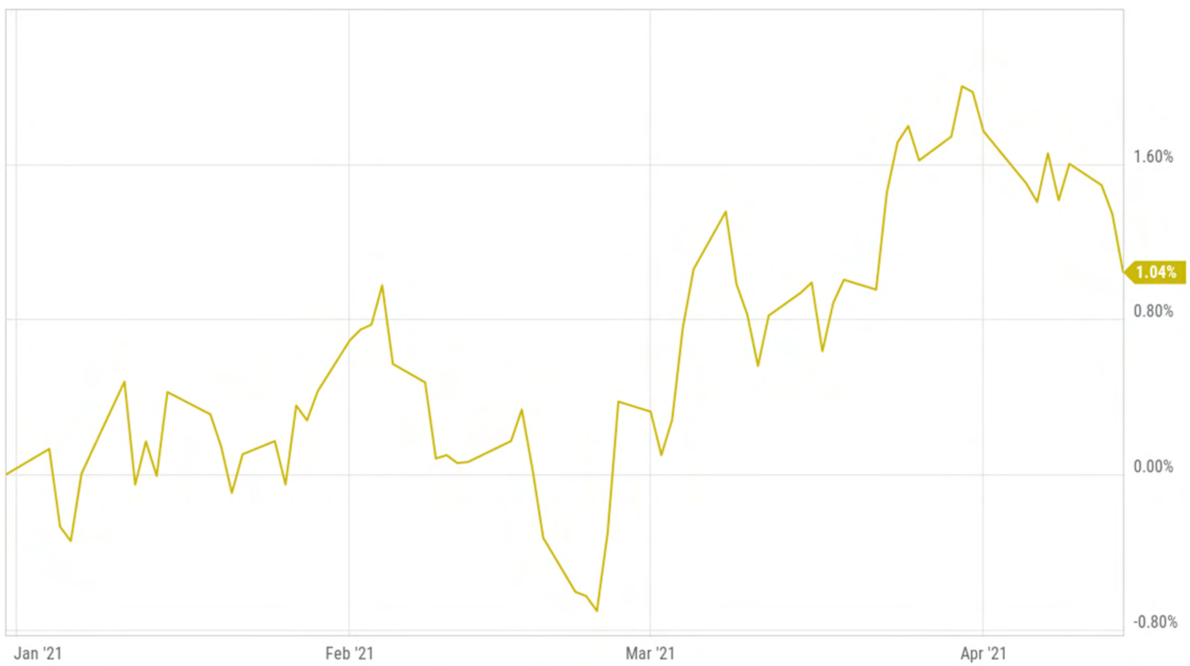
THE DOLLAR

Like interest rates, many factors come into play in the currency markets. While practically every major bank thought the dollar would decrease in 2021, through the first quarter, it was up about 2%, but it has given back about 1% in April so far (against a basket of foreign currencies – the Euro, Pound, Yen, and Australian Dollar).

Part of the dollar strength is Europe being slower than anticipated with its recovery out of COVID. It got a jump on the US and then quickly fell behind with an increase in new cases and delays in the delivery of the vaccine. Conversely, the US economy is improving, coupled with a strong vaccine level. Additionally, the fast rise of the 10-year Treasury attracted foreign investors, which boosted its early value increase. As rates have come off their highs slightly and stabilized, the dollar has lost a bit of its early gain. In comparison, the dollar has remained flat against the Chinese Yuan, as both these economies are recovering, with China ahead presently in its recovery.

The dollar is important to the economy for several reasons, as a weaker dollar helps make US exports become more attractive to overseas buyers, but it also raises the cost of imports to the US. A key import is oil, so there are trade-offs. In our view, given the effects of continued struggles of many overseas trading partners with COVID, and a 10-year Treasury that appears to be stabilizing for a while, the greenback is likely to remain flat, which should translate to no trade disruptions or hurting the bottom-line of multinational firms.

DOW JONES FXCM DOLLAR INDEX (% CHANGE)



MARKET INFLUENCES

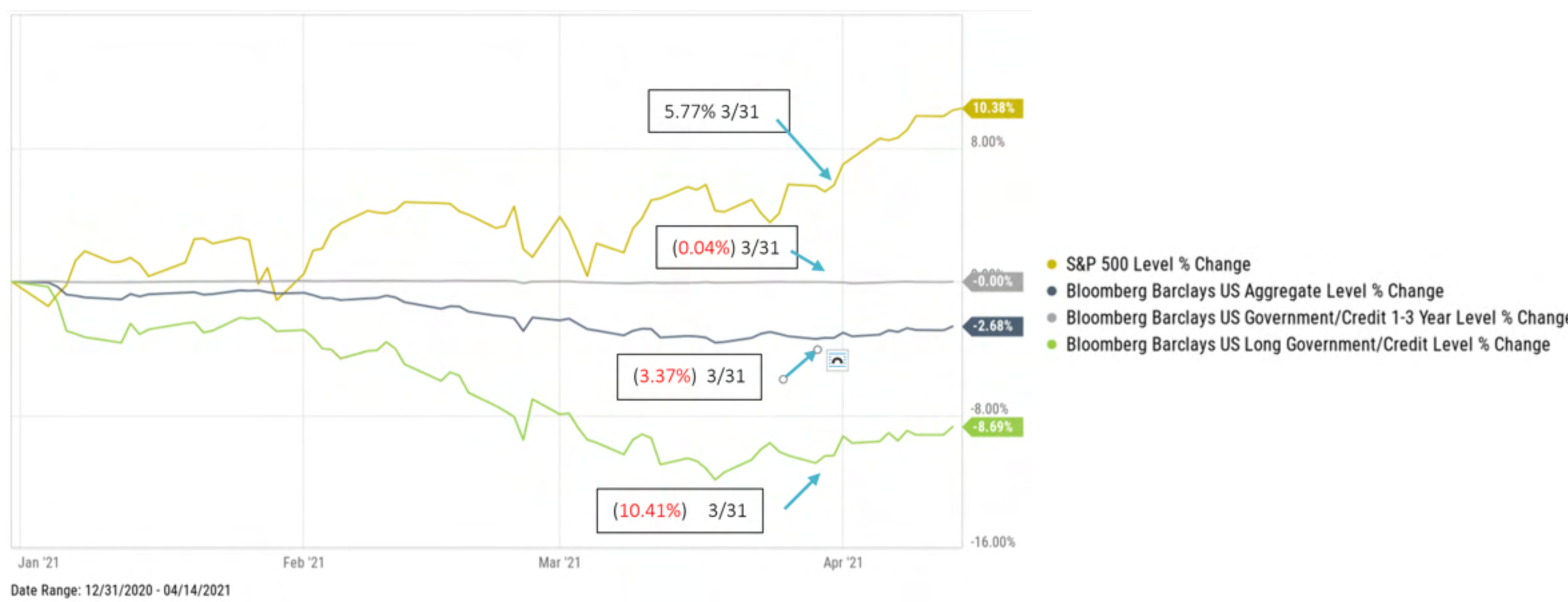
This past quarter has been one of steady movement in the equity world, and as mentioned in our fixed income commentary, bonds have seen some erosion because of interest rate changes.

BOND FLOWS INTO STOCKS

As of the time of this writing, the US equity market is up over 10% through mid-April. At the end of the first quarter, it was up 5.77%. This happened despite holiday related pandemic infections in January and early February. Subsequently, vaccinations were on the rise, especially at the start of March (and now into April). The market, as a forward-looking indicator, continues to point to a back to the future premise.

To convey the past being a guide but not a predictor, in our fixed income commentary we pointed out how the S&P dropped with a rise in the 10-year Treasury. This was attributed to several factors, one being the high amount of growth stocks that affect the market-cap weighted index, but also due to the rapid ascent of the 10-year Treasury in such a tight timeframe (causing fear for some stock market participants). However, history shows an interesting disparity in returns and the movement of the 10-year Treasury. Since the Great Financial Crisis ended (early 2009), whenever the 10-year Treasury rose (but was below 3.6%), returns in the stock market increased. Therefore, a rise in yield meant a rise in the market. When the yield was above 3.6%, though, stocks declined with further increases in the 10-year Treasury. Interestingly, from 1965-January 2009, the rise in rates correlated positively with a rise in stock returns, with 4.5% as the threshold for opposite returns. Again, we're reminded that just because something happened in the past does not automatically mean it will happen in the future.

S&P 500 AND US BOND MARKET MATURITIES



Bond funds did flow into the stock market when bond prices fell; however, given the heavy weight of technology firms in the index, the flow was disguised. As can be seen from the previous chart, depending on the maturity of bonds held, there was a fair amount of funds available for the equity market. It is our general thesis that the economy is continuing to recover, which naturally pushes rates up a bit. Therefore, we believe there will be continued migration of bond holdings to equities, which aligns with investors having a higher confidence level.

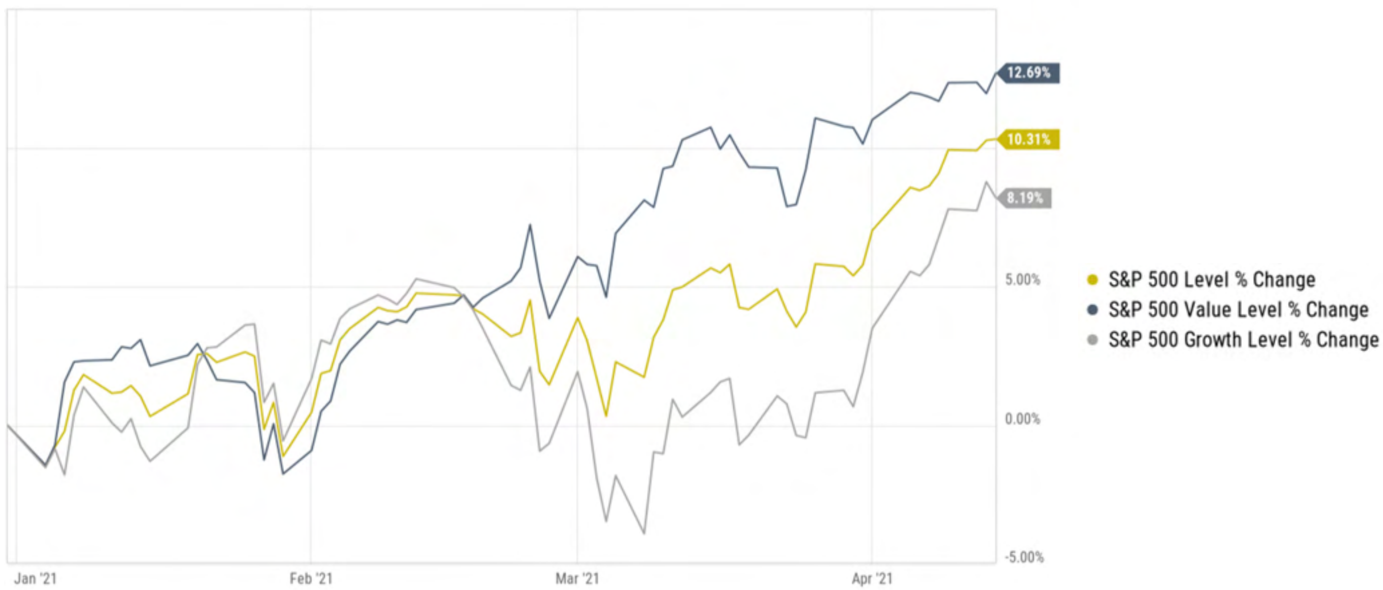
STYLE

While the S&P has done well year to date, there has been a style box change of leaders. Growth stocks took all the fame and glamour during 2020, as low interest rates and shut-downs created a mecca for technology-driven firms. However, in 2021, as we continue back to the future, the recovery has fostered value style stocks, as they have pulled the overall market this year, up 12.69% through mid-April.

Value stocks have an array of definitions, but principally they offer a "value" to the buyer when the market has under-appreciated their fundamentals. Dividend stocks usually get lumped into the value style box; because they provide a quarterly pay-out to shareholders, their overall valuation is lower. Furthermore, many cyclical stocks fall into the value style box, as they have fluctuations in value given economic cycles.

While many market observers will debate the style box leaders, we believe value has a bit of an edge as we continue back to the future (and investors seem to agree given YTD returns). Value companies are typically mature businesses, many of which were closed during the pandemic and are getting back up to speed with output. They are not glamourous high-flyers like their growth stock counterparts, which can perhaps hit the proverbial home run. Instead, they have stable income statements and balance sheets and are the "bread and butter" names.

S&P 500 STYLE COMPARISON



SPECULATION

We would be remiss if we did not mention the headline-grabbing, retail speculative investors, who organized to try to manipulate a few stocks, with the principal name being GameStop. While we wrote about this in our Weekly Updates, and believe it has gained far too much press—including nightly evening news—this did influence the market. While the retail investor was casted far below institutional traders using algorithms, retail investors, using social media as a platform, acted in unison and influenced selected stock prices. The problem is that more novice investors get caught up in the frenzy, thinking they can make a killing in the market, but sadly it is usually their bank accounts that get killed. This was a wake-up call to the industry and put risky money investors on notice. We believe it will surface again, but prudent investment practices should remain safe.

This past quarter also saw excess attention given to cryptocurrencies, such as Bitcoin. Again, we wrote a good piece on this via our Weekly Updates, but while everyone and their relatives are talking about Bitcoin, only about 1 in 10,000 can even come close to a partial explanation of what Bitcoin is and how it works. The truth is that very few people understand it, but everyone wants a piece of it. The old adage is that if you cannot explain what you are investing in, you should not be investing in the product.

The media seems to be hyping cryptocurrencies as a hedge against inflation (and to be clear, the word currency is a very loose word to describe Bitcoin, or any cryptocurrency at present). The inflation hedge argument is partially based on the limited supply of Bitcoin. In theory, Bitcoin is supposed to have a finite supply, but it still is being mined (somewhat like gold, the former inflation hedge of centuries.) Bitcoin mining is complicated, involving complex algorithm-based formulas and requiring giant warehouses with banks of computers, all working to solve the formula, just to "earn" one Bitcoin—and that is the simple explanation! The point is that supply is still increasing. Right now, in our view, given the volatility of the product, it is hard to justify as a hedge presently, and concerns of cyber-attack are ever-present. In fact, the Federal Reserve Chair indicated that the Fed's number one concern at present is cyber-attacks on financial institutions. If investors want to use cryptocurrency as their payment source, they too might want to take a page from the Federal Reserve's book.

Throughout our Outlook we've made sporadic references to **Back to the Future**, the classic movie series in which time travel allowed a young man to go back in time, only to find out that his activities while in the past would alter the future. After over a year of a global pandemic, we all yearn for the time when things were "normal." In our Outlook, we are alluding to a time before the pandemic when markets did what they were supposed to do, and, for the most part, cause-and-effect relationships were well defined.

As we point out in our theme, the economy is recovering, and this provides a level of comfort to investors. However, recovering means nothing more than returning to a state of normalcy. Just like a time traveler, there is never a return to the way things were, and there should not be, as we would never advance if things never changed.

The world, and subsequently the economy, are different, and while the past guides the future, the future will never be the past. Therefore, we need to take the lessons of the past to guide us into the future, knowing we can never go back. With the lessons learned from this pandemic, patterns, habits, and perceptions have all been altered. Just like in the past, the future is unknown, but with our role as Advisor, we are tasked with taking the leap as we head back to the future.

To a certain degree, it likely has never been so easy to see the future, if we use the past as our guide. The economy continues to gain steam, and the runway looks long after a complete dismantling of a global economic engine. Many bumps still exist on our flight forward, but attitudes (and companies) have changed. Jobs are returning with initial jobless claims down to the lowest level during the pandemic, and continuing unemployment claims are also dropping. Retail sales are starting to show significant strength as Main Street store fronts open. Manufacturing is strong (but it still has a way to go to catch up to supply shortages). Restaurants are slowly being filled again, but they still have challenges of social distancing restrictions and labor shortages, so it is not full steam ahead for them just yet. Even airline seats are being filled, including the middle seat. (Speaking of—if any good could have come out of this pandemic, the elimination of the middle seat would have been grand!) All in all, we see an economy that is positioned to continue its flight back to the future.

With all this optimism, market pundits are beginning to wonder how long this can last. Markets are never intended to be gauged as whether it is time to be all in or all out. This strategy of timing never wins. Allocation is critical and participating in the markets is paramount. While many panic that equity markets are at all-time highs, and have risen dramatically over the past 12 months, history (yes, the past) suggests upward trends will continue, despite the large gains already seen. In our opinion, it is time to head back to the future…

OUR VISION

end.

MACRO TEAM

TODD ARTWELL
SENIOR FIXED INCOME ANALYST

GREG FARRELL
VICE PRESIDENT,
SENIOR PORTFOLIO MANAGER

BRIAN LESTER, CFA
DIRECTOR OF EQUITIES

ELIZABETH PERRY
PORTFOLIO OPERATIONS MANAGER

DYLAN POTTER, CFP®
VICE PRESIDENT,
PORTFOLIO MANAGER

SARAH SWAN
VICE PRESIDENT,
MARKETING

MARK THOMPSON
EQUITY ANALYST

JOHN TRENTACOSTE
DIRECTOR OF FIXED INCOME

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