Profitable Risks / Unprofitable Risks

Loss avoidance is a key to long term investment success. We deem certain risks profitable, to be exploited with sound research, while other risks are inherently unprofitable and should be avoided.

Our Risk Management Tenets

✓ We believe in extensive asset class diversification
✓ We actively manage tactical asset allocation policy
✓ Our stock selection process emphasizes intrinsic value, earnings growth, innovation, and durable competitive advantages
✓ We believe excess returns are achievable due to market inefficiencies that persist over time
✓ We seek to build diversified portfolios of stocks with attractive valuations, quality balance sheets and above-average earnings growth
✓ We closely monitor valuation measures to limit downside risk
✓ We carefully control portfolio average capitalization and beta

Imbalances

“You can’t predict the future but you can prepare for it.” – Howard Marks

Executive Summary: Growing imbalances in the global economy lead us to a more cautious approach to risk.

Imbalances in the economy and markets are the slow-moving train wrecks that we may be at least vaguely aware of, but which move so slowly from day to day that the warning sirens of disaster don’t wail until it’s too late to do much about it. Not all imbalances cause financial market disruption, some get addressed by good policy, some by changing technology or demographics, and some continue for a long time as low intensity bothers. Part of the problem in assessing them is that it’s hard to tell when or even if one will lead to a big financial market correction. The classic example is the housing bust in 2007, which was facilitated by excessive creation of credit, promoted by extraordinarily easy monetary policy in the early 2000s. At first we saw the rise in home prices as a good thing, a positive offset to the collapse in household wealth that occurred in 2001 as a result of the tech-wreck, the crash of irrationally high valuations of internet stocks. Consumers contributed mightily to economic growth in the mid 2000s, later we understood more clearly by widespread use of home equity lending. By the time we understood how far mortgage lending standards had fallen and the extent of the poison injected into the financial system from sub-prime mortgages, the markets’ goose was cooked. Our purpose here is to identify imbalances that currently represent a significant source of disruption risk for the financial markets and assess the probabilities they present for destabilization.

As in any competitive arena in which differing approaches, philosophies and tactics are deployed in the attempt to determine a winner, offense and defense both play important roles. Sports analogies come to mind but the point applies to financial market strategies as well. We devote significant energies to scouring the global markets for opportunities to deliver superior returns, which is our offensive scheme. But we also devote equally intense efforts to trying to understand where we are in the economic and market cycles, with a cold eye and appreciation that all cycles end, usually badly. Our defensive scheme is to chronicle the things that could go wrong, starting with identifying imbalances and assessing the possibilities that those imbalances could correct abruptly and send the economy and/or markets into a tailspin. Balancing risk-seeking efforts to deliver superior returns with risk-avoidance tactics when the risk/return trade-off has turned unattractive is a constant challenge in investment strategy. Late-cycle dynamics compel a stronger sensitivity to obvious imbalances than early in the cycle. Economic cycles usually end as a result of significant over-valuation of prominent and widely held financial or real assets, with some catalyst emerging to force a correction to more normal values, and that correction driving...
retrenchment and risk aversion across the economy. When evidence of late-cycle behavior is present, defensive tactics gain priority and loss avoidance becomes a stronger strategic imperative than the pursuit of excess return.

Our base case view of the U.S. economic trajectory is more of what we have seen in the last few years, trends between 1.5-2.5% in real gross domestic product (RGDP). Growth slowed below the lower end of that range in the last year, with RGDP growing an anemic 1.2% in the year ending in June. The energy shock and negative ripple effects for capital spending, a 20% surge in the value of the Dollar due to Fed guidance that short-term interest rates would head up and continuing cautious behavior from consumers were all contributors to that slowdown. While our bias is an expectation that the Dollar remains relatively firm in the year ahead, it has traded more steadily in a narrow range in the last year, and is actually about 5% off the peak as the market has concluded that the Fed is likely to be a lot less aggressive in raising the Funds rate than they projected last year. Consequently, the U.S. manufacturing sector, on its heels in the last couple of years, is recovering some of its competitive balance, and appears to be driving a modest inventory rebuilding cycle this summer. Fed branches that track economic data for a real-time estimate of RGDP indicate 3.0-3.5% growth in the summer quarter. Consumers came out of their winter shelters late this year and spent some money in May and June, which breathed life into the production sector, however continuing sluggishness in real disposable personal income, historically a governor of consumer spending, suggest that the potential for a sustained acceleration in consumption is limited. Thus our conclusion is that the acceleration in RGDP in the third quarter is not likely to be a significant cyclical event, but is rather more the noise of the economy struggling to grow in the upper half of the 1.5-2.5% range in which it has been bound since 2009.

The bigger picture is that eight years after the crash of the global financial system in the fall of 2008, the U.S. and most other developed economies continue to work to rebuild and recapitalize their banking systems, and escape from the deleveraging and deflationary pressures that have lingered in the aftermath.

Export oriented economies in both the developed and developing world continue to struggle to adjust to slowing global growth that has negatively impacted world trade.

There are several indications of late-cycle dynamics that draw our attention to their potential to signal stormy weather ahead. Yield premiums on corporate bonds over Treasuries are at cyclical narrows, especially apart from the energy sector. Companies have responded to the market incentives provided by central bank buying of corporate debt in Europe to lever up their balance sheets with debt and engage in defensive mergers, as opposed to capital investment projects that create new jobs and products. The best example of that this year is the acquisition of SAB Miller by InBev, the merger of the Miller High Life and Budweiser beer empires, financed by $64 billion of debt, which is about monopolizing shelf space and creating a protective moat against the insurgency of rapid growth in craft beer production.

The commercial real estate cycle is indicating late-cycle behavior, with increasing supply pressuring rents, and many smart REITs (Real Estate Investment
Trusts) are in disposition mode and building cash positions. Corporate profits have been contracting for over a year, mostly but not entirely due to the collapse of energy prices. The Unemployment Rate at 4.9% is marginally under the Fed’s definition of Full Employment. Wage gains have hardly been robust, stagnant growth in a 2.0-2.5% range in recent years has been the norm, before inflation. However, they have inched slightly higher to a 2.6% rate over the last year, and if that modest acceleration continues it will further dent corporate profitability, since there is scant ability to raises prices. Global trade continues to decelerate, with the IMF warning of stall speed real growth in the global economy at 3%, exacerbating adjustment challenges in China and other Emerging Markets.

Finally, the Fed’s motivation in attempting to normalize the Fed Funds rate, meaning raise it up from zero to something closer to a historical norm, 3.0-3.5% their stated intention over the next several years, clearly isn’t about reigning in inflationary pressures but is apparently a lot more about creating a lever to ease liquidity conditions at some point if or when recessionary conditions emerge. Against this back-drop of spreading late-cycle behavior, what follows is a review of several of the imbalances in the global economy and our assessment of their potential to destabilize and disrupt the markets.

**Consumer Deleveraging:** One of the major imbalances in recent years was the explosion of household debt that funded the housing boom which burst in 2007 and resulted in a major reduction in the use of debt since. Household debt as a percent of disposable personal income has contracted sharply since 2007, which has been one of the major drivers of subdued consumer spending, along with a still high underemployment rate. Our assessment is that the housing crash in 2007 was a watershed event that will continue to have an echo in restrained use of consumer debt for the foreseeable future, which we refer to as a secular trend that will persist over more than one economic cycle. Secular turning points are easier to conjure than confirm and can take a couple of decades to prove up, but we’ll note that we’re nearly a decade down the road from the peak of the debt cycle and consumers continue to behave cautiously. The other side of the coin of consumer deleveraging is that the debt-fueled expansion of the chronic U.S. trade deficit in recent decades has narrowed sharply since its nadir in 2006, and is a game changer for economies that built up export capacity to sell into the U.S. Consumer deleveraging doesn’t hold much potential for abrupt disruption in the U.S. economy at this point, however several of our trading partners will continue to suffer withdrawals from their addiction to trade with the U.S.

**Excess Global Manufacturing Capacity:** The fall of the Berlin Wall and the collapse of the Soviet Union 25 years ago unleashed a global manufacturing renaissance that, combined with free trade initiatives such as NAFTA (North American Free Trade Agreement) and GATT (Global Agreement on Tariffs and Trade) has driven global growth, benefited consumers enormously and lifted billions out of poverty. China and Germany particularly invested heavily and posi-

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tioned as export leaders, with a galaxy of Emerging Market countries benefiting by provisioning manufacturing inputs. Germany has struggled with the global slowdown but has benefitted from the dysfunctional Euro, being linked to a cheaper currency than if Deutschmarks were still in circulation. Germany’s partners in the EU (European Union) are on the flip-side of that arrangement, stuck in a sluggish economy in deflationary conditions with an expensive, inflexible currency. That tension within the EU was a contributor to Britain’s exit from the continental trading union, which has raised doubts once again about the viability of the economic union.

China especially has struggled with the slowdown in global trade since 2008 and represents the chief source of potential instability in the global markets. China has attempted to offset its growing excess manufacturing capacity by stimulating investment in domestic demand, largely by provision of easy credit that has grown to bubble proportions. China’s ratio of private debt to GDP has increased by 60% since 2012, an enormous increase, far eclipsing previous highs and indicative of serious risks of debt implosion should property markets falter. Europe is like a forest fire that has been contained but with smoldering hot spots remaining; while China is a time bomb that may or may not go off, but if it does the disruption to global market stability will likely be severe.

**Trade Wars**: Donald Trump has pretty much promised trade wars with China and Mexico, which needs to be acknowledged in the context of a catalogue of risks to global growth. His missteps following the GOP convention however have resulted in a fairly substantial lead in the polls for Mrs. Clinton, which at this stage, post-conventions with voters making up their minds, a little more than two months out from November 8, is starting to smell insurmountable. Both candidates have been hostile to previous consensus attitudes toward global trade, reflecting populist swells in both parties, lamentable in light of the sweeping benefits to the global economy over recent decades outlined above. While we prefer free trade and see protectionist tariffs and other trade restraints as self-defeating, China’s intransigence and bad faith with respect to dumping prohibitions and serial theft of intellectual property leave it vulnerable to the populist backlash represented by Mr. Trump. Suffice to say that global trade initiatives will move to the back burner next year in any case.

Trade policy has assisted in the achievement of many foreign policy goals in recent decades. As the global economy integrated and tilted away from statist, command models, the U.S. fostered a lucrative alternative that featured partnership and access to U.S. markets. Geopolitical benefits beyond the boost to global growth were considerable. However, the result now includes an unsustainable U.S. trade deficit that threatens global stability. As these issues pertain to Mexico, the U.S. has a continuing strategic interest in promoting stability, growth and opportunity for our southern neighbor. Trade negotiations with Mexico should have a “Handle With Care” label on them.

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It’s worth noting though that a more subversive and effective trade war is already well underway in the form of competitive currency devaluations by nearly all of America’s most significant trading partners. The point of quantitative easing in Europe, Japan and elsewhere was to drive interest rates to the basement and achieve significant devaluation against the Dollar. The Chinese actually resisted until last summer (2015) and finally capitulated with a 7% devaluation of the Yuan. It’s clear that the trade-weighted average 20% appreciation in the Dollar since 2014 has hurt the U.S. economy. If the Fed were to follow through with its median projections for Fed Funds rate increases over the next two years, the Dollar would likely rally further, increasing competitive pressure on the U.S. manufacturing sector. That’s looking pretty unlikely though, given that growth here has slowed below even Europe’s sluggish trends, and Fed guidance now acknowledges the imperative of moving cautiously.

Mr. Trump’s proposals on trade and immigration may sound more Animal House than White House, however at their core is a valid contention that our trade imbalance needs to be addressed. A re-examination of trade policy next year that moves the needle toward a more rational balance among consumption, savings and investment holds the potential to be a positive development.

**Negative Interest Rates:** Roughly 50% of government bonds issued in Japan and Europe are trading at negative interest rates. Central Banks of both remain committed to aggressive quantitative easing, lately joined by the Bank of England (BOE) in response to expected economic weakness arising from BREXIT (the British exit from the European Union). Both the ECB (European Central Bank) and BOE are buying non-financial corporate bonds in addition to governments, all of which contributes to a low lid on U.S. interest rates. As noted earlier, credit spreads on U.S. corporate bonds are benefitting from the lack of hi-grade corporate supply elsewhere in the world. Negative interest rates abroad and exceptionally low interest rates in the U.S. have become known as financial repression, referring to central bank determination that savers, primarily pension funds, will bear the costs of attempts to stimulate growth by encouraging use of cheap credit. As mentioned above, consumers appear to be on a secular deleveraging course and have been in no mood to avail themselves of cheap credit. On the contrary, evidence is growing that consumers are alarmed by the apparent desperation of central banks to promote growth and are increasing precautionary savings balances. Also painfully aware that their retirement savings are suffering from paltry returns, savers are increasing their set-asides for the golden years, defeating the entire premise of negative rates.

Our assessment is that near-zero interest rates in the U.S. are the primary factor driving the acceleration in income inequality, with abundant liquidity supporting high stock prices and feeding popular resentment and the perception that Wall Street is being protected and coddled at the expense of everyone else. Central banks would be well advised to pay attention to the negative feedback loop their policies have created that are infecting our political process. Furthermore, as we have written previously, unfunded municipal pension liabilities in the U.S.

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are approaching crisis proportions. Overly generous benefit packages and unrealistic return assumptions have produced large funding gaps, which will be compounded by collapsing returns in the years ahead. The most meaningful source of systemic risk arising from negative interest rate policies is the likely spread of default risks among municipal bond issuers as pension funding obligations crash their budgets. Negative interest rates are annoying the heck out of savers and low-income earners with limited opportunities, but they are causing pneumonia among municipalities, many of which are slowly suffocating under unachievable pension funding requirements.

**Fiscal Policy Paralysis:** The venerable economist Herb Stein once said, “If something cannot go on forever, it will stop,” a typically pithy and invaluable contribution to the concept of unsustainability\. Publicly held federal debt in the U.S. has doubled relative to GDP since 2008, rising from 42% to 84%. There are a lot of measures of federal debt but publicly held gets the most attention since it is the largest component and the part that needs to be continually refinanced in the public markets. When debt began to rise sharply as a percent of GDP after 2008 we wondered where the crisis threshold would be, where debt servicing requirements would overwhelm the federal budget and deficits would spiral out of control, causing either a currency or a solvency crisis or both. Charles Kindleberger demonstrated that for most countries the point of no return from insolvency was publicly held federal debt at 60% of GDP, an upper bound of public debt tolerance enshrined in the Maastricht Treaty that founded the European Monetary Union. Kenneth Rogoff and Carmen Reinhart updated the analysis and argued countries experience a sharp slowdown in growth when their public debt to GDP ratios cross 90%. By those measures our current fiscal imbalance looks dire, however it turns out the rest of the world is in worse shape and U.S. Treasuries remain the safe harbor of choice. Nevertheless, it remains inescapable that publicly held federal debt has risen into the danger zone.

There are other factors to consider in assessing default risk in this context. Publicly held federal debt does not include the $3.5 trillion of Treasury debt purchased by the Federal Reserve since 2008 through quantitative easing. The Treasury debt on the Fed’s balance sheet presumably will have to be refinanced in the public markets at some point, meaning that publicly held federal debt will ultimately balloon to 103% of GDP as we know it today, which could be larger by the time all that debt gets refinanced, but there will also likely be additional new debt. There is also another $4 trillion of unmarketable federal debt placed as IOUs in the Social Security and Medicare trust funds, which also will need to be refinanced in the public markets eventually. Adding both the Treasuries on the Fed’s balance sheet and the IOUs in the trust funds to the equation, we can see that publicly held federal debt will move toward 125% of GDP over the next 10-20 years. Al Gore may have been right about the lock box. It should be noted that Greece began its slide on the slippery slope toward default and depression when its publicly held debt crossed the 125% mark. Other scary considerations are the likelihood that the Medicare and Social Security trust funds have been seriously under-reserved and that the unfunded liability is estimated at $55 trillion. Without accounting for an unfunded liability estimate CBO

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5 Herbert Stein, “Herb Stein’s Unfamiliar Quotations”, Slate, May 16, 1997
6 Charles P. Kindleberger, Manias, Panics and Crashes, 1978
7 Carmen M. Reinhart and Kenneth S. Rogoff, This Time is Different, 2009
The Consumer Financial Protection Bureau has increased the costs and reduced the supply of mortgage credit. The National Labor Relations Board, the "C.B.O., “The Budget and Economic Outlook: 2016 to 2026”, Publication 51129, January 2016

Walt Kelly, “Pogo”, Post-Hall Syndicate, April 22, 1970


Regulatory Overkill: The biggest failure in the run-up to the crash in 2008 was regulatory, in that mortgage originators were selling highly flawed loans in plain sight to Wall Street for securitization and distribution to the public, and no one put a stop to it. Ben Bernanke took over the Fed Chairmanship in February 2006, although the disaster fuse was lit by that point. For nearly two decades prior, the pinnacle of the regulatory authority of the U.S. financial system was chaired by Alan Greenspan, a self-described devotee of libertarian writer Ayn Rand and practitioner of benign neglect toward the banking system. Greenspan professed in 2004 that financial markets were effective disciplinarians of financing practices and that banks’ self-interest was a powerful brake on their activities. The Fed had the authority to prohibit deceptive lending practices and failed to do so. The tools existed for the Fed to prevent the collapse of the mortgage markets, which led to the crash of the U.S. financial system in the fall of 2008, if only the Fed had employed them. Stronger bank capitalization, stronger vigilance from the financial regulatory apparatus to stridently enforce existing laws, and standardization and consolidation of credit default swaps on a clearing house exchange would be sufficient responses to the risks presented in 2008. However, the Obama Administration has instead deployed a massive escalation in regulation, not just in the banking system and financial markets, but in many sectors of the economy.

The Consumer Financial Protection Bureau has increased the costs and reduced the supply of mortgage credit. The National Labor Relations Board, the...
Environmental Protection Agency and the Department of Energy have all imposed costly new regulations on American business. The Affordable Care Act has raised employer costs and incentivized small business to limit hiring. The justifications for many of the new regulations are debatable, although we’ll concede there are at least two sides to every debate, however the costs in terms of lost opportunities for jobs and income growth are considered too rarely in the regulatory rationalizations. There can be little doubt the still high 9.7% underemployment rate is directly related to the present growth-stifling regulatory environment. While the over-regulation of business is not likely to be a source of abrupt disruption to the financial markets, the failure to sponsor conditions that lead to full employment of the labor force in this cycle means that when the next chapter of destabilization does come, it is likely to be more intense than normal due to such a large swath of the labor force remaining marginalized.

But there is one instance of new regulation that is likely to be a source of significant financial market instability at some point. The Dodd-Frank financial system regulation enacted in 2010, which includes the Volcker Rule that severely limits banks’ proprietary trading, has resulted in sharply reduced trading volume in the financial markets, as dealers have limited capacity to inventory securities. Set against a proliferation of institutional intermediaries employing trading algorithms and other high frequency trading techniques, the risk is high that late-cycle environments could experience sharp spikes in volatility and severe downside corrections in market prices as crowded trades are unwound, often referred to as a flash crash. The face of today’s financial regulation is Alfred E. Neuman smiling, saying, “What, me worry?”

**Poor Political Leadership:** Without taking sides or expressing a preference for a partisan position, it should be an uncontroversial observation that we have endured an administration for almost eight years that has employed a clear preference for regulation over promoting growth. Growth is the tonic that can cure many of the ills afflicting our economy: income inequality, labor mobility, productivity and profitability, better opportunity for all. Yet the Administration has repeatedly failed to elevate growth as a policy priority. There is an active anger in the body politic that is expressing disenchantment with the economic trajectory since 2009 in different ways. Both parties have been transformed by this year’s campaigns. The Sanders insurgency has forced the Clinton campaign to the left, with her call for “debt free college education” emblematic of her increasing use of “free stuff” as campaign planks. The Trump campaign is unrecognizable as set of traditional Republican aspirations, with its emphasis on retaliatory actions toward trading partners and reckless abandonment of long-standing geopolitical alliances. Polls indicate that if the election were held today Mrs. Clinton would be the victor, a result looking increasingly likely, despite her weaknesses as a candidate. The possibility certainly exists, with the probability rising daily, that Mrs. Clinton will win with a substantial enough margin that control of the U.S. Senate may revert to the Democrats. The U.S. House appears likely to maintain a Republican majority even in a strong Clinton win and continue to be a hurdle for legislation, although the GOP’s ability to screen judicial nominations in the Senate may be greatly diminished.

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12 Mad Magazine, December 1956, Issue #30

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The main message of this year’s elections is that the electorate is voicing a strong desire for a change in direction on global trade and unhappiness with economic opportunity. Both candidates are giving voice to the protests against unfair trade and have competing plans for government directed infrastructure spending. Neither candidate has expressed any credible intention to address the poor federal budget outlook, since that would be in conflict with an electorate that is expressing a strong preference for more government, not less. Since it’s looking like a Clinton win at this point, and there is no indication so far that she has any interest in deregulation, we have to conclude that regulatory overkill will continue, if not expand further. Both of Mrs. Clinton’s likely approaches to trade and regulation constitute restraints on U.S. growth potential. We suspect that if a Clinton victory becomes a high probability in October, the stock market may exhibit a relief rally due to the diminished uncertainties surrounding a potential Trump presidency. Our assessment, however, is that the good governance necessary to help guide the Fed to more effective monetary policy, lead the country to a more sustainable fiscal policy and loosen the regulatory straight-jacket that is restraining growth is increasingly unlikely. The prospect of four or eight more years of similarly unsatisfying economic performance as the last eight years constitutes a dismal policy backdrop for investors. The plaintive refrain we continue to hear from friends and investors is: with 300 million people, these two are the best we have?

**Equity Market Valuations:** Equity valuations are high and rising, seemingly disconnected from the slump in earnings that has occurred over the last two years. The Price/Earnings ratio for the S&P 500 is over 17X, the highest since 2003; and the Price/Sales ratio, which is not impacted by financial engineering like earnings can be, is at 1.82, the highest since before the tech-wreck in 2001. These lofty valuations are enabled by the abundant liquidity provided by the Fed, which has depressed U.S. Treasury 10-year yields to historic lows around 1.50%. The Treasury 10-yr is often used as a valuation standard for stock prices, in comparison to the inverse of the Price/Earnings ratio, known as the Earnings Yield. Yet the yield spread between Treasuries and the Earnings Yield has rarely demonstrated any timing usefulness, and we have serious doubts that the current 10-year Treasury yield is a valid comparison for stock prices, considering its manipulation by the Fed and the strong foreign investor flows coming into Treasuries, fleeing negative interest rates at home. Our assessment is that U.S. equity valuations are in fact disconnected from the reality of the current earnings recession, which we expect will correct in the not distant future. One plausible catalyst for the correction is the conclusion of the presidential election, bringing clarity to an expectation that fiscal stimulus and infrastructure investment in 2017 are likely, which could easily lift Treasury yields 50 basis points or more, a jolt that could snap equity investors out of their valuation fantasies. Over-valuation is the primary driver of our current tactical underweight in Equities relative to strategic targets, which is reinforced by the cumulative weight of the threats to growth represented in the imbalances discussed above.

**Epilogue:** This review of imbalances in the investment and policy environments is not intended as a comprehensive analysis of investment prospects. As
emphasized at the outset, it is a chronicle of things that could go wrong and potentially trigger sharp adjustments in the financial markets. This is an elaboration of our defensive scheme and a focus on the things that give us pause in the pursuit of excess return around the world. It’s unusual that the list of potential hazards is so long and some with such undefinable timelines are so dark, which is partly a function of the late-cycle characteristics which are prevalent today. The sense that the economy is in a late-cycle phase increases our sensitivity to these backdrop concerns. We remain alert to opportunities to add risk in asset classes that exhibit attractive risk/return propositions. However, the concerns expressed here have caused us to shift our emphasis measurably toward capital preservation in the current environment. We hope our friends and clients find the discussion useful. We hold to the belief that an articulation of the sources of risk and dysfunction in public policy can help inform the public and contribute to positive change.
Yields are subject to change with economic conditions. Yield is only one factor that should be considered when making an investment decision.

U.S. Treasuries, municipal bonds are subject to credit risk. Quality varies widely depending on the specific issuer. Interest from certain municipal bonds may be subject to state and/or local taxes and in some circumstances, the alternative minimum tax. Unlike Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and fixed principal value.

Corporate bonds generally provide higher yields than U.S. treasuries while incurring higher risks. Certain high yield/high-risk bonds carry particular market risks and may experience greater volatility in market value than investment-grade corporate bonds. Government bonds and Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and fixed principal value. Interest from certain municipal bonds may be subject to state and/or local taxes and in some circumstances, the alternative minimum tax. Unlike U.S. Treasuries, municipal bonds are subject to credit risk. Quality varies widely depending on the specific issuer.

Fixed Income securities are subject to availability and market fluctuations. These securities may be worth less than the original cost upon redemption. Corporate bonds generally provide higher yields than U.S. treasuries while incurring higher risks. Certain high yield/high-risk bonds carry particular market risks and may experience greater volatility in market value than investment-grade corporate bonds. Government bonds and Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and fixed principal value. Interest from certain municipal bonds may be subject to state and/or local taxes and in some circumstances, the alternative minimum tax. Unlike U.S. Treasuries, municipal bonds are subject to credit risk. Quality varies widely depending on the specific issuer.

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This is only an opinion and not a prediction or promise of events to come.

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