

NEWSLETTER AND CAPITAL MARKETS REVIEW

FEBRUARY - MARCH 2022

On Wednesday, February 23rd, the S&P closed below the January 27th low. This is problematic from a market psychology perspective and likely points to a further consolidation in US stock prices. Granted, that low was exacerbated by the tragic events in Ukraine and Putin's barbaric acts against a free democratic Europe-adjacent society but several indications that equities were and still are headed lower were mounting before the Russia-Ukraine crisis exploded. The trailing PE ratio for the S&P is 22x vs. the 10-year average of 20x, which is arguably inflated due to the persistently low interest rate environment. Market breadth is deteriorating as indicated by several measures such as the percentage of index members trading above their long-term average (the 200-day moving average shown in the first chart), which is nearly 45% and has been steadily declining since mid-2021. It appears that the S&P does not make a major bottom until only 20% or so index members are still trading above trend. This could indicate two possible paths to a bottom. On one path, the market draws down sharply until that 20% threshold is crossed. On the other, the market grinds sideways to slightly down for a prolonged period of time until the long-term averages level off, essentially allowing the market to catch up to itself. We hope for the latter but guard against the former.

The situation in the Ukraine complicates matters for the US Fed in the midst of higher energy costs and rampant inflation throughout the US economy. Energy prices are part of and contribute to inflation, but they also serve as a broad-based and regressive tax, sucking liquidity from all areas of the US and global economies. The Fed has to play its role in reining in inflation by winding down its stimulus programs and raising rates, but must do so while considering the effects of peak oil so that we do not tip into stagflation or recession.

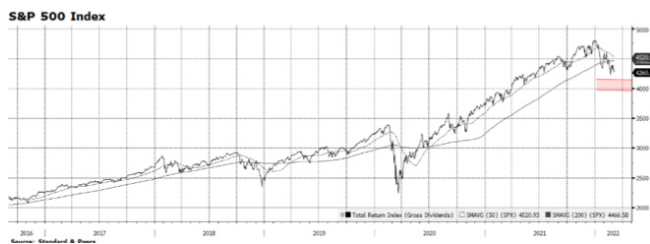
Commodity and food prices likely will remain high, especially considering Ukraine is a major global supplier of metals as well as wheat and corn. The Russian invasion is disrupting mining operations and obviously the planting season, and the global sanctions regime compounds the supply challenges by effectively reducing Russia's own contribution to global commodity markets.

In the shadow of these challenges, Fed Chairman Powell has been signaling a slightly less proactive inclination on the track of likely rate increases compared to where he was at the beginning of the year. In hindsight, the Fed should have begun tightening policy at least a quarter ago and perhaps even as early as Summer 2021 given solid employment trends and escalating inflation, even with the concerns of the Delta and then Omicron COVID-19 surges.



Review and Outlook cont'd

Weakening equity markets will likely face stiff headwinds as policy becomes less accommodative. The outsized stock price gains since the pandemic bottom are unlikely to be repeated, and markets will give back a quantity of those gains, or possibly level off for an extended period while the market regresses back to long term trend lines. The annualized total return of the S&P 500 since the pre-pandemic peak on February 18, 2020 through the end of February 2022 is 15.3%. If returns had been a more moderate yet still very robust annualized 8 - 10% the index would be in an approximate range of 3965 to 4120 (the shaded region on the second chart). That would imply a decline of about 7.5% from the end of February and we would not be surprised to see prices drop below those levels temporarily. We have a sense that the overall US stock market will stay in a range and even consolidate further downwards until the effects of evolving policy conditions, inflationary pressures and geopolitical concerns are priced in or recede.



[charts and data courtesy Standard & Poors, Bloomberg LP © 2022]

Portfolio Positioning

A little more than a month ago, we took steps to reduce our exposure to equity risk as the capital markets digested their nearly unprecedented run- up since the pandemic nadir in March of 2020. Our feeling has been that signals of transient inflation are becoming more systemic and, combined with a regime change from the Federal Reserve from stimulating to tightening, the short-term prospects for equities are less attractive. Since that time markets took a brief respite and even rallied a bit before continuing to grind and sometimes lurch lower. We have now taken a further incremental step away from equities in both US and foreign markets as we look for the catalyst that will define the bottom of this downward trajectory. Within our ETF models, we

made the shift primarily in US large cap growth and in Developed Europe equities, and in our ESG models through core and growth-biased large cap equities and broad international equities. All proceeds were committed to cash and cash equivalents for the moment. This further reinforces our underweight allocation to equities overall as well as keeping a modest underweight in fixed income, with cash now even more overweight. Within global equities, we materially lowered US exposure, kept an underweight in Emerging Markets, and established an underweight with respect to Eurozone stocks while continuing an underweight in Japan. Within fixed income, we are overweight in the US with a preference for mortgages and investment grade corporate credit. We have little to no exposure to non-US fixed income except through Green Bonds in our ESG series portfolios. All portfolios holding fixed income maintain lower duration than the benchmark.



Risk Outlook

- **Inflation** – What once was episodic is being reinforced by ongoing and new challenges turning small concentrations of inflation into a system-wide problem. Price rises are becoming more prevalent across the economy, and the Russia-Ukraine conflict just adds insult to injury as energy markets ran up to levels not seen since the bubble preceding the Financial Crisis. In many regards it is surprising, maybe even astonishing, that inflation has not been more of a concern for years now. We are more than a decade in to post-Crisis easy monetary policy and a booming stock market only briefly interrupted by the pandemic and now inflation, the Fed and the Russia-Ukraine conflict. The coordinated government response to the economic damage of the pandemic was massive. Had all of that stimulus settled into the “real” economy, inflation would be on a tear. We believe that the capital markets have served as a pressure relief valve, with stimulus settling out of the real economy and into the markets inflating asset prices. Correlation does not equal causation, but there seems to be a relationship of some sort between the magnitude of the stimulus and the increase in aggregate value in just the public markets. The challenge now is distinguishing between inflationary hotspots with very clear causal links and pathways to resolution, and more systemic inflation with no focused direct causes and therefore no clear tools for fixing. We have seen spikes in prices of building materials and scarcity of new cars for purchase as examples. But, while we cannot discount those observations entirely, we principally see them as graphic examples of how interdependent world economies and supply chains are and how fragile they were with just-in-time inventory management. While investors have extolled just-in-time since Toyota popularized it, it introduced an inelasticity into global supply chains that was not capable of absorbing the blow of COVID. We liken this to everyone on the highway cruising at 70 Mph riding bumper-to-bumper and doorhandle-to-doorhandle. It works fine until somebody swerves or stamps on their brakes. This was further exacerbated by climate-related issues with beetle infestation and fire affecting Western timber stocks and storms knocking petro-chemical production capacity off line among several other challenges. The results were issues such as a microchip shortage affecting the ability of factories to finish automobiles for

delivery. We believe as major parts of the global economy get back in order that the current focused situations like cars, appliances, chips and building supplies will self-correct, but by then it may be too late as inflation becomes widespread and entrenched. The global sanctions regime surrounding Russia will also play in, challenging energy markets and holders of Russia debt, which will almost certainly add volatility to the inflation situation. In the meantime, as investors and market watchers, we are looking at the confluence of business practices that are not sustainable, resilient or adaptive and externalities like global health, territorial conflict and climate change which can and will disrupt businesses and markets again.

- **Rates** – Rate increases are coming from the Fed, although the slope of that increase is uncertain given competing forces like inflation, energy prices, and war. Even a slight normalization of the rate environment could have profound effects in fixed income markets, severely dragging down assets like 30-year Treasury Bonds which are normally seen as safe harbors from risk. Global financial instability may actually moderate that some as the US T Bond is the world’s mattress for protecting personal, sovereign and corporate wealth, which will pin down rates to some degree. Wall Street has been cautioning about the risk of rising rates since the end of the Financial Crisis in 2009, but we have yet to actually have to live with those risks because a slow grind recovery followed by a series of crises including COVID have conspired to hold central bank policy where it has been – accommodative. We can observe that rising rates, which are now imminent, are not welcome in markets that have enjoyed easy money for more than a decade now. This compels us to think about risk in globally diversified portfolios differently, where the traditionally more conservative parts of asset allocations may actually represent more material risk in the nearer term.



Risk Outlook [cont'd]

- **The National Balance Sheet** – Continuing on the related themes of inflation and rates, the Federal Reserve has started winding down the extraordinary measures they have been taking through asset purchases. That has a couple implications – one is telling the markets that the training wheels can come off. The Fed feels like their additional help is no longer as needed. That is positive in tone which should be good for market sentiment, but offset by the disappointment of losing a major bond investor. This does mean a more orderly bond market where institutional investors are not competing with the government for bond inventory. Again, this is good, but it also means less liquidity. This is a slow turn of the battleship of state. They are not really shrinking the balance sheet. Just growing it less fast, so most of the market reaction will be sentiment-driven rather than based on real stresses from lower liquidity.
- **COVID-19** – We are now looking at the global transition of SARS CoV-2 and COVID-19 from pandemic to endemic, and what that means for progress and prosperity in developed and developing economies. Vaccine deployment continues and close on its heels the promise of new therapies in pill form that may make addressing severe illness as simple for COVID as Tamiflu does for influenza. New strains of the virus may contest the efficacy of those vaccines, but after two years the world has become more adaptive to the challenge and the need to hit the “off switch” on the world economy is far less than the early stages when the virus represented all danger with no defense. As we have previously expressed, the global community remains vulnerable to a have/have-not dichotomy based on access to virus-fighting resources. Indications are that pricing will be calibrated according to economic capacity, which is a promising development that may help to reduce the gap between developed and developing nations in the same way COVAX is working to do so through access to vaccinations. With these developments we may be less than a year away from COVID no longer being a meaningful factor in global economies.
- **China and Russia** – One of our long-term risk themes continues to be our focus on Chinese Communist Party actions which have not materially

shifted for the better in the COVID era. From aggression in the Asia-Pacific region to military tension along the border with India to suppression of Hong Kong citizens' rights and the interests of the Uighur population and the lack of contrition for their early role in failing to stop COVID-19 in its tracks, all may contribute to China-directed backlash or retaliation. There does seem to be regional coherency in the response as nearly all Pacific nations have aligned with the US against Chinese aggression. From lack of respect for intellectual property rights to involvement in global criminal drug trafficking to financial crimes and human rights abuses bordering on genocide, the country is finding it harder to get the global community to look the other way. We view this as a risk to investment in China and investment in companies reliant on a Chinese supply chain, but likely bullish for other parts of the Asia Pacific interested in usurping China's role as the manufacturing floor for the world. Meanwhile Russia continues to operate from other pages in the same playbook, manipulating natural gas markets in Europe and staging a full invasion of the sovereign nation of Ukraine. This is disrupting agricultural markets as the invasion interrupts Ukraine's ability to produce and provide agricultural products, and the global sanctions against Russia in response severely limit their own access to markets, effectively taking two consequential producers out of global markets. North America is food-independent, but because of the interconnectedness of global commodity markets, this kind of disruption may compound inflationary pressures in food.



ESG Considerations

We are going to redirect our series of discussions on ESG and inflation this month from our intended next topic of housing, even though there is both presence and urgency to it, in order to turn our focus to the deteriorating situation in Ukraine and the ESG and inflation implications there.

The general question we have been getting as chest thumping on the Ukraine/Russia border turned from posturing to invasion is “What is the portfolio’s exposure to Russia?”. The question is rooted in the sincere hope not that they could be losing money but that they could be exposed to and profiting from (and in) a country that does not share our values and priorities.

The short answer for WCM’s ESG portfolios is somewhere between very little and none. The more interesting question is the usual followup – “How did you avoid it?” The answer requires revisiting some of the foundational principles of ESG investing and how they inform a good ESG investment process. Viewing Russia and

Russia’s sphere of economic, social and environmental influence through the ESG lens allows portfolio managers to avoid the very real, very persistent systems-level risks in Russia in the same way ESG managers avoided a great deal of the pain from the Financial Crisis and the collapse of the last oil bubble in 2008.

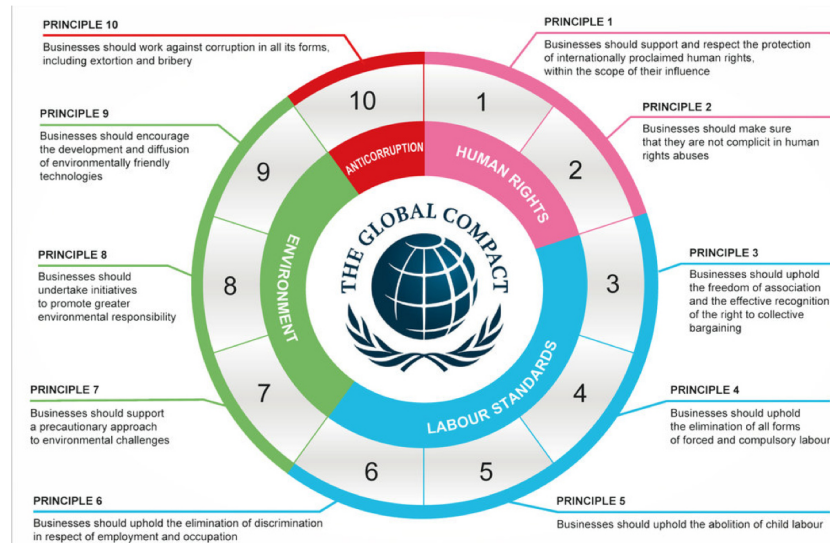
It is important here to distinguish between risks related to Russia and direct Russian exposure. A portfolio manager likely would elect to not own Russian banks but may well own European, Asian or North American banks that hold some amount of Russian debt. That does raise questions about that bank’s commitment to ESG and sustainable finance that need to be examined, but it is a derivative exposure. In globally intertwined economies and markets it is difficult to entirely avoid the risk, as the world is finding in the move to implement a sanctions regime around Russia.

Russia and the Environment

Hydrocarbons are a significant portion of Russia’s

overall economy and Russia’s share of global production, particularly oil, puts it right between the US and Saudi Arabia and more than double Canada. There is some dependency on when the measure is taken and the current surge in oil and gas prices will distort this somewhat, but the top three companies by revenue in Russia are oil companies while in the US an oil company barely broke the top 5 (Fortune 500, 2020) and in Canada they

barely get into the top 10 (Fortune Global 500, 2018). With an economy principally driven by extraction – hydrocarbons, minerals, precious and industrial metals and minerals, monocrop agriculture, and fishing – and a resurgent defense and aerospace sector, environmental performance is not a priority in Russia.



ESG Considerations [cont'd]

The environmental track record in North America leaves much to be desired as well, particularly where it involves treatment of indigenous peoples and their territory, and the state is often complicit in stifling public discourse and acts of protest against corporate interests. But, the US and Canada have not criminalized the existence of environmental interest groups in the same way Russia has, complete with special police units storming homes and offices, arresting personnel and declaring many environmental organizations essentially as criminal enterprises. The principal governmental oversight agency Rostekhnadzor, which has similar remit to parts of the US EPA and the civilian portions of the US Departments of Energy and Interior, has proven notoriously corrupt, eliminating another potential backstop to ensure basic environmental management practices. In a setting where corporations and the state are one and the same and where independent watchdogs are criminalized for campaigning for transparency and accountability, it is difficult to even assess environmental performance and risk much less commit capital to investment opportunities.

Since we are talking about Russia it seems appropriate to channel Ronald Reagan's favorite Russian proverb – trust but verify. In this instance ESG-committed asset managers can neither trust nor verify. Some ESG-committed managers that utilize a best-in-class approach across all economic sectors are willing to commit capital to companies that historically have made their money in extractive but economically necessary materials like oil, minerals and metals, but with a focus on companies that are leading in institutionalizing environmental practices and research and development to shrink footprints and usher in a clean-and-green economy. None of that can be found, at least with any degree of confidence, in 21st century Russia.

Russia and Society

In the case of E, S and G in emerging and frontier markets, intrepid portfolio managers do go in search of investment opportunities that succeed, or at least try to, despite the prevailing norms in a particular country. Managers will examine areas such as discrimination, free expression, workplace safety, human trafficking, corruption, and access to basic needs like water, nutrition, healthcare and education. There are unfortunately regions where the deck is stacked overwhelmingly against these priorities and there is not just the risk of failing to avoid controversies, but the

allocation of capital could actually further support problems, particularly where corruption and graft run rampant.

After showing some early promise in the post-Soviet era, Russia has backslid into autocracy and kleptocracy, with tremendous hazard that a failure to play by the regime's rulebook ends with being shut down, nationalized, jailed or even executed. The extinction of free press, marginalization of international NGOs, state control, and lack of governmental and corporate transparency obscure needed information to assess risk. What is observable, even correcting for the bias from making these observations from the perch of a Western liberal democracy, is that human rights are not a sufficient priority and there are few governmental or societal systems in place to drive for better.

According to the CATO Institute Human Freedom Index for 2021 (Ian Vásquez, Fred McMahon, Ryan Murphy, and Guillermina Sutter Schneider), Russia ranks 126 of 165 countries, keeping company with countries like Rwanda, Brunei, and the UAE. Belarus even ranks higher (!) at 109. It should be noted China does rank 150th only topping countries like Syria, Iraq, Somalia and Yemen, and this is indeed problematic in ESG investing terms and illustrates the difficult patchwork quilt of considerations that go into evaluating investments. It is rarely a single factor or controversy that drives inclusion or exclusion, and as with any investment decision it is a question of whether the totality of positives outweighs the negatives, with allowances that there are some bright lines that asset owners say cannot be crossed.

It is therefore difficult to find situations in Russia where it is verifiably safe to deploy investment capital that is supportive of the UN Global Compact and the UN Sustainable Development Goals.

THE HUMAN FREEDOM INDEX

Rank	Freedom rank change (2018–2019)	Country/Territory	Personal freedom	Economic freedom	Human freedom	Freedom score change (2018–2019)
87	▲ 3	Senegal	7.66	6.25	7.07	▲ 0.01
88	▲ 3	Madagascar	7.91	6.33	7.02	▲ 0.00
89	0	Colombia	7.14	6.82	7.01	▼ 0.06
89	▲ 3	Lesotho	7.32	6.57	7.01	▲ 0.00
91	▼ 4	Malawi	7.72	5.96	6.99	▼ 0.10
92	▼ 4	Bolivia	7.41	6.28	6.94	▼ 0.14
93	▲ 3	Mexico	6.72	7.20	6.92	▼ 0.02
94	▲ 5	Jordan	6.42	7.59	6.91	▲ 0.04
95	▲ 3	Côte d'Ivoire	7.42	6.18	6.90	0.00
120	▼ 4	Rwanda	5.65	7.35	6.36	▼ 0.13
121	▲ 4	Kuwait	6.07	6.72	6.34	▲ 0.07
122	▼ 1	Uganda	5.54	7.42	6.32	▼ 0.07
123	0	Nigeria	5.79	6.97	6.28	▼ 0.02
124	▲ 2	Mali	6.55	5.83	6.25	0.00
125	▼ 1	Nicaragua	5.67	7.04	6.24	▼ 0.04
126	▼ 4	Russian Federation	5.90	6.70	6.23	▼ 0.10
127	0	Azerbaijan	5.96	6.44	6.16	▲ 0.02
128	0	Qatar	5.48	7.09	6.15	▲ 0.05
129	▲ 7	Angola	6.50	5.50	6.09	▲ 0.29
130	-	Comoros	5.73	6.55	6.07	-



ESG Considerations [cont'd]

Russia and Governance

It is not possible to have a conversation about Russia in terms of leadership or business and markets without invoking concerns about governance. It was not even possible to discuss the environment and society as above without multiple direct and indirect references to governance challenges. In the field of ESG investing, good governance means good transparency and ethics and a culture of including and appropriately prioritizing the interests of all stakeholders. In some cases a culture of good governance is built around muscular law and regulation to define and protect stakeholder interests. In others it is dictated by the free market, including the expectations of customers, communities, suppliers, partners, lenders, even competitors.

Evidence is everywhere that Russia is a government-run crime syndicate. The market is far from free because the government is picking the winners and losers. The winners are those who bend the knee, pay economic tribute and defer power to the autocratic regime. Astonishing quantities of wealth from the extraction and exploitation of Russia's vast natural and people resources have been concentrated in the hands of a relative few who have channeled that wealth to foreign jurisdictions,

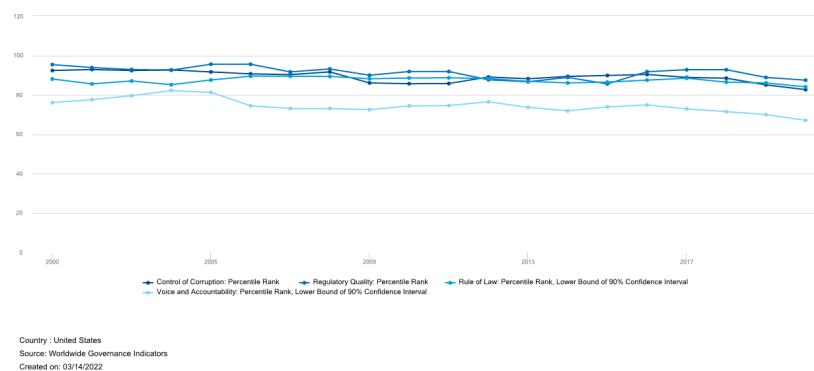
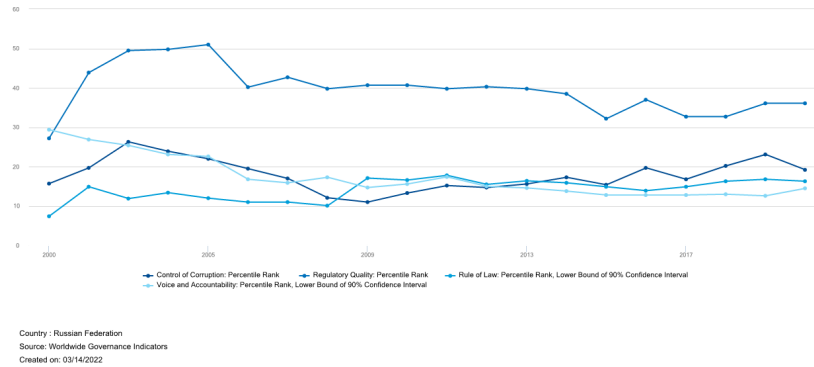
impoverishing the country further. They are far from the only country where this is the case, and those other countries are similarly considered uninvestable from a governance point of view.

The systems and incentives are not in place to foster and guarantee good governance and the stewardship of investment capital with integrity. That is a broad swipe at Russia and is absolutely unfair to individuals and

specific businesses that live their lives and practice their trades with care and integrity. The question from an investment point of view is whether the conditions are favorable for these select situations to succeed first, and then be permitted to perpetuate that success into the future without fear of reprisal.

Investing can be an act of courage, but that is not generally the province of market portfolios. That is for dedicated impact investment strategies where systemic

change and positive impact is an equal or even superseding priority to economic return. On that basis, Russian investment in the context of ESG is not completely out of the question. But, for the select instances where an opportunity may be found, it comes with a raw capitalist question – Is the reward (premium) for taking the risk sufficient to compensate the investor or is that risk better allocated elsewhere?



ESG Considerations [cont'd]***Other Observations***

Not all investment strategies integrate ESG considerations in the same way. Particularly for so-called “passive” strategies where there is a formula or methodology without discretion that defines what is in the portfolio, Russian investment could be present, although it is likely to be more selective and underrepresented as compared to traditional market-weight indexes. Our view is generally that a standard of being “not not-investable” is insufficient, and we apply that view not just in areas like geography, but also when it comes to carbon and other considerations. An underweight to a controversy accomplishes very little. The investor is still exposed, and the source of the controversy still has access to capital. In those instances, we will look for a robust activism and engagement program where becoming an investor stakeholder provides a seat at the table to directly address the controversy.

In the case of Russian companies, many state-controlled, and Russian bonds whether corporate or governmental, ditto, engagement is not a credible avenue for relief from controversy, so a best-of-a-bad-bunch approach is not adequate. For this reason, we favor active management for strategic holds in challenging emerging markets and will tend to use passive instruments that may have greater unmanaged exposure to these risks on a tactical basis only.

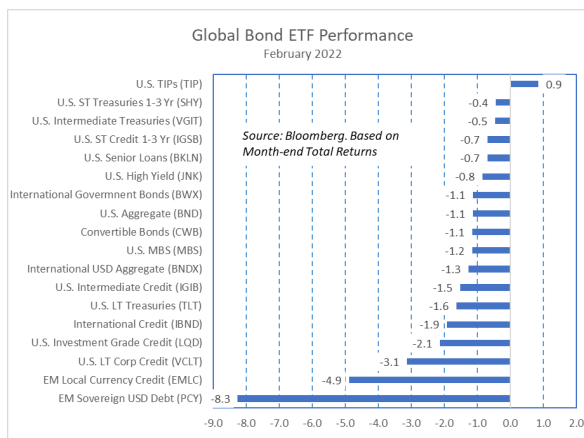
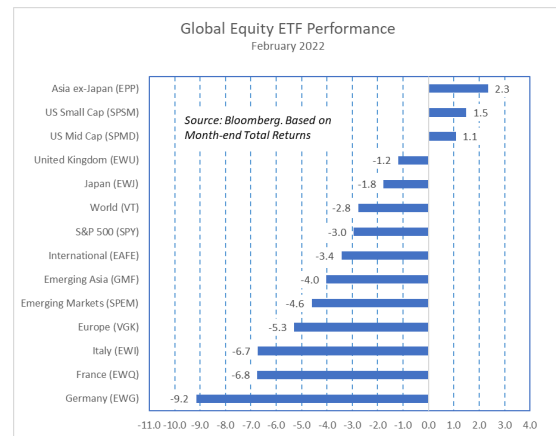


February 2022 Capital Market Review

Warren Buffett has been quoted and misquoted many times as saying something to the effect “Only when the tide goes out do you find out who’s been swimming naked”. It is a corollary to the similar folksy notion that a rising tide floats all boats, or put another way – “Don’t confuse brains with a bull market.” With rampant fiscal and monetary stimulus flowing from governments and central banks around the world driving markets higher, it would have taken an effort for investors to not make money over the last several years. Broadening inflation and global geopolitical turmoil on top of central banks shifting from stimulating to tightening is putting indiscriminate downward pressure on stock and bond markets and even digital assets and driving investors to traditional hiding spots like precious metals. A lot of investors who have allocated believing that 20%+ returns in stocks and real estate are normal and would persist are reaching for their swim trunks right now.

Equity Markets

Month-to-month regime-change in equity market leadership continued in to February 2022 in both surprising and unsurprising ways. Even after clawing back from how January ended and recovering from severe down days through February, US mega-caps (SPY) still finished down -3.0%. In the current environment of high inflation and market uncertainty this is not all that surprising, but bucking that outcome US Small and Mid-Cap (SPSM and SPMD respectively) rebounded significantly from last month, leaping from -7.4% and -7.2% in January to this month’s positive 1.5% and 1.1%. Emerging Markets (SPEM) and Emerging Asia (GMF) both lost momentum as well, dropping further back to -4.6% and -4.0%, respectively. No surprise, exposure to the economic fallout of the Ukrainian conflict and the global sanctions regime against Russia hit greater Europe particularly hard. The UK (EWU) lost ground in the pack, previously maintaining market leadership in December and January, but landing at -1.2% this month. Broad Europe (VGK) and specific markets like Italy (EWI) and France (EWQ) all tumbled to the bottom of the list, and Germany (EWG), being the most exposed to Russian energy of the major European markets, fell the hardest.



Bond Markets

Inflation is a big part of the bond story for February (note US TIPS diverging from other asset types), and even high quality bonds continue to fall well short of expectations of providing a safe harbor from equity turmoil. The most notable print for the month was in EM Sovereign Debt (PCY) at -8.3%, increasingly signaling the risk of a cascading crisis in that asset space particularly with the likelihood of a Russian default rising rapidly. Convertible Bonds (CWB), with their more mid-cap equity type behavior, managed to more or less hold ground along with High Yield (JNK) and Mortgages (MBS), but it is important to remain watchful of these asset types because of their sensitivity to forces beyond just rates and the Fed. With

inflation exceeding a 7% annualized rate at this time real returns on bonds are even more unattractive at present.

The returns cited reflect total return performance of exchange traded funds listed in the corresponding bar charts



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Diversification and strategic asset allocation do not guarantee a profit nor protect against a loss in declining markets. All investments are subject to risk, including the loss of principal.

The information contained herein is based upon the data available as of the date of this document and is subject to change at any time without notice.

Portfolios that invest in fixed income securities are subject to several general risks, including interest rate risk, credit risk, the risk of issuer default, liquidity risk and market risk. These risks can affect a security's price and yield to varying degrees, depending upon the nature of the instrument, and may occur from fluctuations in interest rates, a change to an issuer's individual situation or industry, or events in the financial markets. In general, a bond's yield is inversely related to its price. Bonds can lose their value as interest rates rise and an investor can lose principal. If sold prior to maturity, fixed income securities are subject to gains/losses based on the level of interest rates, market conditions and the credit quality of the issuer.

Foreign investments are subject to risks not ordinarily associated with domestic investments, such as currency, economic and political risks, and may follow different accounting standards than domestic investments. Investments in emerging or developing markets involve exposure to economic structures that are generally less diverse and mature, and to political systems that can be expected to have less stability than those of more developed countries. These securities may be less liquid and more volatile than investments in U.S. and longer-established non-U.S. markets.

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ETFs included in portfolios may charge additional fees and expenses in addition to the advisory fee charged for the Selected Portfolio. These additional fees and expenses are disclosed in the respective fund/note prospectus. For complete details, please refer to the prospectus.

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