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WEALTH MANAGEMENT

3rd Quarter 2024 Investment Letter by Erik Ridgley, CFA

CEO & Chief Investment Officer of Salem Partners Wealth Management — November 5, 2024

- We are very pleased with +36.4% total returns for U.S. large cap equities and +10.4% total returns for municipal bonds over the past 12 months ending 9/30.
- S&P 500 earnings growth consensus forecasts are +9.8% in 2024, +13.3% in 2025, +13.2% in 2026, and the U.S. economy continues to outperform expectations.
- Homeowners saw values of their houses appreciate 54.4% over the past five years, which provides another positive wealth effect.
- The Fed began a new interest rate-cutting cycle because CPI inflation keeps falling (now 2.4%) and unemployment is gradually rising (3-month average rate rose to 4.1% from its 12-month low of 3.8%).
- We believe these tailwinds to markets will persist into 2025.

Unsurprisingly, the highest interest rates in over 15 years are causing hardships for private businesses that borrowed too much money. It reminds me of my meeting with the CEO of Capital One back in the mid-1990's, when I asked him if it's too risky to lend to his low credit score borrowers during recessions, and he sighed, "Erik, for our customers it's always a recession." Alas, the more things change, the more they stay the same.

Asset Class Benchmark Returns – Year-to-Date 2024 (YTD as of 9/30) and 3rd Quarter 2024 (3Q24)

YTD:	+22.08%	2Q24:	+5.89%	U.S. Large Cap Equities: S&P 500 Index
YTD:	+18.66%	2Q24:	+6.61%	Global Equities: MSCI All Country World Index (ACWI)
YTD:	+12.99%	2Q24:	+7.26%	Foreign Developed Equities: MSCI EAFE Index (EAFE)
YTD:	+12.12%	2Q24:	+5.05%	60/40 Allocation: 60% ACWI / 40% Muni Bond
YTD:	+11.17%	2Q24:	+9.27%	U.S. Small Cap Equities: Russell 2000 Index
YTD:	+16.86%	2Q24:	+8.72%	Emerging Markets Equities: MSCI Emerging Markets Index
YTD:	+15.69%	2Q24:	+16.09%	Real Estate: S&P U.S. REIT Index
YTD:	+8.00%	2Q24:	+5.28%	Junk Bonds: U.S. Aggregate Corporate High Yield Index
YTD:	+4.45%	2Q24:	+5.20%	U.S. Fixed Income: U.S. Aggregate Bond Index (AGG)
YTD:	+2.30%	2Q24:	+2.71%	Municipal Bonds: Bloomberg Barclays Muni Bond Index
YTD:	+4.08%	2Q24:	+1.36%	Cash: U.S. T-Bills (1-3 Months) Bloomberg Index

How Can We Fix Our Federal Debt?

Federal debt as a percentage of GDP is rising and is now 124% vs. 60% from 1991 to 2007 and 40% from 1965 to 1985, but investors in our Treasuries and the dollar don't care about this (yet), and neither do voters, all of which we discussed in detail in last quarter's investment letter. In this quarter's investment letter we will discuss how we can fix our debt. The popular solution proposal is to "grow our way out of it" but we should grow our economy whether we have a debt problem or not. Growing the economy is necessary but not sufficient to fix our debt. A more useful insight is "when you are in a hole, stop digging."

Government spending is roughly 23% of GDP. For the past five decades the government has collected tax revenues of roughly 18% of GDP each year, even though income tax rates have been both lower and higher during that time, because individuals and businesses can choose to increase or decrease their taxable income in reaction to different income tax rates. If we assume (as we should) this 50-year pattern of collecting tax revenues of 18% of GDP will persist, then the only way we can "stop digging" is to reduce government spending to 18% of GDP. (GDP is total value of goods and services produced per year.)

How Do We Compare to Other Countries?

Government debt-to-GDP ratios for China and G7 countries are Japan: 255%, Italy: 144%, United States: 124%, France: 110%, Canada: 106%, United Kingdom: 104%, China: 89%, and Germany: 66%.

Is This a New Problem?

No. The Co-Chairs of the President's National Commission on Fiscal Responsibility and Reform, Erskine Bowles and Alan Simpson, released a draft of their recommendations for deficit reduction and debt stabilization on November 10, 2010. As the introduction of their draft argued, "The problem is real, the solution is painful, there's no easy way out, everything must be on the table, and Washington must lead."

How Much Time Do We Have?

The bad news is that government spending is forecasted to rise to 27.3% of GDP over the next 30 years, which we can call "digging faster". The good news is if we credibly implement plans starting "X" years from now to reduce government spending from 23% (or higher) to 18% of GDP over the following 30 years, which would be "digging slower", then the Treasury bond markets will give us the time we need, as long as our nominal GDP growth rate (5.5% in 2024) exceeds the average interest rate on government debt outstanding (3.4% as of Aug, per Statista). No one knows what a prudent limit on "X" years from now is. Of course, sooner is better.

Will Reducing Government Spending Lower GDP Growth Rates?

In the short run the answer is yes, but in the long run the answer is no. (This might be a good topic for next quarter's investment letter.)

Will Reducing Government Spending Lower Inflation?

Yes. And vice versa.

Can We Increase Government Spending During Recessions?

Yes. A credible plan to reduce government spending to 18% of GDP over 30 years could have "automatic stabilizers" which increase government spending temporarily during recessions and decrease government spending during expansions.

Will the U.S. Dollar Remain the Primary Global Reserve Currency?

Yes. The dollar has been the primary global reserve currency since the end of World War II and is the most widely used currency for international trade and commodities transactions. The International Monetary Fund recognizes eight major reserve currencies, of which the U.S. dollar is the most commonly held, making up 59% of official global foreign exchange reserves, followed by the euro at 20%, the Japanese yen at 6%, the British pound sterling at 5%, the Chinese renmimbi at 3%, the Canadian dollar at 2½%, the Australian dollar at 2%, and the Swiss franc at less than ½%.

Factors that contribute to the dollar's dominance include the size of the U.S. economy and the United States' geopolitical strength. In addition, no other country has a market for its debt akin to the $27 trillion U.S. treasuries market. Most countries want to hold their reserves in a currency with large and open financial markets, since they want to be sure that they can access their reserves in a moment of need. Central banks often hold currency in the form of government bonds, such as U.S. treasuries. The U.S. treasuries market remains by far the world's largest and most liquid bond market. It's hard to compete with the U.S. dollar if you don't have a bond market equivalent to the U.S. treasuries market. Thus, the U.S. dollar will continue to be the primary global reserve currency for governments, businesses, and investors for the foreseeable future, because it is better suited for this role than any other reserve currency.

Updated Estimates for Earnings, Revenues, Margins, GDP Growth, Valuations, Interest Rates

Consensus estimates for S&P 500 EPS growth are +9.8% in 2024, +13.3% in 2025, and +13.2% in 2026 per I/B/E/S data by LSEG. Year-over-year quarterly EPS actuals were -1.5% in 4Q22, -3.1% in 1Q23, -5.8% in 2Q23, +4.3% in 3Q23, +7.5% in 4Q23, +6.6% in 1Q24, +11.3% (up from +9.5% in July) in 2Q24, and estimates of +6.0% (down from +8.7% in July) in 3Q24, and +9.6% (down from +14.3% in July) in 4Q24. Thus, the 4Q22 to 2Q23 corporate profits recession ended over a year ago.

Consensus estimates for S&P 500 revenues per share are forecasted to grow +6.8% in 2023, +1.3% in 2024, +5.6% in 2025, and +6.1% in 2026. Consensus estimates for net profit margins are projected to expand from +11.9% in 2023 to 12.4% in 2024, 13.5% in 2025, and 14.0% in 2026, per I/B/E/S data by LSEG.

Wall Street's full year consensus forecast for U.S. real GDP is +2.9% (up from +2.5% in July) in 2023, +2.6% in 2024 (up from +1.3% in Jan), +1.9% in 2025, and +2.0% in 2026, and the quarterly consensus forecasts (QoQ%, SAAR) are +2.2% in 1Q23, +2.1% in 2Q23, +4.9% in 3Q23, +3.2% in 4Q23 (up from +1.2% in Jan.), +1.6% in 1Q24, +3.0% in 2Q24, +2.8% (up from +1.6% in July) in 3Q24 (act.), +1.7% in 4Q24 (est.) per Bloomberg <ECFC>. Average U.S. real GDP growth has been 2.3% over the past ten years. Like we did throughout 2023, we continue to think U.S. real GDP quarterly reports will come in stronger than consensus forecasts.

The European Union and Japan are both forecasted per Bloomberg <ECFC> to accelerate growth in 2025. Europe's economy is forecasted to grow +0.4% in 2023, and +1.0% in 2024, +1.5% in 2025, and +1.7% in 2026, vs. its trend rate of +1.0% real GDP growth. Japan's economy is forecasted to grow +1.7% in 2023, +0.0% in 2024 (down from +0.9% in Dec.), +1.2% in 2025, and +0.9% in 2026, vs. its trend rate of +0.5% real GDP growth.

Price/earnings (P/E) multiples are 21.2 for S&P 500 large cap, *18.2 for S&P 500 large cap excluding tech*, 15.8 for S&P 400 mid cap, 14.6 for S&P 600 small cap, 14.1 for foreign developed, and 11.9 for emerging markets, where E is EPS for 2025 i.e., "next year's earnings", per Bloomberg consensus. The long-term average for U.S. large cap next four quarters P/E multiples is approximately 15-½. Thus, U.S. large cap equity valuations are 37% above average, and after removing the technology sector valuations are 17% above average. U.S. small cap equity P/E multiples are cheaper than their historical averages.

The Treasury yield curve is currently pricing in Fed Funds Rates to be cut in 0.25% increments from 5.00% currently to 4.25% six months from now, and 10-year Treasury yields of 4.35% one year from now, per Bloomberg <FWCM>. The yield curve is also priced for 10-year Treasury yields to gradually increase to 4.7% during the next 5 years. The Treasury yield curve represents the "real money" pricing of many trillions of dollars of U.S. Treasury securities across maturities from 7 days to 30 years, based on bond investors' expectations for the future, which is why it commands the respect of equity investors and the Fed. Of course, the yield curve always reserves the right to change its mind.

The yield curve is upward sloping, with 10-year Treasury yields higher than 2-year Treasury yields by 9 basis points (bps). The yield curve was inverted (downward sloping) from July 2022 until September 2024, with a nadir of 106 bps inverted on June 30th, 2023. Yield curve inversions have historically been reliable leading indicators of future economic downturns, but not this time. Inverted yield curves have (in the past) dis-incentivized banks from lending to corporate borrowers, but rapidly growing private credit funds have partially replaced commercial banks as key sources of capital to private businesses.

High yield bond spreads (over 10-year Treasuries) tightened from 351 bps to 302 bps, after spiking to 406 bps on August 5th, indicating that credit markets continue to price in a soft landing (i.e., not a recession).

<u>Our Forecast: 15% Probability of Recession vs. 50% "Soft-ish Landing" vs. 35% "No Landing"</u>

We estimate a 15% probability of a recession (i.e., "hard landing"), a 50% probability of a "growth recession" (i.e. soft-ish landing, per Fed Chair Powell) which is defined as two or more quarters of 0.0% to +1.0% real GDP growth (QoQ% SAAR) and a material increase in unemployment rates, and a 35% probability of no recession (i.e., "soft landing" or "no landing" with no increase in unemployment rates). Economists have been divided over whether the Fed can defeat inflation without throwing the U.S. into a "hard landing" recession. The bearish case is that "long and variable lags" of tight monetary policy take time to work through the economy, and they will cause a recession in the next six months, and that everything we are seeing is consistent with the late-cycle phase of the business cycle. The bullish case is bolstered by low unemployment rates (caused in part by the retiring generation of baby boomers) and war-time levels of fiscal spending (i.e., $1.8 trillion federal deficit, American Rescue Plan Act, Chips and Science Act, Inflation Reduction Act, and Infrastructure Investment and Jobs Act).

<u>The Fed's Updated Economic Projections for Falling Inflation and Fed Funds Rates Cuts in 2024</u>

The FOMC September quarterly "dot plot" summary of economic projections signaled the Fed will cut the Fed Funds Rate to 4.50% by December 2024, and then to 3.5% by December 2025, and then to 3.00% by December 2026. The rule of thumb is that Fed Funds Rates should be 1% higher than inflation rates to force inflation down. The Fed is now forecasting core personal consumption expenditures (PCE) inflation rate, its preferred measure of inflation, which excludes energy and food, of 2.6% by December 2024 (and Fed Funds Rate of 4.4%), and then 2.2% by December 2025 (and Fed Funds Rate of 3.4%), and then 2.0%

by December 2026 (and Fed Funds Rate of 2.9%), and 2.0% in the longer run (and Fed Funds Rate of 2.9%). Bond market investors directionally agree with the Fed i.e., fed funds futures pricing implies the Fed Funds Rate will be 4.50% by Dec 2024, 4.00% by Dec 2025, and 3.75% by Dec 2026, per Bloomberg <WIRP>. Notably, the ends of Fed Funds Rate hiking cycles (this one ended 7/26/2023) have historically been followed by 12-month periods of well above average equity returns, using data from the past 30 years, with the one exception being 5/15/2000. The Fed is also forecasting stable U.S. real GDP growth of 2.0% and moderately higher unemployment rates of 4.4% for 2024-2026.

Review of 3rd Quarter of 2024: Strong U.S. Economy + Fed Rate Cuts = Bull Market

The S&P 500 index of stocks rose +5.89% including dividends in the third quarter of 2024, from 5,460 to 5,762. 10-year Treasury yields fell from 4.40% to 3.78%. West Texas Intermediate (WTI) crude oil prices per barrel fell from $81.54 to $68.17. The US Dollar currency index weakened from 105.87 to 100.78. U.S. unemployment rate increased from 4.0% to 4.2%. The Fed's 5-yr/5-yr forward inflation expectation rate went from 2.30% to 2.29%, after jumping to 2.46% on July 19th, per Bloomberg <T5YIFR Index>.

Both real and *nominal* U.S. economic activity decelerated in the 3rd quarter due to the lagged cumulative weight of 5.25% of Fed Funds Rate hikes over the past 30 months. The U.S. economy real GDP (QoQ% SAAR) estimates are +1.7% in 4Q24 (est.), +2.8% in 3Q24 (act.), +3.0% in 2Q24, +2.9% in 1Q24, +3.2% in 4Q23, +4.9% in 3Q23, +2.1% in 2Q23, +2.1% in 1Q23, +2.6% in 4Q22, +3.2% in 3Q22, -0.6% in 2Q22, -1.6% in 1Q22.

But earnings, revenues, and expenses are all reported in *nominal* terms, not real terms. The U.S. economy ***nominal* GDP** (QoQ% SAAR) was +4.2% in 4Q24 (est.), +5.4% in 3Q24 (act.), +6.2% in 2Q24, +4.9% in 1Q24, +6.4% in 4Q23, +8.4% in 3Q23, +6.1% in 2Q23, +8.0% in 1Q23, +9.7% in 4Q22, +11.5% in 3Q22, +8.1% in 2Q22, and +6.4% in 1Q22 (Note: the relevant formula is "*nominal* GDP = real GDP + CPI Inflation Rate").

The Fed's preferred measure of inflation, **Core PCE** (YoY%), estimates are +2.7% in 4Q24 (est.), +2.7% in 3Q24 (act.), +2.7% in 2Q24, +3.0% in 1Q24, +3.2% in 4Q23, +3.8% in 3Q23, +4.6% in 2Q23, +4.8% in 1Q23, +5.1% in 4Q22, +5.0% in 3Q22, and +5.0% in 2Q22. The Fed's target rate is +2.0%.

U.S. headline CPI inflation (YoY%) estimates are +2.5% in 4Q24 (est.), +2.6% in 3Q24 (act.), +3.2% in 2Q24, +3.3% in 1Q24, +3.2% in 4Q23, +3.5% in 3Q23, +4.0% in 2Q23, +5.8% in 1Q23, +7.1% in 4Q22, +8.3% in 3Q22, +8.7% in 2Q22, and +8.0% in 1Q22. The Fed's target rate is +2.0%.

Taxes Are Your Biggest Investment Expense Item

For wealthy investors, taxes often represent the most significant expense item, overshadowing other costs like management fees or transaction charges. This stems from the various forms of taxes they encounter, including capital gains tax, income tax on dividends and interest, and estate taxes. Capital gains taxes can be substantial due to the large profits generated from investments. Additionally, high-income brackets face progressive tax rates, leading to a higher percentage of their earnings being taxed. Strategic tax planning and the utilization of tax-efficient investment vehicles and portfolio management methodologies become crucial for wealthy investors to mitigate their overall tax burden and optimize their net returns.

Estate Tax Law Changes in 2026 Will Cause Some Wealthier and Older Individuals to Revise Plans

We at Salem Partners Wealth Management try to make sure that we are planning well ahead of any potential tax or regulatory changes in order that our clients can be ready for new environments. One such significant change on the horizon is a reduction in the amount of money that individuals can give away during their lifetimes, or pass along upon death, free of estate or gift tax. This amount gets cut in half starting on January 1, 2026. We encourage clients to start understanding whether they may want to address these changes in their current estate plan in anticipation of this change in the laws.

In 2025, individuals will be able to pass along an estimated $14.4 million free from estate or gift tax during their lifetime or as part of their estate. In 2026, that amount will be cut in half. That means a couple which today could pass along $28.8 million to their children or grandchildren tax free can only pass along half of that tax free in 2026. The most obvious clients who may want to think about doing something to take advantage of current laws would be those who are older (70+) and with an estate valued comfortably over the limit in 2026 ($7.2 million for an individual and $14.4 million for a couple) and a clear beneficiary.

Clients that check the net worth box but are younger may also want to consider strategies that take advantage of the laws but leave access to the capital in the hands of the donor during the donor's lifetime.

As always, we are happy to discuss considerations regarding your estate plan at your convenience. We understand that the implications of these and other estate plan issues are complex and want to support you to the greatest extent possible. We also want to make sure that our clients who do want to address the changes can do so before the high demand for planning that is likely to occur in 2025.

Business and Income Tax Planning Can Result in Significant Tax Savings

Business owners looking to contribute up to $300,000 per year of pre-tax money into their retirement plans should consider cash balance defined benefit pension plans. Founders launching start-ups with high growth potential can utilize qualified small business stock (QSBS) to exclude from their taxable income a portion of gain on the sale — up to $10 million or 10 times the investor's cost basis, whichever amount is greater. QSBS can be "stacked" to multiply the tax savings for a spouse, children, and multiple trusts. Private investors and limited partners can also receive the tax benefits of QSBS. Incentive stock options (ISOs) are typically offered to executives and key employees, with potential tax advantages, and non-qualified stock options (NSOs) can be granted to any employee, as well as to consultants and board members. For clients with significant wealth and liquidity, they can use private placement life insurance (PPLI) to place large sums of money in domestic entities that grow free of any taxation while maintaining access to liquidity. The US code contains various tax benefits to incentivize entrepreneurs to start and grow businesses, and we help make sure our clients don't miss out on them, so they can focus on building great businesses.

Proven and Repeatable Processes: Portfolio Rebalancing, Tax Loss Harvesting, and Tax Deferral

Portfolio rebalancing is a useful tool for long-term investors because it serves two important purposes. First and foremost, it keeps asset allocations in line with targets that have been codified in clients' investment policy statements (IPS). Second, it can be a mechanism to naturally "buy low, sell high", because it involves adding to an asset class that has decreased in price (e.g., >10%) relative to the overall portfolio, and cutting back an asset class that has increased in price relative to the overall portfolio. Good

judgement, disciplined decision-making, and operational excellence are necessary to obtain the best results for every client from portfolio rebalancing.

Another proven methodology for long-term investors to take advantage of market volatility is tax loss harvesting. Unlike tax loss selling, tax loss harvesting precludes adverse impacts to investment returns, by simultaneously replacing the sold securities with very similar securities, while avoiding IRS wash sale rule violations. We actively implement tax loss harvesting throughout the year whenever material market declines create opportunities.

Tax losses provide economic value because investors can use them to offset capital gains tax, and unused tax losses can be carried forward into future years until they are fully used. The maximum federal tax rate on short-term capital gains is 40.8%, including the 3.8% net investment income tax, and for Californians the maximum combined state and federal tax rate is 54.1%. Although no one likes down markets, tax loss harvesting can effectively reduce negative returns by up to 54.1%, without sacrificing full participation in the inevitable market recovery for long-term investors.

Tax deferral strategies involve delay or avoidance of realization of capital gains through judicious planning and portfolio management. Unrealized capital gains can be permanently eliminated over time with prudent trust & estate planning, via step up in cost basis when wealth transfers from one generation to the next.

Risk Management

Asset allocations should be based on well-designed investment policy statements to enable investors to get through bear markets without selling equities, by using fixed income or cash to draw upon until stock markets have recovered, which is common sense short-term risk management. However, comprehensive risk management should also account for the long-term shortfall risk of not achieving long-term portfolio growth objectives due to sub-optimal asset allocations and portfolio construction. Along the way, contingency risks (i.e., low probability and high impact) need to be efficiently managed with various tools including adequate liquidity, appropriate insurance protection (note: we do not sell insurance), coordination with clients' trusts & estate attorneys, and proactive tax planning with clients and their CPAs.

Long-Term Investing

To paraphrase Warren Buffett, successful investors need to invest for the long-term and avoid being swayed by the fear and greed of others that can cause irrational swings in the market. We do not let the daily noise and volatility of the markets deter us from our mission to be faithful stewards of our clients' capital. As long-term investors, we and our clients have committed ourselves to adhere to well-defined investment policy statements, which have been custom-built for each individual client, to achieve their long-term investment objectives, while accepting the inevitable price fluctuations of the public markets.

As fiduciaries, we relentlessly seek out the lowest costs and best terms for our clients. As trusted advisors, long-term relationships are of primary importance to helping our clients achieve successful outcomes through personalized financial planning and disciplined implementation.

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Conclusions

2024 and 2025 should see a continuation of the economic trends and earnings narratives that dominated much of 2023, which was an excellent year for investors with the discipline and fortitude to stick to their plans. We've enjoyed spectacular +36.4% total returns for U.S. large cap equities and +10.4% total returns for municipal bonds over the past 12 months ending 9/30. S&P 500 earnings growth consensus forecasts are +9.8% for 2024 and +13.3% for 2025, and the U.S. economy continues to outperform expectations. The Fed began a new interest rate-cutting cycle because CPI inflation keeps falling (now 2.4%) and unemployment is gradually rising (3-month average rate rose to 4.1% from its 12-month low of 3.8%).

We forecast a below average 15% probability of a recession, 50% probability of a "soft-ish" landing, and 35% probability of no landing. U.S. large cap equity P/E multiples *excluding technology* are 17% above their historical averages, however U.S. small cap P/E multiples are cheaper than their historical averages.

We wish all our clients and friends a festive fall. We will keep working hard to generate superior long-term after-tax investment returns for each of our clients with personalized financial planning and customized portfolios, and we are grateful for the trust and confidence our clients have placed in us.

Please let us know if you have any questions.

Best Regards, Erik

Erik Ridgley, CFA
CEO & Chief Investment Officer
Salem Partners Wealth Management
11111 Santa Monica Blvd, Suite 2250
Los Angeles, CA 90025
(310) 806-4200 main
(310) 806-4217 direct
(310) 497-0776 mobile
eridgley@salempartners.com
www.SalemPartners.com/Wealth-Management (PDF version of investment letter available via this link)

- Fiduciary registered investment adviser (RIA) founded in 2004. We are celebrating our 20th anniversary!
- Personalized financial planning and customized portfolios combined with institutional investment management expertise to drive superior long-term after-tax outcomes.
- Assets under management custodied at Charles Schwab ($7.8 Trillion in client assets across 34 million customer accounts) in segregated accounts under clients' names.
- Welcoming new clients with over $10 million to invest with us.

Selected to Los Angeles Business Journal's List of Leaders of Influence: Wealth Managers in 2023, 2022, 2021, 2020, 2019 (see website for disclosures)

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Disclosures

- **Past performance is not a guarantee of future results. Investments can lose money.**
- This analysis is not a guarantee, prediction, or projection of any particular result and your actual results may vary materially from those presented herein.
- Total return is the industry standard and our method of measuring investment performance in client reports. Total return is the investment income received or accrued plus the change in market value over a specified period divided by the market value at the beginning of the period.
- All total account performance returns in client reports are time-weighted total returns, displayed as net of all fees.
- Recognizing that past performance does not guarantee future results and that indices differ from actual portfolios, the data presented are based on the historical performance of their respective asset classes. When necessary, indices are used as proxies for the asset classes. The indices are not managed, not subject to fees nor transaction costs, nor available for direct investment. In certain instances, assumed rates of return or inflation are incorporated as part of the presentation. However, there is no guarantee that these assumptions will be realized in the future, and they shall not be deemed as a guarantee of future results.
- Investment returns portrayed are subject to the effect of material market or economic conditions during the specified time periods.
- Investment returns of indexes reflect the reinvestment of dividends and interest income.
- Investment returns of indexes do not reflect the effect of any fees or expenses since they do not ever pay any fees or expenses. You cannot invest directly in an index.
- Investments portrayed can generate profits, but they can also incur losses.
- Equity (stocks), fixed income (bonds), and other investments do not always gain or lose value at the same time. Historically, volatility has been reduced over time by holding multiple non-correlated asset classes in a portfolio.
- Diversification within an asset class is important because it can eliminate idiosyncratic (i.e., individual security) risk within an asset class, but it cannot eliminate systemic (i.e., market) risk of an asset class. No investment strategy or allocation can eliminate risk or guarantee investment returns.
- Although single-asset class diversification is an important tool in the toolbox of investing, relying on it alone might cause an investor to forego the benefits of other non-correlated asset classes that may help them achieve their long-term goals. Asset allocation differs from single-asset class diversification because it involves being diversified across multiple diversifying asset classes.
- Assets are broken out by market cap and style using data supplied from S&P, MSCI, Bloomberg, Morningstar, Inc. and other sources.
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11111 Santa Monica Boulevard, Suite 2250, Los Angeles, California 90025 TEL 310-806-4200 FAX 310-806-4212