Investment Philosophy Statement

SALMON | HAUGER
Wealth Management Group
of Wells Fargo Advisors

Index Portfolios

Setting an Investment Plan

To achieve any goal, one should start with a clear plan of action. Just as a business should have a business plan, the individual investor, household or investment committee should have an investment plan before participating in the financial markets.

Our work with each client begins with the development of such an investment plan. This details his or her assets and liabilities, income and expenses, financial goals, investing temperament, time horizon, tax considerations, liquidity needs and any other relevant factors. After analyzing these objectives and constraints, we identify a set of investment portfolio solutions with a range of risk-adjusted return expectations that may be suitable for the client.[1]

Through our Envision® process, we then estimate the likelihood that the investor may achieve his or her goals for each solution by stress-testing it against a wide array of hypothetical future market conditions. This stress-test helps us to identify the mix of equities, fixed income, cash and alternative investments that we believe is most suitable for the investor given his or her objectives and constraints. The higher the ratio of equities to fixed income, in general, the higher the expected return as well as risk.

Once we identify a suitable mix of securities, we recommend an appropriate course of action, which typically results in the investor adopting the mix as his or her strategic asset allocation. Along with any additional directives from the client, the strategic asset allocation forms the foundation of the investment plan and guides any investment management decisions we make.

Studies have shown that 80 to 90 percent of an investment portfolio's return variability over time is based on its asset allocation. Security selection, market timing and other factors account for the remaining 10 to 20 percent.[2] Consequently, the core of our investment process is setting and regularly reviewing each client's investment plan.

Portfolio Design and Composition

Our *Index Portfolios* are designed to provide our clients with broadly diversified investment portfolios that can be tailored to their individual investment plans. We use low-cost exchange traded funds (ETFs) as well as open and closed-end mutual funds to seek a suitable, risk-adjusted total return in the form of dividends, interest payments and capital appreciation.

The portfolios range from one consisting primarily of equities seeking long-term capital appreciation with an investment time horizon of at least 10 to 15 years to one consisting primarily of fixed income seeking income and capital preservation with a holding period of at least three to five years. We offer nine additional portfolios between these two ends of the spectrum. The client's investment plan determines which portfolio is most suitable given his or her objectives and constraints.

Each portfolio typically consists of three to seven large capitalization (cap) U.S. ETFs and mutual funds with weighted average market caps greater than $10 billion, four to 10 small and medium cap U.S. ETFs and mutual funds with weighted average market caps between $500 million and $10 billion and five to 10 developed international and emerging market ETFs and mutual funds with weighted market caps ranging from $5 billion to greater than $10 billion. These funds are typically diversified across sectors and industries as defined by the Global Industry Classification Standards.

Individual funds in the large cap U.S. portion of the portfolio typically have weights between three and 15 percent and collectively account for 35 to 60 percent of the overall equity allocation. Small and medium cap U.S. funds as well as developed international and emerging market funds typically have weights of 1.5 to six percent. The small and medium cap funds as well as developed and emerging market funds typically each account for 15 to 35 percent of the overall equity allocation.

Investment and Insurance Products: ▸NOT FDIC Insured ▸NO Bank Guarantee ▸MAY Lose Value

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For balanced accounts the portfolios typically hold nine to 15 fixed income ETFs and mutual funds, and are invested in short, intermediate and long-term investment grade fixed income, high yield fixed income as well as developed international and emerging market debt.

Of the overall fixed income allocation, short-term investment grade fixed income typically has a weight of 20 to 50 percent, intermediate-term investment grade fixed income of 25 to 60 percent and long-term investment grade of zero to 20 percent. High yield fixed income as well as developed international and emerging market debt each typically have a weight of zero to 15 percent. Generally, 80 percent or more of the fixed income allocation is investment grade. Investment grade bonds have a relatively low risk of default.

Benjamin Graham, known as the father of value investing, said that the market is a voting machine in the short run and a weighing machine in the long run.[3] Investors, prone to behavioral biases like fear and greed, can drive asset prices above or below their intrinsic long-term values in the short term. A security's intrinsic value is an estimate of the present value of its future cash flows. To take advantage of investment opportunities presented by such short-term price movements as well as to manage risk, we may make short-term tactical weighting or hedging adjustments. Typically, 15 percent or less of the portfolio is tactically allocated to enhance the client's risk-adjusted rate of return. These adjustments are generally made using ETFs, which allow us to make tactical adjustments without disrupting the other ETFs and mutual funds.

The weight of the portfolio's cash or cash alternatives position typically ranges from five to 15 percent, consistent with our guideline to be fully or near fully invested, except under extraordinary circumstances such as periods of extreme market volatility when it may be appropriate for the cash position to be higher.

Portfolio Management and Security Selection

Warren Buffet said, "To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insights or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework."[4] The interests of the investor are well-served when the portfolio management process follows a set of clearly defined investing disciplines. This helps prevent both the investor and portfolio manager from making poor decisions based on emotional biases.

About 40 to 60 percent of the ETF and mutual fund positions in our portfolios are what we refer to as core holdings. We plan to hold these funds over the long term because we expect them to survive the test of time and perform well over several business cycles. Because certain sectors of the economy tend to perform better during certain stages of the business cycle, about 25 percent of the positions may be based on our expectation that they could benefit from current economic conditions. The remaining 15 percent is reserved for tactical adjustments based on short-term price movements and to manage risk as stated previously.

The desired holding period for most securities is one to five years. We adhere to the adage, "Let your profits run and cut your losses quickly." Avoiding excessive trading of the portfolio reduces the impact of taxes on the investor's after tax return. High portfolio turnover can trigger unwanted short-term capital gains taxes, increase the number of buy and sell decisions that have to be made and can risk turning an otherwise sound investment process into a speculative hyperactive affair.

The universe of funds considered for our portfolios includes over 2,500 open and closed-end ETFs and mutual funds that have research coverage from various Wells Fargo Advisors-affiliated and other research providers. We are able to purchase no load and load mutual funds at their net asset values. This allows us to avoid paying a purchase fee when we buy a mutual fund.

Using a comprehensive screening program that we developed, we consider a variety of fundamental and technical factors in our portfolio management process. Fund selection incorporates a variety of criteria, including manager tenure, performance relative to the appropriate benchmark, expense ratios, investment philosophy, style consistency, tax efficiency, portfolio turnover, upside and downside market capture, bear market performance, and the alignment of the portfolio manager and fund company's interest with the investor's needs and goals.

Sell decisions are based on a number of factors, including prolonged periods of poor performance relative to the appropriate benchmark, change in manager tenure or investment philosophy, a bloated asset base that seems to be hurting performance, an increase in fees, alleged violations of fiduciary responsibilities, the appearance of better investment opportunities, style drift compared to what is stated in the mutual fund prospectus, tactical shifts to the asset allocation or style weightings and portfolio rebalancing.

There has been much written about the merits of active versus passive investing, actively managed mutual funds versus index funds, mutual funds versus ETFs and no load funds versus load funds. We do not see these debates as either/or. Our portfolios usually include both approaches, which we believe allows us to design portfolios that better fit a client's needs. Using quantitative and qualitative analysis and screens, we choose funds for the portfolios that score well on multiple criteria and promote portfolio diversification.

Our ETF and mutual fund reviews, which we require prior to any purchase or sale unless extraordinary circumstances preclude doing so, involve reading the available investment research and documenting our reasonable and adequate basis for the purchase or sale.

This screening and review process is often referred to as fundamental analysis. This approach evaluates the relative merits of securities based on their fundamental and technical factors independent of how they can be expected to perform based on broader economic trends. In addition to this bottom-up approach, our investment process uses a

top-down approach whereby analysis of economic trends, monetary and fiscal policy as well as the stage of the business cycle helps guide our security selection.

In the fixed income portion, we seek to add value through duration adjustments to manage interest rate risk, sector swaps and yield spread analysis. The fixed income component of a balanced portfolio is typically invested in ETFs and mutual funds, allowing us to make adjustments quickly in response to changes in the direction of interest rates as well as corporate liquidity and credit quality.

We believe that all too often the mutual fund providers seem to put maximizing fees and profits ahead of the best interests of the investor. For this reason, when selecting funds for the portfolios, we carefully review fund expenses, the stewardship of the fund provider as well as the culture of the fund family.

Investing Discipline

"To thy own self be true" is sage advice, particularly when it comes to investing. To select suitable investments, the investor must first determine what they require from their financial assets. Working with the investor, we formulate a sound investment plan and follow a disciplined investment process. A well-constructed plan may provide the investor with a high likelihood of achieving his or her goals with the lowest level of risk. Perhaps our most difficult, yet most important task is helping the investor navigate the emotional ups and downs of investing in the financial markets. Having over 30 years of investing experience, our senior managers can give a seasoned perspective when it is needed most.

Our clients have direct access to us should they have any questions or concerns. By maintaining communication, we believe we may be able to help them avoid any pitfalls created by downward market cycles. Additionally, we provide each client with a written progress evaluation on a quarterly basis that includes a comparison of his or her investment performance to a benchmark as well as an asset allocation review. Each client also receives a monthly statement and a 1099 statement at the end of the year.

Disclosures:

Richard Salmon and Michael Hauger act as the group's Private Investment Program (PIM) Portfolio Managers, and are authorized to make all discretionary decisions for advisory program accounts. Other team members referenced in this document provide support and assistance in the implementation of the investment strategy as outlined by the portfolio managers.

The PIM program is not designed for excessively traded or inactive accounts, and may not be suitable for all investors. Please carefully review the Wells Fargo Advisors advisory disclosure document for a full description of our services. The minimum account size for this program is $50,000.

Envision methodology: Based on accepted statistical methods, the Envision tool uses a simulation model to test your Ideal, Acceptable and Recommended Investment Plans. The simulation model uses assumptions about inflation, financial market returns and the relationships among these variables. These assumptions were derived from analysis of historical data. Using Monte Carlo simulation, the Envision tool simulates 1,000 different potential outcomes over a lifetime of investing varying historical risk, return, and correlation amongst the assets. Some of these scenarios will assume strong financial market returns, similar to the best periods of history for investors. Others will be similar to the worst periods in investing history. Most scenarios will fall somewhere in between. Elements of the Envision presentations and simulation results are under license from Wealthcare Capital Management LLC. © 2003-2021 Wealthcare Capital Management LLC. All Rights Reserved. Wealthcare Capital Management LLC is a separate entity and is not directly affiliated with Wells Fargo Advisors. Diversification does not guarantee profit or protect against loss in declining markets. Asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns.

Stocks offer long-term growth potential, but may fluctuate more and provide less current income than other investments. Dividends are not guaranteed and are subject to change or elimination. There is no assurance that the target price will be attained.

Technical analysis is only one form of analysis. Investors should also consider the merits of Fundamental and Quantitative analysis when making investment decisions.

Exchange Traded Funds and Mutual Funds are subject to risks. Investment returns may fluctuate and are subject to market volatility, so that an investor's shares, when redeemed or sold, may be worth more or less than their original cost.

Investments in fixed-income securities are subject to market, interest rate, credit and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and/or principal. This risk is heightened in lower rated bonds. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity.

[1] Wells Fargo Advisors Investment Institute. (2017). *Capital Market Assumptions.*
[2] The Journal of Wealth Management, Vol. 8, No. 3. (2010). *Strategic Asset Allocation and Other Determinants of Portfolio Returns.*
[3] Graham, B., Zweig, J., & Buffett, W. (1984). *The Intelligent Investor.*
[4] Graham, B., Zweig, J., & Buffett, W. (1984). *The Intelligent Investor.*

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