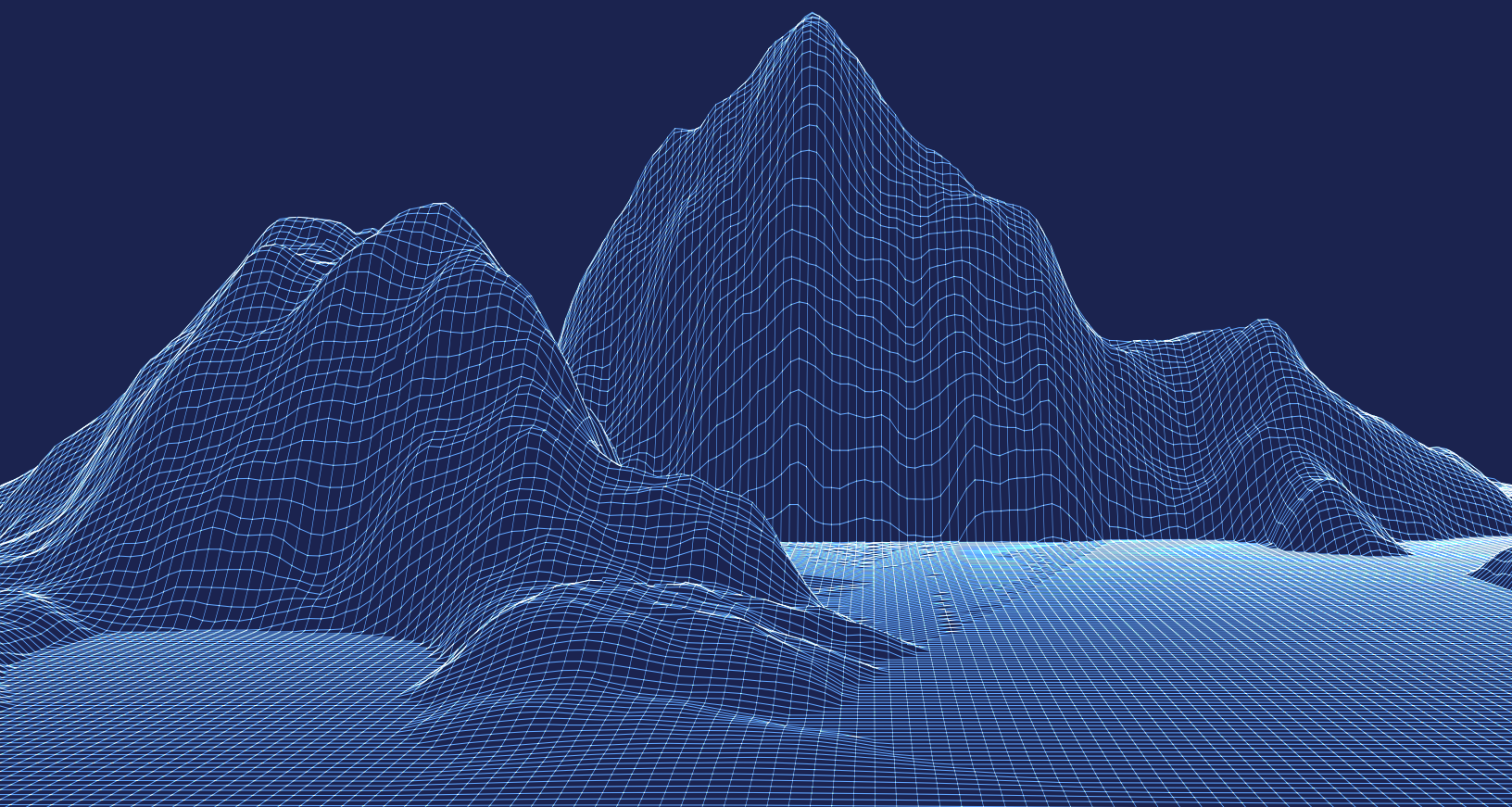


MARCH 2025

# Generating Income and Managing Volatility to Drive Long-Term Returns



■ ■ Those entering or nearing retirement are starting to rethink their approach to investing.

For these investors, a possible market drawdown represents a significant risk to their core source of retirement income. Additionally, many will need those investments to last longer than anticipated as the average length of retirement increases. Addressing these two factors means prioritizing the portfolio's long-term capital appreciation and current income.

Building an equity portfolio focused on growth and income requires a more sophisticated strategy than simply “buying the market” by investing in an index like the S&P 500 because today, the ten largest US stocks account for more than one-third of the value of the S&P 500. As a result, a drop in one of these holdings can lead to a significant drawdown in the index. Declines like this can have a material effect on investors relying on returns to fund their cost of living.

## Year-End Largest S&P 500 Weights

1980		1985		1990		1995		2000	
1	Int'l Bus. Machines 4.3%	Int'l Bus. Machines 6.4%	Int'l Bus. Machines 2.9%	General Electric 2.6%	General Electric 4.1%	General Electric 2.6%	General Electric 4.1%	General Electric 2.6%	General Electric 4.1%
2	American Tel & Tel 3.8%	Exxon Corp 2.7%	Exxon Corp 2.9%	AT&T Corp 2.2%	Exxon Corp 2.6%	AT&T Corp 2.2%	Exxon Corp 2.6%	Exxon Corp 2.6%	Exxon Corp 2.6%
3	Exxon Corp 3.8%	General Electric 2.2%	General Electric 2.3%	Exxon Corp 2.2%	Pfizer, Inc 2.5%	Exxon Corp 2.2%	Pfizer, Inc 2.5%	Pfizer, Inc 2.5%	Pfizer, Inc 2.5%
4	Stand'd Oil, Indiana 2.5%	American Tel & Tel 1.8%	Philip Morris Cos 2.2%	Coca-Cola Co 2.0%	Citigroup Inc 2.5%	Coca-Cola Co 2.0%	Citigroup Inc 2.5%	Citigroup Inc 2.5%	Citigroup Inc 2.5%
5	Schlumberger, Ltd 2.4%	General Motors 1.5%	Royal Dutch Petrol 1.9%	Merck & Co 1.8%	Cisco Systems 2.4%	Merck & Co 1.8%	Cisco Systems 2.4%	Cisco Systems 2.4%	Cisco Systems 2.4%
6	Shell Oil 1.9%	Royal Dutch Petrol 1.1%	Bristol-Myers Squibb 1.6%	Royal Dutch Petrol 1.7%	Wal-Mart Stores 2.0%	Royal Dutch Petrol 1.7%	Wal-Mart Stores 2.0%	Wal-Mart Stores 2.0%	Wal-Mart Stores 2.0%
7	Mobil Corp 1.9%	duPont (EI) deNemours 1.1%	Merck & Co 1.6%	Philip Morris Cos 1.6%	Microsoft Corp 2.0%	Philip Morris Cos 1.6%	Microsoft Corp 2.0%	Microsoft Corp 2.0%	Microsoft Corp 2.0%
8	Standard Oil of Cal 1.8%	Amoco Corp 1.1%	Wal-Mart Stores 1.6%	Procter & Gamble 1.2%	Amer Intl Group 2.0%	Procter & Gamble 1.2%	Amer Intl Group 2.0%	Amer Intl Group 2.0%	Amer Intl Group 2.0%
9	Atlantic Richfield 1.6%	BellSouth Corp 1.0%	American Tel & Tel 1.5%	Johnson & Johnson 1.2%	Merck & Co 1.8%	Johnson & Johnson 1.2%	Merck & Co 1.8%	Merck & Co 1.8%	Merck & Co 1.8%
10	General Electric 1.5%	Sears, Roebuck 0.9%	Coca-Cola Co 1.4%	Microsoft Corp 1.1%	Intel Corp 1.7%	Microsoft Corp 1.1%	Intel Corp 1.7%	Intel Corp 1.7%	Intel Corp 1.7%
<b>Top 5 Sum</b>		<b>16.8%</b>	<b>14.5%</b>	<b>12.3%</b>	<b>10.9%</b>	<b>10.9%</b>	<b>14.0%</b>	<b>14.0%</b>	<b>14.0%</b>
<b>Top 10 Sum</b>		<b>25.5%</b>	<b>19.8%</b>	<b>20.0%</b>	<b>17.7%</b>	<b>17.7%</b>	<b>23.5%</b>	<b>23.5%</b>	<b>23.5%</b>
2005		2010		2015		2020		2024	
1	General Electric 3.2%	Exxon Mobil 3.1%	Apple Inc. 3.0%	Apple Inc. 6.7%	Apple Inc. 7.6%	Apple Inc. 6.7%	Apple Inc. 7.6%	Apple Inc. 7.6%	Apple Inc. 7.6%
2	Exxon Mobil 3.0%	Apple Inc. 2.5%	Alphabet Inc 2.8%	Microsoft Corp 5.3%	NVIDIA Corp 6.6%	Microsoft Corp 5.3%	NVIDIA Corp 6.6%	NVIDIA Corp 6.6%	NVIDIA Corp 6.6%
3	Microsoft Corp 2.4%	Microsoft Corp 2.0%	Microsoft Corp 2.3%	Berkshire Hathaway 4.4%	Microsoft Corp 6.3%	Berkshire Hathaway 4.4%	Microsoft Corp 6.3%	Microsoft Corp 6.3%	Microsoft Corp 6.3%
4	Citigroup Inc 2.1%	Berkshire Hathaway 1.7%	Berkshire Hathaway 1.7%	Alphabet Inc 3.3%	Amazon.com Inc. 4.1%	Alphabet Inc 3.3%	Amazon.com Inc. 4.1%	Amazon.com Inc. 4.1%	Amazon.com Inc. 4.1%
5	Procter & Gamble 1.7%	General Electric 1.6%	Exxon Mobil 1.7%	Facebook Inc 2.1%	Alphabet Inc 4.0%	Facebook Inc 2.1%	Alphabet Inc 4.0%	Alphabet Inc 4.0%	Alphabet Inc 4.0%
6	Wal-Mart Stores 1.7%	Wal-Mart Stores 1.6%	Amazon.com Inc. 1.6%	Tesla Inc 1.7%	Meta Platforms 2.6%	Tesla Inc 1.7%	Meta Platforms 2.6%	Meta Platforms 2.6%	Meta Platforms 2.6%
7	Bank of America 1.6%	Google Inc 1.6%	General Electric 1.6%	Berkshire Hathaway 1.4%	Tesla Inc 2.3%	Berkshire Hathaway 1.4%	Tesla Inc 2.3%	Tesla Inc 2.3%	Tesla Inc 2.3%
8	Johnson & Johnson 1.6%	Chevron Corp 1.5%	Facebook Inc 1.5%	Johnson & Johnson 1.3%	Broadcom Inc 2.2%	Johnson & Johnson 1.3%	Broadcom Inc 2.2%	Broadcom Inc 2.2%	Broadcom Inc 2.2%
9	Amer Intl Group 1.5%	Int'l Bus. Machines 1.5%	Johnson & Johnson 1.5%	JP Morgan Chase & Co 1.2%	Berkshire Hathaway 1.7%	JP Morgan Chase & Co 1.2%	Berkshire Hathaway 1.7%	Berkshire Hathaway 1.7%	Berkshire Hathaway 1.7%
10	Pfizer, Inc 1.5%	Procter & Gamble 1.5%	Wells Fargo 1.4%	Visa Inc 1.2%	JP Morgan Chase & Co 1.4%	Visa Inc 1.2%	JP Morgan Chase & Co 1.4%	JP Morgan Chase & Co 1.4%	JP Morgan Chase & Co 1.4%
<b>Top 5 Sum</b>		<b>12.5%</b>	<b>10.8%</b>	<b>11.4%</b>	<b>21.8%</b>	<b>21.8%</b>	<b>28.7%</b>	<b>28.7%</b>	<b>28.7%</b>
<b>Top 10 Sum</b>		<b>20.4%</b>	<b>18.6%</b>	<b>19.1%</b>	<b>28.6%</b>	<b>28.6%</b>	<b>38.7%</b>	<b>38.7%</b>	<b>38.7%</b>

Source: FactSet & SWP Research

## Annual S&P 500 Contribution of 10 Largest Weights During Positive Performance Years

Year	Top 10 as % of Total	S&P 500 Perf.
2007	78.7%	3.5%
2023	68.4%	24.2%
2024	68.1%	23.3%
2020	58.9%	16.3%
1999	54.5%	19.5%
2021	45.0%	26.9%
1998	36.8%	26.7%
1996	33.9%	20.3%
2017	33.3%	19.4%
2019	32.8%	28.9%
2007	78.7%	3.5%
2023	68.4%	24.2%
2024	68.1%	23.3%
2020	58.9%	16.3%
1999	54.5%	19.5%
2021	45.0%	26.9%
1998	36.8%	26.7%
1996	33.9%	20.3%
2017	33.3%	19.4%
2019	32.8%	28.9%
1997	19.1%	31.0%
2013	17.6%	29.6%
2009	15.5%	23.5%
1992	14.9%	4.5%

Source: FactSet & SWP Research

This problem becomes pronounced in a setting where retirement lasts longer than ever. *A retiree aged 65 can expect to live for another 20 years<sup>1</sup>*. Therefore, many retirees will need their savings to go further than they expected. *Against this backdrop, it's not surprising that over half of surveyed Americans over the age of 50 worry they won't have enough money saved for retirement<sup>2</sup>*.

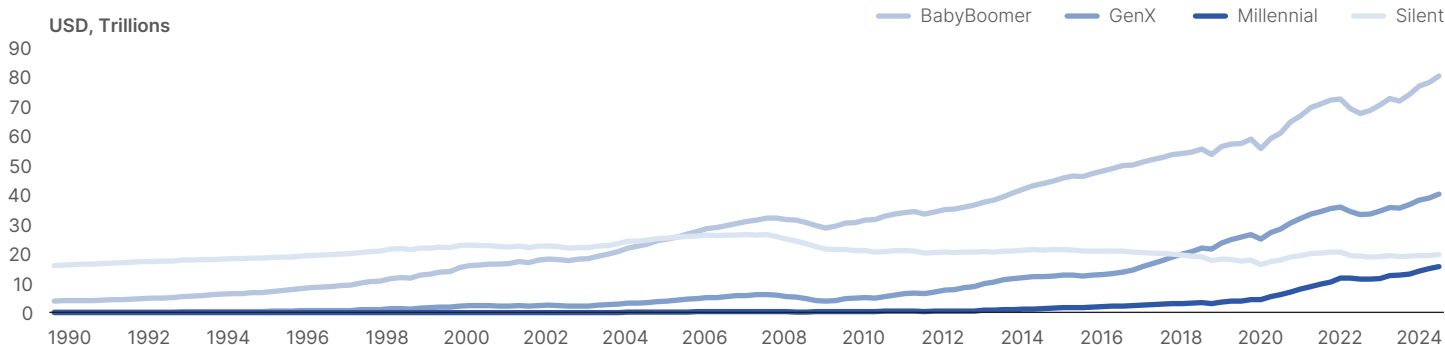
For investors approaching retirement, we believe that a shift to high-quality, income-generating stocks offers the chance to capture a competitive return with less volatility than the broader market. Now is the time to be more intentional about what's in a retirement portfolio and why it's there.

Here, we offer a clear breakdown of why investors should consider a strategy that prioritizes long-term appreciation and income and how to implement it.

# Rethinking Asset Allocation in Retirement

■ ■ Every day, 10,000 Baby Boomers reach the age of 65. For most, this milestone means entering retirement. When starting this phase of life, many are surprised by how dramatically the game of personal finance changes.

## Wealth by Generation



Source: FRED & SWP Research

Suddenly, income-generating investments become crucial to success. Volatility in the stock market creates more anxiety than before, and inflation fears are more intense. Retirees need a plan for dealing with these new challenges.

One solution is to build a financial plan that includes income-generating stocks that aim to manage volatility. This approach seeks to meet the investor's capital needs while reducing volatility, managing downside risk, and outpacing inflation.

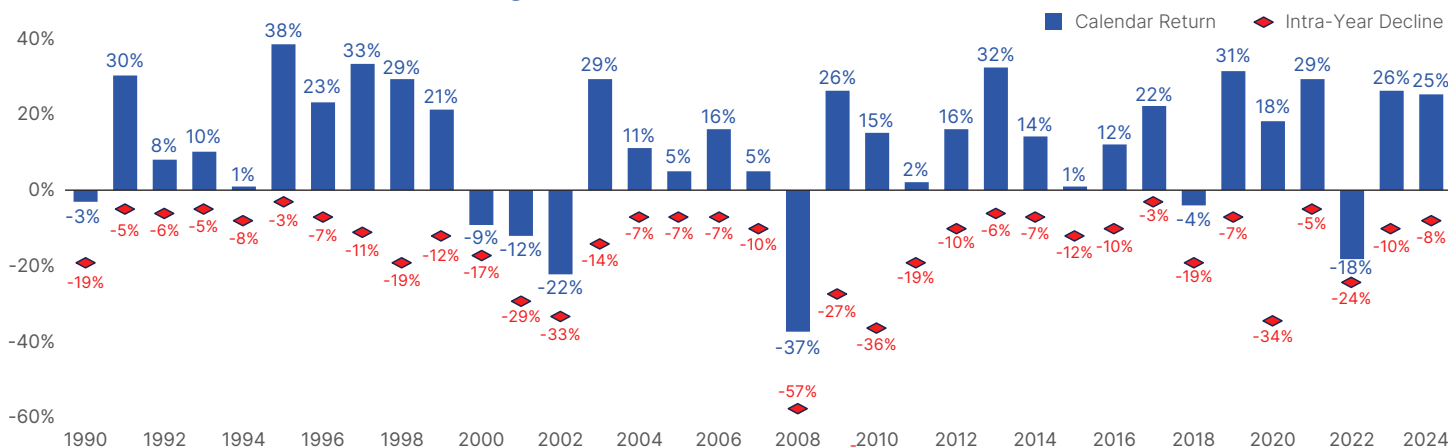
Prioritizing income generation means gaining exposure to dividend-paying stocks. These equities have long been an engine of growth in the S&P 500. In fact, over the last nine decades, about 40% of the annualized total return of the S&P 500 has come from dividend payments and reinvestments.

A focus on dividend-paying stocks offers two key benefits compared to non-dividend-paying stocks. *First, research shows that dividend-paying stocks tend to exhibit lower volatility over*

*the long-term*<sup>3</sup>. *High quality dividend paying equities have tended to hold their values better during recessionary periods, potentially mitigating losses (by losing less) in down years and thereby helping to lower sequence of returns risk which is the risk of negative returns occurring late in the investor's working years and/or early in their retirement*<sup>4</sup>. Second, dividend-paying stocks often generate higher risk-adjusted returns. These two characteristics are critical for investors who will be drawing on their investments to support their cost of living. *Consider findings from the Journal of Financial Economics showing that "a long-term investor who ignores variation in volatility gives up the equivalent of 2.4% of wealth per year"*<sup>5</sup>. This loss alone could seriously impact an investor's ability to meet their expenses.

Only one question remains: How do investors put this plan into effect? The answer might be to manage volatility by focusing on high-quality, dividend paying stocks. Here's how.

## S&P 500 Calendar Year Return vs. Largest Intra-Year Decline



Source: FactSet & SWP Research

# Managing Volatility by Focusing on High-Quality Companies

## ■ ■ Why Does Quality Matter?

Focusing on high-quality companies matters because investors nearing or entering retirement need the support of equities that can generate positive cash flow or earnings at a faster rate than the overall economy. This outperformance helps deliver returns that outpace inflation.

Consider the example of a \$2.5 million retirement portfolio consisting of 60% stocks and 40% bonds. It's reasonable to assume an annual average return of 7%. In this hypothetical scenario, the retiree withdraws \$100,000 per year.

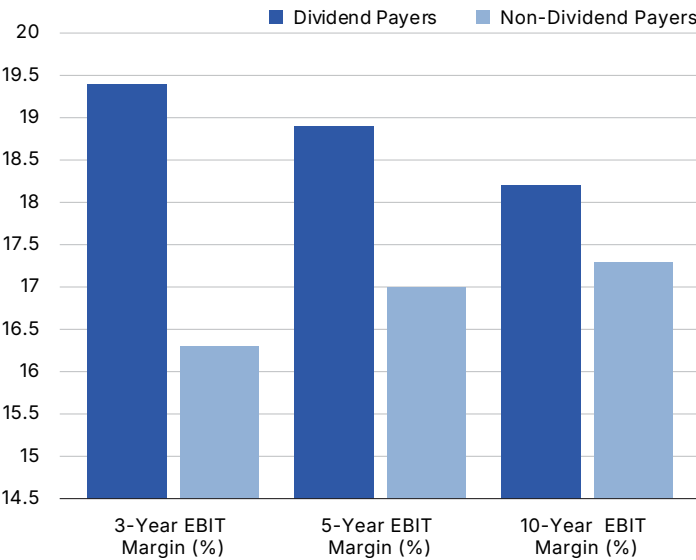
At an annual inflation rate of 2%, the retiree is still in a strong financial position after 20 years. However, at a 4% annual inflation, the investor faces the risk of depleting their savings. In this example, a difference of just 2% can seriously impact one's retirement. Unfortunately, investors cannot control inflation. But they can control the stocks they hold. For this reason, it's crucial to hold stocks that are well positioned to withstand periods of elevated inflation.

## ■ ■ What Do We Consider a "High Quality" Company?

A high-quality company has competitive moats. As Warren Buffet explained in a famous shareholder's letter, "A truly great business must have an enduring 'moat' that protects excellent returns on invested capital. The dynamics of capitalism guarantee that competitors will repeatedly assault any business 'castle' that is earning high returns. Therefore, a formidable barrier such as a company's being the low-cost producer or possessing a powerful world-wide brand is essential for sustained success"<sup>6</sup>.

A high-quality company also achieves higher-than-average profitability ratios, such as operating margin (EBIT) or return on equity (ROE). Additionally, these companies must have the characteristics to generate above-average, sustainable earnings, and free cash flow. High quality also means having consistent profit margins and earnings growth.

S&P 500 Data for Period Ending December 31, 2024



Source: FactSet & SWP Research

## ■ ■ How Do We Screen for Quality?

SWP assesses a potential equity investment by identifying the company's industry peer group. Then, we benchmark the company's profitability ratios against the average of that peer group. We assess key ratios including gross margin, operating margin, and ROE on both an absolute and relative basis.

We also carefully examine metrics revealing the company's financial strength, including financial leverage ratios like Net

Debt/EBITDA and free cash flow generation ratios such as free cash flow yield. Our portfolio managers also examine dividend coverage ratios, such as the payout ratio.

Importantly, this process incorporates both historical performance and our team's projections for future results. In a highly competitive investment landscape, an independent perspective on company quality is crucial given the significant impact this issue can have on stock performance.



# Seeking Income-Producing Equities to Help Fund Retirement

## ■ ■ Why Do Dividends Matter?

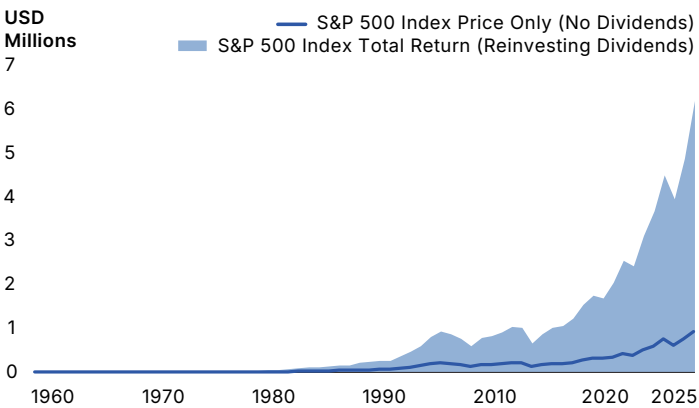
Choosing companies with a high likelihood of paying regular, growing dividends matters because income is critical for funding a retirement. Moreover, research shows that dividend payments are often indicative of companies with strong potential for future performance. *A study published in the Financial Analysts Journal concluded, "The historical evidence strongly suggests that expected future earnings growth is fastest when current payout ratios are high" <sup>7</sup>.* Put simply, the quality of dividend growth stocks is often higher than those of the broader market.

Additional research also shows that dividend payments have the potential to offer stabilization in a portfolio during market downturns. *S&P Global conducted a review of the 15 worst-performing months for the S&P 1500 and learned that a group of dividend-paying stocks outperformed the index by 229 basis points over the same period <sup>8</sup>.* More research echoes this finding. *Data published in the Journal of Corporate Finance shows that dividend-paying stocks outperform non-dividend-paying stocks by 1% to 2% per month in a declining market <sup>9</sup>.* The same body of research found that the outperformance of dividend-paying stocks further widens during periods of more severe market corrections.

## ■ ■ How Do Dividends Support Retirement Income Needs?

Stable, growing dividends are crucial to meeting retirement needs because they contribute roughly 40% of equity total returns over the long term for the S&P 500 Index. Without a focus on dividends, investors risk missing out on these returns.

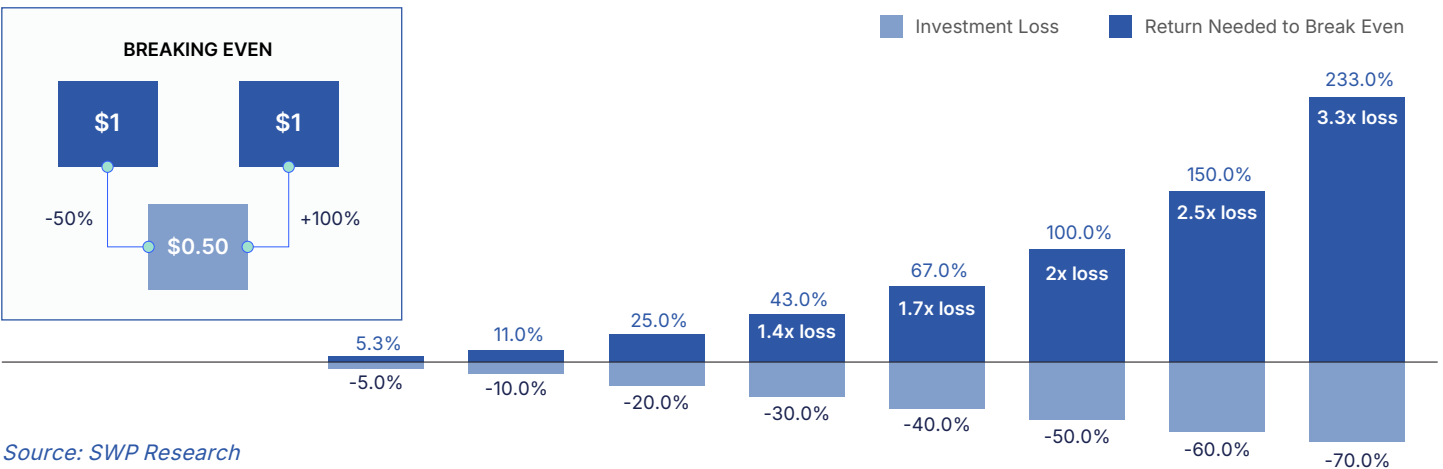
### The Power of Dividends and Compounding Growth of \$10,000 (1960-2024)



Source: FactSet & SWP Research

By focusing on dividend-paying companies, investors also gain a degree of stability that mitigates volatility in other market areas. For example, as bond yields decline, dividend stocks become even more important for generating income. This kind of risk management becomes important when the investor cannot rely on the smoothing effect that a long term horizon has on market drawdowns.

## The greater the loss, the harder it is to break even



Source: SWP Research



## ■ ■ What do Dividends Tell Us About a Company?

Dividends are also a way to identify companies that are likely to be more stable. Companies that have regularly increased their dividends tend to weather downturns and are more likely to continue to pay dividends. However, not all dividends are created equal. Choosing companies that don't assume excessive debt to fund the dividend is important. For this reason, we do not necessarily target stocks with the highest dividend yields. Excessively high yields can serve as a warning that the dividend's sustainability is in question.

*Dividends also offer hints about the company's future.*

*Research has shown that "dividend changes offer economically meaningful information about future earnings" and that "dividend increases (decreases) are followed by persistently*

*higher (lower) unexpected earnings"*<sup>10</sup>. This finding underscores the way dividends can reward shareholders in the near term with a payment while also rewarding them over the long term with earnings growth. This dynamic makes intuitive sense because a company that is strong enough to pay its investors is likely to also have the financial resources to pursue growth opportunities.

*"Dividends are like rewards for patience and loyalty, a tangible expression of a company's gratitude to its shareholders."*

— Peter Lynch

## Average Annual Returns and Volatility by Dividend Policy

S&P 500 Index 1973-2024

	Returns	Standard Deviation	Beta
<b>Dividend Growers &amp; Initiators</b>	10.24%	16.09%	0.88
<b>Dividend Payers</b>	9.20%	16.84%	0.94
<b>No Change in Dividend Policy</b>	6.75%	18.56%	1.02
<b>Dividend Non-Payers</b>	-0.89%	24.94%	1.21
<b>Dividend Cutters &amp; Eliminators</b>	4.31%	22.06%	1.17
<b>Equal-Weighted S&amp;P 500 Index</b>	7.65%	17.71%	1.00

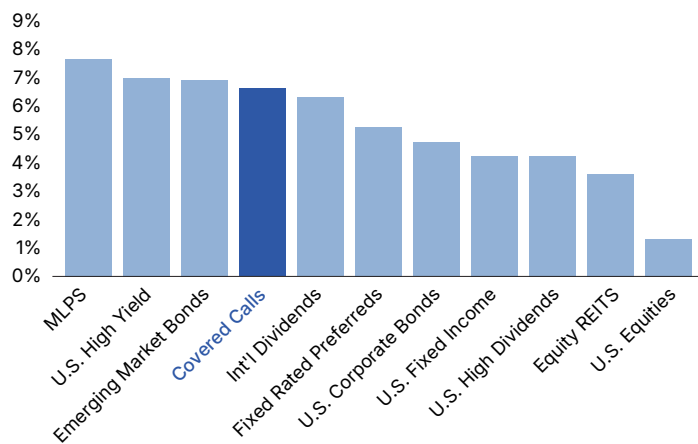
Source: FactSet & SWP Research

## ■ ■ How Do Covered Call Strategies Generate Income and Mitigate Risk?

Under some circumstances, implementing a covered call strategy can help increase income and reduce risk. This strategy involves selling call options while simultaneously holding a long position in the underlying stock. This long position is covered because it allows the investor to deliver the shares if those owning the call option decide to exercise the contract.

This approach benefits the investor by providing income—via premiums—even during periods when the stock is experiencing little movement. With covered calls, SWP can generate greater income for its clients relative to other equity ETFs in the marketplace.

## Yields by Asset Class (Trailing 12-Month Distribution)



Source: FactSet & SWP Research

# Taking a More Strategic Approach to Investment Selection

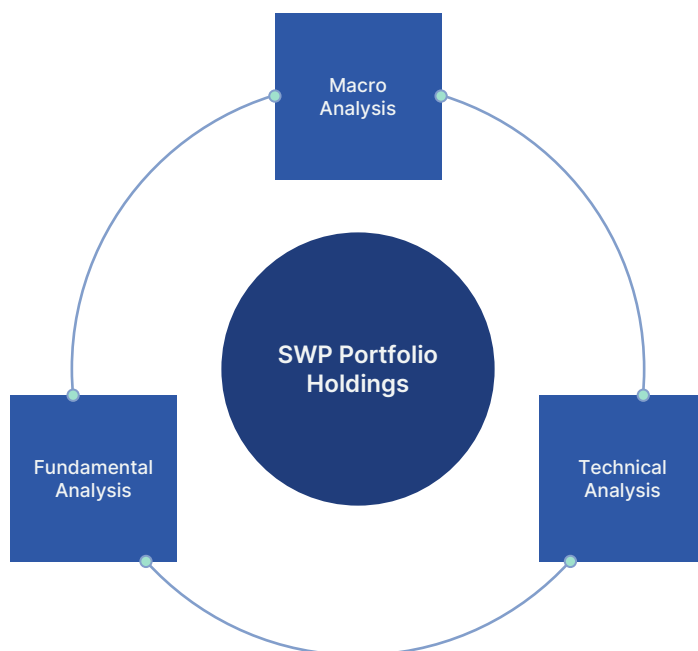
## ■ ■ What is the Benefit of SWP's Hybrid Investment Approach?

SWP offers a hybrid approach that can account for the full range of dynamics that drive stock performance. We do so by applying a three-part approach consisting of macro analysis, technical analysis, and fundamental analysis.

Our macro analysis accounts for inflation expectations, interest rate and credit analysis, monetary and fiscal policy, geopolitical issues, business cycle analysis, and currency and commodity markets. This aspect of our hybrid investment approach is our "big picture" view of the factors that could influence the market and the individual equities we are considering.

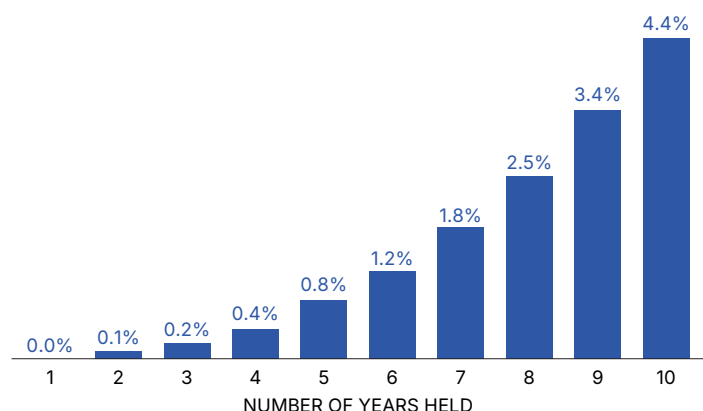
Our technical analysis covers more granular data like relative strength, intermarket analysis, support and resistance levels, seasonal patterns, market sentiment, behavioral finance, and trend and pattern analysis. Generally, technical analysis uses price and volume data to gain insight into future price movements in certain stocks. It is based on the idea that stock prices, over the long term, will often follow trends and patterns.

Our fundamental analysis explores the factors influencing an equity's intrinsic value. This helps us understand whether the equity is trading above or below its fair value. We consider the company's competitive positioning and products, identifiable near-term catalysts, management team, revenue and cost drivers, future cash flow, balance sheet health, and valuation.



By combining these three into one hybrid investment approach, SWP views each holding in the fund from a range of perspectives. This method is crucial for meeting our investment objective of investing at least 80% of the fund's net assets in income-producing equity securities that are judged to have strong growth characteristics. At SWP, we characterize "growth" companies as those that are expected to achieve superior profitability ratios, such as operating margin or return on equity, and that can generate above-average growth in earnings and free-cash-flow to support consistent dividend increases.

## Cumulative Benefit From Investing in ETF over the Mutual Fund in this Illustrative Example



Source: SWP Research

## ■ ■ Why Does an ETF Make Sense?

An ETF structure offers key advantages, such as using in-kind redemptions to minimize taxable events by transferring securities instead of selling them and avoiding capital gains distributions. Additionally, by experiencing less capital flows, an ETF structure can reduce the need to pay out capital gains.

Additionally, because ETFs trade throughout the day, there is a decreased chance that the share price of the ETF will be above or below those of the underlying shares. This characteristic means that the ETF is often a more direct representation of the securities it holds than a comparative mutual fund, which is not priced throughout the day.



# Targeting Income-Generating, Low-Volatility Investments for a Stronger Retirement Portfolio Selection

■ ■ Investors who are planning for or approaching retirement are reevaluating their strategies to address the dual challenges of market volatility and longer life expectancies. The conventional approach of investing in indices like the S&P 500 poses risks due to the concentration of value in a few large stocks, which can lead to significant portfolio drawdowns.

Given that retirements now often span 20 years or more, many are concerned about outliving their savings. Transitioning to high-quality, income-generating investments can provide

competitive returns with reduced volatility, making it crucial to take a deliberate and purposeful approach to retirement portfolio management.

At SWP, we offer a plan for these challenges in one ETF designed to provide both long-term capital appreciation and attractive income. Our three-part hybrid investment approach and covered call strategy help investors fund their retirement needs in a way that we believe is more compelling than other investment products.

If you're interested in learning more about the potential benefits of incorporating high quality, growth orientated dividend-paying stocks into your investment strategy, book a [30-minute virtual meeting](#) with our Chief Investment Officer, Nate Fischer.

# Definitions

- **EBIT** or operating income, represents a company's earnings from its core operations before deducting interest payments and income taxes, providing a clearer picture of core business performance.
- **Return on Equity (ROE)** is a financial ratio that measures a company's profitability by showing how much profit a company generates for each dollar of shareholder equity invested.
- **Gross margin** is the percentage of a company's revenue that it keeps after deducting direct expenses such as the cost to produce the goods or services sold.
- **Operating margin** is a profitability ratio that helps analyze a company's operational efficiency by measuring operating income (EBIT) as a percent of total revenue.
- **Absolute basis** is a actual value or measurement of return, valuation, growth, liquidity, etc., irrespective of its relation to those values of other companies, a historical measurement of the company as a standalone.
- **Relative basis** is a value or measurement of return, valuation, growth, liquidity, etc., directly in relation to those values of other peer companies, often expressed as a ratio.
- **Net debt to EBITDA** is a ratio the assesses a company's leverage and its ability to cover its debt obligations using its operational earnings.
- **Free cash flow (FCF) yield** assesses how much cash a company generates from its core operations, after accounting for capital expenditures, relative to its overall market value.
- **Payout ratio** measures how much of a company's earnings are distributed as dividends, indicating the company's ability to consistently pay dividends.

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