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Investment Insights Quarterly

From the Desk of Bill Hornbarger, Chief Investment Officer

January 2026

A Look at Equity Valuations

The new calendar year starts with a favorable macro backdrop for financial assets. Monetary policy is expected to ease further as we move through the year; there is supportive fiscal policy through deregulation and an increase in capital investment related to artificial intelligence infrastructure; and the consensus expectations are for S&P 500 earnings to grow in the low double digits. These tailwinds are counterbalanced by inflation remaining stubbornly above the U.S. Federal Reserve's 2% target and a softening labor market.

One of the major themes for the financial markets as we head deeper in the new calendar year is the "conflict" between what we see as a relatively benign environment (as noted above) and stretched valuations in many segments of the equity markets. We generally believe in the idea that "price matters." Put more simply, when one invests in equities at more attractive valuations, they tend to perform better over the subsequent five- and 10-year periods, and the opposite is also true—historically when one invests in equities at higher valuations they tend to have lower returns in subsequent periods. This relationship does not always hold true (a recent example is the 0% interest rate period following the Global Financial Crisis) but it is an important concept to be mindful of.

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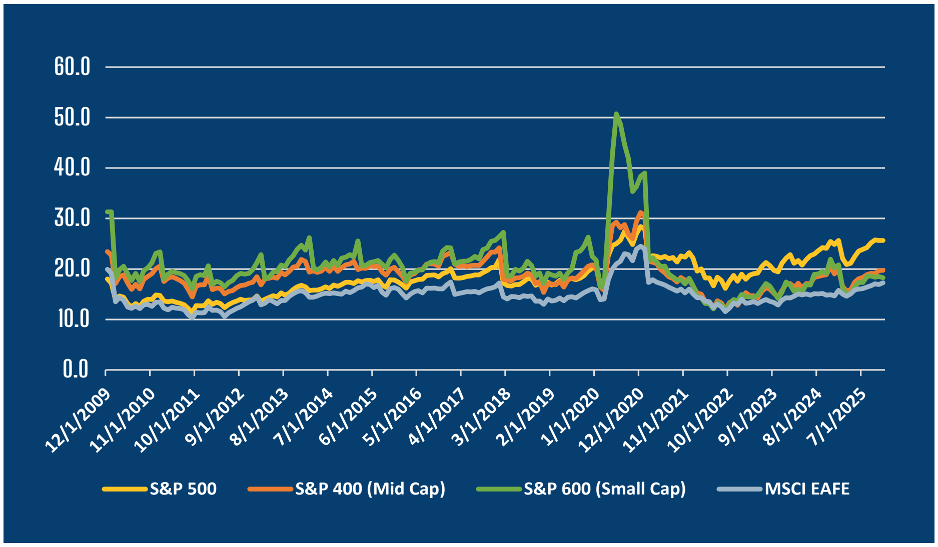
With that in mind, we thought it would be beneficial to take a quick look at valuations across the equity markets. The first graph shows price/earnings ratios (PEs) for major market segments through time. This is probably the most popular metric for measuring valuation.

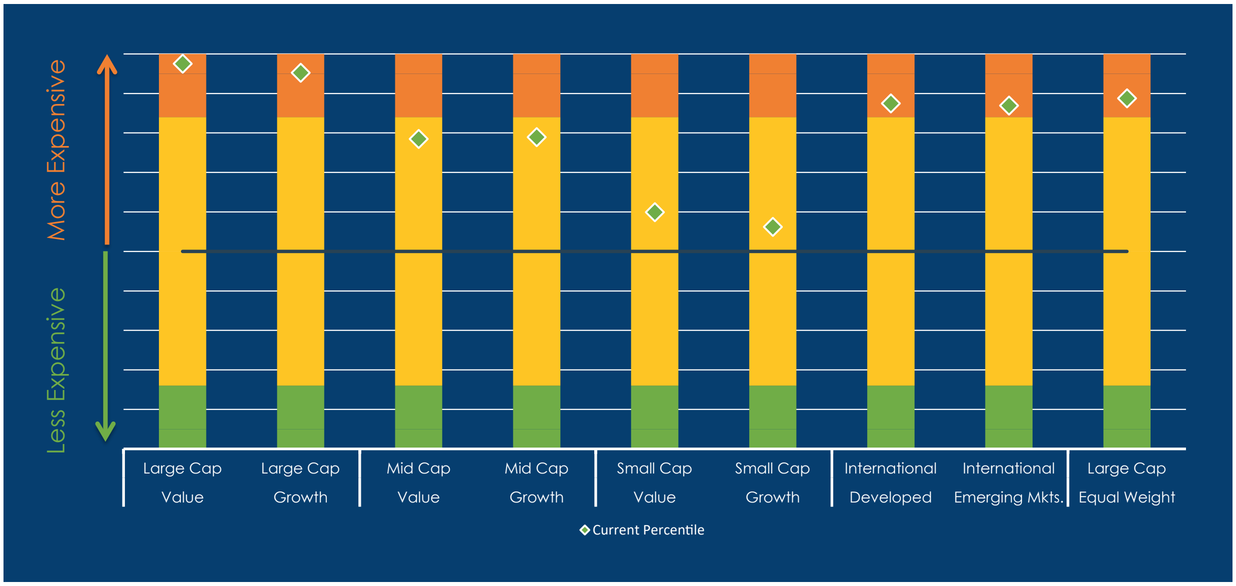
Historical Price/Earnings Ratios by Market Segment
2010 to Current



As of December 31, 2025
Source: Bloomberg

While the P/E ratio is an important tool, it can tell an incomplete story. We use a broader valuation metric that also incorporates price/sales, price/book value, and price/cash flow, along with the P/E ratio.

Equity Asset Classes Value Rank to Own History



As of December 31, 2025
Source: Bloomberg/BFE calculations

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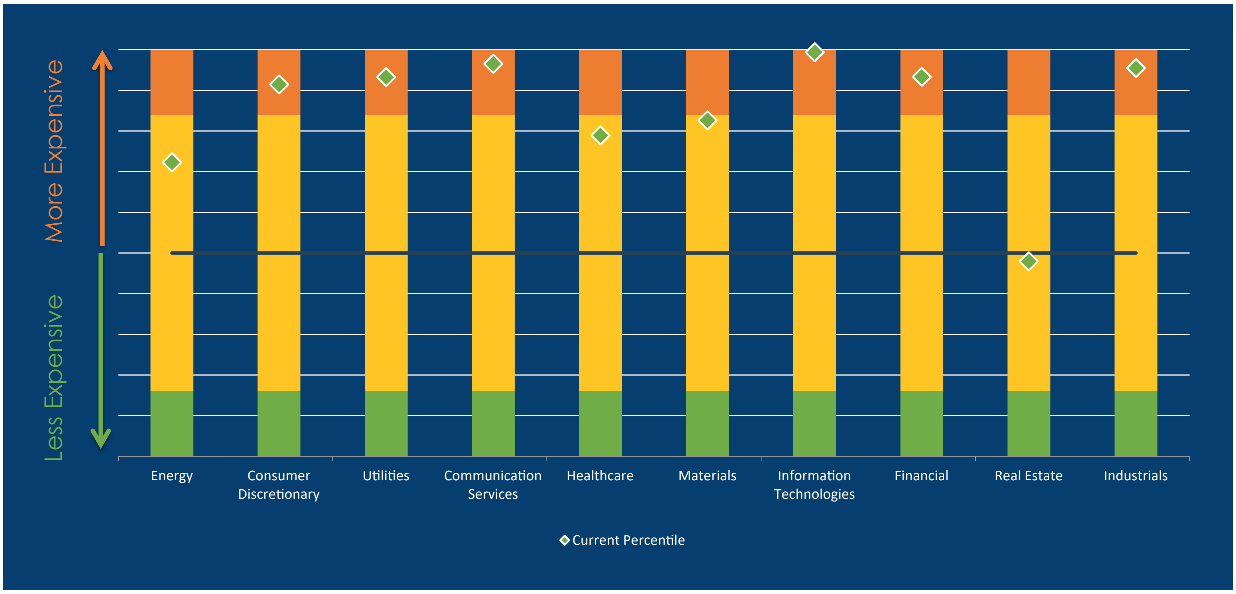
We use the same methodology and apply it to the sectors of the S&P 500.

S&P500 Sector Value Rank to Own History



As of December 31, 2025
Source: Bloomberg/BFE calculations

And finally, we also calculate the equity market risk premium each month. The equity risk premium is the hypothetical additional return that investors expect to earn from investing in stocks over a risk-free rate, compensating them for the higher risk associated with equity investments.

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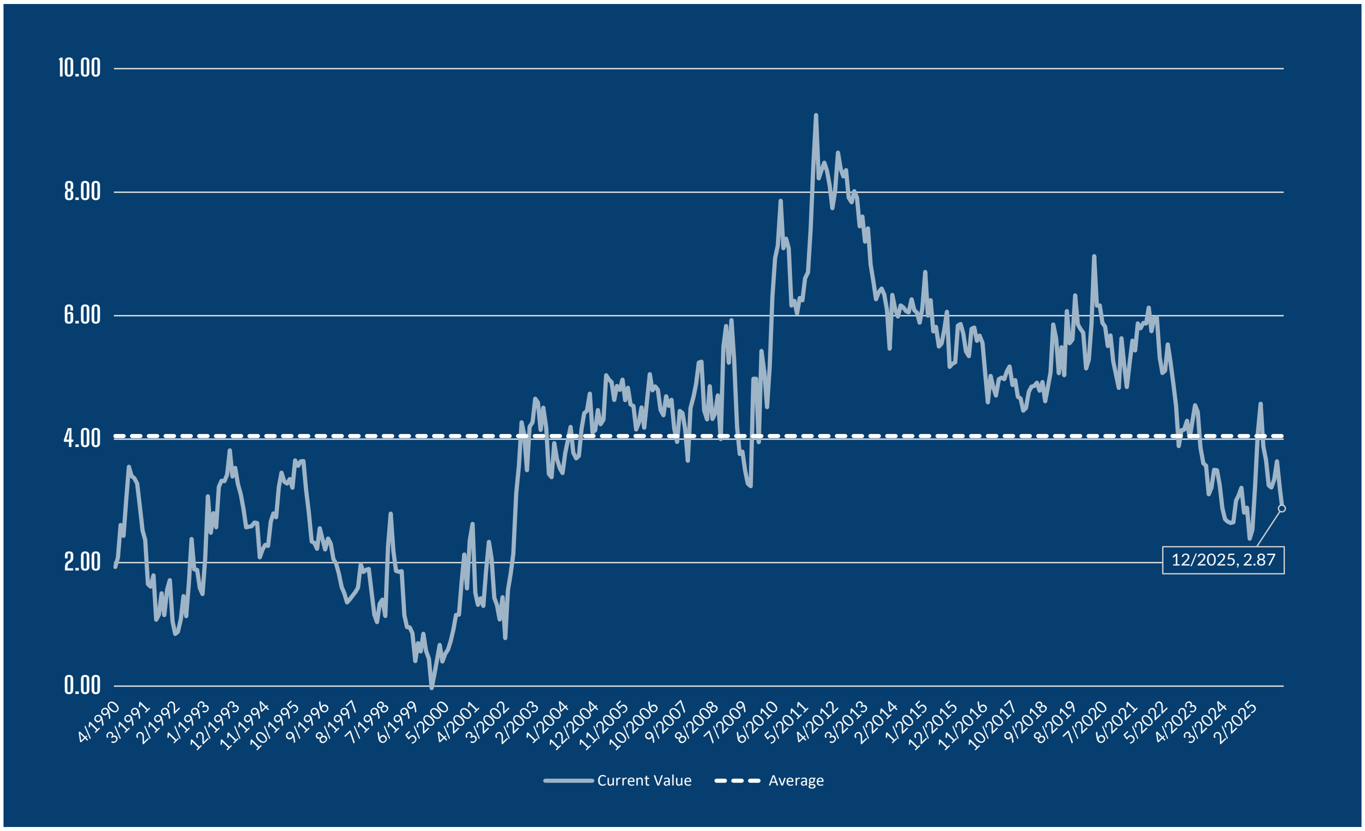
Equity Risk Premium

Earnings Yield (1/S&P 500 PE ratio) less Real 10-year Yield (10-Year-Expected Inflation)



As of December 31, 2025
Source: Haver/BFE calculations

After an extended period of strong returns, it should come as no surprise that by just about all measures, equity valuations are extended. Those in the bearish camp point to them and say that inevitably they must mean-revert. Just as we caution about getting too euphoric, we also think it is a mistake to get too bearish. Current valuations suggest the possibility of a period of below historical average returns, which is different than negative returns. Those who are more bullish point towards productivity gains and margin expansion and stable bond yields. We remain cautious about valuations but mindful of the track record of equities. Part of the higher returns have been volatility and periods of negative returns, but investors who stay the course have been rewarded.

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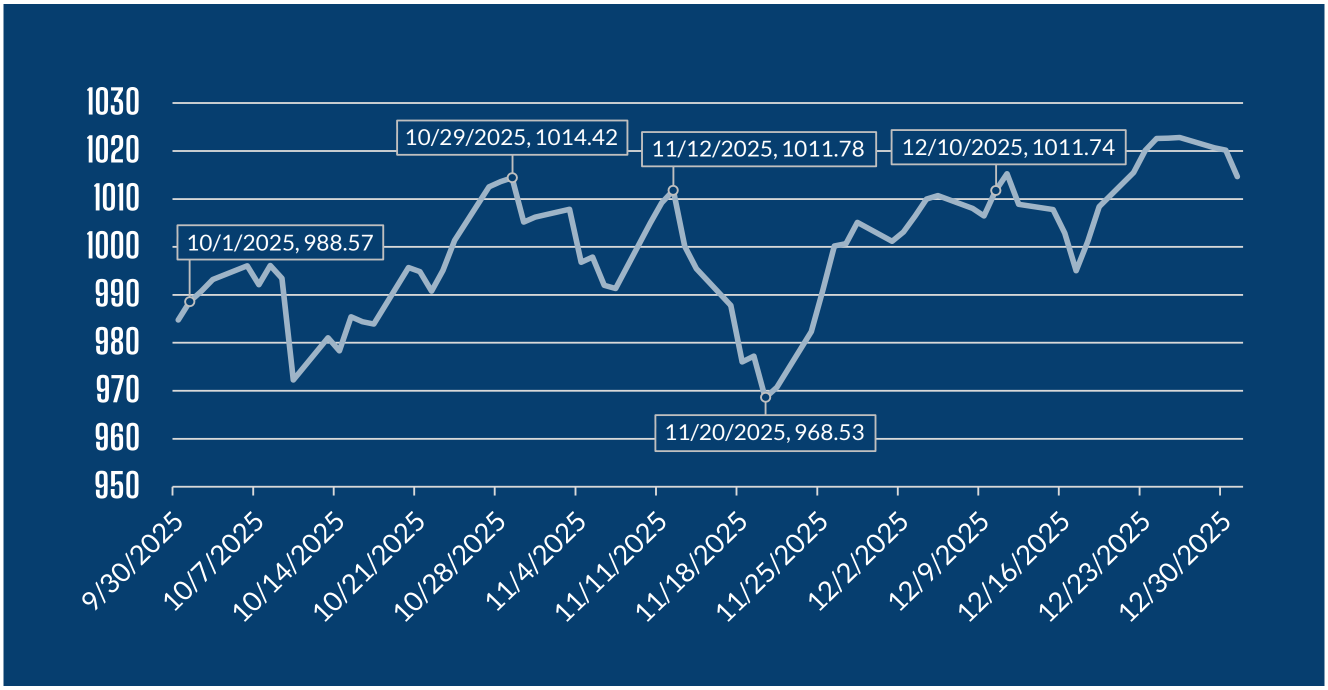
Q4 Key Dates

- The U.S. government was shut down from October 1 to November 12 as the two parties could not pass a budget or continuing resolution to fund government spending and activities. During that time, no government economic statistics were released.
- October 1 – U.S. government shut down with many workers furloughed or working with no pay.
- October 29 – U.S. Federal Reserve (Fed) met and lowered interest rates 25 bps, citing a shift in the balance of risks.
- November 12 – U.S. government reopened after the longest shutdown in U.S. history (43 days), coinciding with dovish comments from NY Fed President John Williams about a December cut.
- November 20 – After rallying over 1.5% at open on Nvidia earnings, the S&P and Nasdaq composite shed -1.6% and -2.2%, respectively. Bitcoin briefly hit a key $86,000 100-week moving average, and the unemployment rate rose to 4.4%.
- December 10 – Fed lowered rates for the third consecutive meeting.

Global Stock Market
MSCI ACWI in USD



As of December 31, 2025
Source: Bloomberg

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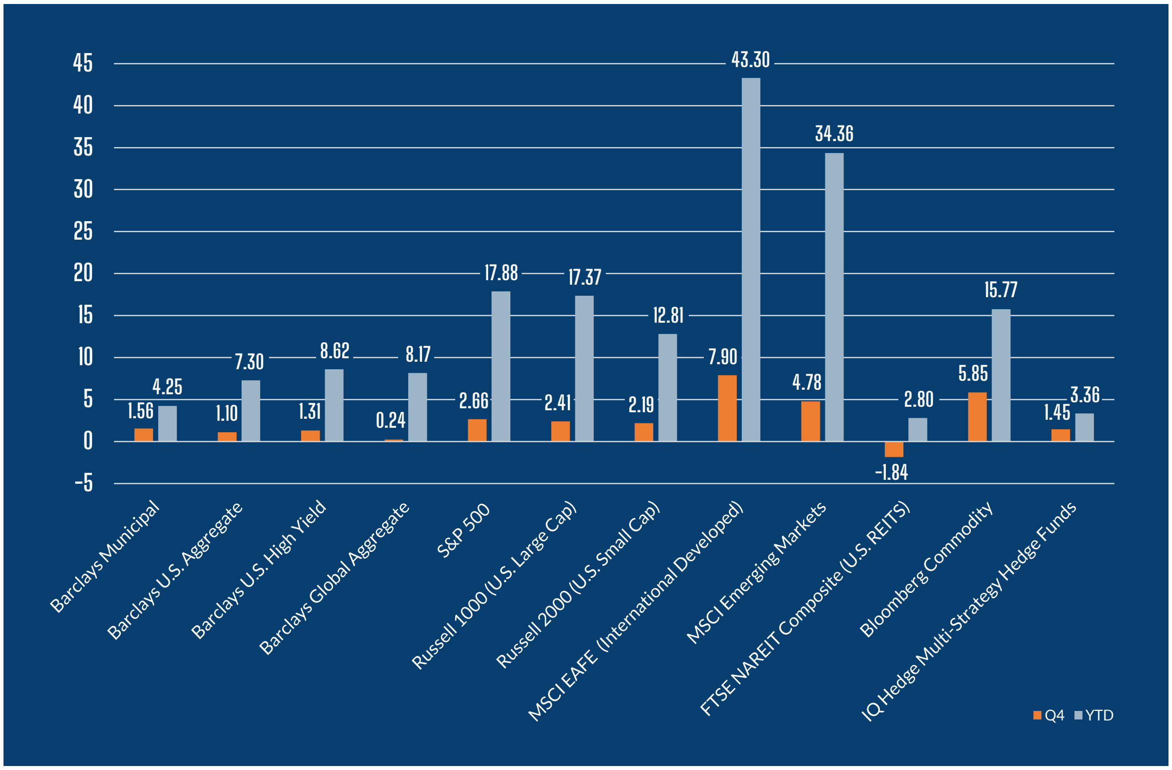
Asset-Class Returns

Comparing Recent Quarter and One-Year Total Returns



As of December 31, 2025
Source: Conway

Fixed Income

- Fixed income across the globe benefited from spread tightening to end the year along with higher starting yields.
- While the 10-year Treasury yield was fairly rangebound in December, it ended the month slightly higher, and this was negative for core fixed income. Munis performed slightly better due to favorable technicals.
- Credit posted solid returns, largely driven by coupon clipping.

Equities

- U.S. equities were a mixed bag last month as large caps mostly gained ground while small caps fell in value.
- Value beat growth across all market capitalizations, and large caps outpaced small caps.
- The S&P 500 posted a gain of 17.9% in 2025, and the 10-year return now stands at a remarkable 14.8%.
- Stocks outside the United States posted modest gains with some outsized returns from emerging markets.
- Within EAFE markets, small caps lagged large caps, and value stocks outpaced growth stocks. Value-driven Europe also outperformed Japan.
- Within emerging markets, most of the strength came from Eastern Europe and Asia, excluding China.
- The weaker U.S. dollar boosted EAFE returns by 92 basis points (bps) in December and emerging-market returns by 38 bps.

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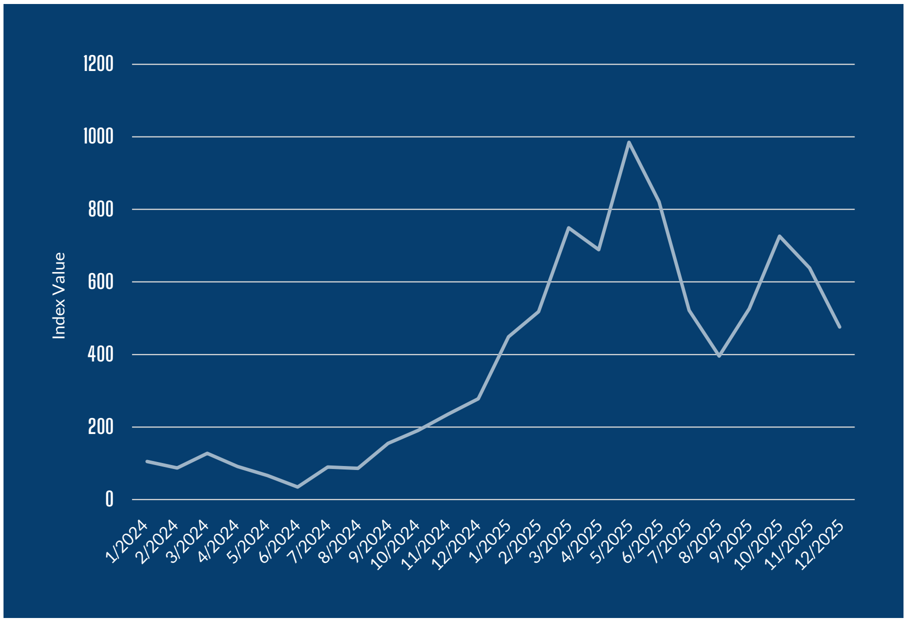
Uncertainty

U.S. Economic Policy Uncertainty Index: Entitlement Programs

1985 = 100

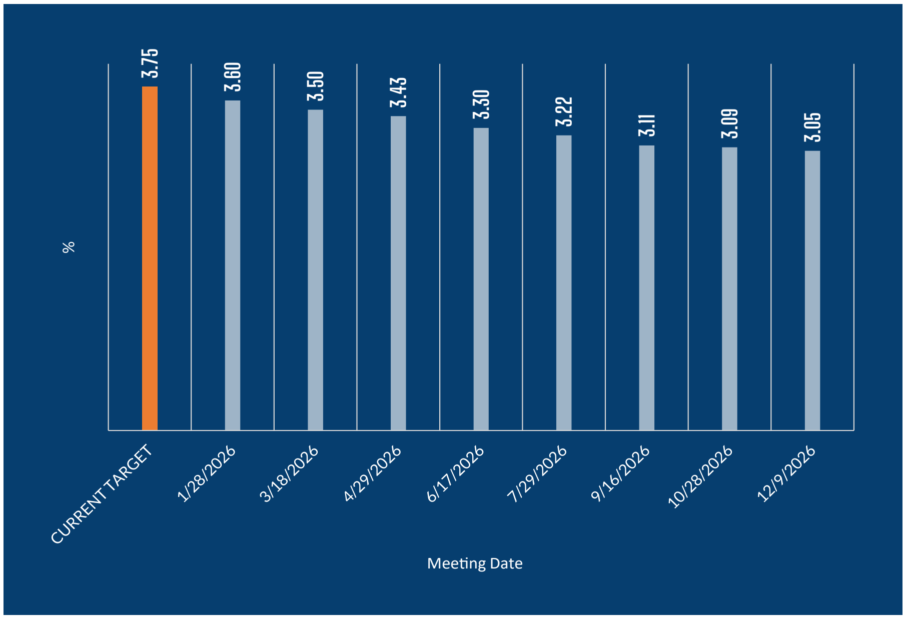


As of December 31, 2025
Source: Haver

- Real-time data was hard to find during the government shutdown.
- The shutdown itself was in part due to opposing views on health care subsidies.
- This is reflected in the economic uncertainty index broadly with a spike in the shutdown months, particularly around entitlements.

Monetary Policy

Fed Funds Futures Implied Policy Rates



As of December 31, 2025
Source: Bloomberg

- The Fed cut rates twice in the quarter (Q4) as the balance of risks shifted slightly toward concerns over the labor markets.
- There were several dissents among Fed members about the need for rate cuts.
- The Fed's December projection materials indicate it sees one additional rate cut in 2026 while the market looks for two to three more.

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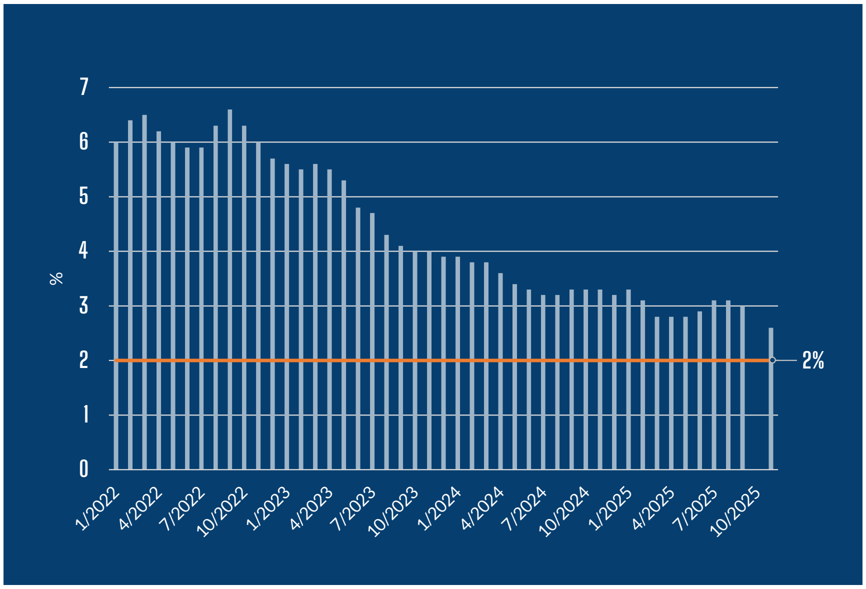
Inflation

Core CPI

Year-over-Year % Change



As of December 31, 2025
Source: Haver

- Inflation has been slowly declining but remains above the Fed's 2% target for core (ex-food and energy) inflation.
- During the shutdown, government data was not reported or reported on a delayed basis, including CPI.
- The Fed missed a critical Consumer Price Index report in October.

Tariffs

2025	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	YTD total
Tariff revenue (bn)	$7	$7	$8	$16	$22	$27	$28	$30	$30	$174
Imports (bn)	$317	$288	$343	$276	$276	$266	$292	$263	$276	$2,597
Effective tariff rate	2.3%	2.5%	2.4%	5.7%	8.0%	10.0%	9.5%	11.2%	10.8%	6.7%

As of December 31, 2025
Source: U.S. Census Bureau, U.S. Department of Treasury, U.S. International Trade Commission, J.P. Morgan Conway

- Tariffs generated meaningful revenue for the United States.
- The statutory tariff rate was 30% in April but had fallen to 15.6% by December 31, 2025.
- The issue of the President's authority to issue tariffs unilaterally is now in the courts.

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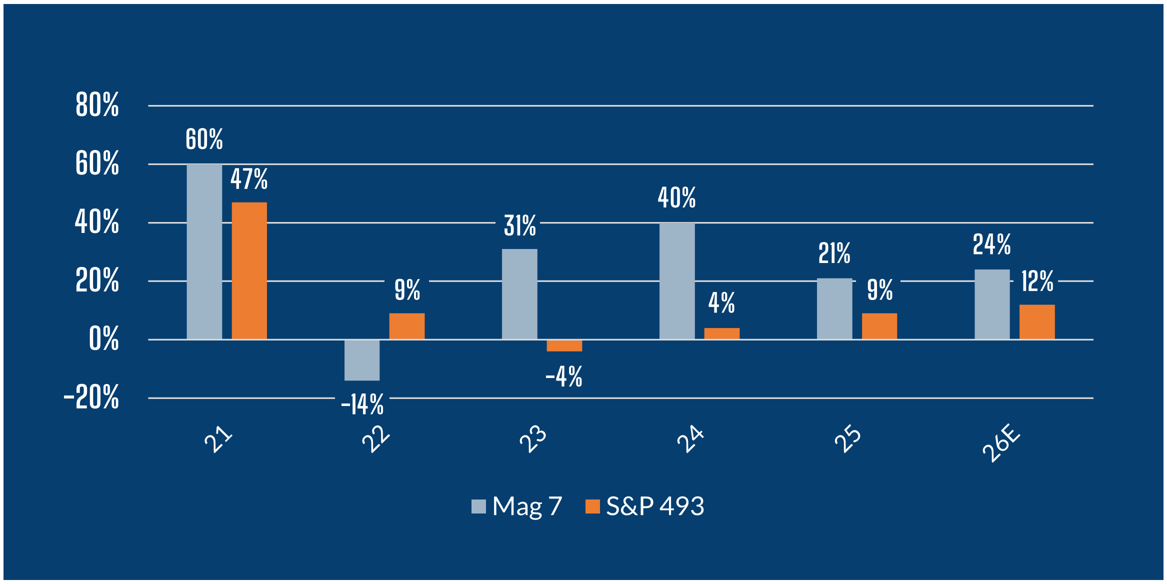
Market Concentration

Year-over-Year Earnings Growth



As of December 31, 2025
Source: Conway

Returns	’21	’22	’23	’24	’25
S&P 500	27%	-19%	24%	23%	16%
S&P 500 ex-Mag 7	23%	-12%	11%	14%	13%
Magnificent 7	40%	-40%	76%	48%	23%
Share of returns	*33%*	*56%*	*63%*	*55%*	*46%*

As of December 31, 2025
Source: Conway

- The Magnificent 7 continues to be a large driver of the S&P 500 returns.
- Mag 7 earnings are expected to continue to outpace the rest of the market.

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The Economy

	2000 - 2024		Latest available
	Share of nominal GDP	Average contribution	3Q 2025 contribution
Consumption	68%	1.7%	2.4%
Business fixed investment	13%	0.4%	0.4%
Government spending	19%	0.3%	0.4%
Residential	4%	0.0%	-0.2%
Net exports	-4%	-0.1%	1.6%
Change in private inventories	-	0.0%	-0.2%
Real GDP	100%	2.3%	4.3%

As of December 31, 2025
Source: J.P. Morgan, BEA, FactSet, Conway

- The U.S. economy continues to exceed expectations.
- Third-quarter GDP (latest available) was much stronger than expected, raising expectations that the year ended solidly.
- Consumption and trade were big drivers of GDP growth during the quarter.

	Current Estimate	Last Update
Atlanta Fed GDP Now (Q4)	2.7%	01/05/26
NY Fed Nowcast (Q4)	2.1%	01/02/26
Cleveland Fed (2026)	2.9%	12/23/25
Bloomberg Survey	1.0%	12/17/25

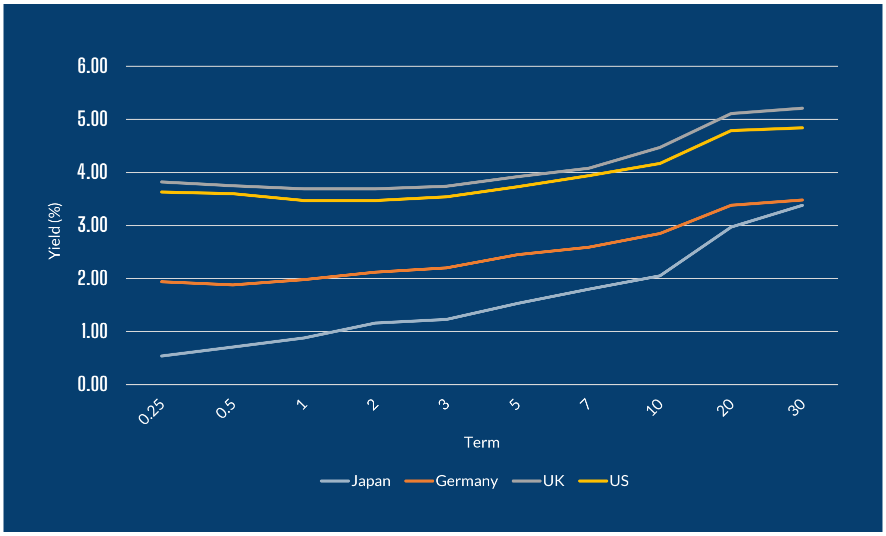
As of December 31, 2025
Source: Bloomberg, Atlanta, New York and Cleveland Fed

- The U.S. economy continues to expand.
- The expectations for a recession have declined from earlier this year and per Bloomberg stand at 30%.
- Inflation remains stubbornly above the Fed's target, and job growth has weakened but the economy has maintained positive momentum.

Government Bond Curves

Japanese and U.K. yields rose while U.S. and German yields fell in a repeat of the previous quarter. Global yield curves are generally positively sloped as monetary policy continues to evolve and "normalize."

Global Government Bond Yield Curves
End of Q4 2025



As of December 31, 2025
Source: Bloomberg

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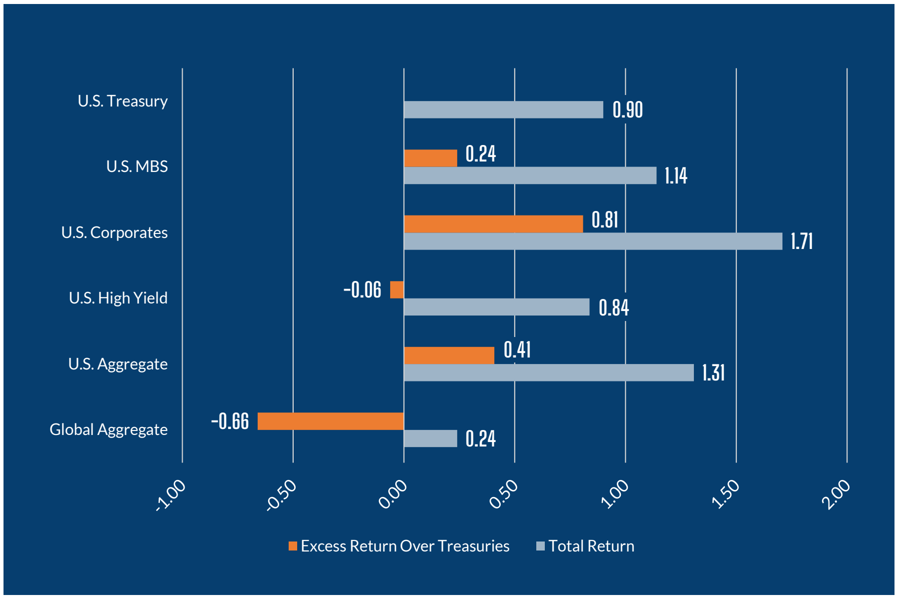
Fixed Income Performance (Q4)

Falling benchmark Treasury yields provided a strong tailwind for global fixed-income sectors. U.S. credit and MBS outperformed by a significant margin for the second consecutive quarter.

Fixed Income Performance

Q4 2025

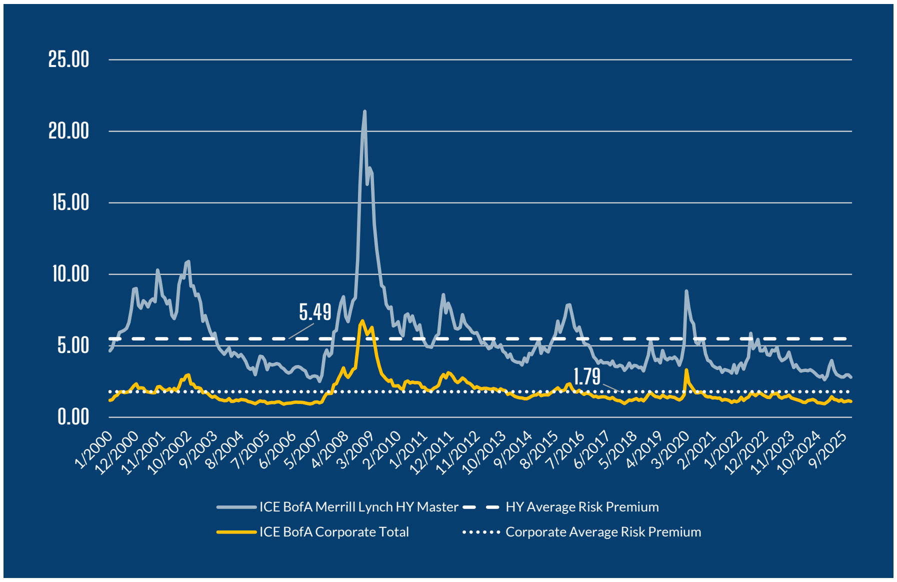


As of December 31, 2025
Source: Bloomberg

Credit

Credit spreads narrowed slightly during the quarter and remain at historically tight levels.

Investment-Grade and High-Yield Credit Spreads



As of December 31, 2025
Source: Haver

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Municipal Bonds

Municipal bonds continue to offer a yield advantage for high tax bracket investors. Municipal yields did not keep pace with Treasuries in the recent decline, making them more attractive.

Term	AAA General Obligation (%)	U.S. Treasury (%)	Municipal % of Treasury
1	2.47	3.54	69.9%
2	2.42	3.46	70.0%
3	2.36	3.54	66.7%
4	2.36	3.64	65.0%
5	2.37	3.74	63.4%
7	2.47	3.94	62.8%
10	2.71	4.19	64.7%
15	3.26	4.62	70.5%
20	3.89	4.85	80.2%
25	4.07	4.95	82.2%
30	4.13	4.84	85.4%

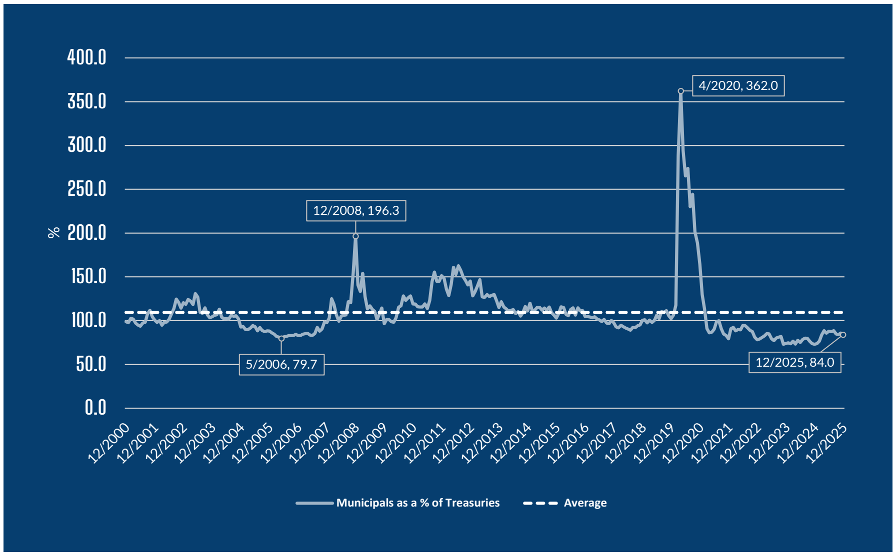
As of December 31, 2025
Source: Bloomberg

Municipal Bonds

Municipal bond credit quality remains strong and demand high.

Municipal Yields as a Percentage of Treasury Yields

ICE/Bank of America Municipal Master/10-Year Treasury



As of December 31, 2025
Source: Haver

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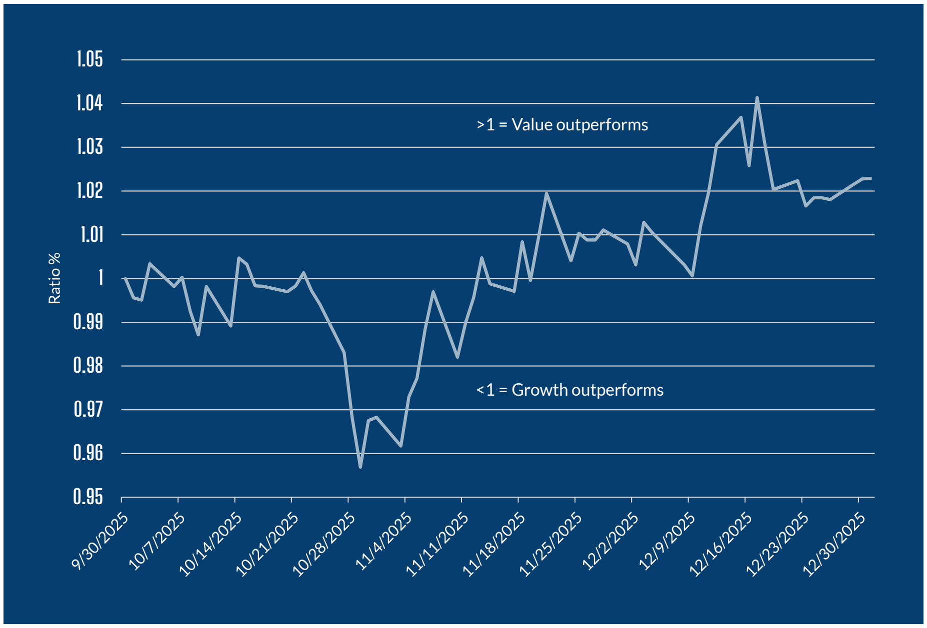
Equity – Value vs. Growth

Value outperformed growth in the quarter, particularly late in the year.

Large Cap Value/Large Cap Growth - Q4 2025

Russell 1000 Value/Russell 1000 Growth



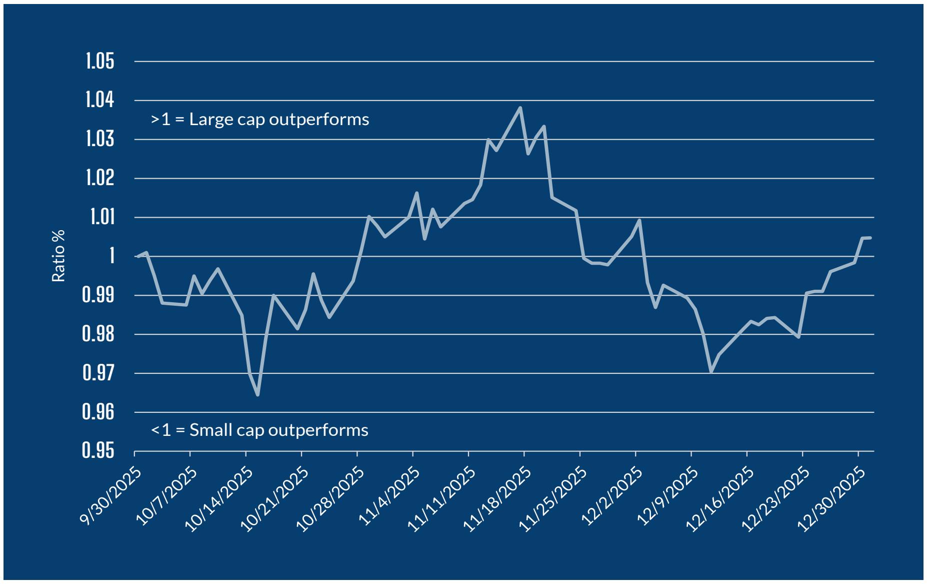
As of December 31, 2025
Source: Bloomberg

Equity – Large vs. Small

Large cap outperformed small cap during the quarter.

Large Cap/Small Cap - Q4 2025

S&P 500/Russell 2000



As of December 31, 2025
Source: Bloomberg

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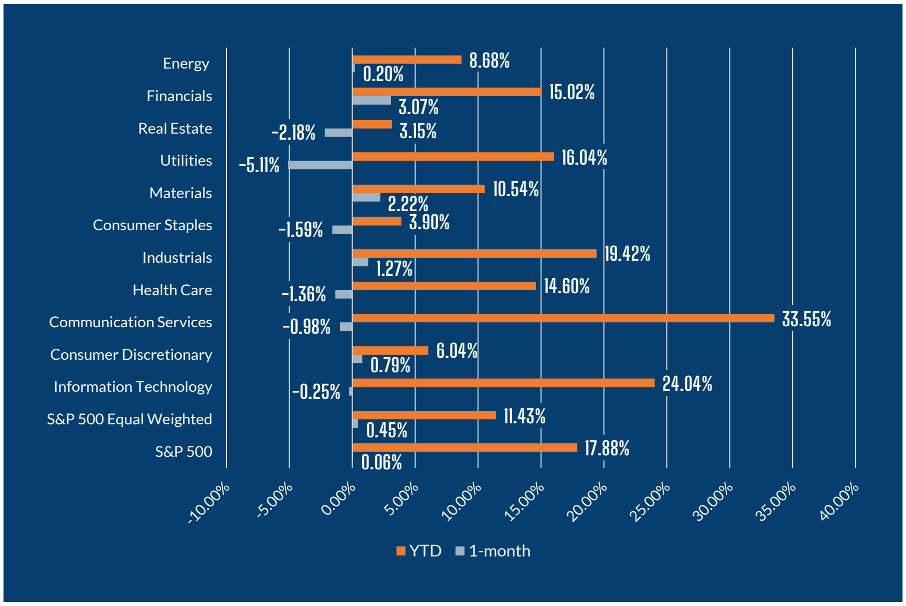
U.S. Equities – Return by Sector

All sectors were higher for 2025, with tech and telecom the strongest.

S&P 500 Sector Returns

Q4 2025

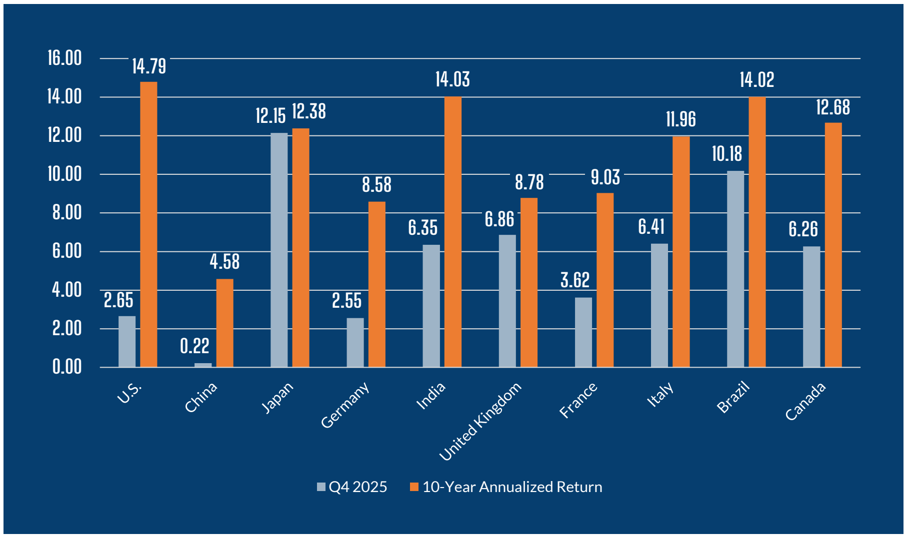


As of December 31, 2025
Source: Conway

Country Total Returns (%) – 10 Largest Economies

Global equities were strong in Q4 with all of the major international markets positive for the quarter, as well as the trailing 10-year period.

Country Total Equity Market Returns



As of December 31, 2025
Source: Bloomberg

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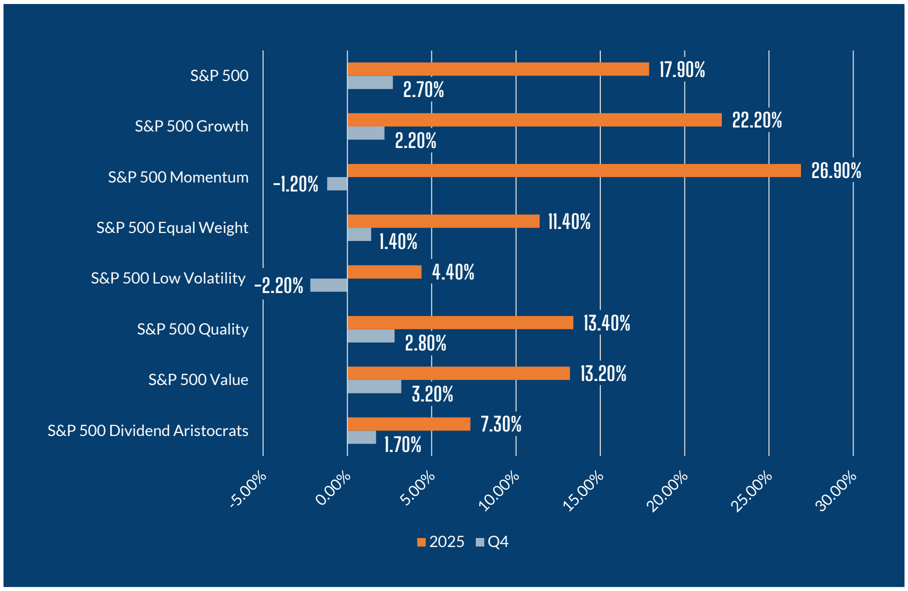
U.S. Equity Factors – Total Return Q4

The markets were mixed at year-end by factor style. Momentum and growth had strong years.

Total Return: Core Factors
Q4 2025

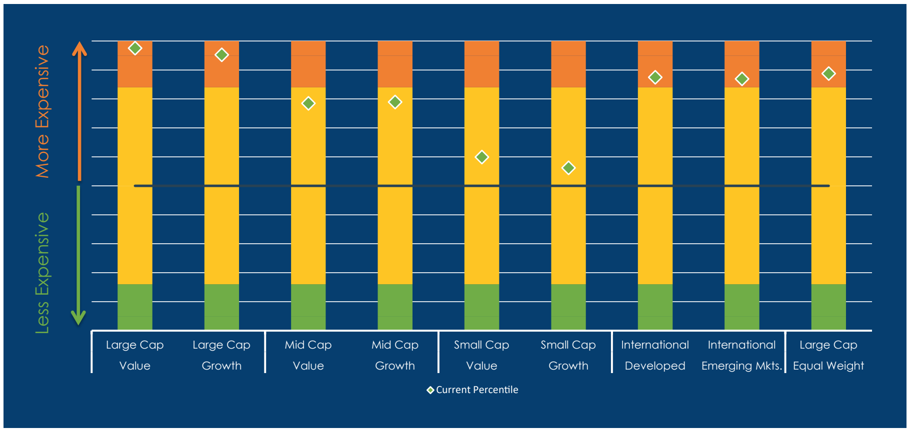


As of December 31, 2025
Source: S&P

Valuations

Large-cap stocks remain expensive relative to history and the most expensive part of the market. Valuations remain above long-term averages by size and style.

Equity Asset Classes Value Rank to Own History



Equally weights P/B, P/CF, P/S, P/E and compares to own history

As of December 31, 2025
Source: BFE, Bloomberg

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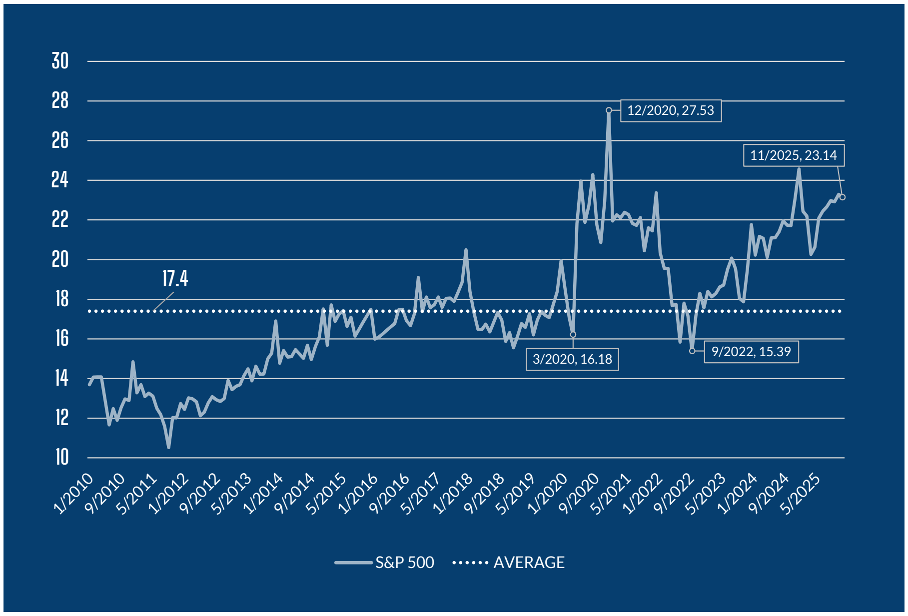
Valuations

U.S. large-cap stocks remain expensive relative to history. Most sectors are trading above long-term averages with tech, industrials, telecom, consumer discretionary and financials being the most expensive sectors and real estate and energy the cheapest.

S&P 500 Composite: Forward Price/Earnings (P/E) Estimate
(Current + Three Quarters)

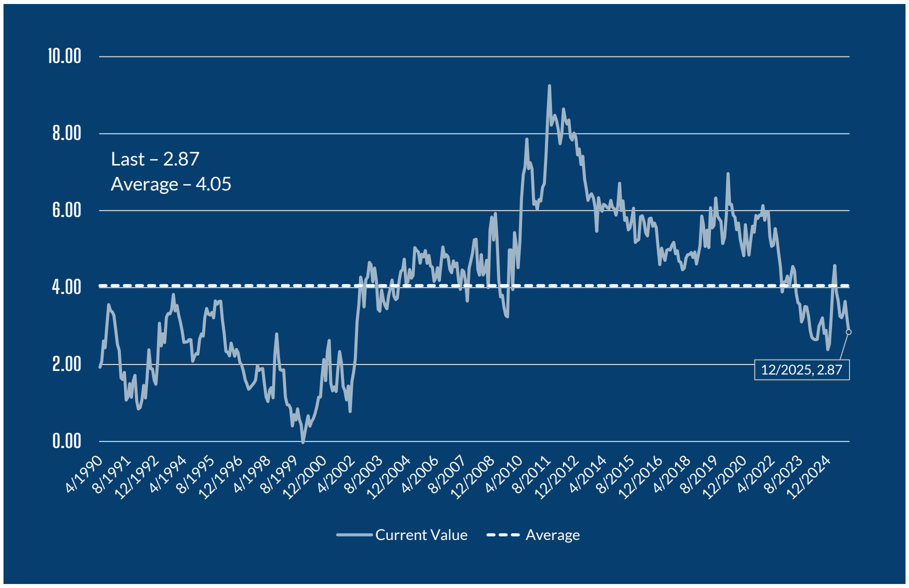


As of December 31, 2025
Source: Haver

Equity Risk Premium

The equity risk premium (ERP) is a valuation metric showing an "expected" return for stocks over bonds. The strength of the market have resulted in the ERP below long-term averages.

Equity Risk Premium
Earnings Yield (1/S&P 500 PE ratio) less Real 10-year Yield (10-Year-Expected Inflation)



As of December 31, 2025
Source: BFE

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Valuations

Valuations remain stretched relative to history in large-cap, while small- and mid-cap look less expensive.

Forward P/E vs. 20-year avg. P/E

	Value	Blend	Growth
Large	17.1/14.0	22.0/16.2	28.8/19.8
Mid	15.6/14.6	17.3/16.5	26.8/21.3
Small	17.2/16.9	23.4/23.0	34.5/31.3

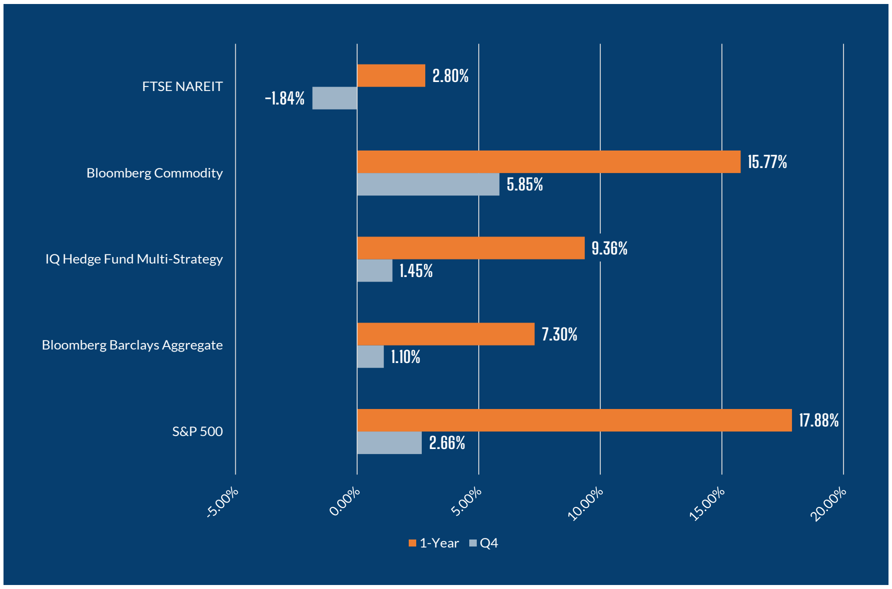
Forward P/E vs. 20-year avg. P/E

	Value	Blend	Growth
Large	122.5%	135.8%	144.9%
Mid	107.1%	105.2%	125.9%
Small	102.1%	101.6%	110.1%

As of December 31, 2025
Source: J.P. Morgan

Alternative Returns

Q4 2025



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Source: Conway

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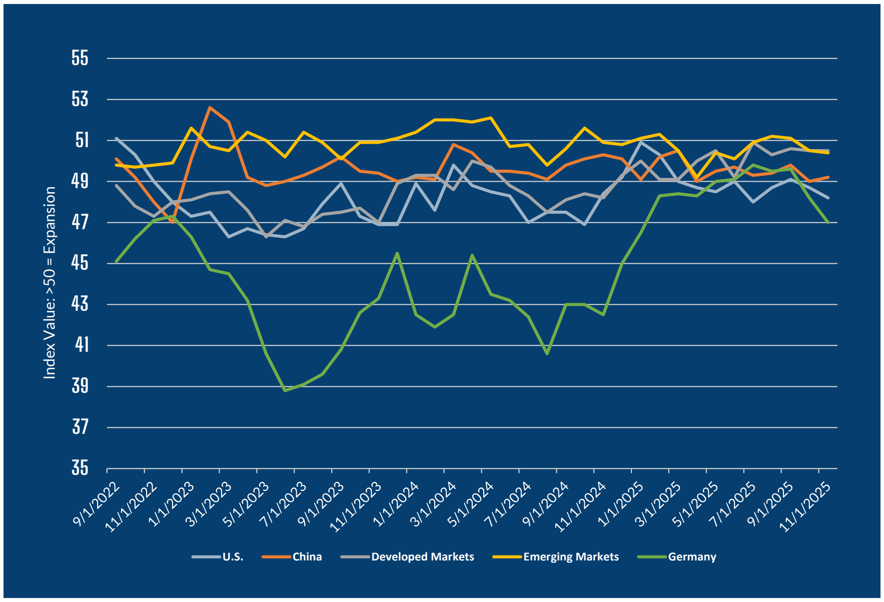
PMI Composites

The Purchasing Managers Index (PMI) is a survey-based measure of the prevailing direction of trends in the manufacturing sector. Readings >50 equal expansion and <50 contraction. By this measure, global growth remains muted.

Global Manufacturing Surveys



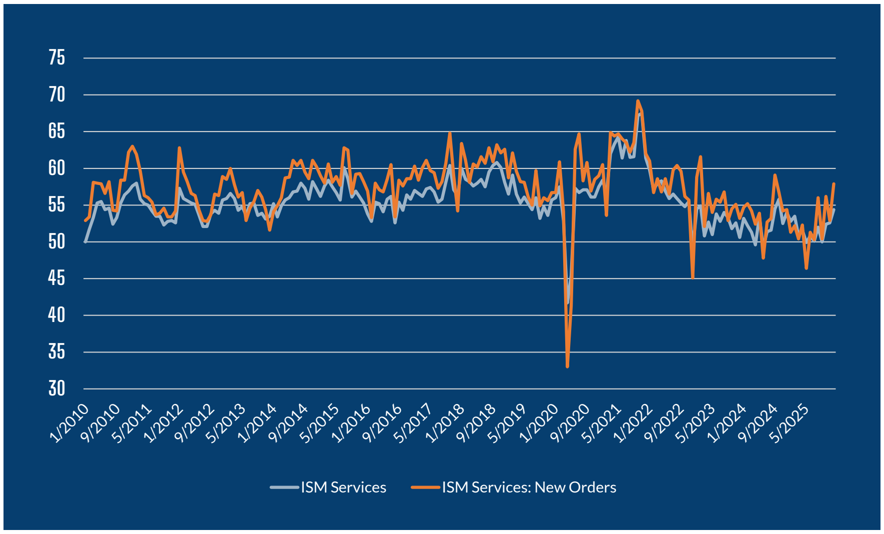
As of December 31, 2025
Source: Bloomberg, Haver

Services

The service side of the economy continues to grow at a moderate pace.

ISM Services vs. ISM Services New Orders

<50=Contraction, >50=Expansion



As of December 31, 2025
Source: Haver

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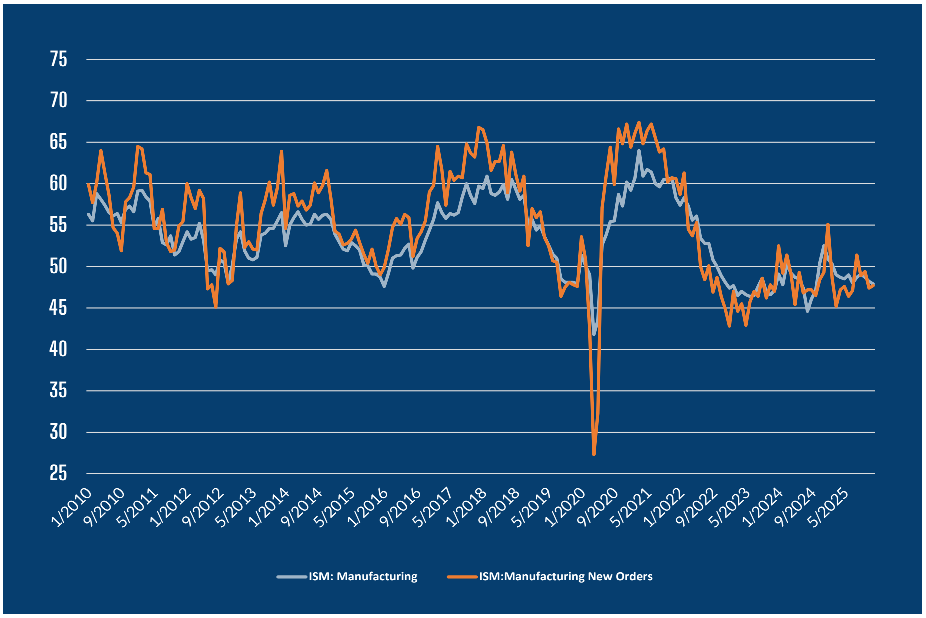
Manufacturing

Manufacturing softened slightly during Q4 and remains in negative territory by survey.

ISM Manufacturing vs. ISM Manufacturing New Orders

<50=Contraction, >50=Expansion

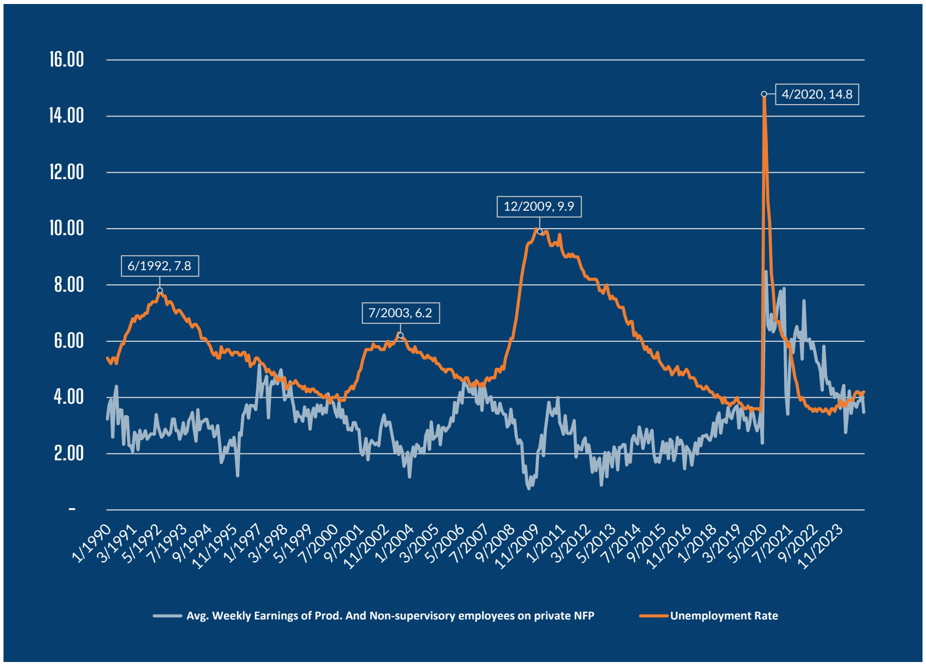


As of December 31, 2025
Source: Haver

Employment

The unemployment rate has crept higher, alleviating some pressure on wages.

Unemployment Rate and year-over-year Wage Growth



As of December 31, 2025
Source: Haver

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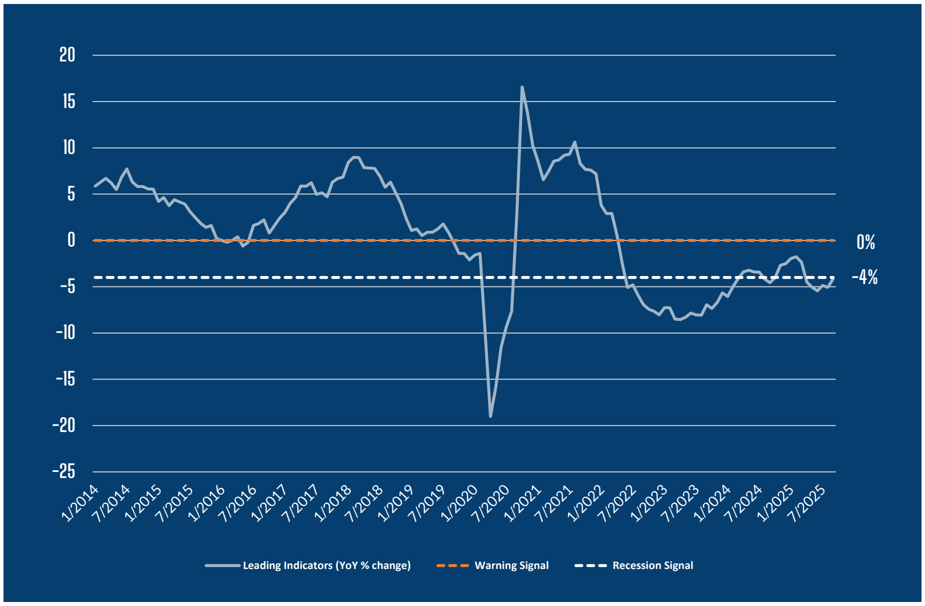
ECONOMIC REVIEW

Leading Indicators

Leading indicators have not been updated since the shutdown but were trending weaker heading into Q4.

Composite Index of 10 Leading Indicators

Six-Month % Change-Annual Rate



As of December 31, 2025
Source: Haver

BENJAMIN F. EDWARDS®
INVESTMENTS for GENERATIONS®

One North Brentwood Boulevard, Suite 850
St. Louis, Missouri 63105
(855) 382-1600
www.benjaminfedwards.com

December 31, 2025	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Bloomberg U.S. Treasury Bill 1-3 Month	0.35%	1.01%	4.29%	4.29%	4.91%	3.24%	2.18%
Bloomberg Municipal	0.09%	1.56%	4.25%	4.25%	3.88%	0.80%	2.34%
Bloomberg US Govt/Credit Intermediate	0.34%	1.16%	5.35%	5.35%	4.77%	1.97%	2.09%
Bloomberg U.S. Aggregate	-0.15%	1.10%	7.30%	7.30%	4.66%	-0.36%	2.01%
Bloomberg U.S. High Yield	0.57%	1.31%	8.62%	8.62%	10.06%	4.51%	6.53%
Bloomberg Global Aggregate	0.26%	0.24%	8.17%	8.17%	3.98%	-2.15%	1.26%
U.S. Equity Indices							
DJ Industrial Average	0.92%	4.03%	14.92%	14.92%	15.36%	11.58%	13.10%
S&P 500	0.06%	2.66%	17.88%	17.88%	23.00%	14.43%	14.82%
NASDAQ Composite (Price)	-0.53%	2.57%	20.36%	20.36%	30.46%	12.52%	16.59%
Russell 1000	0.01%	2.41%	17.37%	17.37%	22.73%	13.59%	14.59%
Russell 1000 Growth	-0.62%	1.12%	18.56%	18.56%	31.14%	15.32%	18.12%
Russell 1000 Value	0.68%	3.81%	15.91%	15.91%	13.89%	11.33%	10.53%
Russell Mid Cap	-0.28%	0.16%	10.60%	10.60%	14.35%	8.68%	11.01%
Russell 2500	0.08%	2.22%	11.91%	11.91%	13.74%	7.26%	10.40%
Russell 2000	-0.58%	2.19%	12.81%	12.81%	13.73%	6.09%	9.61%
Russell 2000 Growth	-1.28%	1.22%	13.01%	13.01%	15.58%	3.18%	9.57%
Russell 2000 Value	0.18%	3.26%	12.59%	12.59%	11.73%	8.88%	9.26%
Non-U.S. Equity Indices							
MSCI World	0.84%	3.20%	21.60%	21.60%	21.71%	12.66%	12.74%
MSCI ACWI	1.07%	3.37%	22.87%	22.87%	21.20%	11.70%	12.28%
MSCI ACWI Ex-U.S.	3.02%	5.11%	33.11%	33.11%	17.95%	8.46%	8.95%
MSCI EAFE	3.01%	4.91%	31.89%	31.89%	17.82%	9.47%	8.72%
MSCI EAFE Growth	1.77%	1.89%	21.12%	21.12%	13.51%	4.76%	7.80%
MSCI EAFE Value	4.20%	7.90%	43.26%	43.26%	22.23%	14.14%	9.38%
MSCI Europe	3.91%	6.26%	36.25%	36.25%	18.97%	10.98%	9.19%
MSCI Japan	0.56%	3.26%	25.05%	25.05%	17.96%	6.99%	8.01%
MSCI AC Asia	2.01%	3.97%	30.22%	30.22%	17.27%	5.21%	8.45%
MSCI EAFE Small Cap	2.30%	2.73%	32.49%	32.49%	15.52%	6.11%	7.94%
MSCI ACWI Ex-U.S. Small Cap	1.99%	3.02%	29.88%	29.88%	16.17%	7.41%	8.59%
MSCI Emerging Markets	3.02%	4.78%	34.36%	34.36%	16.97%	4.67%	8.86%
MSCI EM Asia	2.98%	4.58%	32.94%	32.94%	17.41%	4.08%	9.31%
MSCI China	-1.21%	-7.35%	31.42%	31.42%	11.85%	-3.03%	5.71%
MSCI EM Eastern Europe	6.22%	14.62%	76.58%	76.58%	37.52%	-11.15%	0.53%
MSCI EM Latin America	1.20%	8.37%	55.67%	55.67%	15.42%	9.22%	9.26%
MSCI EM Small Cap	0.86%	1.69%	19.08%	19.08%	15.97%	8.94%	8.74%
MSCI Frontier Markets	4.84%	6.61%	47.48%	47.48%	22.05%	10.06%	8.31%
Hedge Fund Indices							
IQ Hedge Multi-Strategy	0.70%	1.45%	9.36%	9.36%	9.22%	3.74%	4.00%
Real Assets Indices							
FTSE NAREIT Composite	-2.03%	-1.84%	2.80%	2.80%	6.29%	4.74%	5.73%
Alerian MLP	-1.62%	3.79%	9.76%	9.76%	20.00%	25.97%	8.84%
Bloomberg Commodity	-0.32%	5.85%	15.77%	15.77%	3.96%	10.64%	5.72%
S&P Global Infrastructure	-0.66%	2.37%	22.58%	22.58%	14.64%	10.97%	9.42%
Other							
Oil Price Brent Crude	-3.72%	-9.21%	-17.59%	-17.59%	-10.86%	3.27%	5.02%
CBOE Market Volitility (VIX)	-8.56%	-8.17%	-13.83%	-13.83%	-11.64%	-8.06%	-1.95%

Source: Morningstar

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