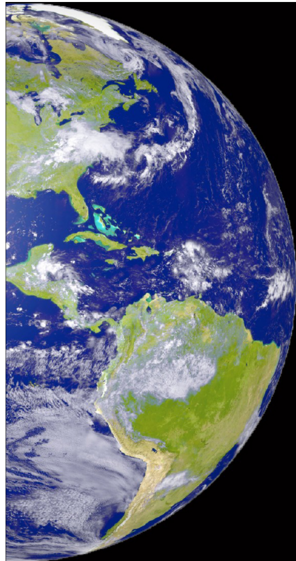

August, 2018

THE GLOBAL INVESTMENT PULSE

Published By

Legend Financial Advisors, Inc.® & EmergingWealth Investment Management, Inc.®

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THE MOST FAVORABLE DEBT POSITIONS?

By Louis P. Stanasolovich, CFP®, CCO, CEO and President of Legend Financial Advisors, Inc.® and EmergingWealth Investment Management, Inc.®

With a few exceptions, traditional bond (fixed debt) positions have not performed well since the beginning of 2016. Instead, variable rate debt positions have had better results. In 2016 and 2017, these types of positions had better results than traditional bonds due to the higher levels of interest paid that they offered. This statement is still true in 2018, but now interest rates are rising as well putting downward pressure on traditional bond positions.

Since it is anticipated that the Federal Reserve (Fed) will continue to raise interest rates into 2020, variable rate debt investments have historically benefitted from increases in interest rates while traditional bonds have stumbled or lost money.

Debt Positions, *continued on page 4*

THE RISKS AND REWARDS OF HIGH YIELD (JUNK) BONDS

By James J. Holtzman, CFP®, Legend Financial Advisors, Inc.® and EmergingWealth Investment Management, Inc.®

Returns on high yield bonds a.k.a. junk bonds can be very attractive especially relative to higher rated bonds. These corporate debt securities are essentially unsecured, bonds that carry different risks than investment grade AAA, AA, A or even BBB bonds. These bonds are rated no higher than the BB by Standard and Poor's or Baa by Moody's. Unrated bonds may also be included in the junk category. It is best not to invest in individual junk bonds. Otherwise, an investors' risks will skyrocket.

In the past, junk bonds were issued primarily by financially troubled corporations that were having difficulty raising capital elsewhere. Today, however, smart start-up companies, many in the high tech industry and many energy - related companies

Risks And Rewards, *continued on page 6*

MASSIVE STOCK MARKET LOSSES EXPECTED DURING NEXT 12-YEAR PERIOD ACCORDING TO NEW STOCK VALUATION ANALYSIS

By John P. Hussman, Ph. D., President, Hussman Investment Trust

As Edited By Louis P. Stanasolovich, CFP®, CCO, CEO and President of Legend Financial Advisors, Inc.® and EmergingWealth Investment Management, Inc.®

While the charts, starting on page 10, provide a quick update regarding current valuation extremes, it is not expected that the stock market will fall substantially over the next couple of years, but over the next 12 years, returns are expected to fair poorly—in the range of a negative 2.5% to negative 3.0%. Buying and holding S&P 500 indexes over the next 12 years will not be a winning strategy. The first chart is a Margin-Adjusted CAPE (Cyclically-Adjusted Price-To-Earnings ratio), which substantially improves the reliability of Robert Shiller's Cyclically-Adjusted P/E ratio by adjusting the earnings figure for variations in the implied profit margin. This measure is not vulnerable to the "dropoff" of earnings from the financial crisis, as is true for the

12-Year, *continued on page 8*

INDEXES ARE BECOMING MORE "GROWTHY"

By Doug Ramsey, CFA, CMT, Chief Investment Officer, The Leuthold Group, LLC

Investors concerned about excess enthusiasm for mega-cap Tech should note that cap-weighted indexes have become much "growthier" in style relative to equal-weighted indexes, and the latter should offer better protection during a sell-off in Social/Mobile/Cloud.

We used the Morningstar style-box methodology for an analysis of Value/Growth characteristics within the S&P 500 and S&P 600 indexes (using ETFs). The style scores are calculated

Indexes, *continued on page 7*

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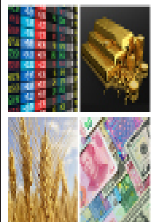

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LOUIS P. STANASOLOVICH, CFP®, EDITOR

Louis P. Stanasolovich, CFP® is founder, CCO, CEO and President of Legend Financial Advisors, Inc.® (Legend) and EmergingWealth Investment Management, Inc.® Lou is one of only four advisors nationwide to be selected 12 consecutive times by Worth magazine as one of "The Top 100 Wealth Advisors" in the country. Lou has also been selected 13 times by Medical Economics magazine as one of "The 150 Best Financial Advisors for Doctors in America", twice as one of "The 100 Great Financial Planners in America" by Mutual Funds magazine, five times by Dental Practice Report as one of "The Best Financial Advisors for Dentists In America" and once by Barron's as one of "The Top 100 Independent Financial Advisors". Lou was selected by Financial Planning magazine as part of their inaugural Influencer Awards for the Wealth Creator award recognizing the advisor who has made the most significant contributions to best practices for portfolio management. He has been named to Investment Advisor magazine's "IA 25" list three times, ranking the 25 most influential people in and around the financial advisory profession as well as being named by Financial Planning magazine as one of the country's "Movers & Shakers" recognizing the top individuals who have done the most to advance the financial advisory profession.

FOREIGN INVESTMENT OPTIONS

By Diane M. Pearson, CFP®, PPC™, CDFA®, Legend Financial Advisors, Inc.®
and EmergingWealth Investment Management, Inc.®

Many investors own foreign equities in their portfolios. When investing in foreign investments, it is important to remember all are subject to foreign currency risk. Nevertheless, U.S. investors generally own foreign equities in three primary ways.

Foreign Exchanges:

Foreign stocks can be purchased directly through many U.S. brokerage firms. This approach provides investors with greater flexibility and control than other foreign investment methods. However, not all brokerages will invest directly in foreign stocks. It is also difficult to diversify properly among individual foreign equities with small sums of money (less than $100,000.00).

American Depositary Receipts (ADRs):

ADRs were introduced to the financial markets in 1927. Today, more than 1,000 foreign ADR issues are traded on U.S. stock exchanges today. Banks, such as JP Morgan and BNY Mellon, issue ADRs for shares or fractional shares in overseas firms and retain the corporate stock certificates. Smaller sums of money are required than with foreign exchanges.

Mutual Funds/Exchange-Traded Funds (ETFs)/Exchange-Traded Notes (ETNs):

Mutual Fund choices include international funds that only hold foreign stocks, global funds containing both U.S. and overseas issues and single country funds that invest all assets into one nation's stocks as well as foreign balanced funds and global asset allocation funds. Typically, investors can buy a mutual fund, ETF or ETN for $250.00 to $2,500.00. ETFs and ETNs, typically have no minimums.

Analyzing any type of fund's track record no matter what form it takes and understanding management's goals are important aspects to consider when investing both at home and abroad. Generally speaking, it is easier to invest in foreign investments through mutual funds, ETFs or ETNs.

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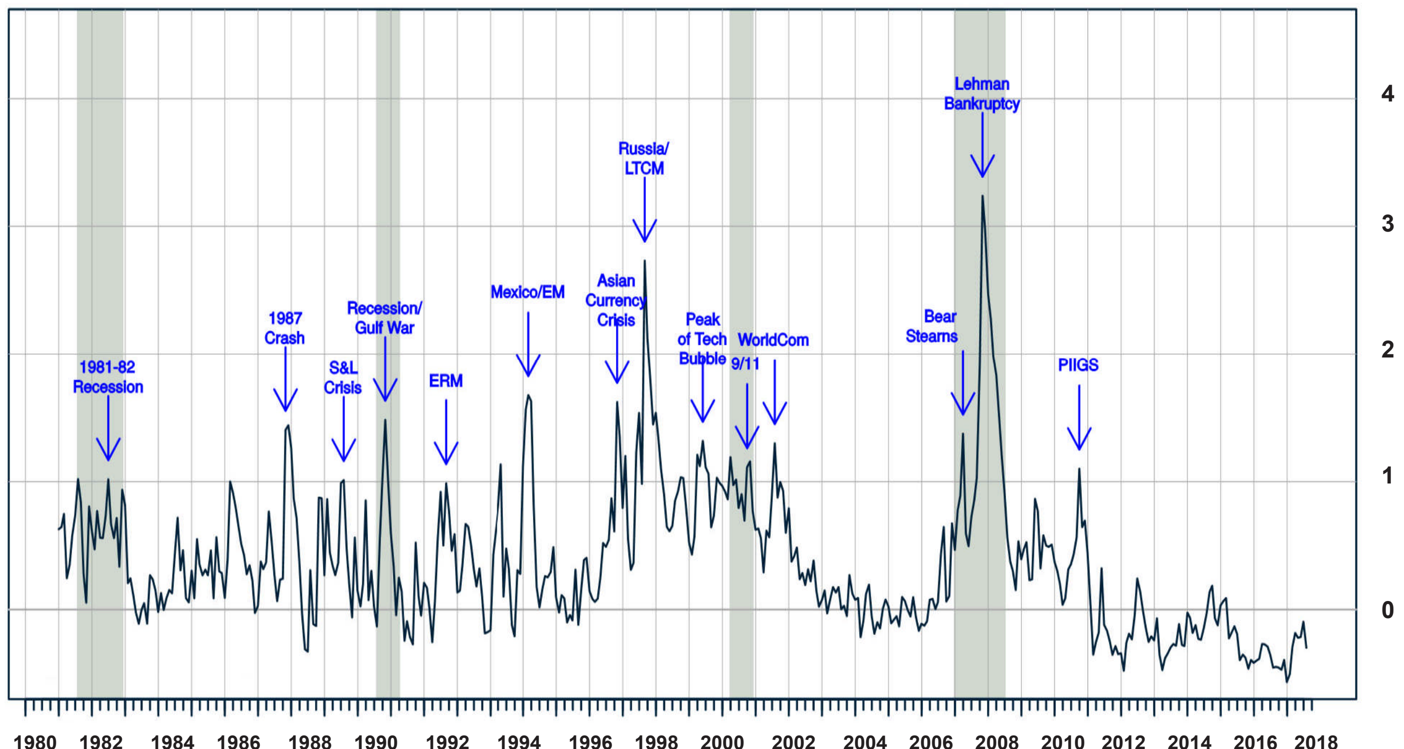

Debt Positions, *continued from page 1*

As mentioned in the last several issues of *The Global Investment Pulse*, traditional bond (fixed debt) investments, for the most part, continue to lose money in 2018. If interest rates continued to rise into 2020, most traditional bonds will either continue to lose money or likely not make very much money.

While the variable rate debt investments below are performing as expected, they are not long-term "Buy And Hold" type investments since they are lower-rated investments. Once in a Recession, or near one, liquidating these investments would be the better part of valor. Currently, a Recession is not near, but economic situations change rapidly.

Listed below is the Barclays Aggregate Bond Index (the highlighted line) which is a proxy for traditional bonds. Listed below the index are six examples of mutual fund variable rate debt investments (all are institutional share classes – lowest fees) that can be used in the near term to take advantage of rising interest rates. Please note the six investments are listed for illustrative purposes only.

A quick glance at the numbers below reveal that since the beginning of 2016, the variable rate funds, except in one instance, outperformed the Index in all years. **(Please read the footnotes to gain better understanding of these investments.)**

Please keep in mind no investment result is guaranteed. The purpose of this article is merely to state an investment strategy for consideration to be discussed with each reader's advisor or broker.

Index	2016	2017	2018 Year-To-Date Through August 28th, 2018
Barclays Aggregate Bond Index[1]	+2.65%	+3.54%	-1.09%
Fund Name			
Bank Loan Fund #1[2]	+11.07%	+4.47%	+3.57%
Bank Loan Fund #2[2]	+7.68%	+3.61%	+2.32%
Bank Loan Fund #3[2]	+11.51%	+5.06%	+2.94%
Bank Loan Fund #4[2]	+10.25%	+3.38%	+3.27%
Variable Rate Jumbo Mortgage Loan Fund #1[3]	+9.78%	+14.04%	+4.73%
Variable Rate Jumbo Mortgage Loan Fund #2[3]	+11.07%	+9.94%	+3.23%

Footnotes:

[1] This is a bond index.

[2] This type of mutual fund generally owns variable rate corporate loans originally issued to corporations by banks that were purchased by the mutual fund. The loans adjust interest rates every 30 to 90 days up or down, depending upon the direction of interest rates. These loans are usually rated BB, B, or non-rated. They are cousins of high-yield bonds.

[3] This type of mutual fund generally owns variable rate jumbo individual (high credit score homeowners – over 700) mortgages or mortgage pools that are usually selling at substantial discounts to their maturity values (generally 20.0% to 40.0%). Many of these mortgages were originated prior to the 2007 to 2009 financial crisis. They are also known as ALT-A mortgages. Many of these mortgages never defaulted during the financial crisis because they were usually so far underwater (several hundreds of thousands of dollars per mortgage) and, therefore, the underlying homeowners could not sell their home because most of these homeowners did not have the cash to pay the difference between the loan principal and the market value. Fortunately, many of these "surviving" homeowners kept making their payments and still own their houses making these valuable mortgages to own. The total return on these mortgages that the mutual funds own are an increasing interest rate as interest rates rise due to the variable nature of the loans and increasing principal value as they near maturity. Please note this category of mortgages are considered lower-rated debt.

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CD INTEREST RATES ARE HIGHER BUT STILL ARE A HIGH RISK INVESTMENT

By James J. Holtzman, CFP®, Legend Financial Advisors, Inc.® and
EmergingWealth Investment Management, Inc.®

Buying Certificates of Deposit (CDs) has been a loser's game for the large majority of the time since 2002 due to the fact that the "real interest rate" [meaning the interest rate minus the inflation rate (also known as the Consumer Price Index or CPI)] has returned less than zero percent. Please see the chart below. The red line depicts the interest rates CDs pay minus inflation. As evidenced on the chart, CDs have provided negative real returns most of the time since 2002.

Also, when the red line is below the green line, even if it is above zero, this means that inflation is higher than the rate of interest being paid, indicating a loss of purchasing power.

In addition, let's not forget about income taxes. In all situations, unless a CD is purchased within a retirement account, investors have to pay income taxes on a poor investment that have lost purchasing power. This is known as a real real interest rate – after inflation, after income taxes.

The impending question of today is now that interest rates are rising is: "Will CDs perform any better versus inflation?" The answer is No! The evidence is on the chart.

In reality, CDs are useful only for a very short-term timeframe such as a month or two – in other words; a place to keep money very short-term. As evidenced in this article, CDs make little, if any, sense as a long-term investment because interest rates on such investments tend to track the inflation rate. In effect, the only guarantees you are receiving from CDs is that you won't lose principal, but you will lose purchasing power, which is the only thing money is good for.

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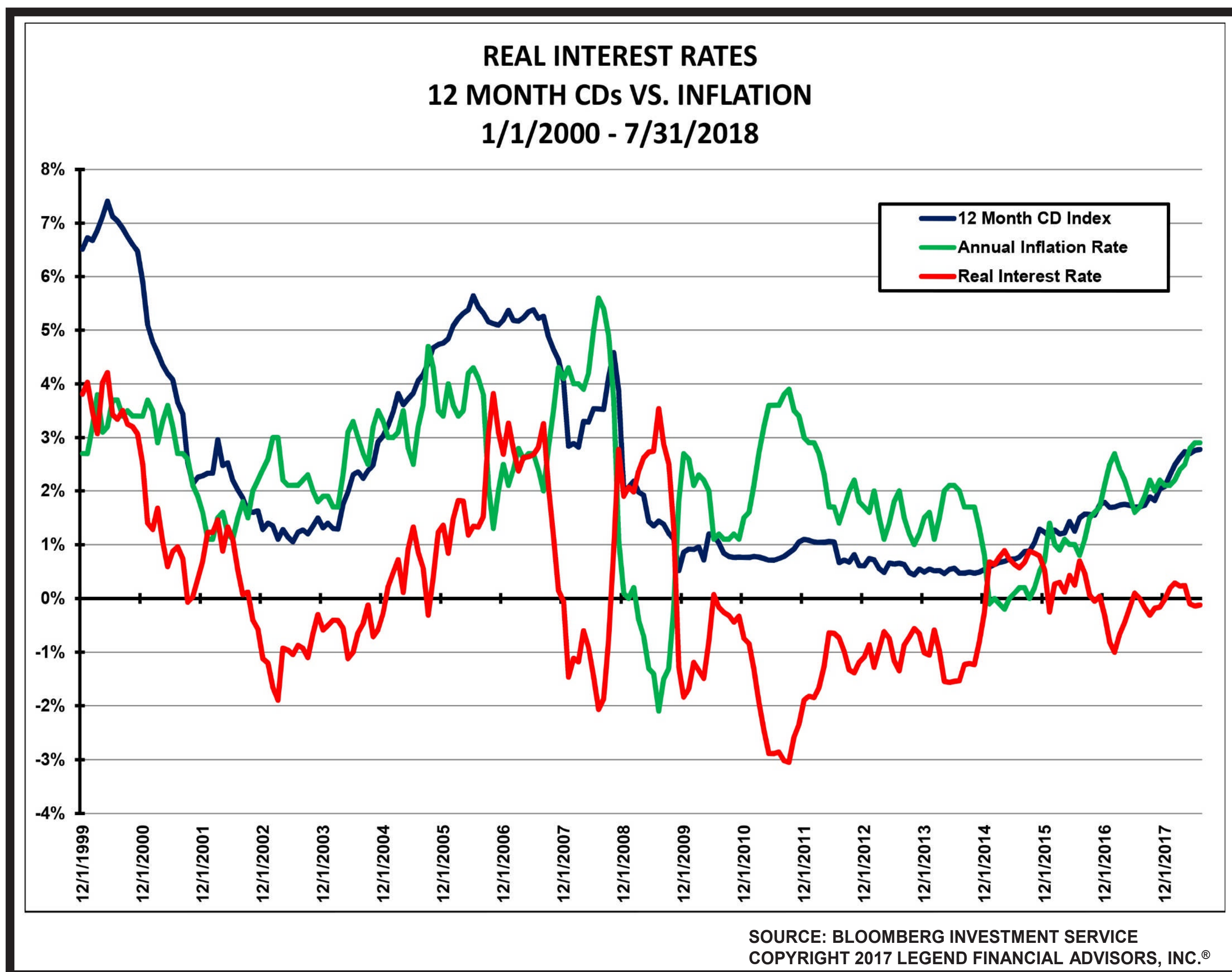

SOURCE: BLOOMBERG INVESTMENT SERVICE
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make up the greatest number of new bond issuers. These firms often have extended lines of credit with financial institutions. Some prefer not to dilute ownership of earnings by issuing new stock.

Each bond, like the stock of a company, carries industry risks. For example, with energy, how stable these companies are depends upon how high the price of energy is. Of course, the higher the price of energy, the better. Recessions can cause a number of these companies into bankruptcy.

Historical figures show that junk bonds are approximately 20 times more likely to default than high-grade bonds. In return for the higher risk, junk bonds usually pay 4.0% to 6.0% (although currently that number is approximately 3.5%) more per year than investment grade bonds.

Still, the annual rate of default is usually less than 2.0% of the outstanding value of the aggregate junk bonds market valuation and because defaulted bonds normally retain a portion of their value, the annual net loss in the junk bond market amounts to as little as 1.0% of the total outstanding value of junk bonds.

Whether to include junk bonds in an investment portfolio depends largely on the investor's tolerance for risk. These bonds have demonstrated a relatively good track record over the past 25 years, but the risk is real. Past performance cannot be viewed as an accurate predictor of future performance. Should the investment industry experience a severe downturn, for example, defaults and substantial losses could be expected in the junk bond market.

Due to high-risk factors, investors should avoid allocating substantial portions of their portfolio to junk bonds, whether purchased directly or indirectly. When purchasing junk bonds, it is best to purchase them through mutual funds. The underlying junk bonds of ETFs and ETNs are usually illiquid. Combined with the illiquid nature of ETFs and ETNs will cause investors to lose more money than a similarly managed mutual fund when liquidating their position.

Another factor to keep in mind that favors junk bonds over high grade bonds are the higher interest rate payments from junk bonds usually protect investors capital better than high grade bonds as interest rates rise. If interest rates stay level, junk bonds should also outperform high grade bonds due to their higher yields. If interest rates fall in smaller increments, junk bonds will also outperform. Only when interest rates fall dramatically will lower coupon high grade bonds outperform. In an extended economic recession such as the last recession in 2007 to 2009, defaults could drive long-term junk bonds' values down sharply.

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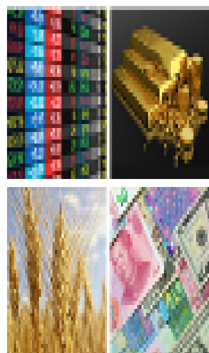

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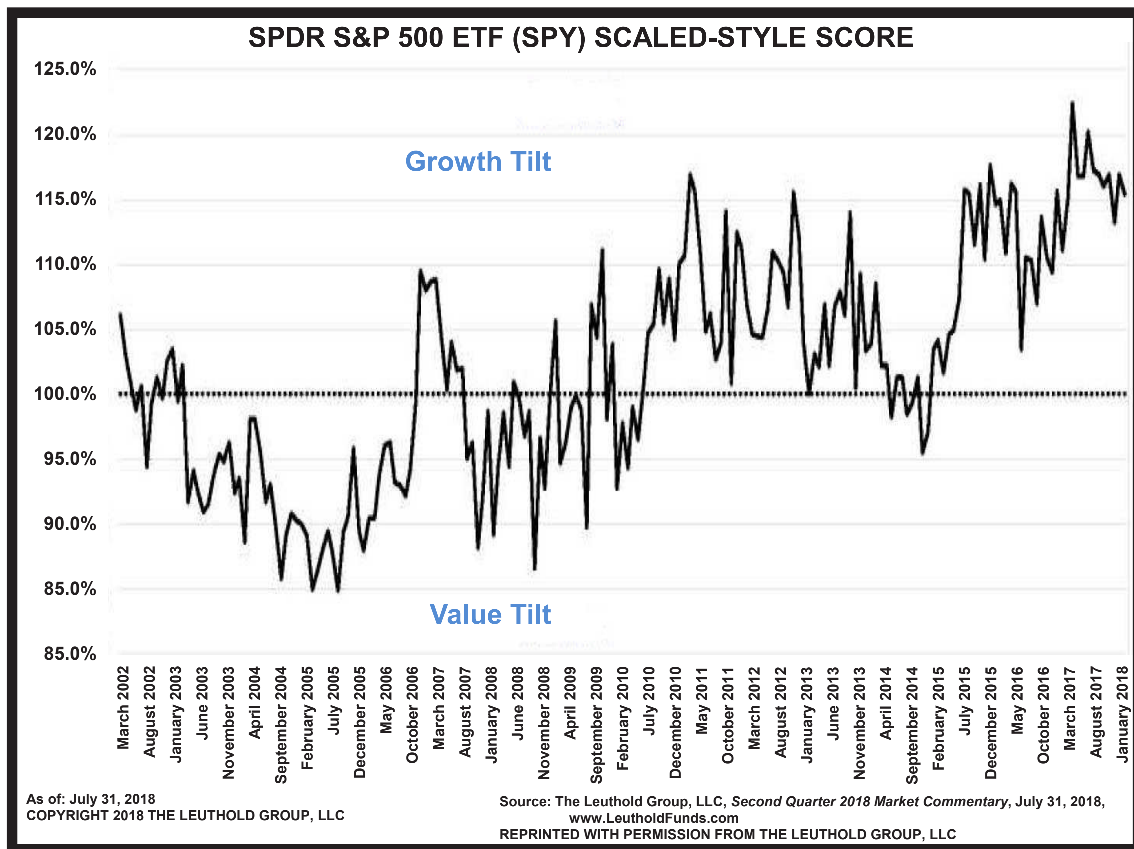
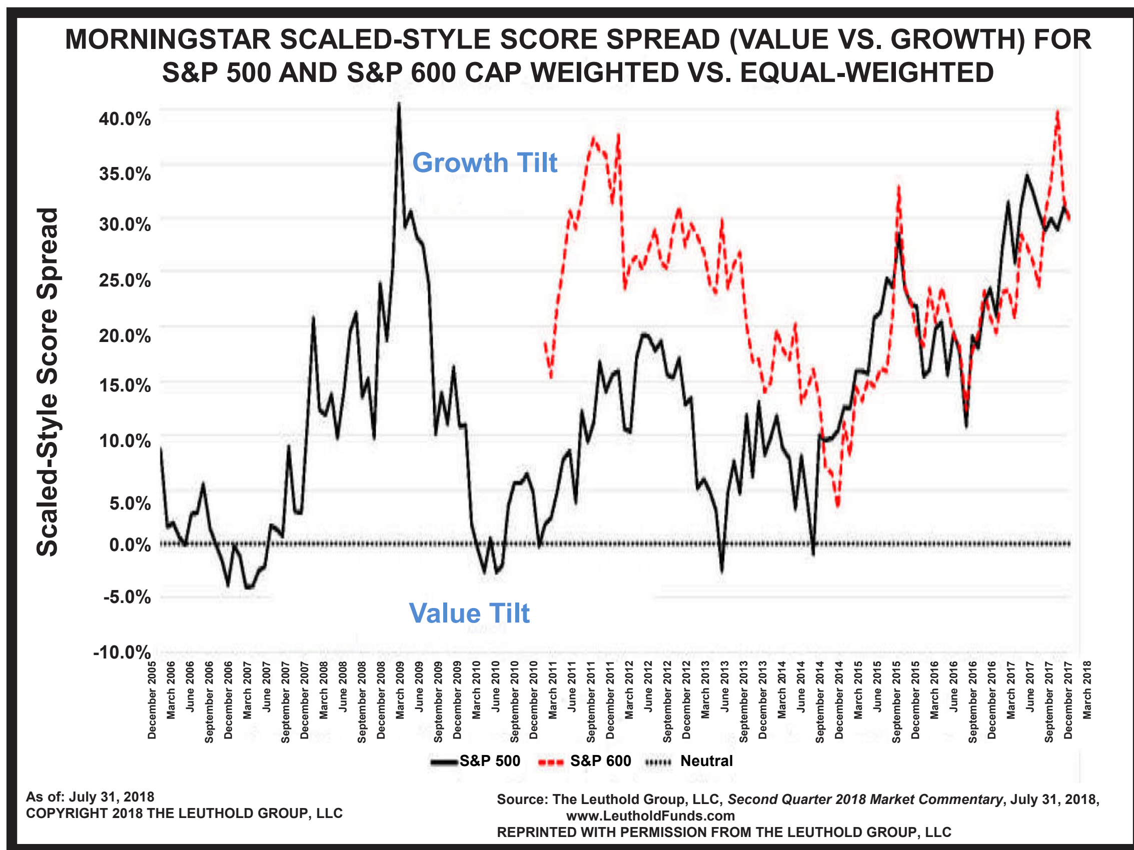
Indexes, continued on page 1

using five metrics of "value" (the most important being P/E on forward earnings), and five "growth" metrics (the most important being analysts' long-term growth estimates), rolled into one score. The style score for each index is calculated as the size-weighted average of each stock.

The first chart, to the top right, plots the SPDR S&P 500 ETF (SPY) style, scaled to a neutral Value/Growth reading set to 100. It shows that, over the last year-and-a-half, the S&P 500 has become significantly more "growthy," registering an all-time-high "growth" reading of 22.0% above neutral in July 2017. This confirms our suspicion that the cap-weighted S&P 500 has become more heavily-tilted toward expensive Growth companies.



The second chart, to the bottom right, continues the exercise by plotting the difference in scale-style scores between the cap-weighted and equal-weighted versions of the S&P 500 and small cap S&P 600 (using ETFs). In both the large and small universes, the cap-weighted indexes are now approximately 30.0% more growthy than their equally-weighted counterparts. It seems clear that if (when) the market's fascination with Growth stocks begins to fade and leadership shifts to Value, the cap-weighted indexes—having a much higher exposure to the Growth style—would suffer to a much larger degree than the equal-weighted indexes.



Source: This article was excerpted from "Indexes Are Becoming More 'Growthy'", by Doug Ramsey, CFA, CMT, Chief Investment Officer, The Leuthold Group, LLC, (*Second Quarter 2018 Market Commentary*, July 31, 2018), www.LeutholdFunds.com

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12-Year, *continued from page 1*

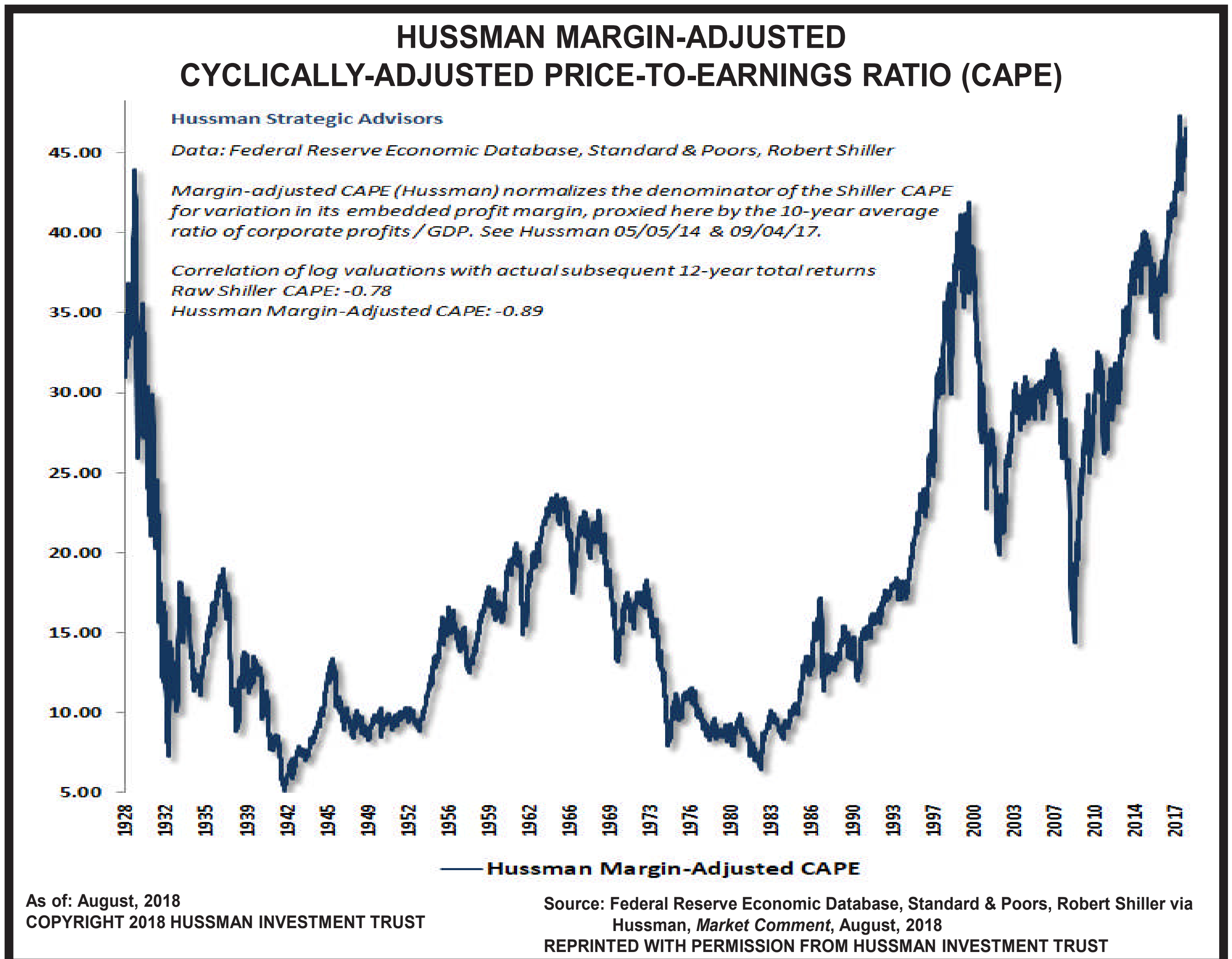
raw Shiller P/E. Moreover, normalizing profit margins does not imply that profit margins will decline over the near term, or even during the coming economic cycle.

A valuation ratio is nothing more than shorthand for a properly discounted cash flow analysis. It's important to recognize that stocks are a claim not on next year's earnings, or the next few years of earnings, but to the very long-term stream of cash flows that will be delivered into the hands of investors for decades and decades to come. The Margin-Adjusted CAPE is tightly correlated with the ratio of the S&P 500 to the actual discounted value of subsequent S&P 500 dividends, across more than a century of history. [See "Hussman Margin-Adjusted Cycically-Adusted Price-To-Earnings Ratio (CAPE) below.]

At present, stock market losses projected over the completion of this stock market cycle are expected to be on the order of -64.0% for the S&P 500 Index, -57.0% for the Nasdaq 100 Index, -68.0% for the Russell 2000 Index, and nearly -69.0% for the Dow Jones Industrial Average.

The next chart on the top of page 9 shows the relationship of our Margin-Adjusted CAPE (left scale, log, inverted) and actual subsequent S&P 500 total returns over the following 12-year period. Notice that market valuation extremes like 2000, 2007 and today always induce an "error" between the two lines, because by definition, a move to extreme overvaluation means that recent returns have been better than one would have anticipated 10-12 years earlier based on valuations at the time. As it happens, those "errors" are strongly correlated with shorter-term cyclical variations in consumer confidence, which is another way of saying that investors often ignore valuations based on their psychological mood. That's why it's important to couple the analysis of valuations with measures of market internals that help to gauge investor attitudes toward speculation and risk-aversion. [See "The Hussman Versus Margin-Adjusted Cylcically-Adjusted Price-To-Earnings Ratio (CAPE) chart on the top of page 9.]

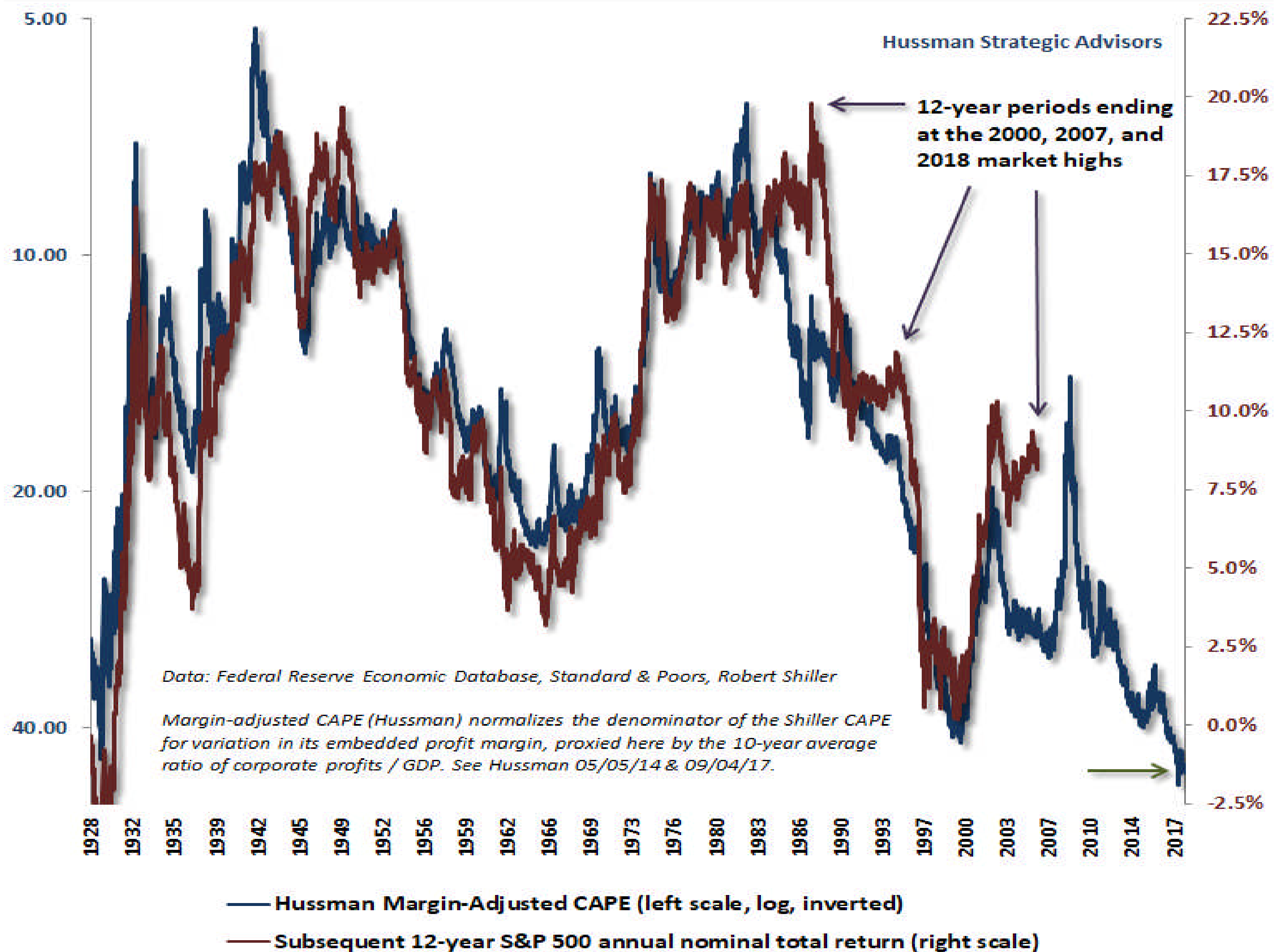
While it's true that interest rates are low, therefore, because growth rates are also low, no valuation premium is actually "justified" by low interest rates – a fact that one can demonstrate using any discounted cash flow method. As a result, stock market forecast models like the "Fed Model" actually have a very poor relation-



12-Year, *continued on page 9*

12-Year, *continued from page 8*

THE HUSSMAN VERSUS MARGIN-ADJUSTED CYCLICALLY-ADUSTED PRICE-TO-EARNINGS RATIO (CAPE)



As of: August, 2018

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Source: Federal Reserve Economic Database, Standard & Poors, Robert Shiller via Hussman, *Market Comment*, August, 2018

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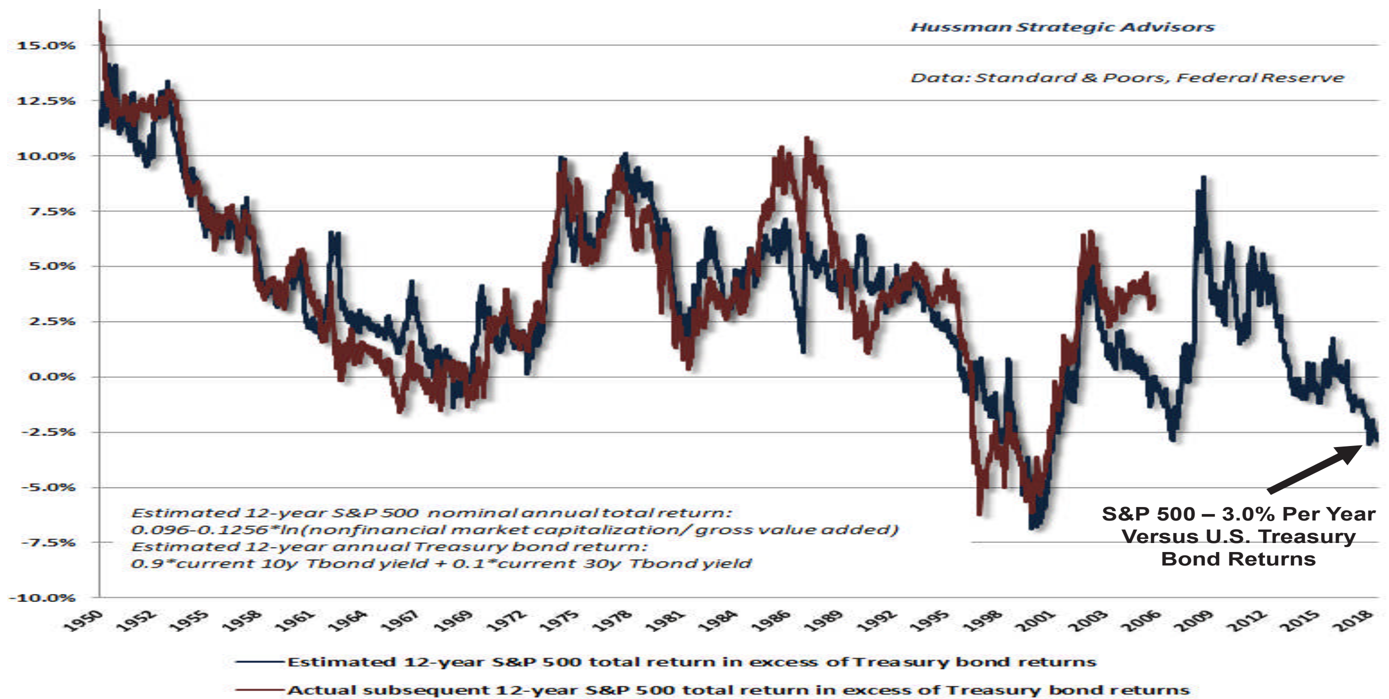
ship with actual subsequent market outcomes, and aren't even well-correlated with subsequent "equity risk premiums" (the difference between stock market returns and Treasury bond returns).

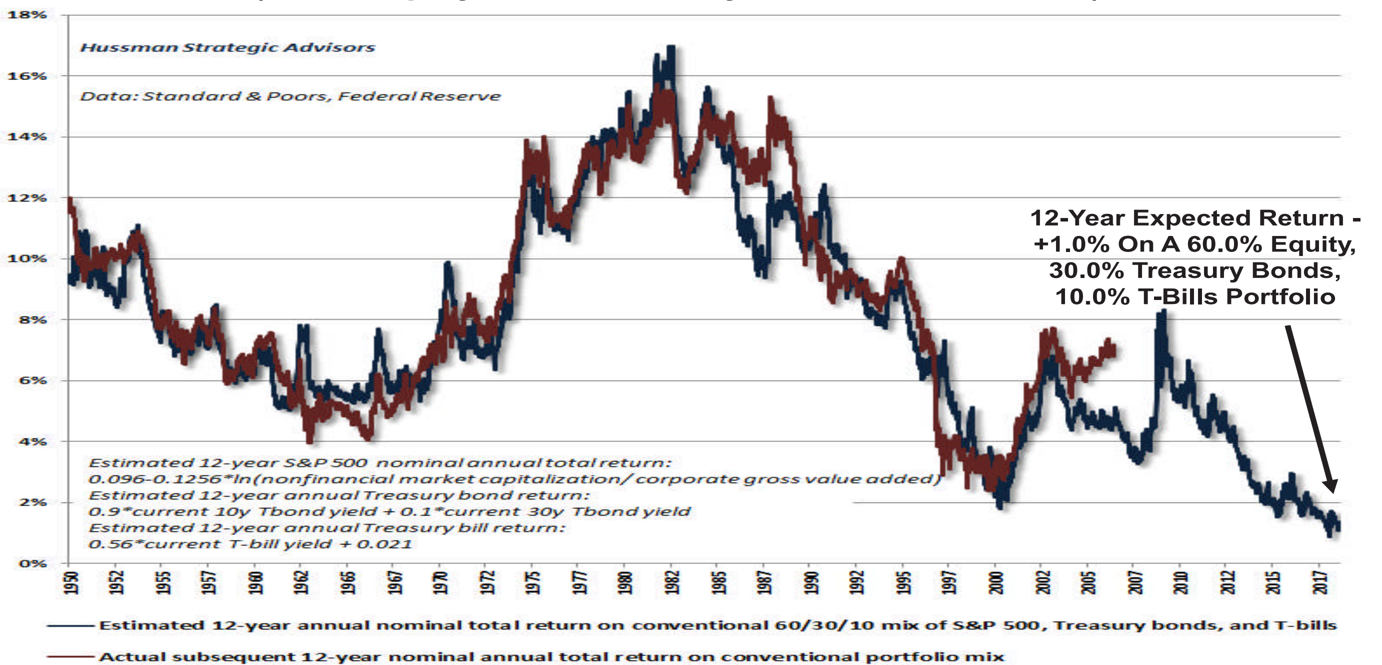
The most reliable way to estimate the equity risk premium is to use valuations to estimate probable market returns, and then to subtract bond yields from that estimate. These estimates are presented below, along with the actual subsequent market return in excess of Treasury bonds. Note in particular that even at today's low level of interest rates, we estimate that the S&P 500 will underperform U.S. Treasury bonds by roughly 3.0% annually over the coming 12-year horizon (See "Actual Subsequent 12-Year S&P 500 Total Return In Excess Of Treasury Bond Returns" chart on the top of page 10.)

The fact that interest rates are low doesn't actually improve the outlook for investors. Rather, it adds insult to injury because security valuations are extreme across-the-board. The chart below shows the estimate of 12-year total returns on a conventional passive portfolio mix invested 60.0% in the S&P 500, 30.0% in U.S. Treasury bonds, and 10.0% in U.S. Treasury bills. The red line shows the actual subsequent 12-year total return of this asset mix. Presently, a passive portfolio mix is expected to underperform the return on risk-free U.S. Treasury Bills over the coming 12-year period, mainly because the stock market component of passive returns is likely to be negative. (See "Actual Subsequent 12-Year Nominal Annual Total Return On Conventional Portfolio Mix" chart on the bottom of page 10.

12-Year, *continued on page 10*

12-Year, continued from page 11





Source: This article was excerpted from "Extrapolating Growth", by John P. Hussman, Ph. D., President, Hussman Investment Trust, (*Market Comment*, August, 2018), www.hussman.com

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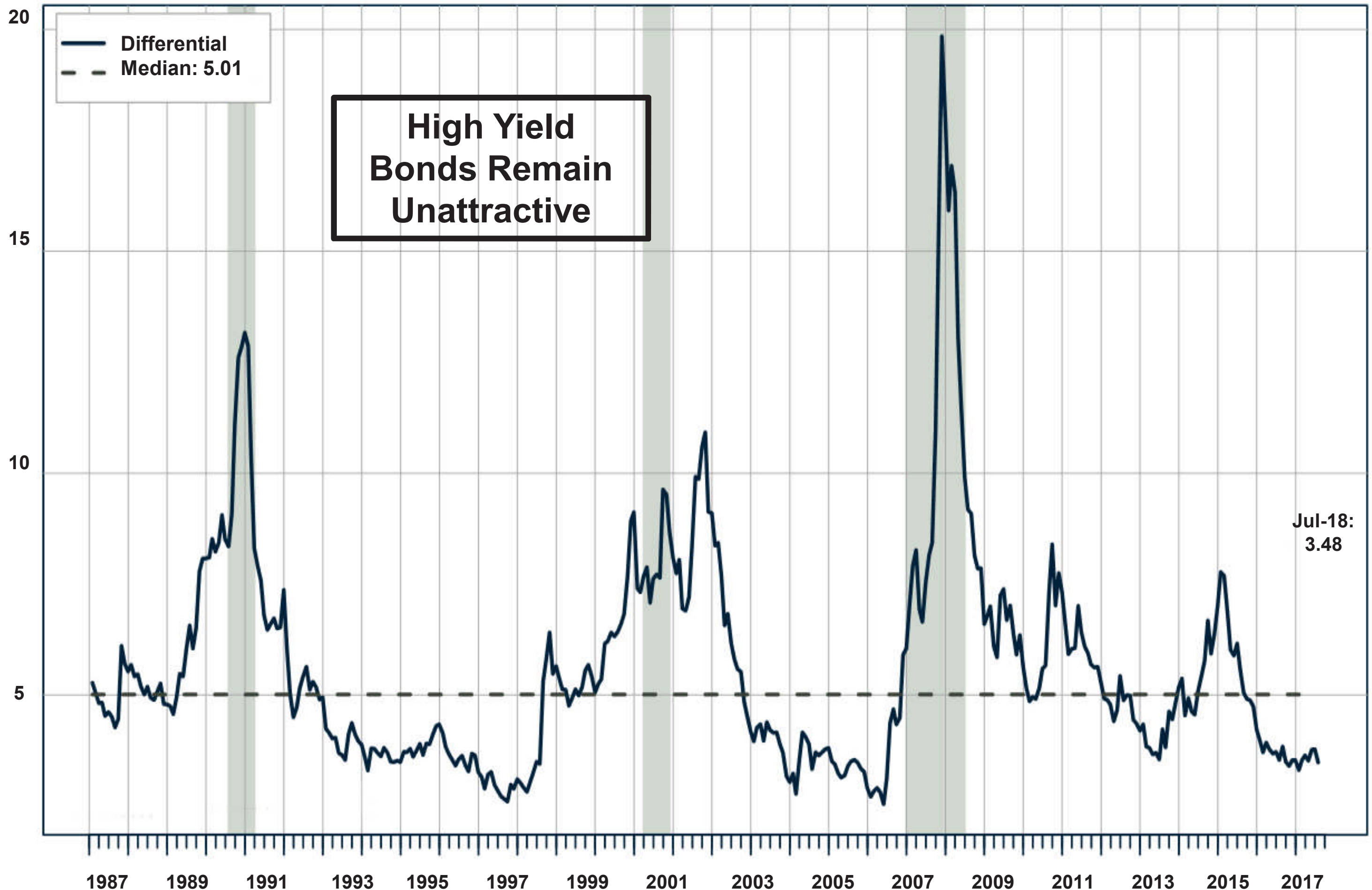

FED WATCH

INTEREST RATES AS OF AUGUST 24, 2018

Fed Funds Rate Range:	**1.75 – 2.00%**
Fed Discount Rate:	**2.50%**

2018 UPCOMMING FED MEETING SCHEDULE

September 25-26

November 7-8

December 18-19

Source: Bloomberg Investment Services

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2018 YEAR-TO-DATE PERFORMANCE

January 1, 2018 to July 31, 2018
(7 months)

	2018 Year-To-Date
Consumer Price Index (Inflation)	2.22%
90-Day Treasury Bills Index-Total Return	1.01%
Bloomberg Intermediate Term Corporate Bond Index	-0.95%
Barclays Aggregate Bond Index-Total Return	-1.59%
High Yield Corporate Bond Index – Total Return	-0.57%
S&P Leveraged Loan Index – Total Return	2.94%
HFRX Global Hedge Fund Index	-1.00%
S&P 500 Index (U.S. Stock Market)	6.47%
MSCI EAFE Index (Developed Foreign Equities)	0.02%
MSCI Emerging Market Index (Equities)	-4.43%
Newedge CTA Index (Managed Futures)	-5.35%
Dow Jones–UBS Commodity Index-Total Return (USD)**	-3.14%
Dow Jones U.S. Real Estate Index-Total Return (USD)**	2.32%
Gold Bullion	-6.54%

As of: July 31, 2018

Compound and Total Returns include reinvested dividends. Newedge Index is equally-weighted.

** USD = U.S. Dollar

Source: Bloomberg Investment Service

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SECULAR BEAR MARKET WATCH

April 1, 2000 to July 31, 2018
(18 years and 4 months)

	Annual Compound Return	Total Return
Consumer Price Index (Inflation)	2.13%	47.20%
90-Day Treasury Bills Index-Total Return	1.55%	32.68%
Barclays Aggregate Bond Index-Total Return	4.80%	136.32%
High Yield Corporate Bond Index – Total Return	8.66%	358.54%
S&P Leveraged Loan Index – Total Return	4.93%	141.96%
HFRX Global Hedge Fund Index	2.41%	54.90%
S&P 500 Index (U.S. Stock Market)	5.53%	168.28%
MSCI EAFE Index (Developed Foreign Equities)	3.88%	101.06%
MSCI Emerging Market Index (Equities)	7.13%	253.78%
Newedge CTA Index (Managed Futures)	4.19%	112.31%
Dow Jones–UBS Commodity Index-Total Return (USD)**	-0.78%	-13.33%
Dow Jones U.S. Real Estate Index-Total Return (USD)**	10.48%	522.28%
Gold Bullion	8.41%	339.55%

As of: July 31, 2018

Compound and Total Returns include reinvested dividends. MSCI Indexes do not include dividends prior to 2002. Newedge Index is equally-weighted.

** USD = U.S. Dollar

Source: Bloomberg Investment Service

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Note: During Secular Bear markets U.S. Stocks have historically returned a little more than inflation or a little less than inflation—plus or minus 1.50%—and generally last between 15 to 25 years. The last Secular Bear market (1966 to 1982) lasted 17 years and underperformed inflation by approximately one-half of one percent per year. The other Secular Bear markets since 1900 were 1901 to 1920 and 1929 to 1949. In both cases, the U.S. Stock market outperformed inflation by approximately 1.50% per year. All of the aforementioned performance numbers are pre-tax.

The performance of the U.S. Stock market so far in the current period (April 1, 2000 to the present) certainly appears to indicate that we are in a Secular Bear market. Long-term returns (over the next 10 years) for the S&P 500 will probably be slightly worse than the last 18 years and 4 months. Current 10 year normalized P/Es (long-term valuations) indicate approximate annual compound returns of slightly less than 3.00% over the next 10 years. Of course during the next 10 years, returns during various periods will be significantly higher and lower than the expected return. For example, the more the stock market rises in the near term, the less returns after that period will be and vice versa.

LEGEND FINANCIAL ADVISORS, INC.® & EMERGINGWEALTH INVESTMENT MANAGEMENT, INC.'S® INVESTMENT MANAGEMENT SERVICES

Legend Financial Advisors, Inc.® (Legend) and EmergingWealth Investment Management, Inc.® (EmergingWealth) offer Personalized Investment Management Services to individuals and institutions. Investment portfolios are developed to match the client's return and risk requirements, which are determined by the clients' completion of a Risk Comfort Zone Questionnaire, with the guidance of a Legend Wealth Advisor or EmergingWealth Advisor, respectively. Each type of investment portfolio is managed to achieve the short, intermediate and long-term investment objectives of the client, as may be applicable.

INVESTMENT PROCESS

Investment Portfolios:

Unlike most financial advisory firms that offer one style of investment or portfolio type, we offer a wide array of investment portfolios that usually fit with the large majority of client needs. If necessary, we will create customized solutions as well. For the types of investment portfolios, please see our Investment Portfolios, Potential Return and Risk Spectrum Chart on the next page. For a detailed description of our portfolios, please contact Louis P. Stanasolovich, CFP®, founder, CCO, CEO and President of both firms for a confidential discussion at (412) 635-9210 or e-mail us at legend@legend-financial.com.

Investment Research:

Our Investment Committee performs extensive research to identify opportunities, mitigate risks and structure investment portfolios. Emphasis is placed on developing portfolios that maximize the potential return relative to the amount of risk taken.

In-depth due diligence including face-to-face interviews in many instances with portfolio managers for open-end mutual funds is performed on each investment we select for a portfolio. Factors (both from a qualitative and quantitative standpoint) that we conduct a thorough analysis of each investment include, but is not limited to, liquidity (including the primary investment and/or the underlying investments, if utilizing pass through vehicles such as open-end mutual funds or exchange-traded products), income taxation, all related costs, return potential, drawdown potential (historical declines from peak-to-trough), volatility and management issues (Anything having to do with the management team of a stock, open-end mutual fund or an exchange-traded product.).

All portfolios for EmergingWealth are subadvised by Legend.

Client Education:

Education is very important to us. We are dedicated to educating each client about the different investment portfolio types and how they relate to market volatility, time horizons, and investment returns. It is our goal to ensure that the client understands and agrees with our investment philosophy. Furthermore, we assist each client in selecting a risk tolerance level with which they are comfortable. Ultimately, an investment portfolio is designed to meet the client's objectives.

PERFORMANCE REPORTING

Many investment firms only offer monthly brokerage statements, which provide minimal information; typically only account and investment balances. We, on the other hand, provide detailed quarterly reports that outline performance, income and management fees (among other items) in a simple, easy-to-read report. In addition, each performance report is sent with an extensive index page that illustrates the investment environment during the reporting period.

FEES

To find out more about the fees for either Legend or EmergingWealth's Investment Management services, please contact Louis P. Stanasolovich, CFP®, founder, CCO, CEO and President of both firms for a confidential discussion at (412) 635-9210 or e-mail us at legend@legend-financial.com.