NORTHERN TRUST
ASSET MANAGEMENT

Stewardship in Focus: Governance Reform — Lessons from Japan, Signals for Korea

Our approach
We assess whether governance reform is translating into board effectiveness, credible strategy and disciplined capital allocation.

Why it matters
Governance reform matters when stronger structures and disclosure lead to better corporate decisions and sustainable shareholder value creation.

What we've done
We use Japan's reform experience to identify broader stewardship lessons for investors and draw implications for Korea as governance reform momentum builds.

Executive Summary

Japan's decade-long governance reform offers an important lesson for Korea's current reform momentum: governance reform matters most when it changes corporate behavior, not simply when companies adopt new structures or improve disclosure. Japan has made substantial progress in governance architecture, with independent directors and board committees now common among large listed companies. However, financial outcomes have improved more gradually. While more companies now meet key reference points such as ROE of at least 8% and PBR of at least 1x, the improvement has been less pronounced than the change in board structure.

For investors, this highlights a critical distinction between governance reform activity and governance reform effectiveness. Higher dividends, share buy-backs and reductions in cross-shareholdings have signaled greater attention to shareholders in Japan, but these actions alone do not demonstrate comprehensive capital discipline. The more meaningful test is whether boards are providing effective oversight of management and whether companies are making coherent decisions on existing assets, new investment, balance sheet use and shareholder returns.

Korea is at an earlier stage of this journey. The long-standing "Korea discount" reflects weak capital efficiency, limited minority shareholder protection and governance structures often influenced by controlling shareholders. The Corporate Value-Up Program, alongside market expectations, regulatory pressure and legal reforms, has encouraged companies to set out plans to improve capital efficiency, shareholder returns and valuation. However, while many companies have published value-up plans, many KOSPI-listed companies still trade below book value. Reform momentum is building, but evidence of broad-based improvement in valuation and sustained capital discipline remains limited. The focus is therefore likely to shift from participation and disclosure to the quality of execution.

For NTAM's stewardship activities, the implication is clear. We do not assess reform by governance structures, disclosure or headline shareholder return announcements alone. Our engagement focuses on whether strengthened frameworks are supporting sustainable shareholder value creation in practice. In both Japan and Korea, we assess whether boards are providing effective oversight and accountability, whether companies have developed credible and decision-useful strategies to address weaker performance or valuation, and whether those strategies are reflected in disciplined capital allocation over time.

Across both markets, the central question is whether governance reform is leading to better board oversight, stronger capital discipline and more credible shareholder value creation over time.

AUTHORS

Parag Saxena
Stewardship Specialist

Wataru Terada
Stewardship Specialist

Japan’s Reform Experience and Key Lessons

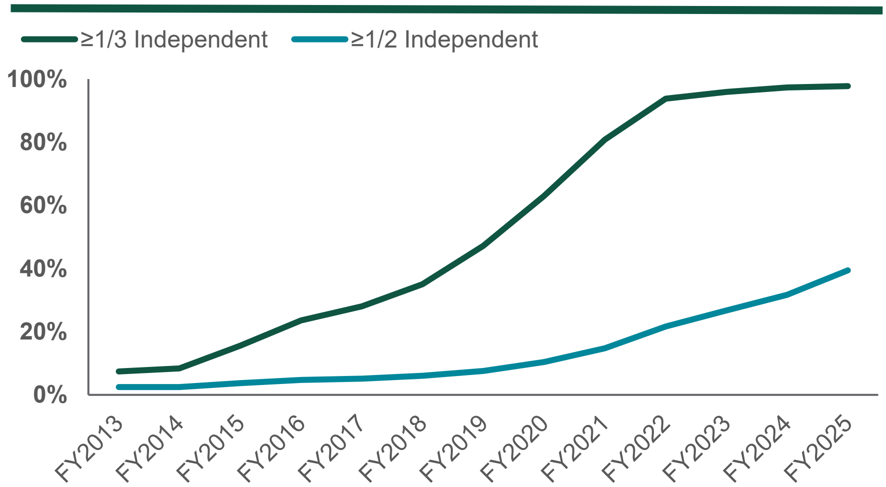
Japan’s corporate governance reform was never intended to be merely a compliance exercise. It formed part of a broader effort to revive corporate dynamism, strengthen earning power, improve capital efficiency, and enhance the competitiveness of Japan’s equity market. The modern reform cycle is generally traced to the 2013 Japan Revitalization Strategy, followed by the 2014 Stewardship Code and the 2015 Corporate Governance Code.

These two codes became the core pillars of the reform framework. The Stewardship Code was designed to encourage more constructive dialogue between investors and companies, while the Corporate Governance Code aimed to strengthen board oversight, accountability, and decision-making. The objective was not simply to put better governance structures in place, but to reshape incentives and behavior in support of sustainable corporate value creation.

Governance structures have strengthened, but financial outcomes have improved more slowly

A decade on, Japan has made significant progress across multiple areas, especially in the strengthening of governance structures. By FY2025, around 98% of TOPIX constituents had appointed independent outside directors to at least one-third of the board, up from approximately 7% in FY2013. Committee adoption has also advanced markedly. In the Prime Market, around 95% of companies had established nomination or remuneration committees, including advisory committees, by FY2024, compared with approximately 13% in FY2015. [1] Taken together, these developments suggest that much of the core governance architecture is now in place.

TOPIX: BOARD INDEPENDENCE

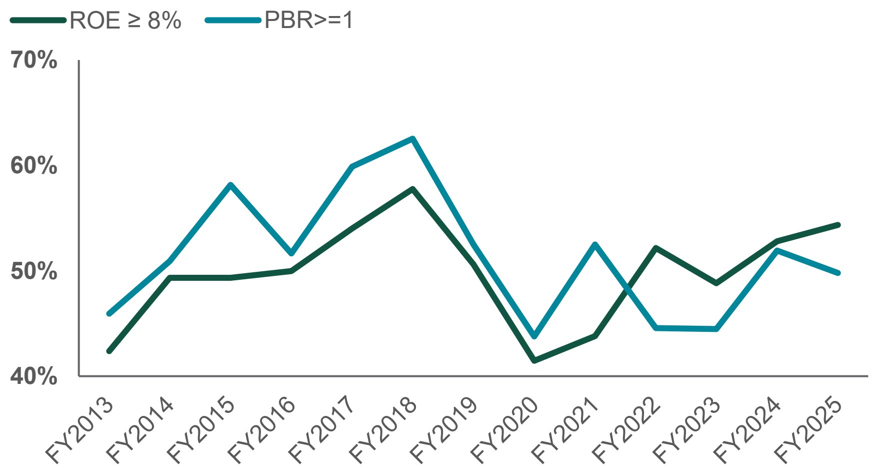


Source: Bloomberg; 1,296 TOPIX constituents with consistent data availability across FY2013–FY2025

However, the more important question is whether these changes have translated into long-term value creation. Here, the picture is more mixed. Two metrics have become particularly important in Japan’s reform debate among policymakers, market institutions, and investors as reference points for minimum levels of capital efficiency and valuation: an ROE of at least 8% and a PBR of at least 1x. Within the TOPIX universe, the share of companies with ROE of at least 8% increased from around 42% in FY2013 to approximately 54% in FY2025. Over the same period, the share of companies with a PBR of at least 1x rose from about 46% to roughly 50%. While this represents clear progress, the improvement is far less pronounced than the shift seen in board structures. This suggests that, although Japan moved relatively quickly to strengthen governance structures, translating those reforms into tangible financial outcomes has been more gradual.

[1] Tokyo Stock Exchange, *White Paper on Corporate Governance*, p. 65-66.

TOPIX: SHARE ABOVE ROE & PBR REFERENCE



Source: Bloomberg; 1,411 TOPIX constituents with consistent data availability across FY2013–FY2025

In practice, many Japanese corporates have focused on a relatively limited set of levers in their efforts to improve ROE, most notably dividends, share buy-backs, and the reduction of cross-shareholdings. These actions are important and, in many cases, have served as visible signals of a greater willingness to consider shareholder interests more seriously. However, they do not, on their own, fully address the broader question of whether boards and management are allocating capital effectively to support sustainable shareholder value creation.

For investors, the more meaningful test is broader and more holistic: whether companies are demonstrating disciplined management of existing assets, allocating capital to new investments only where returns are expected to exceed the cost of capital, maintaining an appropriate balance sheet and capital structure in light of that cost of capital, and otherwise returning capital to shareholders in a considered and value-accretive manner.

The focus has now shifted from structure to effectiveness

This gap between structural reform and financial outcomes has come into sharper focus since 2023, when the Tokyo Stock Exchange (TSE) specifically requested listed companies to be more conscious of returns on capital, cost of capital, and share price. That was an important step because it clarified where attention was increasingly shifting. The issue was no longer simply whether companies had the right governance structures. It was whether those structures were leading to better financial outcomes. The TSE further called on companies to develop relevant strategies, articulate them clearly to investors, and refine them over time through continuing dialogue. That direction remains firmly in place today. The Financial Services Agency finalized the latest revision of Japan's Stewardship Code in 2025, and the Corporate Governance Code is currently under review with a similar emphasis.

Japan's experience therefore highlights an important distinction for investors. Governance structures can change relatively quickly, but stronger board effectiveness, capital discipline, and shareholder value creation take longer to emerge.

Korea's Reform Moment

Japan's experience provides a useful reference point for Korea's reform trajectory. As in Japan, the objective is to encourage stronger long-term shareholder value creation. However, Korea remains at an earlier stage of the process, with reform momentum now building through a combination of regulatory pressure, market expectations, and more explicit legal measures. The key question is whether this momentum can accelerate the transition from structural reform to effective outcomes, or whether a similar lag between structural improvements and financial performance, as observed in Japan, will emerge over time.

Reform momentum is building

Korea's reform push is being driven by pressures broadly similar to those observed in

Japan, particularly the need to improve long-term shareholder value creation. At the center is the long-standing "Korea discount," with valuations constrained by weak capital efficiency, limited protection for minority shareholders, and boards that have often been more aligned with controlling shareholders than with the broader investor base.

The policy response is becoming increasingly concrete. Inspired in part by recent initiatives in Japan, the South Korean government in 2024 introduced the Corporate Value-Up Program, encouraging companies to articulate how they plan to improve capital efficiency, shareholder returns, and valuation. While participation remains largely voluntary, it is increasingly reinforced by growing market and regulatory pressure. In parallel, recent legal reforms have strengthened shareholder rights, board accountability, and oversight.

In practice, companies are increasingly expected to assess the drivers of their valuation, set out clear and measurable plans to improve capital allocation and returns, and disclose these transparently to investors. Taken together, these developments suggest that Korea's reform approach combines market pressure with stronger legal backing than was seen in Japan.

Signs of progress, but not yet proof

Encouragingly, Korea's reform agenda is beginning to elicit a corporate response, particularly in the form of improved strategy disclosure and a greater willingness among some companies to engage with investors on capital efficiency and shareholder returns. However, improved disclosure is not the same as improved discipline, and progress remains uneven.

As more companies develop value-up plans, the focus is increasingly shifting from disclosure to implementation. Companies are being assessed on whether they can link balance sheet strength, ROE improvement, payout policy, and the use of excess capital within a coherent capital allocation framework.

Financial institutions provide an early illustration of where this pressure is most visible. Korean financial holding companies have begun to articulate clearer shareholder return frameworks, including higher payout ratios, buy-backs, and cancellations of treasury shares. While the sector is not representative of the broader market, it offers an initial indication of how policy pressure and investor expectations can influence corporate behavior.

By the end of May 2026, 731 listed companies had published value-up plans, covering 83.1% of total market capitalization. At the same time, the broader picture on company valuation remains mixed. As of late May 2026, 523 of 808 KOSPI-listed companies were still trading below book value, pointing to substantial room for improvement at the aggregate level.[2] This contrasts with the recent strength in the KOSPI, which has been driven largely by a small number of large semiconductor companies, particularly Samsung Electronics and SK Hynix[3]. Taken together, this suggests that reform is gaining traction, but has not yet translated into broad or sustained improvements in valuation.

The real test lies ahead

The real test is whether these reforms lead to meaningful changes in corporate behavior, particularly within controlled corporate groups where related-party influence and limited board challenge remain key concerns. There is a risk that value-up plans become a disclosure exercise, while boards retain flexibility to defer more substantive capital discipline. Looking ahead, the focus will increasingly shift to the quality of plans and, more importantly, their execution in practice. This places particular emphasis on board effectiveness—its ability to oversee, challenge, and incentivize management, and to ensure that strategy is translated into disciplined capital allocation decisions. Progress will be judged less by the volume of reform activity and more by whether these efforts lead to sustained improvements in shareholder value creation over time.

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[2] Korea Exchange, *Monthly Corporate Value-Up Status (May 2026)*.
[3] Mark Saunokonoko, "Chip, chip ... boom? South Korea tech makers join the trillion-dollar club but some fear a short-circuit looms," The Guardian, 3 June 2026.

What This Means for NTAM's Stewardship Activities

Japan's reform experience offers a clear lesson: governance reform tends to matter most when it changes behaviour, not simply structure. New governance frameworks and disclosures are important, but their impact ultimately depends on whether they contribute to more effective boards, stronger capital discipline, and improved long-term shareholder value creation. Structural reform can move relatively quickly, but behavioural and financial outcomes typically take longer to emerge and require sustained pressure.

That lesson is highly relevant to Korea, which remains at a relatively early stage of reform. Better disclosure, value-up plans, and legal change may strengthen the formal framework, but do not in themselves demonstrate stronger board oversight, improved protection for minority shareholders, or more disciplined capital allocation. For investors, the central question is therefore already similar: whether reform is beginning to influence how companies are governed and how capital is used in practice.

For NTAM, this points toward three connected stewardship priorities that increasingly guide our engagement and assessment:

- **Board effectiveness and accountability:** whether the board appears willing and able in practice to advise, oversee, and constructively challenge management in support of long-term shareholder value creation.
- **Development and disclosure of credible strategy:** whether the company has clearly identified what may be holding back performance and valuation, and has developed and articulated a credible strategy to address it.
- **Strategy execution and capital allocation discipline:** whether that strategy is being reflected in decisions over time, particularly in how capital is allocated across investment, portfolio management, balance sheet use, and shareholder returns.

This does not imply the application of a single capital allocation model across all companies. Business models, growth opportunities, financial profiles, and risk tolerances differ. However, companies would generally be expected to explain how their governance, strategy, and capital allocation choices are intended to support sustainable shareholder value creation over time. From a stewardship perspective, the focus is less on prescribing specific outcomes and more on assessing whether decisions appear coherent, credible, and appropriately accountable to long-term shareholders.

These priorities are intended to shape, and are increasingly reflected in, how we assess reform in practice. In both Japan and Korea, the key question is not simply whether governance structures have changed, but whether boards are using those structures to support better decisions, more disciplined capital allocation, and more credible shareholder value creation over time. The table below summarizes this stewardship lens.

Stewardship Focus	Core Question	What We Scrutinize in Practice
Board effectiveness and accountability	Is the board genuinely overseeing shareholder value creation and holding management to account?	• We look for evidence that the board is doing more than meeting formal governance thresholds. The key question is whether it appears able and willing to advise, oversee and challenge executives on key topics, including business strategy and capital allocation.
Development and disclosure of credible strategy	Has the company clearly identified what is holding back business and financial performances and developed and articulated a credible strategy to address it?	• We assess whether the company has clearly identified key drivers of weaker business and financial performance and articulated a coherent and credible strategy to address them. • This includes whether management has defined clear strategic priorities, including capital allocation frameworks, in a way that is consistent and appropriate to the company's business model, financial position, and risk profile. • We also consider the quality of disclosure and communication with investors, including whether the strategy is sufficiently specific, measurable, and decision-useful.
Strategy execution and capital allocation discipline	Is that strategy being carried through in actual decisions, and is capital being allocated in a way that is likely to improve value over time?	• This is where stated ambition can be tested against actual decisions. We examine whether companies are demonstrating elements of disciplined capital allocation across four key dimensions. • 1. In managing existing assets and business portfolio, we assess whether underperforming businesses or assets are being improved, restructured, or divested where appropriate, and whether non-core assets and cross-shareholdings are being addressed. • 2. In allocating capital to new investments, we evaluate whether capital is generally deployed where returns are expected to exceed the cost of capital. • 3. In maintaining an appropriate balance sheet and capital structure, we consider whether leverage, liquidity, and overall capital structure are appropriately calibrated to the company's risk profile and financial position, and whether they support an efficient and sustainable cost of capital over time. • 4. We assess whether excess capital is returned to shareholders in a considered and value-accretive manner where reinvestment opportunities do not appear to justify retention.

Case Studies[4]

Central Japan Railway Company – Escalating Concerns on Capital Discipline and Executive Incentives

The Challenge

Central Japan Railway Company is a Japan-based passenger railway operator best known for operating the Tokaido Shinkansen, one of Japan's core transportation arteries. The company is also investing heavily in its flagship Chuo Shinkansen project, a superconducting maglev line intended to create a second high-speed rail route between Tokyo, Nagoya, and eventually Osaka. The Chuo Shinkansen represents one of the most consequential capital allocation decisions facing JR Central. The latest estimated construction cost for the Shinagawa–Nagoya section is ¥11 trillion, significantly above the company's estimated operating cash flow for the next 10 years. However, the project has faced substantial execution delays, with the opening timeline moving from the original 2027 target to 2035 or later. These delays, together with inflation and specification changes, have increased expected costs by approximately 60% from the original estimate. Despite the financial importance of the project, disclosure on its return profile remains very limited, and the figures that have been disclosed do not appear reassuring. The company's assumptions imply, in the first year of operation, an ordinary profit margin of around 4%, while ordinary profit relative to total capital expenditure is approximately 0.6%. Given the project's national infrastructure significance, our concern is whether continued investment is being assessed through a disciplined capital-allocation framework, rather than simply as a commitment to complete a strategically important project irrespective of its economic attractiveness.

What We Did

We have been engaging with JR Central to seek clearer disclosure on the Chuo Shinkansen's expected return profile and the forward-looking economic rationale for continued investment. Our objective has not been to dictate whether the company should

[4] NTAM. See page 9 for more information on case studies.

proceed with the project, but to understand whether such a large and long-duration capital commitment is being assessed with appropriate capital discipline and shareholder interests in mind. We have also raised a related governance concern: executive incentives do not appear sufficiently aligned with the long-term financial outcomes of the project. Executive shareholdings are currently very limited, the company has no equity-linked compensation, and performance assessment remains largely annual. In our view, this structure is not well suited to a multi-decade, highly capital-intensive investment whose success or failure could have long-term implications for shareholder value.

The Outcome

The company acknowledged our concerns. However, including in our most recent meeting with the company ahead of the AGM, we have not yet seen sufficient willingness to improve transparency around the project's risk-return profile or to adjust the remuneration structure to better align executive accountability with such a significant, long-duration investment. Given this, and the importance of the project to the company's future, we concluded that escalation was warranted. We decided to vote against the chair of the Remuneration Committee to signal our concern that the current incentive framework does not adequately hold executives accountable for one of the most consequential capital allocation decisions facing the company. We will continue our engagement with the company on the project's economic viability, capital discipline, and executive accountability.

SK Square – Seeking Greater Transparency on Capital Allocation to Narrow the Holding-Company Discount

The Challenge

SK Square is a South Korea-based investment and holding company whose value is overwhelmingly driven by its stake in SK hynix, a semiconductor memory company that represented approximately 96% of disclosed NAV in 1Q26. Although SK Square also holds smaller investments across ICT platforms, mobility, security and other digital businesses, its investment case remains highly sensitive to SK hynix's share price, earnings cycle and dividend policy. The company has taken meaningful steps under Korea's Corporate Value-Up Program, with its 2025 Value-Up Plan setting targets to reduce the discount to NAV below 30% by 2028, maintain PBR above 1.0x, and generate ROE above cost of equity during 2026–2028. SK Square also reported that its NAV discount narrowed from 73% in 2023 to 55% in 1Q26. Despite this progress, we remain focused on whether its value-up strategy can translate into durable shareholder value creation. The company receives substantial dividends from SK hynix and maintains a strong net cash position, while large-scale capital deployment into its stated focus areas has remained limited. This creates a need for greater transparency around how the board assesses capital allocation priorities, including the balance between reinvestment and shareholder returns. For investors, this is central to the SK Square investment case: the company needs to show why shareholders should own SK Square rather than gain direct exposure to SK hynix. A clearer capital allocation framework would help demonstrate how recurring cash inflows and balance-sheet capacity can be used to narrow the structural holding-company discount over time.

What We Did

We engaged with SK Square on its Corporate Value-Up Plan, portfolio strategy and use of recurring cash inflows from SK hynix. We acknowledged the positive direction of its initiatives, including portfolio restructuring and shareholder returns through dividends and buy-backs. We also recognized management's intention to deploy capital into focus areas such as semiconductors and AI, while noting that attractive opportunities had not yet materialized at valuations the company considered compelling. Against this backdrop, we encouraged SK Square to provide clearer disclosure on how the board assesses capital allocation priorities, including the balance between reinvestment, dividends and buy-backs.

The Outcome

Following our engagement, SK Square responded constructively and subsequently introduced a clear 2026–2028 shareholder return policy based on at least 30% of recurring dividend income plus a portion of investment performance, with returns through dividends and buy-backs. We view this as constructive, but not yet the end point. Further value unlock will depend on whether SK Square can demonstrate a clearer and more disciplined capital allocation framework, supported by credible deployment of capital, consistent shareholder returns and continued progress in narrowing the holding-company discount.

Korean Financial Institutions – Strengthening Board Oversight and Shareholder Alignment

The Challenge

Strong governance is critical for financial institutions operating in complex, highly regulated environments, where effective board oversight supports financial stability, risk management, and long term value creation. In Korea, governance disclosure and practices among financial institutions have improved in recent years, supported by regulatory reforms and increased investor scrutiny. However, investors continue to raise concerns in three key areas: the limited depth of sector specific expertise among independent directors, insufficient transparency in executive remuneration disclosures, and weak alignment between directors and shareholders due to minimal independent director share ownership. These issues can constrain investors' ability to assess the quality of independent oversight, evaluate whether incentives are aligned with long term performance and prudent risk taking, and judge overall accountability at the board level. Given the systemic importance of financial institutions, addressing these governance gaps remains a priority for global investors.

What We Did

During Q1 2026, we engaged with four major Korean financial groups: KB Financial Group; Hana Financial Group; Woori Financial Group; and Shinhan Financial Group. This was part of ongoing stewardship dialogue and focused on three core governance themes. We first evaluated board composition, focusing on the breadth and depth of independent directors' expertise, particularly across banking, insurance, and capital markets. We also discussed whether boards were sufficiently equipped to oversee emerging risk areas such as technology, digital transformation, and AI related challenges. In addition, we reviewed the use of external board evaluations and encouraged greater transparency on evaluation methodologies, key outcomes, and how identified skills gaps are incorporated into succession planning. Second, we engaged on executive remuneration, acknowledging recent improvements while advocating for more decision useful disclosure. Our recommendations included clearer articulation of key performance metrics and their relative weightings, greater transparency around incentive calibration, stronger integration of non-financial factors such as risk management, governance, culture, and sustainability, and improved alignment between incentive structures and stated strategic priorities. Third, we raised concerns about the limited share ownership among independent directors and reiterated our expectation that directors should, over time, build meaningful ownership stakes to strengthen alignment with shareholders, referencing advanced global market practices.

The Outcome

All four financial groups acknowledged our feedback and confirmed that the issues raised are actively discussed at both management and board levels. While governance practices in Korea continue to reflect local regulatory and cultural norms, these engagements contributed to constructive dialogue and growing alignment between companies and investor expectations on governance quality, transparency, and accountability.

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ABOUT CASE STUDIES

The case studies presented are intended to illustrate stewardship efforts undertaken by NTAM. Stewardship includes engaging with portfolio companies, policy makers, service providers and other stakeholders - sometimes collaboratively - in an effort to encourage positive change and maximize overall long-term value. They do not necessarily represent the views of all clients, nor do they indicate future performance. Individual results may vary, and not all engagement efforts are successful in driving positive change in portfolio companies.

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