Bonds (Fixed-Income) Investing: Important Disclosures for D.A. Davidson & Co. Clients

The following is important information regarding investments in bonds, including information about the compensation that D.A. Davidson & Co. (“D.A. Davidson”) and our financial professionals (together, “we,” “us” or “our”) receive for buying and selling bonds, and the conflicts of interest those payments create.

If you have any questions about any of the topics discussed below, or bond investing generally, we encourage you to reach out to your D.A. Davidson financial professional.

Please note that the discussion below does not address:

- Treasury bonds, bills or notes, or other fixed-income investments that are guaranteed by the full faith and credit of the U.S. federal government, such as Treasury Inflation-Protected Securities (TIPS) and guaranteed agency bonds issued by the Government National Mortgage Association (GNMA or Ginnie Mae). For a discussion of Treasury instruments and other U.S. Government Guaranteed Bonds (together, “Treasuries”), please refer instead to Treasuries and Other U.S. Government Guaranteed Bonds (Fixed-Income) Investing, which is available at dadavidson.com/Disclosures.

- Municipal bonds issued by state and local governments. For a discussion of municipal bonds, please refer instead to Municipal Bonds (Fixed-Income) Investing, which is also available at dadavidson.com/Disclosures.

Overview of Bonds

Bonds are fixed-income (debt) investments issued by different types of governmental and non-governmental issuers. When you purchase a bond, you are lending the investment proceeds to the issuer. In exchange, the issuer promises to pay a stated rate of interest – called the bond’s coupon rate – until the end of the bond’s life (the “maturity”). At maturity, the issuer also promises to return your money invested (your principal). Across different types of bonds, maturities range from very short terms of one month all the way up to 30 years or more.

Some bonds – referred to as “callable” bonds - allow the issuer to redeem the bond prior to maturity at a set price. Other bonds are redeemable by the issuer prior to maturity upon the occurrence of certain enumerated events. Still other bonds are “extendable” by the issuer, meaning it is allowed to delay the repayment of the investor’s principal past the bond’s original maturity.

Many different types of entities issue bonds, and not all types of bonds are discussed in this summary. However, the types of bonds that we most often recommend to clients (other than Treasuries and municipal bonds), to which this discussion applies, are:

- corporate bonds, which may be issued by private and publicly-traded companies alike, and
- mortgage-backed securities (MBS), which are secured by mortgages on homes and other real estate.

Many mortgage-backed securities are agency securities – i.e., issued by U.S. government agencies. However, it is important to understand that agency bonds issued by government-sponsored enterprises like the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage

1
Corporation (Freddie Mac) are not guaranteed by the full faith and credit of the U.S. Government. The carry Credit Risk - in other words, risk of default. This issue can be confusing for investors, particularly because Ginnie Mae (GNMA) bonds, which have a similar-sounding name, are guaranteed by the U.S. government.

If you have questions about whether a particular agency bond is guaranteed by the U.S. Government, we encourage you to speak to your D.A. Davidson financial professional.

Bond investing can be complicated. However, there are a few basic principles you should understand. Generally speaking:

- **Credit Quality and Coupon (Interest) Rate.** There is an inverse relationship between the creditworthiness of a bond’s issuer (called the “credit quality” of the bond) and its coupon rate. Less creditworthy borrowers – regarded as more likely to default on their obligations – will have to pay higher rates to compensate investors for the increased Credit Risk (risk of default). More creditworthy issuers will be able to pay less interest and still sell their bonds.

- **Interest Rates and Bond Prices.** There is also an inverse relationship between market interest rates and the prices of existing bonds. If interest rates go down, a bond with a (higher) coupon rate will be more valuable by comparison to newly-issued bonds. If interest rates increase, a bond with a (lower) coupon rate will be less valuable by comparison - this is referred to as “Interest Rate Risk.”

- **Maturity and Coupon Rate.** In most cases, there is a direct relationship between a bond’s maturity and its coupon rate. Because Interest Rate Risk is higher over long periods, longer-term bonds will usually have to pay higher rates to compensate investors.

At an individual level, bonds of various issuers have different characteristics, and are selected by investors for different reasons. For example, many investors buy bonds – particularly those with good credit quality - to receive what they hope will be predictable, regular payments of current income. Investors with a higher tolerance for risk and speculation may buy bonds having credit quality that is below investment grade (sometimes referred to as “junk bonds”), which pay higher yields but also have higher Credit Risk. Bonds issued by smaller and less stable companies, or certain foreign companies or governments, are generally considered more speculative (higher risk) investments than bonds issued by large, stable U.S. companies and federal agencies.

Further, unlike investing in mutual funds or other funds that hold significant numbers of different bonds or other securities, directly owning bonds of an individual issuer will not help significantly to diversify your overall investment portfolio. As a general matter, individual bonds are more likely than the broader debt markets to lose a significant amount of value quickly. And, it is more expensive to invest in the bond market by purchasing a large number of bonds directly than to purchase interests in a fund that holds a large number of bonds.

If your D.A. Davidson financial professional recommends bonds for your account, he or she will discuss the specifics of the recommended bonds with you, including material risks.

**Bonds – Our Compensation and Conflicts of Interest**

**Bonds in Brokerage Accounts.** The compensation we receive for buying and selling bonds on your behalf (or to/from you) depends on the specific circumstances.

In some cases, D.A. Davidson acts as an underwriter (in other words, a distributor) of bonds, meaning we sell newly-issued bonds to investors on the “primary” market. In those cases, we receive underwriting, syndicate and other similar fees for our services to the bond’s issuer. These sales are “principal” trades, because we are effectively selling bonds to you from our own inventory.

For bonds underwritten by D.A. Davidson and other primary market sales, the compensation D.A. Davidson would receive is usually “paid” to us as an underwriting discount, which is similar to a mark-up (see below), and expressed as a percentage of the purchase price you pay, would typically be between 0.35% and
2.0%. However, only a reduced portion of this compensation (typically 20-30%) is taken into account when determining your financial professional's compensation for selling you the bonds.

If your D.A. Davidson financial professional recommends an investment in a bond for which we are the underwriter, or any other primary market trade, he or she will refer you to the offering document for the bond, which contains detailed information about all of the compensation we would receive.

On the secondary market, we can also buy or sell existing bonds on your behalf as your agent (broker), where the other party to the trade is a third-party investor. In addition, in some cases we may buy previously-issued bonds for our own account from you, or sell them from our inventory to you, on the secondary market (which are principal trades). For secondary market purchases or sales of bonds, D.A. Davidson charges “mark-ups” (from the prevailing market price) when bonds are purchased, and “mark-downs” when bonds are sold, within your brokerage account. Mark-ups and mark-downs are generally equivalent to brokerage commissions, meaning they are taken out of the transaction proceeds. Again, a percentage of those mark-ups and mark-downs are paid by D.A. Davidson to your financial professional, according to his or her “production” and our commission grid.

The maximum mark-ups and mark-downs we charge on secondary market purchases and sales of bonds are determined according to maturity, under our general fixed-income pricing policy. This means the rates are generally the same as for Treasuries, TIPS, municipal bonds and other fixed-income products, such as CDs, with the same maturity. Please note that these rates are current as of the effective date set forth on the last page of this disclosure, and D.A Davidson reserves the right to change these mark-up and mark-down rates at any time:

For “secondary market” (previously-issued) bond transactions:

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<thead>
<tr>
<th>Maturity</th>
<th>Maximum Mark-Up on Purchase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than one (1) year</td>
<td>0.250%</td>
</tr>
<tr>
<td>1-2 years</td>
<td>1.125%</td>
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<tr>
<td>3-5 years</td>
<td>1.875%</td>
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<tr>
<td>6-14 years</td>
<td>2.250%</td>
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<tr>
<td>15 years &amp; longer</td>
<td>2.500%</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Maturity</th>
<th>Maximum Mark-Down on Sale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than one (1) year</td>
<td>0.250%</td>
</tr>
<tr>
<td>1-2 years</td>
<td>0.625%</td>
</tr>
<tr>
<td>3-5 years</td>
<td>0.875%</td>
</tr>
<tr>
<td>6 years &amp; longer</td>
<td>1.000%</td>
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</tbody>
</table>

These payments (underwriting and similar fees, mark-ups and mark-downs) create conflicts of interest for us. In particular:

- **Primary/Principal Trades of Bonds.** Generally, we receive more total compensation and other benefits for principal trades of bonds (including selling “new issues” to investors on the primary market) than we receive for secondary market trades. When we act as an underwriter, we take on the risk of distribution, meaning we may lose money if our distribution efforts fail. These issues create incentives for us to recommend bonds that we trade on a principal basis, including newly-issued bonds we sell on the primary market.

- **Additional Underwriting Compensation.** In cases where we underwrite bond issuances, we receive underwriting fees, syndicate fees and similar forms of compensation for our consulting and distribution services. These payments create an incentive for us to recommend bonds we underwrite over other investments.
Volume of Bond Trades. We receive compensation for each purchase or sale of bonds that occurs in your brokerage account. This creates an incentive for us to recommend that you trade frequently.

Differential Compensation - Different Bond Maturities. The compensation we receive in connection with buying or selling any particular bond for your account depends on its maturity. This creates an incentive for us to recommend bonds with longer maturities, for which we will receive larger mark-ups and mark-downs.

Differential Compensation - Bonds vs. Other Investments. The compensation we receive for buying and selling bonds on your behalf (or to/from you), will be more or less than we would receive for buying and selling different investments, such as stocks, mutual funds or other products. This creates an incentive for us to recommend investments that pay us more compensation over those that pay us less compensation, or no compensation.

To help manage these conflicts, D.A. Davidson has policies and procedures in place that prohibit our financial professionals from recommending a volume of trading (as to frequency, amount or both) that is excessive under the circumstances, as well as systems to help identify situations where this could be occurring. Recommending excessive trading volume in order to increase brokerage commissions is an abusive practice sometimes referred to as “churning.”

For secondary market trades, we charge the same maximum mark-ups and mark-downs for all types of bonds discussed in these materials – corporate, mortgage-backed, foreign, etc. This is intended to help mitigate the financial incentives that D.A. Davidson and our financial professionals might have to recommend certain types of bonds over others. We also charge the same maximum mark-ups and mark-downs for these types of bonds as for Treasuries, TIPS, municipal bonds, and all other types of fixed-income investments, such as CDs. This is intended to help mitigate the financial incentives that D.A. Davidson and our financial professionals might have to recommend certain types of bonds over other fixed-income investments.

In short, there are conflicts between our interests and those of our brokerage clients relating to bond investments (and the other investments we make available to our brokerage clients). The policies summarized above are intended to help mitigate those conflicts.

Bonds in Advisory Accounts. Neither D.A. Davidson nor our financial professionals receive any mark-ups or mark-downs on secondary market purchases or sales of bonds through our wrap fee programs or other investment advisory accounts (accounts in which the client pays an asset-based fee, as opposed to commissions and other amounts that apply to each transaction). The value of bonds in an advisory account, like the value of other securities held in the account, is included in determining the fee.

If you have questions about the compensation D.A. Davidson or your D.A. Davidson financial professional receives from the sale or purchase of bonds, please contact your D.A. Davidson financial professional.

Bonds – Primary Risks

Bonds, like virtually all investments, carry certain risks. The risks associated with a particular bond will depend on a number of factors, many of which relate to its issuer. Because there are many differences between different bonds and different bond issuers, the potential categories of primary risks are broad. Therefore, this discussion is not comprehensive, and we strongly encourage you to discuss the risks associated with bond investments with your D.A. Davidson financial professional.

However, below are some examples of the most material risks associated with (i) bond investing generally, and (ii) investments in certain bonds:

Risks of Bond Investments Generally:

- Credit Risk (or Default Risk) is the risk that issuer or guarantor of a fixed-income security will be unwilling or unable to meet its obligations to pay interest and/or principal when due, for example due to the issuer’s bankruptcy or insolvency.
- **Interest Rate Risk** is the risk that the value of fixed-income investments will decline because of rising interest rates. The magnitude of this decline will often be greater for longer-term fixed-income securities than shorter-term fixed-income securities.

- **Real Interest Rate Risk (or Inflation Risk)** is the risk that the real rate of return paid on fixed-income investments will be less than the nominal return due to the effect of inflation.

- **Reinvestment Risk** is the risk that, in a declining interest rate environment, investors holding fixed-income investments may have to reinvest proceeds in other investments that do not pay comparable levels of income to those of the redeemed or called investments. This can lead either to a reduction in cash flows or the need to reinvest in investments having a higher Credit (Default) Risk.

**Risks of Corporate Bond Investments:**

- **Business Risk** is the risk that investments in a particular company will lose substantial value or default due to the company’s insolvency or bankruptcy, or fluctuations in the applicable business sector generally.

- **Market Risk** is the risk that the value of investments may decline, at times sharply and unpredictably, because of economic changes or other events that affect individual companies or large portions of the market.

- **Sector Risk** is the risk that investments in a particular sector or industry will lose substantial value or default due to a downturn in that sector/industry, even if the investments are in well-managed companies.

**Risks of High-Yield (“Below Investment Grade” or “Junk”) Bond Investments:**

- **High-Yield Risk** is the risk that non-investment grade fixed-income securities, sometimes known as "junk bonds," have greater credit risk, price volatility and risk of loss than investment grade securities, which can adversely impact returns and asset valuation. High yield securities are considered primarily speculative with respect to the issuer's continuing ability to make principal and interest payments.

**Risks of Bond Investments – Foreign and Emerging Markets Bonds:**

- **Currency Risk** is the risk that foreign currencies will fluctuate in value relative to the U.S. dollar, adversely affecting the value of non-U.S. investments and their returns. An investor can lose money if the local currency of a foreign market depreciates against the U.S. dollar, even if the market value of the foreign investments increases.

- **Emerging Markets Risk** is the risk that markets of emerging market countries are less developed and less liquid, subject to greater price volatility and generally subject to increased economic, political, regulatory and other uncertainties than more developed markets.

- **Foreign Securities Risk** is the risk that investing in foreign (non-U.S.) securities may result in more rapid and extreme changes in value than securities of U.S. issuers, due to less liquid markets, and adverse economic, political, diplomatic, financial, and regulatory factors. Foreign governments also may impose limits on investment and repatriation and impose taxes.

- **Geographic/Country Risk** is the risk that investments concentrated in a certain country or other geographical region will be adversely affected by events occurring in that region, including natural disasters, adverse governmental action, acts of God, war, insurrection or political upheaval, or instability as to markets or other economic and political structures.

**Risks of Bond Investments – Selling Bonds on the Secondary Market:**

- **Liquidity Risk** is the risk that certain investments will not be sufficiently marketable to be sold (liquidated) within a short time frame without incurring a loss in value.
Risks of Bond Investments – Callable or Redeemable Bonds:

- **Prepayment Risk (or Call Risk)** is the risk that the issuer of fixed-income investments will exercise its right to call bonds in order to prepay its obligations prior to maturity, which can result in a decreased rate of return and a decline in value of those investments.

- **Redeemable Bond Risk** is the risk that the issuer of fixed-income investments will redeem the bond upon the occurrence of certain enumerated events prior to maturity, which can result in a decreased rate of return and a decline in value of those investments.

Risks of Bond Investments – Extendable Bonds:

- **Debt Extension Risk** is the risk that the issuer of fixed-income investments will exercise its right to pay principal on the investments later than expected. This may happen during a period of rising interest rates. Under these circumstances, the value of the obligation can decrease and the investor’s portfolio might suffer from the inability to invest in higher yielding securities.

If you have any further questions, please do not hesitate to ask your D.A. Davidson financial professional. More information about investing in bonds, which we encourage you to read, is also available from the U.S. Securities and Exchange Commission (SEC) at investor.gov.

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