Risk Tolerance Questionnaire

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Prepared by: Institutional Solutions Group
22 W Washington
Chicago, IL 60602

Prepared for: ALPS Mutual Fund Services

Risk Tolerance Questionnaire

Different investors have different risk tolerances. Much of the difference stems from time horizon. That is, someone with a short investment time horizon is less able to withstand losses. The remainder of the difference is attributable to the individual's appetite for risk. Volatility can be nerve-wracking for many people and they are more comfortable when they can avoid it. However, there is a definite relationship between risk and return. Investors need to recognize this risk return trade-off. The following risk tolerance questionnaire h as been designed to measure an individual's ability (time horizon) and willingness (risk tolerance) to accept uncertainties in their investment's performance. The total score recommends which of the five risk profiles is most appropriate for the investor.

Time Horizon

1. When do you expect to begin withdrawing money from your investment account?

    a. Less than 1 year
    b. 1 to 2 years
    c. 3 to 4 years
    d. 5 to 7 years
    e. 8 to 10 years
    f. 11 years or more

2. Once you begin withdrawing money from your investment account, how long do you expect the withdrawals to last?

    a. As one lump sum distribution or in less than 1 year
    b. Over a period of 1 to 4 years
    c. Over a period of 5 to 7 years
    d. Over a period of 8 to 10 years
    e. Over a period of 11 years or more

Risk Tolerance

3. Some investors are more willing than others are to accept declines in the value of their portfolio as a trade-off for potentially higher long-term returns. Which response best represents your attitude toward the following statement?

   I am willing to experience large and frequent declines in the value of my investment if it will increase the likelihood of achieving high long-term returns.

   a. Strongly Agree
   b. Agree
   c. Disagree
   d. Strongly Disagree

4. Suppose you had a choice between three hypothetical investments. The table below lists the return possibilities associated with each investment. In any given one-year period, the portfolio may be losing money, earning a return between 0 and 7 percent, or earning more than 7 percent. Of the 3 portfolios shown below, which best matches the risk/return trade-off you would be most comfortable with when investing?

Portfolio	Chance of losing money	Chance of earning 0%-7%	Chance of earning more than 7%
A	5%	85%	10%
B	15%	65%	20%
C	25%	45%	30%

   a. Portfolio A
   b. Portfolio B
   c. Portfolio C

5. Investments with the best chance of high returns typically have the most uncertainty. For example, the portfolio with the potential for the biggest gain in the best case scenario also has the potential for the biggest loss in the worst case scenario.

   How much return are you willing to give up in order to feel comfortable?

   a. I will accept the lowest return in exchange for the portfolio with the smallest and least frequent changes in value.

   b. I will accept a moderate return in exchange for less frequent and smaller changes in value.

   c. I will only accept a high return. I understand that the portfolio will frequently have large changes in value

6. Inflation can greatly erode the return on your investments, especially over time. For example, in a year with a 4% inflation rate, an investment with a 7% return before inflation would only produce an increase in purchasing power of 3%.

   Please specify one of the following statements that best summarizes your attitude toward investing and inflation.

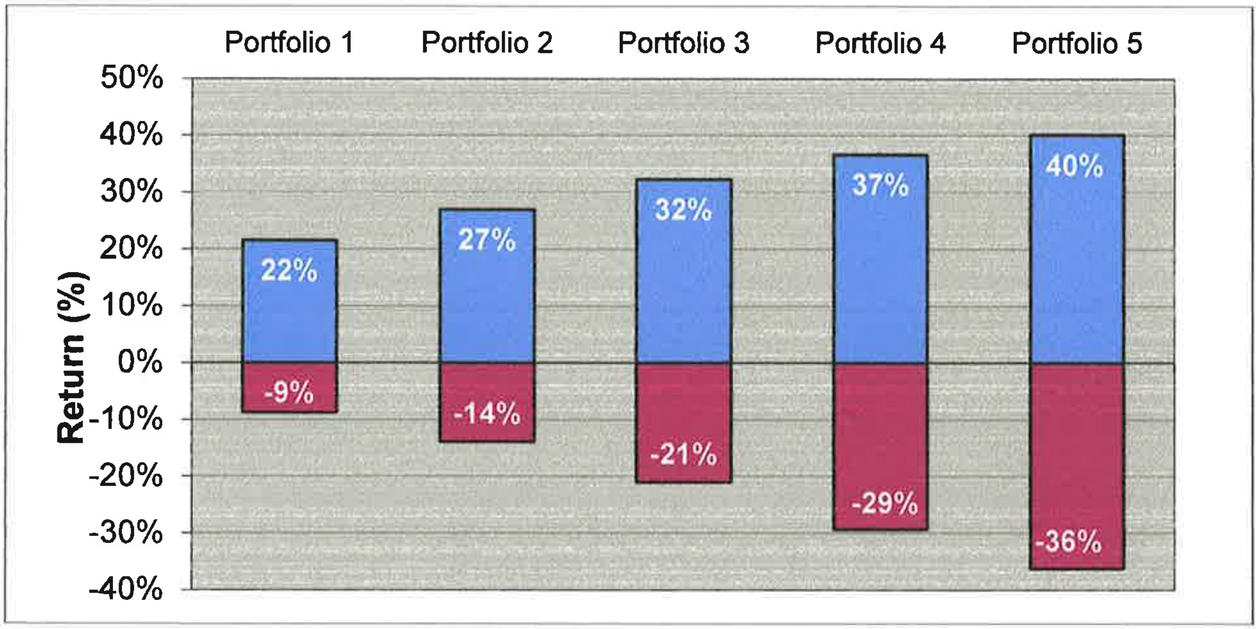
   a. I aim to limit the volatility of my portfolio while keeping pace with inflation.

   b. I aim to moderately exceed inflation while accepting a moderate level of risk.

   c. I aim to significantly exceed inflation while accepting a significant level risk.

   d. I aim to maximize my return while accepting a large and dramatic level of risk.

7. The following graph shows the probable range of returns and losses of five hypothetical portfolios over a one-year period. Notice that portfolios with high returns also have the probability of experiencing large losses. In which of these portfolios would you prefer to invest?



a. Portfolio 1
b. Portfolio 2
c. Portfolio 3
d. Portfolio 4
e. Portfolio 5

8. The table below presents a supposed potential worst-case loss, probable gain, and potential best case gain of $100,000 invested in five hypothetical portfolios over a one-year period. Which one of the following would you prefer to hold in your account?

	Potential Best Case ($)	Probable Gain ($)	Potential Worst Case ($)
Portfolio 1	$ 121,500	$ 105,100	$ 91,300
Portfolio 2	$ 126,900	$ 105,900	$ 86,100
Portfolio 3	$ 132,200	$ 106,700	$ 79,000
Portfolio 4	$ 136,600	$ 107,500	$ 70,700
Portfolio 5	$ 140,100	$ 108,100	$ 63,800

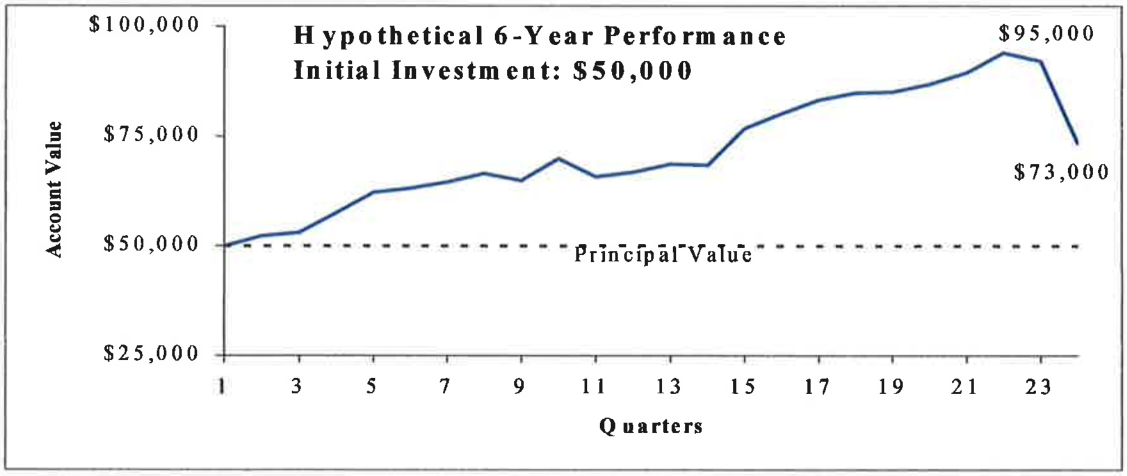
a. Portfolio 1
b. Portfolio 2
c. Portfolio 3
d. Portfolio 4
e. Portfolio 5

9. The following table shows the average return and probability of experiencing a loss in five different hypothetical investments over a twenty-year period. Which of the following investments would you prefer?

	Likely Annual Return	**Number of Negative Years**
Investment A	3%	2
Investment B	4%	4
Investment C	5%	5
Investment D	6%	6
Investment E	7%	7

a. Investment A
b. Investment B
c. Investment C
d. Investment D
e. Investment E

10. Assume that you invested $50,000 six years ago. In the past quarter, the portfolio lost half of its previous gains, as shown in the graph below. What action would you take?



a. I would not change my portfolio.

b. I would wait at least one year before changing to options that are more conservative.

c. I would wait at least three months before changing to options that are more conservative.

d. I would immediately change to options that are more conservative.

Questionnaire Scoring System

Morningstar Investment Management designed the questionnaire scoring system to assign investors to one of five investor risk profiles based on their responses on the risk tolerance questionnaire.

Like the questionnaire itself, the scoring system is divided into two distinct sections:

1. Time horizon score
2. Risk tolerance score

Each section is scored separately, then combined to form a total score. Morningstar Investment Management uses the total score to make the portfolio recommendation. The sections below discuss this process.

Time Horizon Score

The time horizon portion of the scoring is taken from questions 1 and 2. The score on these two questions determines the time horizon level. The time horizon level is used to assign various time horizon factors.

Each investor is assigned a *time horizon level*. In this project, Morningstar Investment Management uses the following time horizon levels:

- The Morningstar Investment Management portfolios are not appropriate for investors with less than a one-year time horizon. These individuals should consider other programs.
- Time horizon of 1 to 2 years
- Time horizon between 3 and 5 years
- Time horizon between 6 and 9 years
- Time horizon of 10 years or greater

Each time horizon level gives the investor access to certain portfolios and restricts the investor's access to others. Investors that score into the shorter time horizon levels are not given access to the more aggressive portfolios. This is consistent with Morningstar Investment Management' belief that individuals with shorter-term horizons should hold more conservative portfolios.

Within each time horizon level, Morningstar Investment Management allows an investor's risk tolerance to determine the appropriate portfolio. If an investor's risk tolerance recommends a portfolio that is restricted (due to the time horizon level), Morningstar Investment Management recommends the most aggressive portfolio the investor's specific time horizon level permits. This process allows conservative investors with short time horizons to score into a portfolio matched to their risk tolerance while at the same time protecting aggressive investors with short time horizons from excessive risk.

The following table shows the point value for the time horizon questions.

Time Horizon

Question 1	Question 2
A. 0	A. 0
B. 1	B. 2
C. 3	C. 4
D. 6	D. 5
E. 9	E. 6
F. 11	

Responses to questions 1 and 2 are added together to arrive at the time horizon level. (_____) [1]

Risk Tolerance Score

The risk tolerance portion of the scoring is taken from questions 3 through 10. Morningstar Investment Management assigns the point value for each response according to its ability to quantify the risks involved in investing and its ability to effectively convey these risks to investors. The highest points are awarded to the most aggressive answer choice. The risk tolerance score ranges from zero (most conservative) to 100 (most aggressive).

Risk Tolerance

Question 3	Question 4	Question 5	Question 6
A. 13	A. 4	A. 4	A. 3
B. 8	B. 7	B. 7	B. 5
C. 5	C. 11	C. 11	C. 8
D. 3			D. 13

Question 7	Question 8	Question 9	Question 10
A. 0	A. 0	A. 0	A. 13
B. 4	B. 4	B. 4	B. 8
C. 7	C. 7	C. 7	C. 5
D. 11	D. 11	D. 11	D. 3
E. 13	E. 13	E. 13	

Responses to questions 3 – 10 are added together to arrive at a risk tolerance score. (______) [2]

Recommending a Portfolio

The summary scoring grid below facilitates the final portfolio recommendation process by combining the time horizon level [1] and risk tolerance [2] scores. To use the scoring grid, find the time horizon score on the top (horizontal) axis and the risk tolerance score on the left (vertical) axis. The intersection of these two points is the recommended portfolio.

Summary Scoring Grid

Risk Tolerance Score	Time Horizon Level					
	Less than 1	1-2	3-5	6-7	8–10	11+
0 to 23	N/A	I	I	I	I	I
24 to 44	N/A	I	II	II	II	II
45 to 64	N/A	I	II	III	III	III
65 to 84	N/A	I	II	III	IV	IV
85 to 100	N/A	I	II	III	IV	V

Investments are subject to risk, including possible loss of principal.

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