July 2021

Clients & Friends –

In this commentary, we will provide a high-level performance update and review our outlook for the next quarter.

As a reminder, the strategy underlying the Newfound Risk Managed U.S. Growth Fund (NFDIX) is designed with the thesis that equity market extremes are becoming *more frequent and more severe.* For lack of a better word, things will remain "weird." To align with this thesis, NFDIX employs a barbell approach, marrying a ladder of increasingly convex positions seeking to out-perform in equity left tails with a ladder of increasingly convex positions that seeks to out-perform in the right.

At its core is a strategic equity position comprised of momentum and defensive style tilts (approximately 30% in both sleeves; 60% total). We complement the core equity position with a systematic trend-following strategy (approximately 30%) which has the flexibility to tilt from fully invested to fully divested into short-term U.S. Treasuries. We implement a ladder of out-of-the-money put and call options (approximately 2.5% each) in an effort to maximize defense in extreme down markets and participation in extreme up markets. Finally, we use the remaining capital (approximately 5%) as collateral for an active U.S. Treasury futures strategy, which seeks to provide a second, diversifying source of returns to the portfolio (varying between 0-to-100% notional exposure).

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Performance Analysis

Too Long, Didn't Read ("TL;DR"): U.S. equity and U.S. Treasury beta were both additive. Tactical signals to overweight equities were additive; tactical signals to underweight Treasury futures were a drag. Structural defensive and momentum equity tilts were slightly additive. Call option positions outweighed the drag from put options.

NFDIX returned 10.44% in Q2 2021. The S&P 500 Total Return Index ("S&P 500") returned 8.55% and a 50/50 portfolio of S&P 500 and 10-Year U.S. Treasury futures portfolio levered up 1.5x ("75/75") returned 7.70%. Year-to-date, NFDIX has returned 10.84%, the S&P 500 has returned 15.25%, and the 75/75 portfolio has returned 9.14%.

Figure 1. Contribution to Portfolio Return

	Total Return (bps)	Average Weight (%)	Contribution to Return (bps)
Defensive Equity	892	31.38	280
Momentum Equity	943	31.38	296
Trend Equity	845	31.42	266
Put Options	-1,244	7.77	-97
Call Options	688	33.15	228
Treasury Futures	190	47.17	90
Cash (and Equivalents)	0	2.06	0
		184.33	1062
Residual			*-18*
NFDIX			1044

Source: Bloomberg.

As a quick technical aside, it should be noted that contribution analysis is fraught with imprecision, and hence there is a *residual contribution* left over in the analysis. One example of a residual contribution is fund fees[1]. Another is cash flow in and out of the fund, which can make the fund appear to hold excess cash for the day (inflow) or levered (outflow). As such, contribution analysis should be considered directionally accurate rather than precisely correct.

Furthermore, in contrast to Q1's performance decomposition, the decomposition in Q2 is performed in a way where the average weight of derivative contracts is based not upon the market value but total notional exposure. In particular, the average weight for the put and call options looks significantly higher than was reported last quarter. The new method helps to better communicate the embedded leverage in different positions in the portfolio. There are, however, two important considerations to keep in mind. First, put and call options are convex instruments, and their implied leverage can swing dramatically with movements in the underlying market. If the market were to fall dramatically, for example, we may see the average weight of the puts be much higher than the average weight of the calls. Second, while the notional dollar exposure is additive, the underlying *market* exposure is not: the puts and calls partially offset each other! While we are long puts, the implicit exposure is short the market. This is clear in looking at the offsetting return contribution of the positions but does not come through when looking at headline dollar notional levels.

The primary drivers of return in Q2 were U.S. equity and U.S. Treasury beta, both of which were positive contributors (estimated at +796bp and +90bp respectively). With persistent positive trends in U.S. equities, the Fund remained overweight equity beta throughout the quarter. Exposure to U.S. Treasury futures remained underweight but increased from 40% to 55% over the quarter. While the total notional exposure did not change dramatically, we can see that the underlying signals supporting that exposure changed from momentum to value as 10-year rates climbed 52bp year-to-date.

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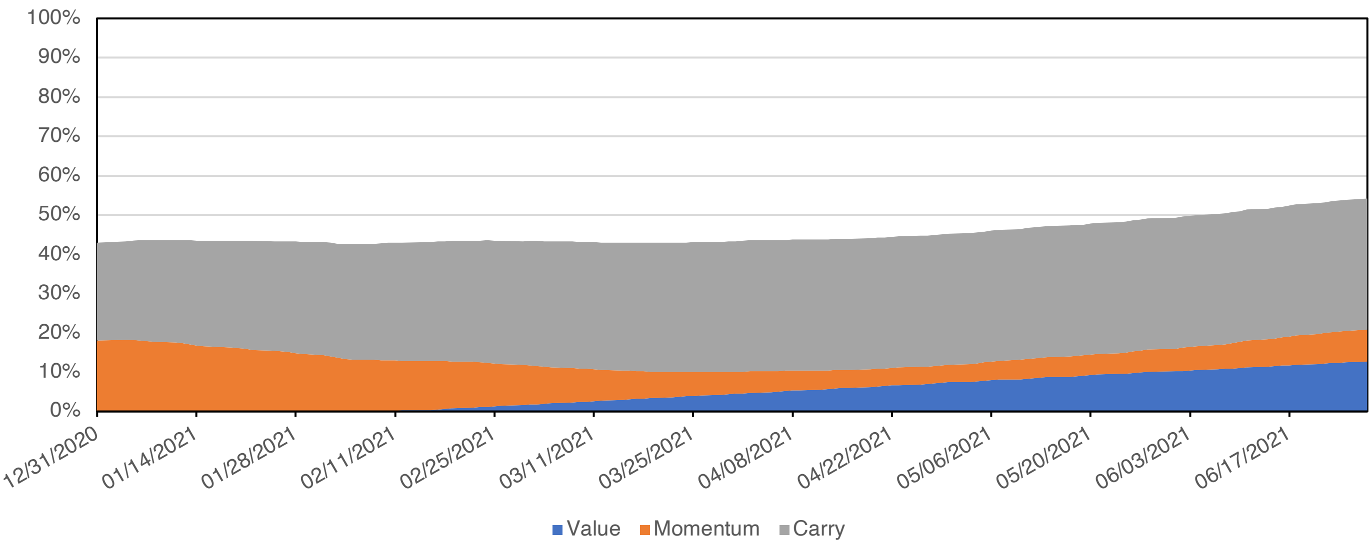
[1] *The Fund's investment advisor has contractually agreed to reduce its fees and/or absorb expenses until at least July 31, 2021. Without these waivers, the Class I Shares total annual operating expenses would be 1.42% as of the August 2020 prospectus update. The fee waivers ensure that the net annual, operating expenses of the Class I Shares will not exceed 1.25% subject to possible recoupment from the fund in future years. Please review the Fund's prospectus for more information regarding the Fund's fees and expenses. Please refer to the disclosures at the end for important information.*

Figure 2. Target 10-Year U.S. Treasury Futures Allocations by Signal

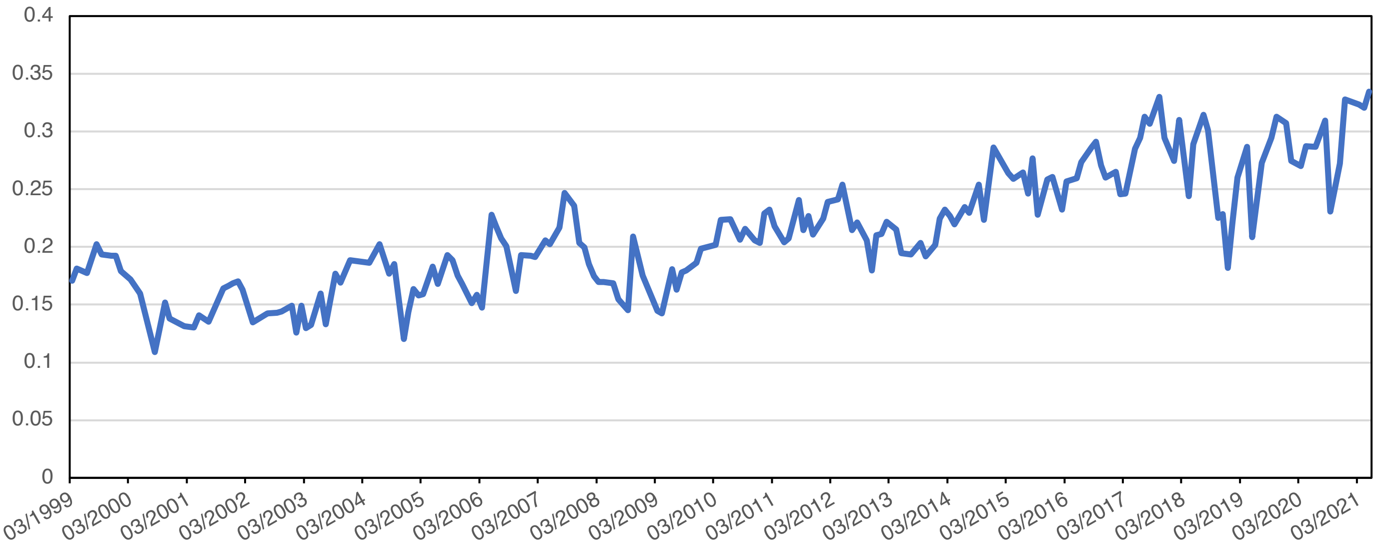


Source: Newfound Research. Allocations reflect target model allocations and do not necessarily reflect the actual holdings of U.S. Treasury futures within NFDIX.

After a difficult first quarter, momentum and quality tilts were largely a neutral impact in Q2. Momentum has now meaningfully de-coupled with quality and has shifted towards value (more on this in the next section), re-introducing meaningful factor diversification into our core equity holdings. This is evident through statistical measures: the rolling 21-day tracking error of NFDIX to SPY has dropped from 8.2% at the beginning of the quarter to 2.5% at quarter end.

Finally, despite a few short-term pops, implied volatility in S&P 500 index options has continued to decline in Q2, acting as a headwind to both put and call option positions. However, two important factors allowed our aggregate option exposure to be additive. First, our target fixed spend approach leads us to buy more call exposure than put exposure, particularly when volatility skew is steep, as it is now (see Figure 3). Second, we implement our call option ladder with call spreads, reducing its sensitivity to changes in implied volatility. With the strong rally in the S&P 500 this quarter, these two features allowed the call ladder to more than offset the losses realized by the put ladder.

Figure 3. S&P 500 3-Month Put Skew
(Implied Volatility of 25 Delta Put – Implied Volatility of 50 Delta Call) / Implied Volatility of 50 Delta Call



Source: SG Cross Asset Research / Derivatives

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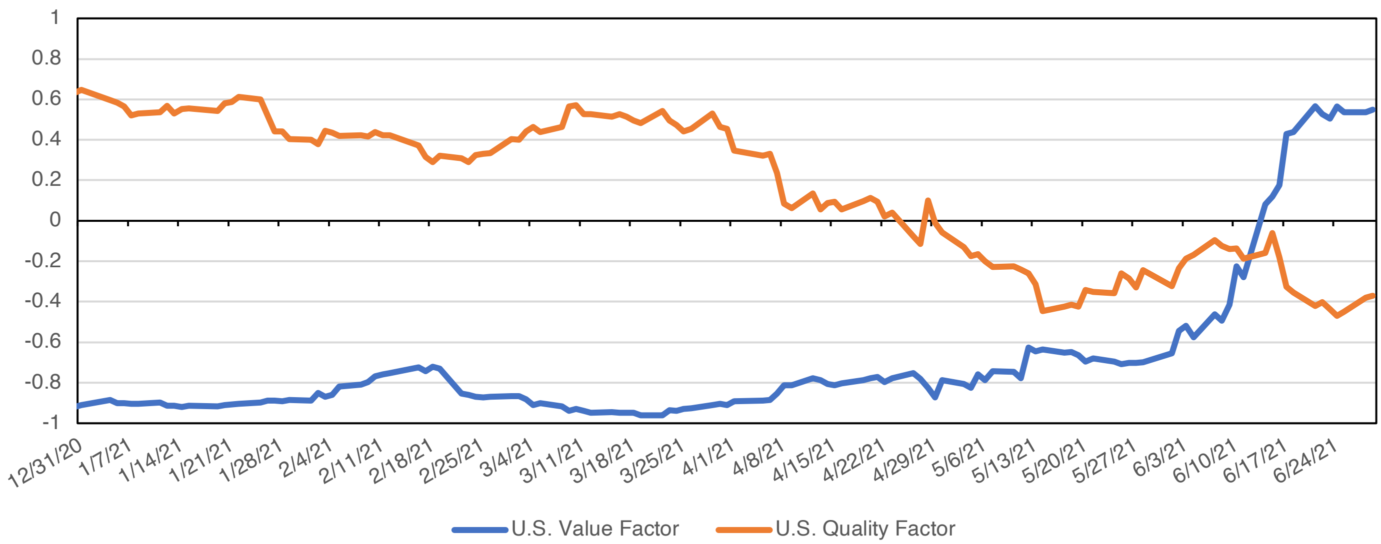
Momentum Wanes in Quality, Waxes in Value

TL;DR: Over the last six months, momentum has dramatically shifted from closely tracking quality to closely tracking value. Quarterly and semi-annually rebalanced momentum ETFs risked lagging this transition. On 3/15/2021 we introduced a process intended to reduce this rebalance risk by continuously monitoring momentum characteristics and constituents. We introduced sector ETFs to account for lagging sector transitions. After most momentum ETFs rebalanced in May, the process indicated that the momentum holdings in the portfolio were within tolerance. Attribution analysis suggests that this process added approximately 31bp of excess return versus having taken no action.

Momentum is a chameleon factor: it owes allegiance to no other characteristic. The strategy goes long (or over-weights) stocks that have recently outperformed and shorts (or under-weights) stocks that have recently underperformed. When the loser basket begins to outperform the winner basket, then by the factor's own rules, it is likely to flip-flop its holdings. This is precisely what we began to see in Q1.

After months of significant overlap with high quality names, momentum began tilting in favor of cyclical/value stocks. Unfortunately, it also became obvious to us that quarterly and semi-annually rebalanced momentum ETFs (which we utilize in our process for tax efficiency reasons) risked missing the entire transition.

Figure 4. Rolling 21-Day Correlation of U.S. Momentum Factor



Source: Bloomberg. Calculations by Newfound Research. U.S. Momentum Factor is the Dow Jones U.S. Thematic Market Neutral Momentum Index. U.S. Value Factor is the Dow Jones U.S. Thematic Market Neutral Value Index. U.S. Quality Factor is the Dow Jones U.S. Thematic Market Neutral Quality Index.

We estimated that the greatest offender was likely to be the iShares MSCI USA Momentum Factor ETF ("MTUM")[4], which has scheduled semi-annual rebalances at the end of November and May. The November rebalance firmly cemented it in high quality technology names and the lack of interim rebalance meant that it could miss the cyclical rotation. Continuing to hold these momentum ETFs meant we risked being overweight the sectors where momentum was waning (e.g. Technology, Health Care, and Consumer Discretionary) and underweight those sectors where momentum was growing (e.g. Financials, Materials, and Energy).

As a corrective effort, on 3/15/2021 we began simulating our own continuously rebalanced momentum model. We used this model to generate target sector weights and compared them versus the effective weights provided by the ensemble of momentum ETFs we held. We then reduced our momentum ETF exposure and introduced select sector ETF positions as needed to achieve our target sector weights.

On 5/28/2021, after MTUM underwent its semi-annual rebalance, the effective sector weights provided by the momentum ETFs and the target sector weights provided by our model converged to a point where the sector ETFs were no longer necessary.

In Figure 5 we can see that the total return of the sector ETFs over this period was 497bp higher than the momentum ETFs. Had the Momentum ETFs comprised the whole sleeve, we estimate that the total contribution to return over this period would have been 109bp (109bp = 87bp x 31.34% / 25.06%) rather than the 140bp that it was, meaning that the process generated 31bp of excess return versus having taken no action.

Figure 5. Contribution to Portfolio Return from 3/15/2021 to 5/28/2021

	Total Return (bps)	Average Weight (%)	Contribution to Return (bps)
Sector ETFs	846	6.28	53
Momentum ETFs	349	25.06	87
		31.34	140

Source: Bloomberg.

This continuously rebalanced model will be monitored on an ongoing basis and adjustments will be made in the momentum sleeve if the infrequent rebalance schedules of the ETFs lead to further divergence from our target.

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Surveying the Landscape

TL;DR: Assets in buffer ETFs and hedged equity funds have exploded. Call option volume is back after a multi-month hiatus. Simple target volatility strategies are nearly "full," but risk parity and multi-asset momentum strategies could still be buyers of equities going forward.

There has been a rush of inflows into buffer ETF and hedged equity funds, and the combined AUM of Innovator's Buffer ETFs, First Trust's Cboe Vest ETFs, and JP Morgan's Hedged Equity fund has now eclipsed $30 billion.[5]

These funds seek to provide some sort of zero-cost downside protection (using puts or put spreads), financed by selling a call option. Excessive crowding into these strategies could have two effects. First, competition to buy puts and sell calls may lead to steepening in the implied volatility skew. The knock-on impact of this steepening is that with the put and put spread strikes pre-defined, investors will have to sacrifice more and more upside to keep the trade "costless."

For example, while polishing this commentary, JP Morgan's Hedged Equity fund executed their quarterly options roll. To pay for the 95%/80% put spread, they sold some 44.6 *thousand* SPX 09/30/2021 calls struck at 4420, which is just 2.9% above the current spot level. This is well below the target 3.5-5.5% range they claim to seek.

One takeaway is that if crowded, systematic buying and selling is artificially steepening skew, upside exposure may be cheap in the tenors these strategies allocate to.

Perhaps more important is that these strategies continue to feed fresh capital into the volatility markets in a manner that could further exacerbate the already Dr. Jekyll and Mr. Hyde behavior of market volatility. The calls sold may lead to counter-cyclical dealer hedging, which can keep market volatility artificially suppressed. The puts purchased may lead to pro-cyclical dealer hedging if equity markets decline, leading to explosive bouts of volatility. (We wrote about these hedging flows in our paper *Liquidity Cascades,* with a full breakdown of the mechanics in Appendix A.)

In decline since late January, call option volume began to pick back up in late May. We cannot help but notice two coincidences. First, the relative performance of the Goldman Sachs Retail Favorites Basket (GSXURFAV) versus the S&P 500 (Figure 6, bottom panel) seems to ebb and flow with call option volume (Figure 6, top panel). Second, the return of call option volume almost perfectly coincided with a crash in crypto markets, which I biasedly believe confirms my priors that it's all the same money sloshing around.

If this money *is* back to wreaking havoc in equity markets, we would likely see cross-sectional equity volatility remain high, leading to lower leverage levels among both fundamental and systematic long/short equity funds. This would have the secondary effect of reducing the demand for quality, growth-at-a-reasonable-price stocks that have been a perennial favorite among equity hedge funds.

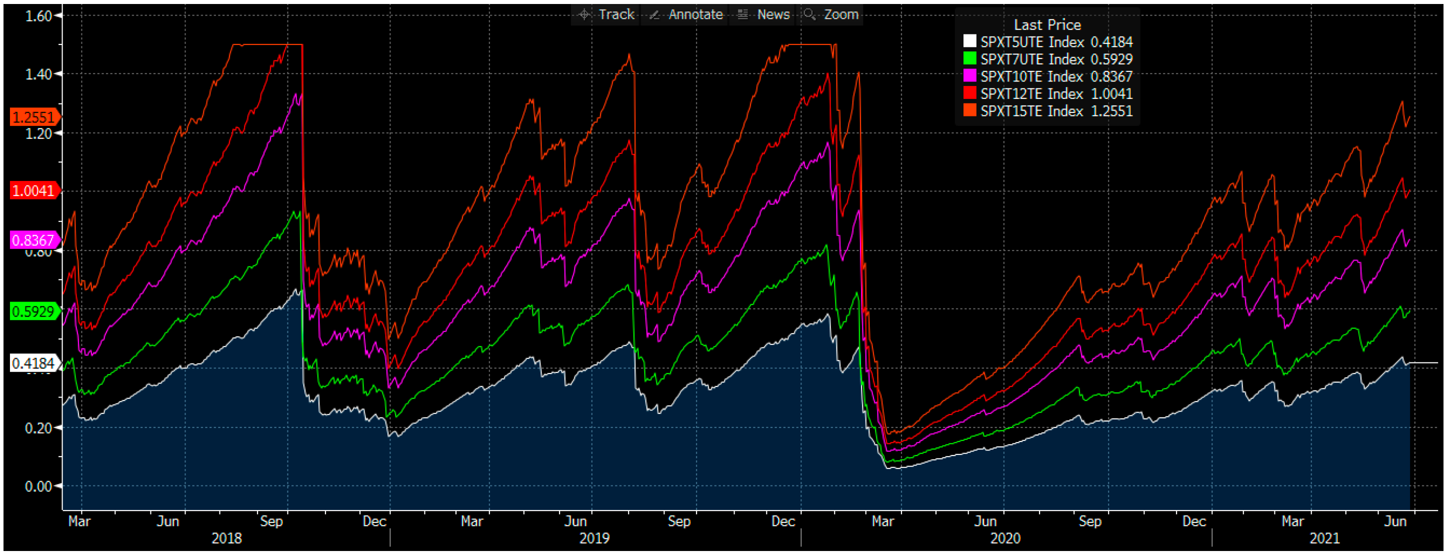
Figure 6. Total U.S. Call Option Volume and Relative Performance of Retail Favorite Stocks versus S&P 500

Source: Bloomberg.

Another measure we're keeping our eye on is the exposure of target volatility strategies, which is almost "full." While not yet at pre-COVID highs, we can see that exposure in S&P 500 target risk indices is approximately 80% of the way there. This means a decline in marginal buying pressure as volatility declines. This also means that these strategies are now *more* sensitive to sudden shocks in volatility (e.g. a move from 15% to 20% realized volatility will cause target exposure to fall by more than a move from 35% to 40%). We believe that persistently low realized volatility can create increasing fragility, as target volatility strategies become increasingly levered. If an exogenous shock occurs, these strategies will all race for the exits at a time when liquidity suppliers (e.g. market makers) are also typically pulling away.

Internal modeling suggests that CTAs are also heavily tilted into equity exposure and have meaningfully increased their leverage. Conversely, Multi-Asset Momentum strategies and Risk Parity have not. In the case of the former, equities are screening unfavorably on a risk-adjusted basis relative to other assets. With the latter, increasing stock-bond correlation has kept a cap on leverage. These are two places where marginal buying pressure could be unleashed.

Figure 6. Exposure to S&P 500 in Various Target Risk Indices



Source: Bloomberg.

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We appreciate the trust you place in having Newfound Research oversee your capital; helping to manage these assets is a responsibility we do not take lightly. We firmly believe that the process we have in place provides our Fund the best opportunity to meet its objective going forward, seeking to capture a significant portion of market growth while reducing the impact of severe and prolonged market declines. If you have any questions, please do not hesitate to reach out.

Sincerely,

Corey M. Hoffstein
Chief Investment Officer
Newfound Research

Fund Performance (Performance at NAV[1, 2, 3], performance as of June 30, 2021)						
	3 Months	6 Months	1 Year	3 Year	5 Year	Inception
NFDIX NAV	10.44%	10.84%	29.19%	6.84%	8.48%	5.26%
S&P 500	8.55%	15.25%	40.79%	18.67%	17.65%	14.65%
50/50 S&P 500 / 1-3 Year U.S. Treasuries	4.21%	7.39%	19.11%	10.93%	9.68%	8.24%

Current performance may be lower or higher than the performance data quoted above. Past performance is no guarantee of future results. The investment return and principal value of an investment in the Fund will fluctuate so that investors' shares, when redeemed, may be worth more or less than their original cost. For performance data current to the most recent month-end, please call toll-free 1-855-394-9777 or visit our website, www.thinknewfoundfunds.com. The Fund's investment advisor has contractually agreed to reduce its fees and/or absorb expenses until at least July 31, 2021. Without these waivers, the Class I Shares total annual operating expenses would be 1.42% as of the August 2020 prospectus update. The fee waivers ensure that the net annual, operating expenses of the Class I Shares will not exceed 1.25% subject to possible recoupment from the fund in future years. Please review the Fund's prospectus for more information regarding the Fund's fees and expenses.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Newfound Risk Managed U.S. Growth Fund. This and other important information about the Fund is contained in the prospectus, which can be obtained by calling 1-855-394-9777. The prospectus should be read carefully before investing. The Newfound Risk Managed U.S. Growth Fund is distributed by Northern Lights Distributors, LLC, Member FINRA/SIPC. Newfound Research LLC is not affiliated with Northern Lights Distributors, LLC.

1) *Performance at net asset value ("NAV") does not include the effect of sales charges.*

2) *The S&P 500 Index is widely regarded as the best single gauge of large cap U.S. equities. The index includes 500 leading companies listed in the United States and captures approximately 80% of available market capitalization. The 50/50 S&P 500 / Barclays US 1-3 Year Treasury Bond benchmark consists of a hypothetical portfolio that is 50% allocated to the S&P 500 Total Return Index and 50% allocated to the Barclays US 1-3 Year Treasury Bond index, rebalanced monthly.*

3) *Performance results include the effect of expense reduction arrangements for some or all of the periods shown. If those arrangements had not been in place, the performance results for those periods would have been lower.*

4) *As of 6/30/21, the Fund maintained a 7.7% allocation to the iShares MSCI USA Momentum Factor ETF ("MTUM").*

5) *Northern Lights Distributors is in no way affiliated with the Innovator's Buffer ETFs, First Trust's Cboe Vest ETFs, or the JP Morgan Hedged Equity Fund.*

Risk Factors

There is no assurance that any Fund will achieve its investment objectives.

Mutual Funds involve risk including the possible loss of principal. ETFs are subject to specific risks, depending on the nature of the underlying strategy of the fund. These risks could include liquidity risk, sector risk, as well as risks associated with fixed income securities, real estate investments, and commodities, to name a few. Typically, a rise in interest rates causes a decline in the value of fixed income securities. A higher Fund turnover will result in higher transactional and brokerage costs.

Like all quantitative analysis, the adviser's investment model carries a risk that the mathematical model used might be based on one or more incorrect assumptions. No assurance can be given that the fund will be successful under all or any market conditions. Overall equity and fixed income securities market risks affect the value of the Fund. Factors such as domestic economic growth and market conditions, interest rate levels, and political events affect the securities markets. The earnings prospects of small and medium sized companies are more volatile than larger companies and may experience higher failure rates than larger companies.

Options Risk: There are risks associated with the sale and purchase of call and put options. As the seller (writer) of a put option, the Fund will tend to lose money if the value of the reference index or security falls below the strike price. As the seller (writer) of a call option, the Fund will tend to lose money if the value of the reference index or security rises above the strike price. The Fund may lose the entire put option premium paid if the reference index or underlying security does not decrease in value. The Fund may lose the entire call option premium paid if the reference index or underlying security does not increase in value.

Click HERE for the current NFDIX prospectus.

Definitions

Beta: *Beta is a measure of a security's or portfolio's volatility relative to the market as a whole. A security or portfolio whose beta is greater than one has historically experienced a greater change in price than overall market prices; while, a security or portfolio with a beta of less than one has historically experienced a price change which is less than the price changes realized by the market as a whole.*

Option Delta: *The delta of an option contract represents the rate of change between the option's price and a one-dollar change in the underlying asset's price. The delta of a call option ranges between zero and one, while the delta of a put option has a range between zero and negative one.*

Option Ladder: *An option ladder refers to the systematic purchase and sale of option contracts where the terms of the option contracts are defined before the transaction takes place and the dates of purchase are staggered. For example, if a strategy was going to purchase one year call option contracts and roll the position when the options were six months from expiration, the strategy could instead purchase one-sixth the amount each month.*

Option Roll: *An option roll is the act of closing a position in an option contract while simultaneously opening a new position in a similar option with a new strike and/or option expiration date.*

Short Sales: *A short sale generally involves the sale of a stock you do not own (or that you will borrow for delivery). Short sellers believe the price of a stock will fall, or are seeking to hedge against potential price volatility in securities that they own. If the price of the stock drops, short sellers will buy the stock at the lower price and make a profit. If the price of the stock rises, short sellers will incur a loss.*

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Newfound Case # 13138026