

Clients & Friends –

In this commentary, we will provide a high-level performance update for Q1 2022, briefly discuss the risk of liquidity cascades in the current market environment, and our view on the momentum equity factor.

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 most likely 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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Q1 2022 Performance Analysis

TL;DR: Both U.S. equity and U.S. Treasury beta were detractors from absolute returns. Tactical signals to overweight equities were a detractor while tactical signals to underweight Treasury futures were additive. Both defensive and momentum equity factor tilts were detractors. Equity trend following signals were a detractor, causing the portfolio to underweight equity exposure during the end-of-quarter rally. Returns from call option positions were a significant drag. Much of this quarter’s underperformance was a reversal of outperformance generated in Q4 2021.

NFDIX returned -12.23% in Q1 2022. The S&P 500 Total Return Index (“S&P 500”) returned -4.60% and a 50/50 portfolio of S&P 500 and 10-Year U.S. Treasury futures portfolio levered up 1.5x (“75/75”) returned -7.60%.

Figure 1. Q1 2022 Contribution to Portfolio Return

	Total Return (%)	Average Weight (%)	Contribution to Return (bps)
Defensive Equity	-6.30	31.44	-198
Momentum Equity	-6.09	31.54	-192
Trend Equity	-6.40	29.07	-186
Put Options	0.00	1.29	0
Call Options	-158.23	1.58	-250
Treasury Futures	-5.60	61.06	-342
Cash (and Equivalent)	-1.79	5.04	-9

	161.02	-1177
<i>Residual</i>		-46
NFDIX		-1223

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*¹ left over in the analysis. One example of a residual contribution is fund fees². 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.

In comparison to the expected long-term allocation of 75% S&P 500 and 75% 10-Year U.S. Treasury futures:

- The Fund held an average 92.05% equity allocation throughout the quarter, a 17.05 percentage point overweight. This created a -78bp drag on relative performance.
- The Fund held an average allocation of 61.06% to 10-Year U.S. Treasury futures, a 13.94 percentage point underweight. This created an 78bp benefit to relative returns.
- Defensive equities under-performed the S&P 500 by 170bp, creating a -53bp drag on relative returns.
- Momentum equities under-performed the S&P 500 by 149bp, creating a -47bp drag on relative returns.
- The Trend sleeve under-performed the S&P 500 by 180bp, creating a -52bp drag on relative returns as it held over 25% of its weight in short-term U.S. Treasuries during the March 14th to end-of-quarter rally.
- Call options lost significant accrued value as markets rolled over, contributing -250bp to relative returns.

	Contribution to Return (bps)
75/75 Portfolio	-760
Equity Beta Overweight	-78
Bond Beta Underweight	+78
Defensive Equity Factor	-53
Momentum Equity Factor	-47
Trend Timing	-52
Call Options	-250
	-1162
<i>Residual</i>	-61

¹ Residual contribution refers to the difference in total return between the generated contribution analysis and the actual fund return.

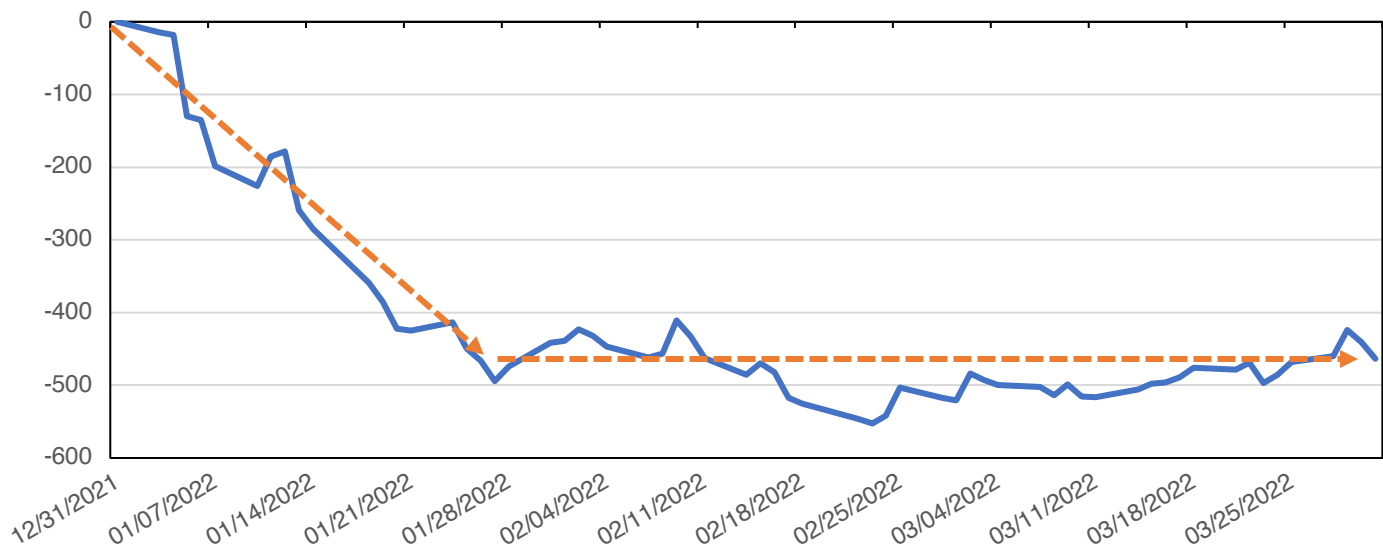
² The Fund's investment advisor has contractually agreed to reduce its fees and/or absorb expenses until at least July 31, 2023. Without these waivers, the Class I Shares total annual operating expenses would be 1.58% as of the August 2021 prospectus update. The fee waivers ensure that the net annual, 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.

NFDIX

-1223

If we measure the relative returns between the Fund and a 75/75 portfolio (Figure 2), we can see that most of the underperformance occurred in January. This is largely because the turn of quarter almost perfectly coincided with the peak in equity markets.

Figure 2. Excess Returns of NFDIX minus 75/75 Portfolio in Basis Points

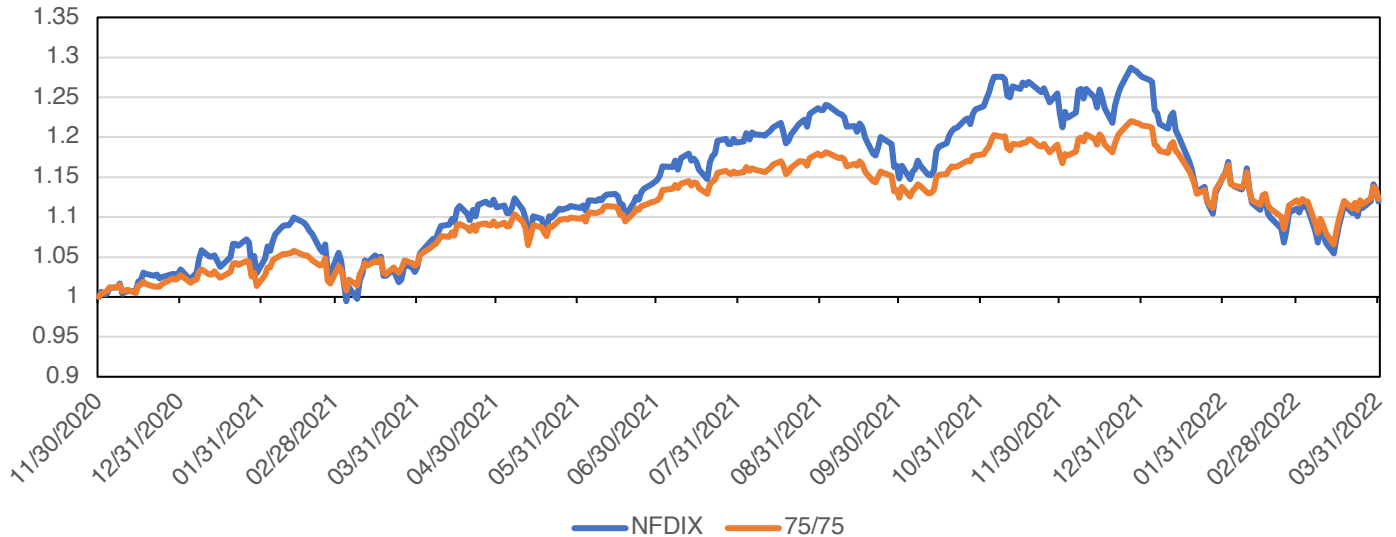


Source: Tiingo; Stevens Futures. Calculations by Newfound Research. The “75/75” portfolio is 75% SPDR S&P 500 ETF (“SPY”), 25% iShares 1-3 Month T-Bill ETF (“BIL”), and 75% front-month 10-Year U.S. Treasury futures. The portfolio is rebalanced monthly. Returns of the 75/75 portfolio hypothetical and are gross of all fees (including, but not limited to, advisor fees, manager fees, transaction costs, or taxes) except for underlying ETF expense ratios. Past performance is not an indicator of future results.

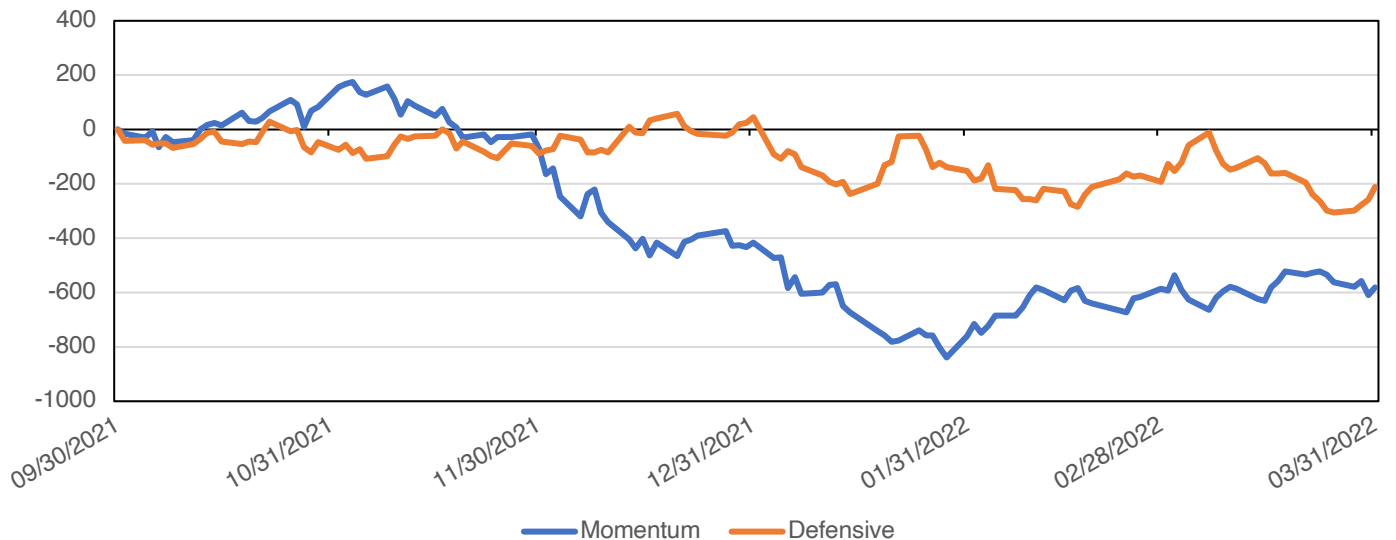
If we zoom out and compare the growth of a dollar in these same portfolios (Figure 3), it becomes more obvious that much of the January underperformance was simply a give-up of Q4 2021’s outperformance. As equity markets rallied into the end of the year, the Fund generated excess relative returns through its call option positions and a tactical overweight in equities. As markets rolled over in the new year, those same sources of outperformance reversed to underperformance. In fact, the net contribution from options positions in Q1 almost perfectly mirrors that of Q4 2021.

Measuring returns from 9/30/2021 to 3/31/2022, we find that the total underperformance of the Fund versus a 75/75 portfolio is -238bp. Approximately 63bp can be explained by fees and the vast majority of the remaining 176bp is due to the underperformance of the momentum factor relative to broad U.S. equities (Figure 4). We will share more thoughts on momentum, specifically, in later sections.

While we certainly do not aim to simply keep up with a 75/75 portfolio, we highlight this only to show that the arbitrary turn of a calendar can make relative performance look just as good (Q4 2021) as it does bad (Q1 2022).

Figure 3. Growth of \$1 in NFDIX vs 75/75 Portfolio Since Strategy Change (11/30/2020)


Source: Tiingo; Stevens Futures. Calculations by Newfound Research. The “75/75” portfolio is 75% SPDR S&P 500 ETF (“SPY”), 25% iShares 1-3 Month T-Bill ETF (“BIL”), and 75% front-month 10-Year U.S. Treasury futures. The portfolio is rebalanced monthly. Returns of the 75/75 portfolio hypothetical and are gross of all fees (including, but not limited to, advisor fees, manager fees, transaction costs, or taxes) except for underlying ETF expense ratios. Past performance is not an indicator of future results.

Figure 4. Excess Returns of Momentum and Defensive Factors versus S&P 500 since Q3 2021


Source: Tiingo; Stevens Futures; Sharadar. Calculations by Newfound Research. “Defensive” is monthly-rebalanced portfolio that is 50% Strong Balance Sheet portfolio and 50% in an equal-weight portfolio comprised of the following ETFs: JQUA, LGLV, USMV, QUAL, FQAL, and FDLO. “Momentum” is an equally weighted portfolio, rebalanced monthly, comprised of the following ETFs: MTUM, FDMO, JMOM, and VFMO. The Strong Balance Sheets portfolio is constructed by: (1) selecting the top 500 U.S. securities by market cap; (2) removing Financials; (3) ranking stocks on Merton’s distance-to-default; (5) filtering out stocks that have the highest momentum; (5) picking the top 100 and equally-weighting them. The portfolio is rebalanced monthly using six

overlapping tranches. Returns of the aforementioned portfolios are backtested and hypothetical and are gross of all fees (including, but not limited to, advisor fees, manager fees, transaction costs, or taxes) except for underlying ETF expense ratios. Past performance is not an indicator of future results.

While diversification failed us in January, not all went wrong in Q1. Throughout the quarter we were able to opportunistically buy back the short legs in many of our call option spreads, most of which had lost between 65-75% of their value. We were also able to roll rungs in both our put and call ladders on March 14th and 15th, partially monetizing gains in our puts while creating more upside convexity in our calls.

* * * * *

Where was the Liquidity Cascade?

TL;DR: While equity futures liquidity was thin entering Q1, we saw little risk of exogenous shocks turning into an endogenous market unwind as influential systematic players had already meaningfully de-risked positions entering Q1.

In our 2020 paper *Liquidity Cascades: The Coordinated Risk of Uncoordinated Market Participants*, we laid out the thesis that the growth of volatility contingent strategies could represent a risk to market stability. Specifically, if the strategies were simultaneously extended in their leverage, an exogenous shock to markets could trigger a violent cascade of selling as the strategies sought to reduce exposure in the face of expanding volatility (a “liquidity cascade”).

The table in Figure 5 highlights some of the major players, including CTAs, Volatility Control mandates, and Risk Parity. Their estimated combined *unlevered* assets under management (“AUM”) sits just under \$1 trillion. With leverage, the gross exposure achieved may be several trillion dollars higher.

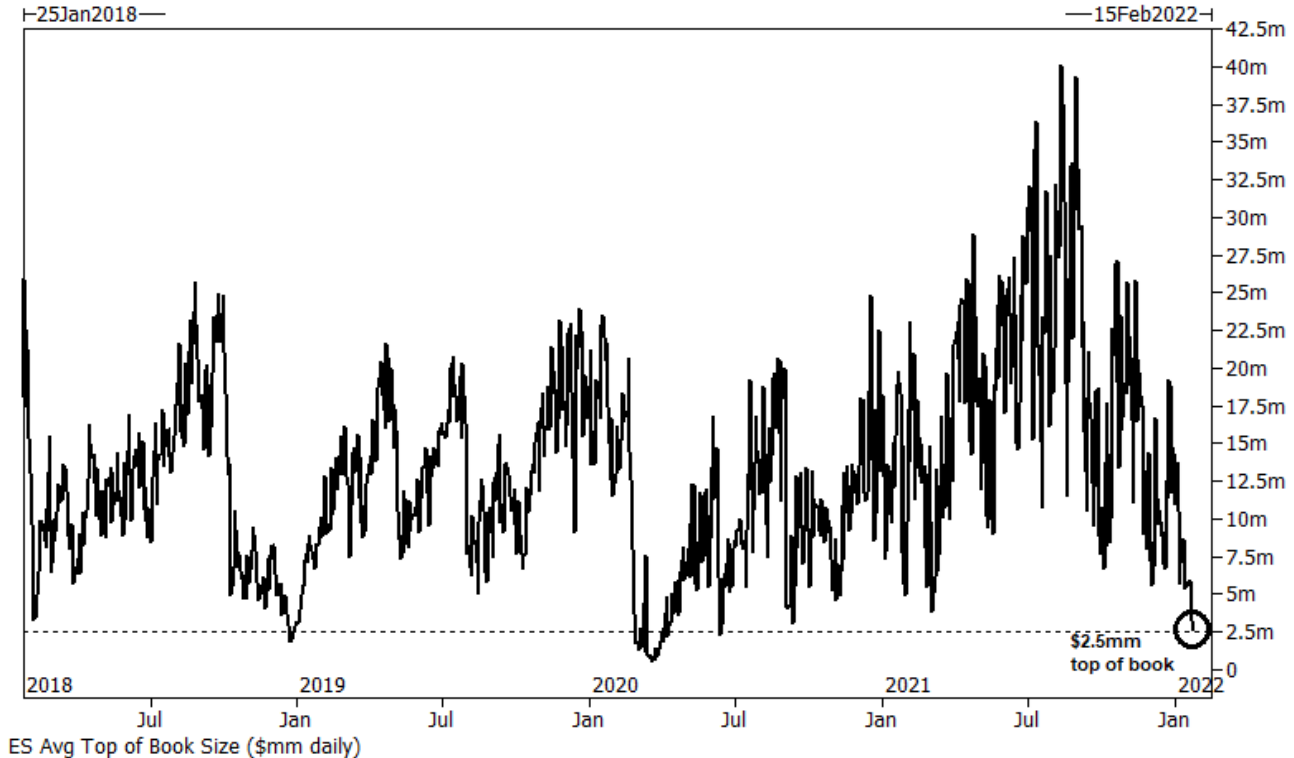
Figure 5. Volatility Contingent Systematic Strategies

Community	AUM	Description
CTAs	\$340 bn	<ul style="list-style-type: none"> • Stocks, Bonds, FX, and Commodities • Price-trend driven • Volatility as a 2nd order effect • Long and short
Volatility Control	\$270 bn	<ul style="list-style-type: none"> • Stocks and Bonds • Sensitive to short/medium-term volatility • Long only
Risk Parity	\$350 bn	<ul style="list-style-type: none"> • Stocks, Bonds, FX, and Commodities • Volatility and correlation as main inputs • Sensitive to longer-term volatility • Long only

Source: Goldman Sachs; Barclay Hedge

If we were to look at equity markets alone, the setup into Q1 seemed ideal for a liquidity cascade: equity markets made new all-time highs while liquidity rapidly dried up to levels not seen since March 2020 lows (see Figure 6). Yet, in our opinion, this only tells part of the story.

Figure 6. Average Daily Top of S&P 500 E-Mini Futures Book Size (\$mm Daily)



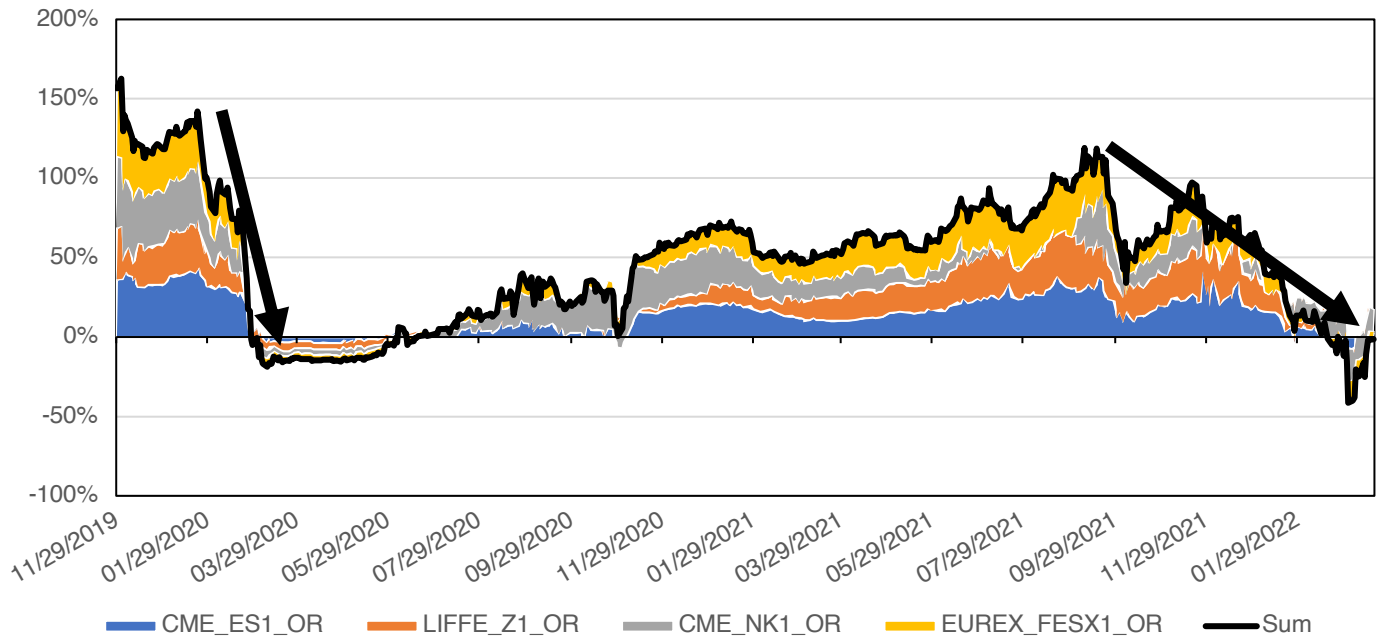
Source: Goldman Sachs

By our estimates, the actual positioning of volatility contingent strategies was quite different entering Q1 2022 than it was entering Q1 2020 (see Figures 7, 8, and 9). The first driver was equity volatility, which sat substantially higher on 12/31/2021 than it did on 12/31/2019 realized 21-day volatility for the S&P 500 was 16.6% versus 7.50% respectively). On this point alone we would expect equity position sizing to be reduced.

However, many of these players are *multi-asset* in nature, and so the volatilities of other assets, and the correlation between assets, plays an important role. The significant correlation seen in the commodity complex in late November 2021, the increasing volatility of the bond market, and the increasing correlation between stocks and bonds all served to reduce the total leverage exhibited by both CTAs and risk parity strategies.

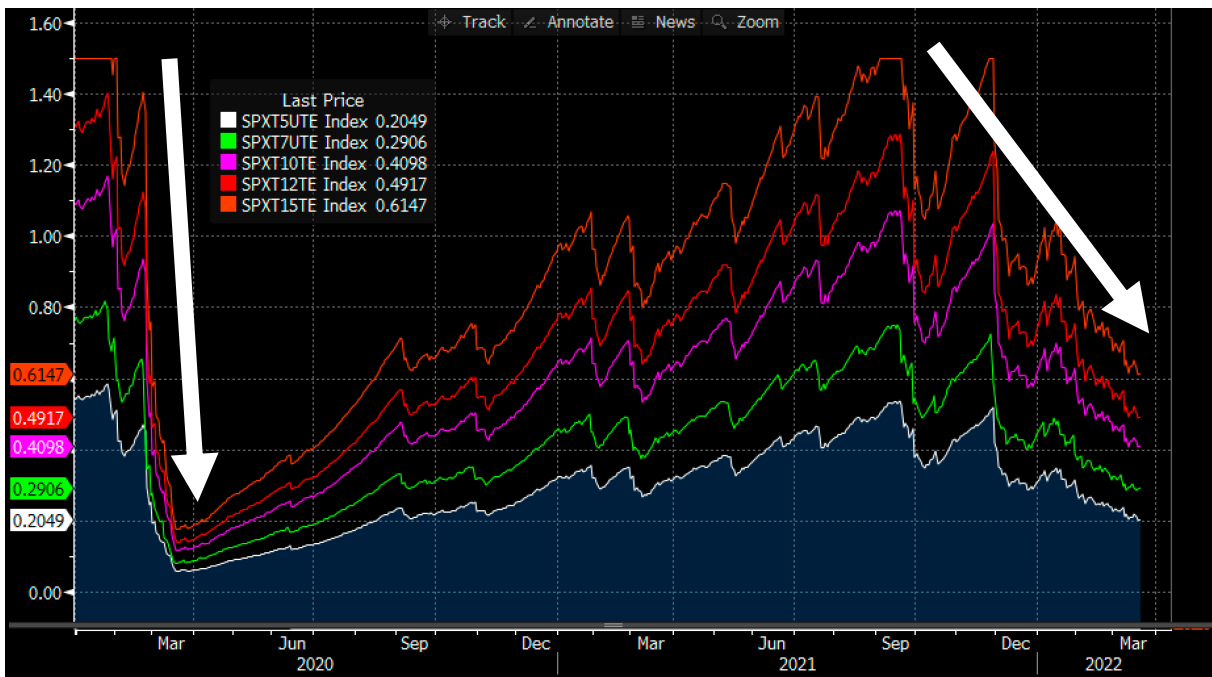
By the time Russia invaded Ukraine, most of these strategies were already substantially de-levered and de-sensitized to further volatility.

Figure 7. Estimate of CTA Positioning in Equity Markets



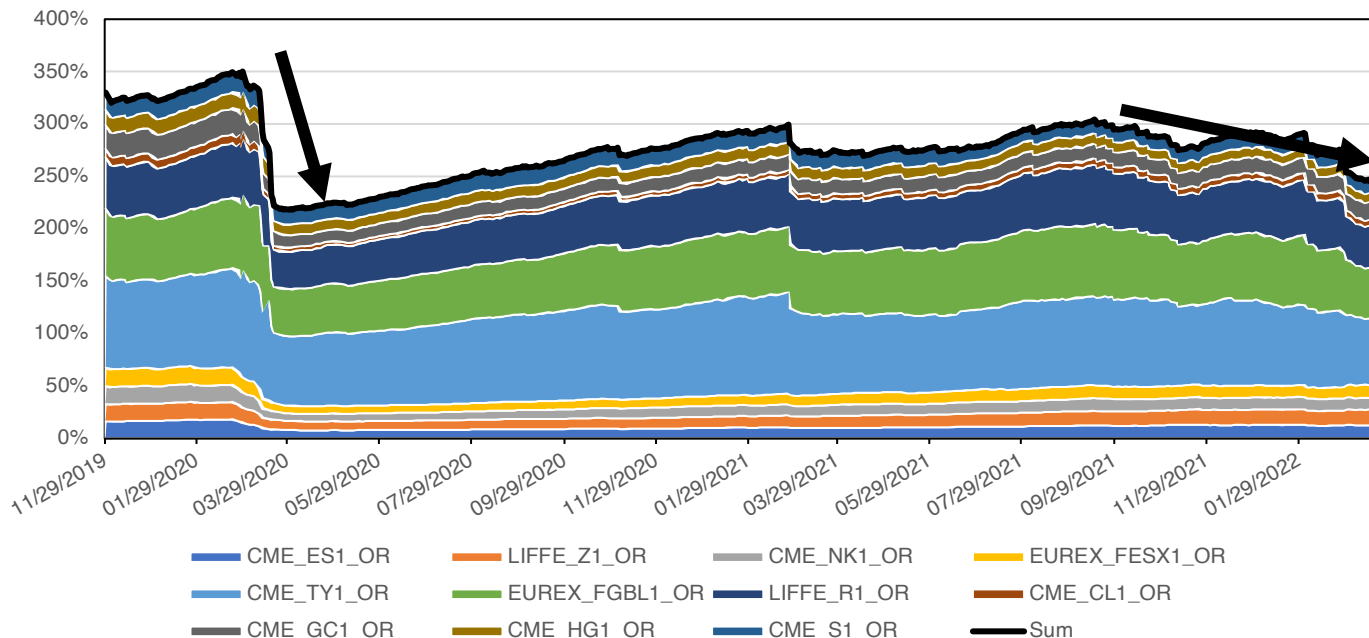
Source: Stevens Futures. Calculations by Newfound Research.

Figure 8. Equity Allocation in S&P Dow Jones Target Volatility Indices



Source: Bloomberg.

Figure 9. Allocation Estimates in Risk Parity Mandates



Source: Stevens Futures; Calculations by Newfound Research.

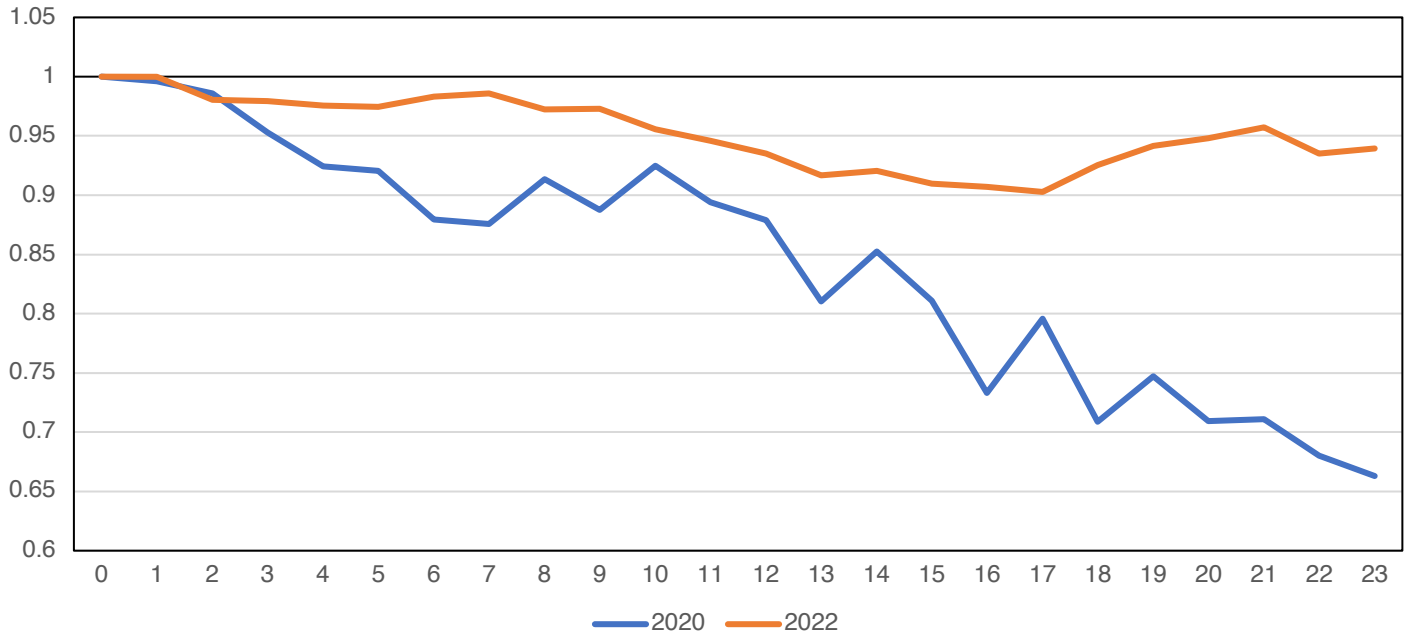
One question we received frequently this quarter was, “how are the puts doing?” The contribution analysis in Figure 1 suggests they did very little. Or, perhaps better stated: they did just enough to offset their own premium decay, but not nearly enough to offset losses in call options or long equity exposure. We believe there were three primary reasons for this.

If buying puts is like buying fire insurance for a house, then the first question we should ask is, “did the house catch on fire? If so, did it do enough damage to overcome our deductible and the premiums we paid?” For the market, this would mean a meaningful decline in price. While Q1 was choppy, the maximum intraday drawdown for the S&P 500 was just -14.4%. If we compare 2022 versus 2020 (Figure 10), we can see that both the depth and the pace of the drawdown in the S&P 500 were significantly more shallow and slower. A very mild house fire just won’t do enough damage for puts struck moderately out-of-the-money (e.g. 25%) to pay off.

Keeping with our fire insurance analogy, a second important driver of the value of the insurance is the question: “did the likelihood of the house catching on fire go up?” We can imagine that short-term fire insurance during a rainy season would have a much lower price than during a dry season. Markets are much the same, though the pertinent metric is *implied volatility*.³ If we use the VIX as a naïve proxy, Figure 11 shows that risk did not reprice in 2022 nearly as violently as it did in March 2020.

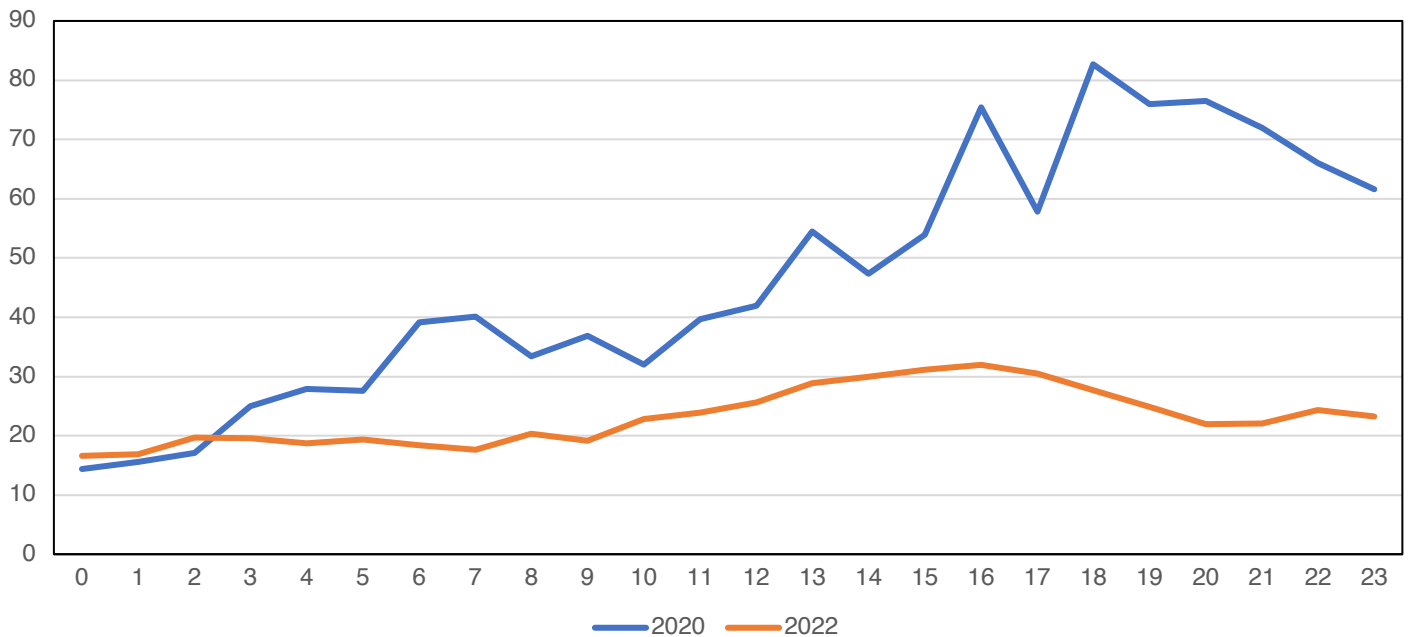
³ The basic logic here is that if the market is pricing a higher probability or larger market moves, a put struck further out-of-the-money has a higher likelihood of ending in-the-money than if there were a lower probability of large market moves. That higher probability commands a higher price.

Figure 10. Growth of \$1 in S&P 500 in first 23 Trading Days from Prior Market Highs



Source: Tiingo. Calculations by Newfound Research.

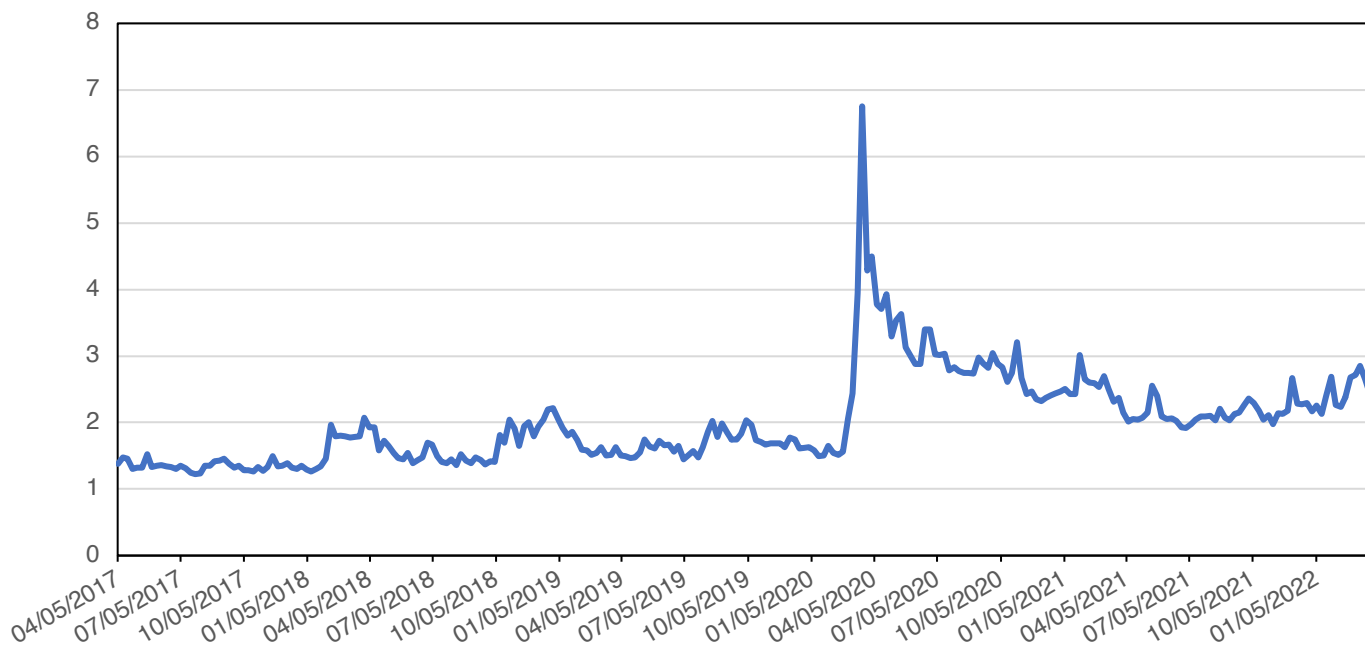
Figure 11. VIX Index in first 23 Trading Days from Prior Market Highs



Source: Tiingo; CBOE. Calculations by Newfound Research.

The final driver relevant for a strategy like ours, where we seek to spend a fixed notional amount of the portfolio on put option positions, is the *cost* of the insurance. This is akin to saying, “we’re only going to spend a fixed dollar amount on fire insurance, so we’ll buy less insurance when the price is high and more insurance when the price is lower.”⁴ Figure 12 demonstrates that in the post-COVID era, the cost of put protection has increased significantly relative to the pre-COVID era. In comparison to December 2019, put protection in December 2021 cost approximately 34% more, meaning that a fixed notional spend model would buy 25% fewer contracts.

Figure 12. Price of a 6-Month 20 Delta SPX Index Put (as a % of SPX Index Level)



Source: Societe General.

Our thesis for using this spend model is that it is significantly harder for markets to exhibit violent selloffs when protection is dear, as it suggests that more participants have protection on (becoming natural buyers in a decline) and fewer participants are short protection (potentially fewer forced sellers in a decline).⁵ While we believe this behavior helps buoy markets in the short-term, we do not believe it necessarily prevents slower, economically-driven grinding declines. In such environments, we expect our longer-dated put ladder and trend-following signals to deliver the most value.

⁴ Note that we very specifically did not say whether the insurance was cheap or expensive, just whether the price was high or low. Cheap and expensive are relative value concepts that exist independent of the actual price level.

⁵ It isn't quite right to say more buyers than sellers, as there is both a buyer and seller for each contract. What we really mean here is that the marginal pressure is coming from those looking for protection, rather than those seeking to sell it.

Has Momentum Lost its Mojo?

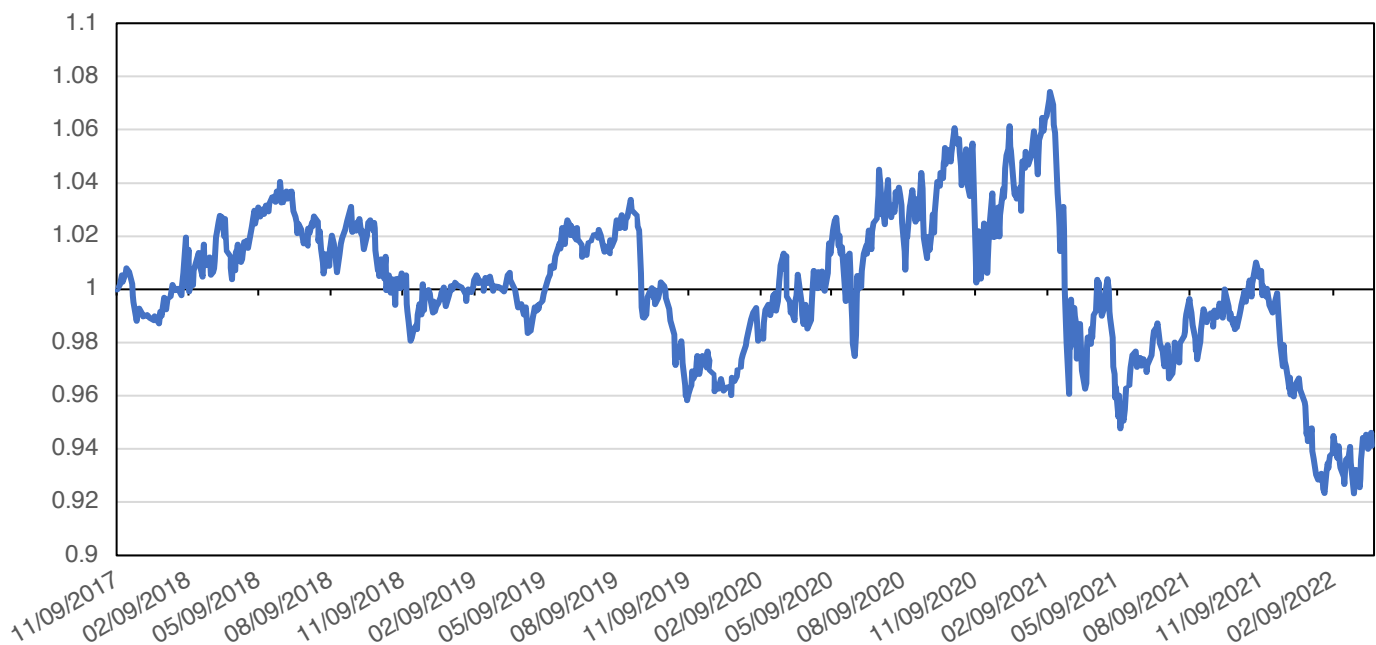
TL;DR: A basket of long-only momentum equity ETFs has significantly underperformed the S&P 500 since late 2020. The culprit appears to be position whipsaw from growth into value equities and back.

At any given time, approximately 31% of our portfolio is allocated to a basket of high momentum U.S. equities. Within the context of the broader portfolio design, this sleeve seeks to generate alpha, particularly during bull markets. Unfortunately, since early 2021, it has dramatically underperformed the S&P 500 (see Figure 13).

What makes momentum distinctive, as a factor, is that it is a chameleon. If quality stocks are doing well, it may buy quality. If expensive, junky stocks are doing well, it will buy expensive, junky stocks. If the stocks of companies who have CEO's that have red hair are doing particularly well, it may buy those stocks, no questions asked.

In certain cases, we can even see momentum buy value stocks before a run-up in price re-rates them from "undervalued" to "not undervalued" and the value factor turns over.

Figure 13. Growth of \$1 in Long Momentum / Short S&P 500 Portfolio



Source: Tiingo; Calculations by Newfound Research. Each factor portfolio is long an equally-weighted basket of ETFs and short the SPDR S&P 500 ETF ("SPY"), rebalanced monthly. The "Momentum" basket is: FDMO, JMOM, and MTUM. Returns of the aforementioned portfolios are backtested and hypothetical and are gross of all fees (including, but not limited to, advisor fees, manager fees, transaction costs, or taxes) except for underlying ETF expense ratios. Past performance is not an indicator of future results.

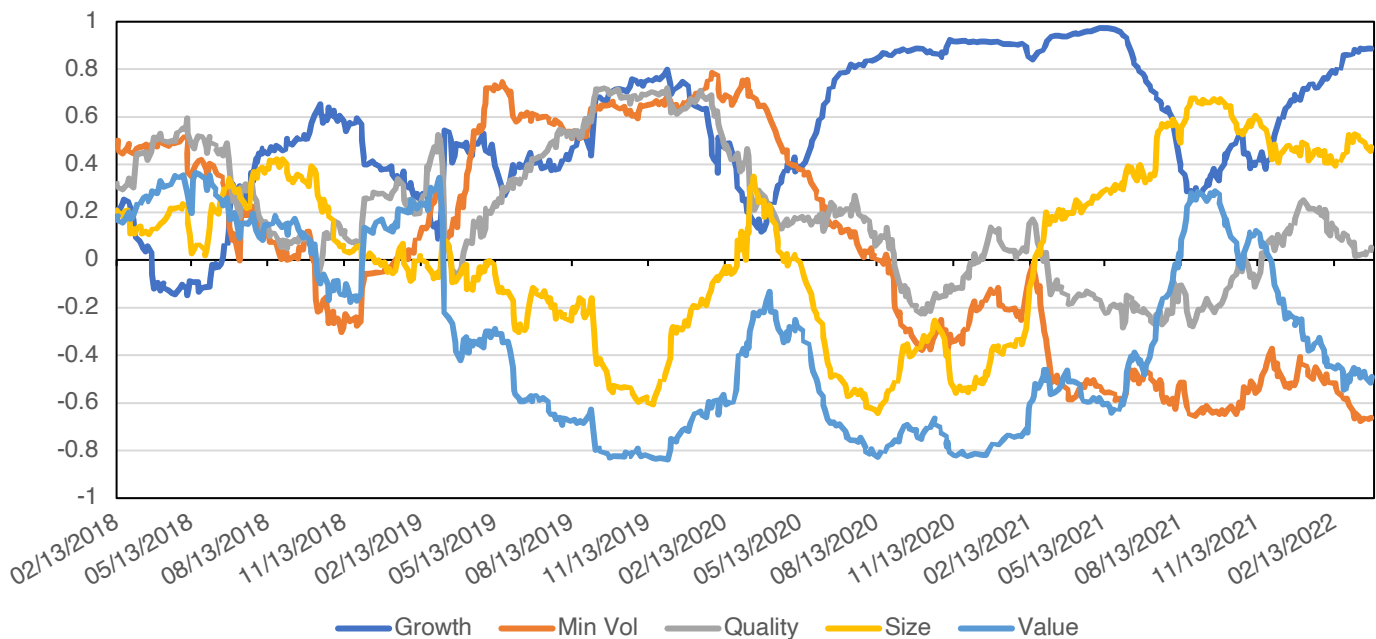
To quickly get a sense of “what is momentum” at any given time, we can look at rolling correlations between momentum and other factors or equity baskets. In Figure 14 we do precisely this and can see that momentum’s correlation with growth, value, minimum volatility, size, and quality has varied dramatically over time.

In 2019, momentum was a mixture of growth, quality, and minimum volatility exposure. Early 2020 saw a de-coupling before momentum leaned almost exclusively into growth names in the post-COVID, “work from home” cycle. It is worth noting that these correlation measures are based upon realized returns and therefore lag the true transition by a few months.

In late 2020, momentum began to shift away from mega-cap names and move down the size spectrum. By mid-2021, it had sold down growth to take on value exposure. That trend would be short lived, as it quickly sold down value to buy back growth in Q4 2021.

The problem is that growth versus value really peaked in June 2020, but the momentum factor did not meaningfully de-couple from growth until June 2021. Beginning in mid-2021, exposure to growth was shed and exposure to value was added, before making an about turn in Q4 2021 to reduce value and increase growth.

Figure 14. Rolling 63-Day Realized Correlation of Factor Returns with Momentum Factor



Source: Tiingo. Calculations by Newfound Research. Each factor portfolio is long an equally-weighted basket of ETFs and short the SPDR S&P 500 ETF (“SPY”), rebalanced monthly. The “Momentum” basket is: FDMO, JMOM, and MTUM. The “Growth” basket is: IWD, RPG, and VUG. The “Min Vol” basket is: FDLO, JMIN, and USMV. The “Quality” basket is: FQAL, JQUA, and QUAL. The “Size” basket is: IWM. The “Value” basket is: FVAL, JVAL, and VLUE. Returns of the aforementioned portfolios are backtested and hypothetical and are gross of all fees (including, but not limited to, advisor fees, manager fees, transaction costs, or taxes) except for underlying ETF expense ratios. Past performance is not an indicator of future results.

The problem with all this nimble dancing is that it was in almost perfect opposition to the music that was playing!

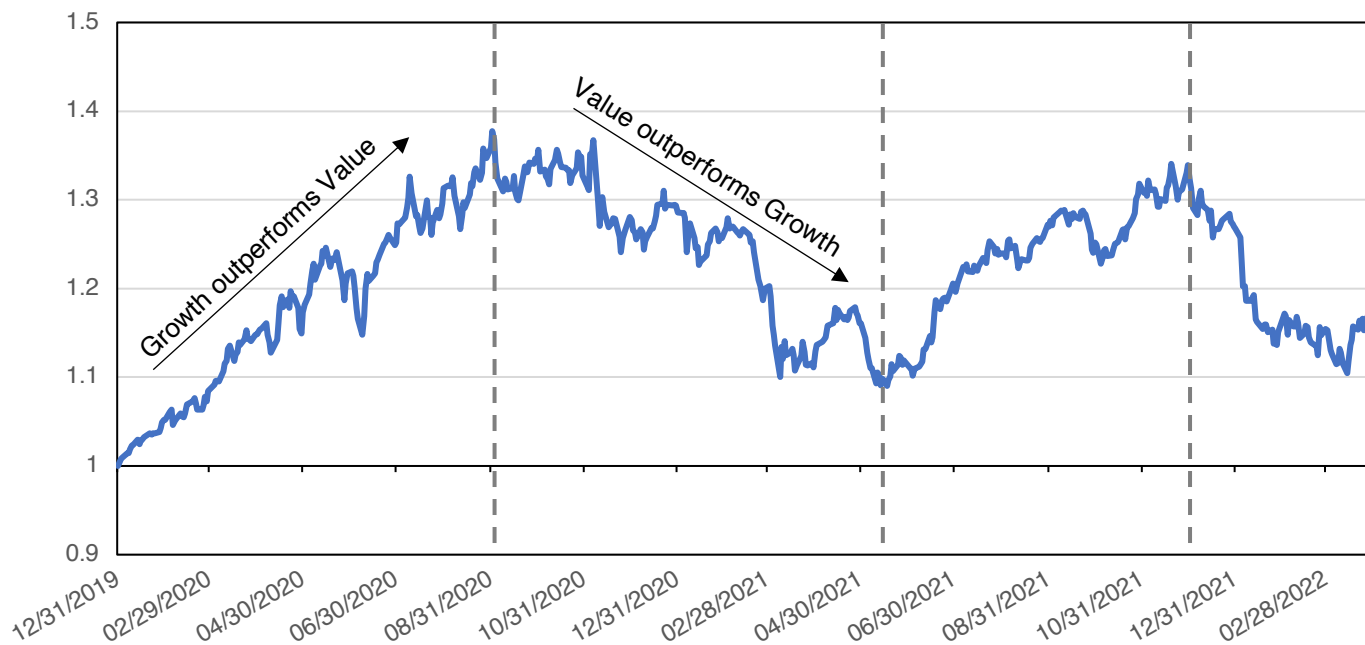
If we were to plot the relative performance of growth versus value stocks (Figure 15), we would see that momentum was well allocated until September 2020, at which point it remained exposed to growth while performance swung heavily in value's favor. Then, momentum started to decouple from growth at almost the precise momentum that growth started outperforming. Finally, as momentum rebuilt its growth exposure by the end of 2021, value took the wheel again.

For momentum to work, there needs to be a continuation of trends. The last two years have seen just the opposite, with significant factor volatility and strong reversals while markets tried to navigate recessionary fears, stimulus impacts, a technology-enabled work-from-home environment, COVID-19's impact on the digital economy versus brick-and-mortar, global re-opening and reflation, and finally fears of inflation and quantitative tightening. With relative performance cycles lasting just 6-to-9 months at a time, by the time momentum was transitioning into the new trend, the opposite trend was taking off.

Can momentum get back onside? We believe one of the causes for momentum's struggles was that the market was highly event-driven over the last two years. For example, in a market where the emergence of a vaccine can lead to a global change in consumer behavior as well as alter the direction of fiscal and monetary policy, *when* that vaccine emerges will have a profound impact on relative security returns.

We believe that as the market transitions from event-driven back to an environment of more continuous, lower-impact information flow, momentum will find its footing again.

Figure 15. Relative Performance of Growth Factor versus Value Factor



Source: Tiingo. Calculations by Newfound Research. Each factor portfolio is long an equally-weighted basket of ETFs and short the SPDR S&P 500 ETF ("SPY"), rebalanced monthly. The "Growth" basket is: IWD, RPG, and VUG. The "Value" basket is: FVAL, JVAL, and VLUE. Returns of the aforementioned portfolios are backtested and hypothetical and are gross of all fees (including, but not limited to, advisor fees, manager fees, transaction costs, or taxes) except for underlying ETF expense ratios. Past performance is not an indicator of future results.

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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 March 31, 2022)						
	3 Months	6 Months	1 Year	3 Year	5 Year	Inception
NFDIX NAV	-12.23%	-2.52%	7.74%	6.51%	5.54%	4.29%
S&P 500	-4.60%	5.92%	15.65%	18.92%	15.99%	13.99%
50/50 S&P 500 / 1-3 Year U.S. Treasuries	-3.49%	1.49%	6.15%	9.99%	8.64%	7.59%

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.

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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.*

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.

Basis Points (BPS, bps): Basis points are used to refer to an increment of 0.01%, or 1/100th of 1%. For example, an investment that has increased in value by 0.50% would be said to have "increased by 50 basis points."

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Newfound Case #14818878