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HOW CAN DYNAMIC EQUITY NAVIGATE RISING RATES?

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EXECUTIVE SUMMARY

- Newton's suite of actively managed Dynamic Equity strategies employs a non-traditional approach to outperforming equity.
- Investors are understandably concerned about the impact that tightening monetary policy, higher interest rates and elevated inflation could have on their equity investments, including Dynamic Equity.
- While a regime of rising short-term and long-term interest rates can pose challenges for equity investors, we believe Dynamic Equity's flexible design is well-suited to navigating the current environment.
- Over its 32-year history (inception date: August 31, 1989¹), Dynamic US Equity (DUSE) has navigated four rounds of concerted US policy rate increases and six overall cycles of rising Treasury yields.
- During all but one of these instances, DUSE either outperformed during the rising-yield regime or fully recouped any negative excess return and subsequently outperformed in the 12 months following the end of the cycle.

Past performance is no guarantee of future performance.

NEWTON'S MULTI-ASSET TEAM

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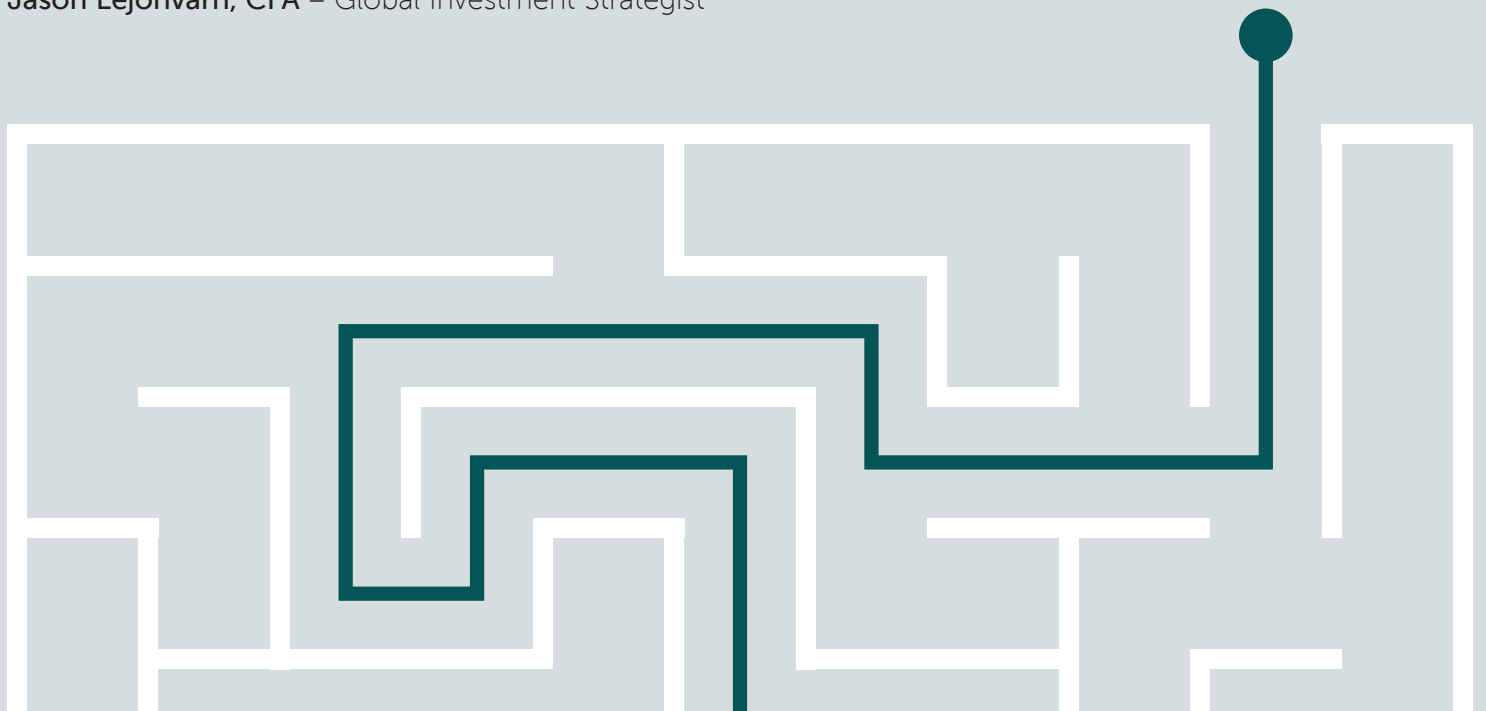
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A Challenging Environment for Equity Investors

After weathering the volatility induced by the Covid-19 pandemic in 2020 and benefiting from strong performance in 2021, equity markets face an uncertain environment in 2022. Before the start of the war in Ukraine, central bankers conceded that inflation was not transient and monetary policy would have to tighten to address levels of inflation not seen since the early 1980s.

Key investor questions include:

- How has our suite of Dynamic Equity strategies navigated past cycles of rising interest rates?
- What implications do recent expectations for short-term and long-term interest rates have for the strategy's current exposures?

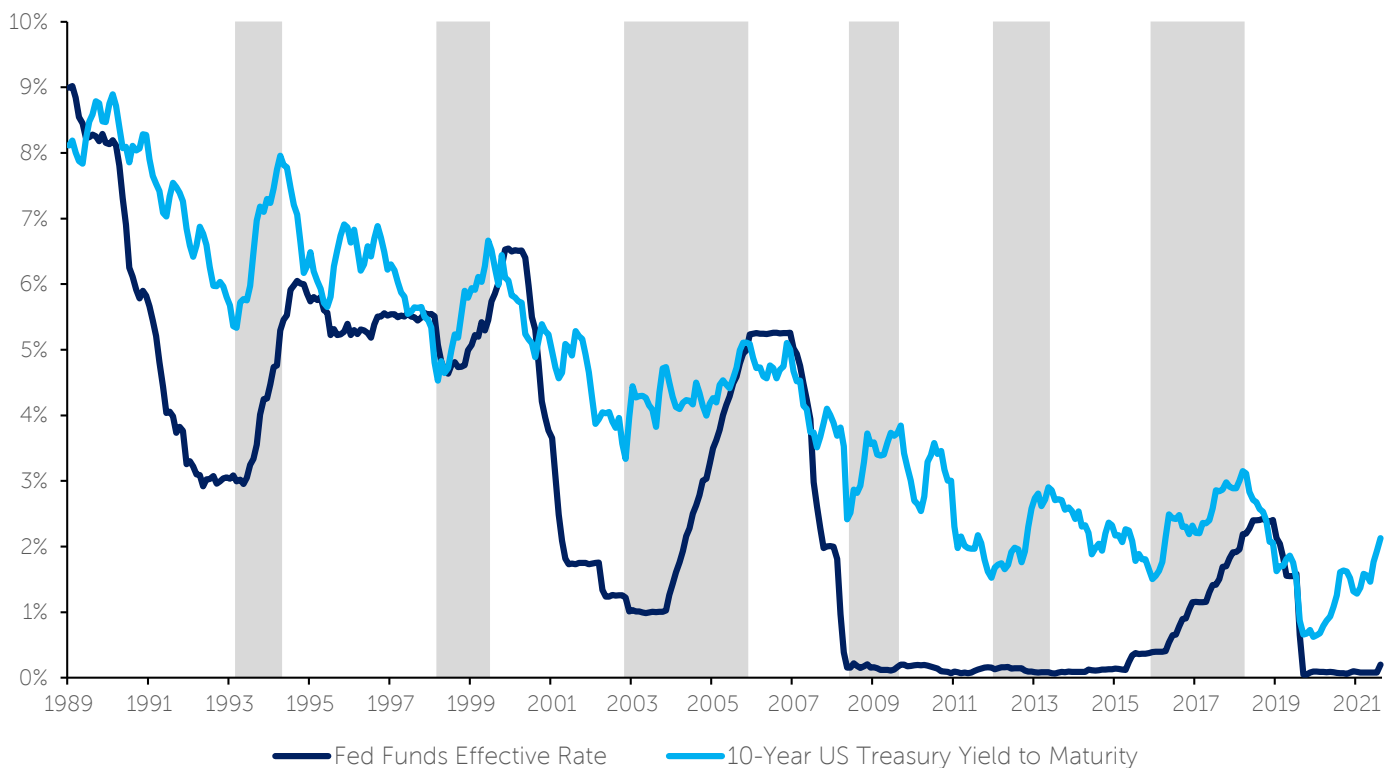
Rising Interest Rates

After a 40-year-long decline in US government bond yields, investors must now contend with rising US interest rates. All else equal, rising rates tend to be viewed as a headwind for equities because they imply higher borrowing costs for both companies and consumers, which can have a knock-on effect on corporate earnings and therefore on stock prices. Today, we are in the early phase of a higher short-term interest-rate cycle (the market-implied fed funds effective rate for the middle of 2023 is around 3.3%) while longer-term yields have also been moving higher.

The chart below shows the downward trend of interest rates since 1989; the shaded areas indicate periods over which the 10-year US Treasury yield rose by more than 1.25%

Fed Funds Effective Rate and 10-Year US Treasury Yield

Monthly Average, August 1989 - March 2022



Source: Federal Reserve Board data (FRED), accessed 4/1/22. The gray shaded areas denote periods modeled in our analysis when the 10-year US Treasury yield is increasing.

While this environment poses some challenges, we do not see it as unambiguously negative for equity strategies. Rather, we believe investment approaches such as Dynamic Equity, which integrate downside risk management and diversify across the major asset premia, are better equipped to navigate this backdrop than passive investments or more traditional, benchmark-constrained equity strategies. How has the Dynamic US Equity Strategy navigated increases in both short- and long-term rates in the past?

Review of Past Tightening Cycles

Since the inception of Dynamic Equity in 1989, the Federal Reserve (Fed) has undergone four policy-tightening cycles (by over 2% in three of the four):

1. Cycle 1 spanned 13 months, starting in January 1994.
2. Cycle 2 lasted 12 months, from June 1999 to June 2000, as the Fed hiked its rates in a belated attempt to control the ‘irrational exuberance’ of the technology, media, and telecoms (TMT) bubble.
3. Cycle 3 ran for two years, from June 2004 to June 2006, as the Fed tried unsuccessfully to cool the overheating US housing market.
4. The final cycle lasted three years, starting in December 2015.

The table below shows DUSE performance during these cycles and their aftermath (12 months following the final rate increase), as well as the strategy’s cumulative performance over the entire period in question.

Performance of Dynamic US Equity Strategy around Increases in the Federal Funds Effective Rate | Net of Fees⁴

Fed Rate Hike Periods		Fed Funds Effective	Fed Funds Effective	DUSE Excess	DUSE Excess Return	DUSE Excess Return
Start	Finish	Rate - Start	Rate - End	Return During Rate Increase Cycle	12 Months after End of Rate Hike Cycle	Start of Rate Hike Cycle Plus 12 months
Jan-94	Feb-95	3.05%	5.92%	-7.78%	9.82%	-1.21%
Jun-99	Jun-00	4.76%	6.50%	-2.97%	7.52%	5.22%
Jun-04	Jun-06	1.00%	5.25%	8.70%	-0.06%	10.41%
Dec-15	Dec-18	0%-0.25%	2.25%-2.50%	5.84%	6.33%	16.20%

Source: Newton, Standard and Poor’s, and Federal Reserve Board data (FRED), accessed 4/1/22. Past performance is not a guide to future performance. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested. The performance results shown are net of investment management fees and reflect the reinvestment of dividends and other earnings. The investment advisory fees are described in Part 2 of the adviser’s Form ADV, which can be obtained from the SEC.gov website or obtained upon request. See important information at the end of this paper.

In the first two cycles, DUSE underperformed the S&P 500®. The 1994–95 cycle was the only period in the last 32 years when bonds did not generate a positive return during an equity correction; it has been recognized as a Fed policy error and is commonly referred to as the “great bond massacre.” In the 1999–2000 cycle, towards the end of the TMT bubble, the strategy correctly foresaw poor equity returns, and de-risked its equity position in the final phase of the equity market’s rise. But, from the peak of the S&P 500 in the third quarter of 2000, DUSE—with a 70% exposure to equities and a 60% exposure to bonds—recovered strongly.

In both instances, DUSE more than recouped the underperformance in the 12-month period following the final policy rate increase when market conditions stabilized. In the first instance, this resulted in an overall return for the strategy that marginally lagged the S&P 500. In the second instance, the strategy benefited from equity exposure that was relatively lower than the benchmark during the post-TMT bubble correction to outperform its benchmark.

In the two more recent cycles, both characterized by strong equity markets and a robust underlying economy, DUSE outperformed handsomely during the periods of rising rates and either maintained or extended that outperformance in the subsequent 12 months after short-term rates peaked. DUSE can outperform, and has done so, during tightening cycles.

Rising Long-Term Rates

The Dynamic US Equity strategy has navigated periods of rising long-term interest rates as well. Since inception, there have been six instances when the yield on the 10-year US Treasury has risen materially (we define this as an increase of at least 1.25%):

1. The first instance spanned 13 months, starting in September 1993.
2. The second lasted 17 months, from September 1999, and included the TMT bubble.
3. The third began in May 2003 and continued for just over three years as the Fed tried unsuccessfully to cool the economy.
4. The fourth unfolded over 15 months, starting in December 2008 and included the aftermath of the global financial crisis.
5. The fifth lasted almost 18 months, from July 2012 to December 2013, and coincided with the European banking crisis.
6. The sixth, starting in June 2016, played out over two years, and related to an overall strong US economy.

In five out of the six instances, DUSE either outperformed or (in one instance) matched its benchmark within 12 months following the end of that cycle’s rate rises, as shown in the table below. During the most recent three cycles, the strategy modestly underperformed in one instance (Dec 2008–Mar 2010), largely because of equity positioning during 2009, but strongly outperformed in the 12 months following the peak in the 10-year US Treasury yield.

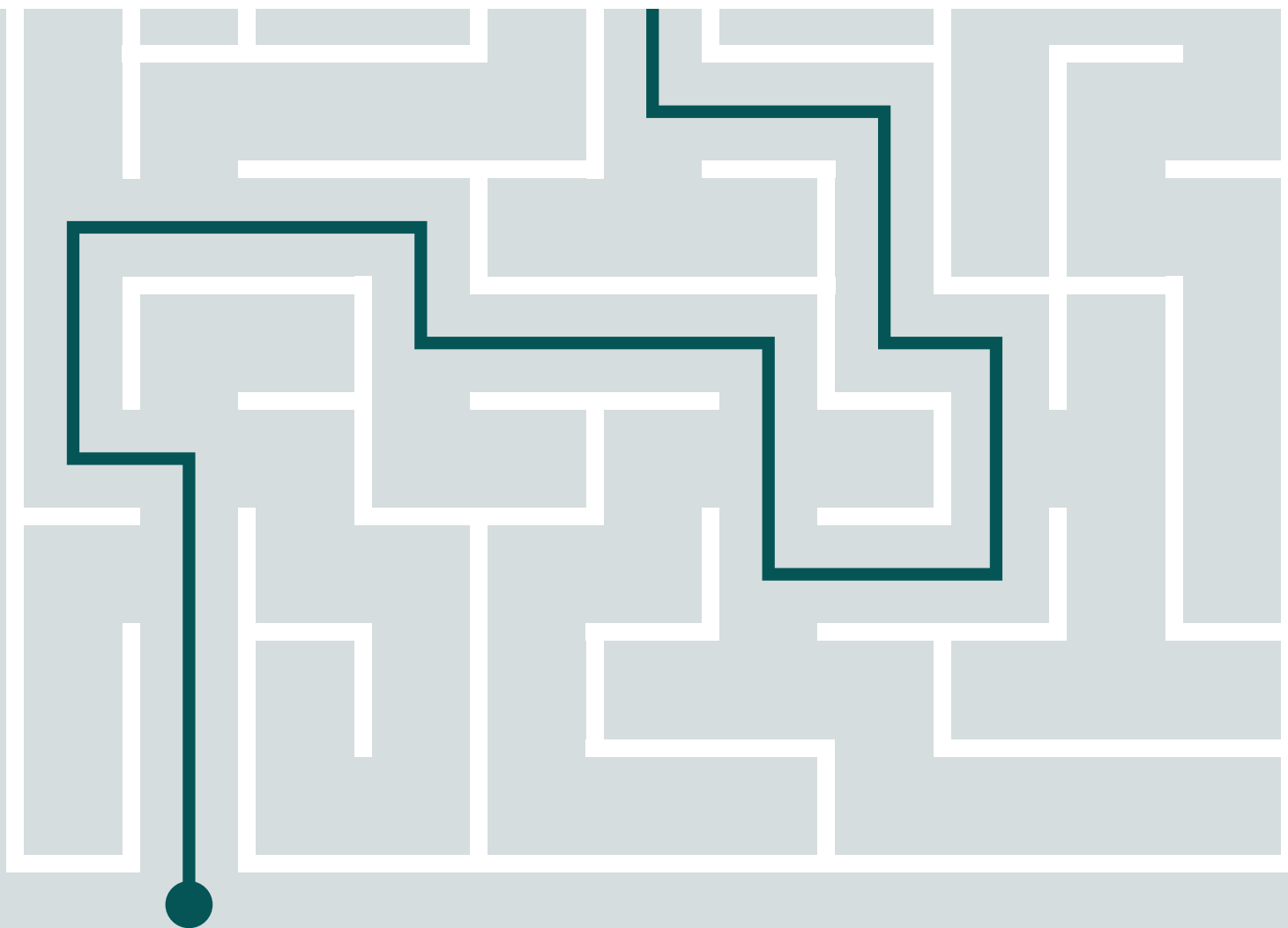
In the earlier three instances, rises in the 10-year yield were both larger in magnitude and from higher starting policy rates and therefore less relevant today. While DUSE underperformed during two of the three periods where the 10-year yield rose, in the first of those two instances, in the aftermath of the great bond massacre of 1993-94, it earned back almost all the underperformance while in the second, during the height of the TMT bubble, the underperformance stemmed almost entirely from an underweight in equities as our models viewed the market as significantly overvalued.

The table below sets out the performance of DUSE during these instances of increasing 10-year Treasury yields and their aftermath (the 12 months following the month in which the yield peaked).

Performance of Dynamic US Equity Strategy during and 12 Months after Cycles of Increases in the 10-Year US Treasury Bond Yield to Maturity (YTM) | Net of Fees⁵

10-Year Treasury YTM Increase Periods		10-Year Treasury YTM	10-Year Treasury YTM	DUSE Net Excess Return	DUSE Net Excess Return	DUSE Net Excess Return
Start	Finish	Start of Period	End of Period	During Yield Increase	12 Months after End of Yield Increase Period	Start of Yield Increase Period Plus 12 months
Sep-93	Nov-94	5.36%	7.96%	-10.13%	10.69%	-4.12%
Sep-98	Jan-00	4.81%	6.66%	-18.63%	14.19%	-0.05%
May-03	Jun-06	3.57%	5.11%	19.07%	-0.06%	22.90%
Dec-08	Mar-10	2.42%	3.73%	-2.18%	9.27%	9.75%
Jul-12	Dec-13	1.53%	2.90%	8.40%	5.67%	17.97%
Jun-16	Oct-18	1.64%	3.15%	2.75%	5.18%	10.31%

Source: Newton, Standard and Poor's, and Federal Reserve Board data (FRED), accessed 4/1/22. Past performance is not a guide to future performance. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested. The performance results shown are net of investment management fees and reflect the reinvestment of dividends and other earnings. The investment advisory fees are described in Part 2 of the adviser's Form ADV, which can be obtained from the SEC.gov website or obtained upon request. See important information at the end of this paper.



Implications Today for Dynamic Equity Positioning & Performance

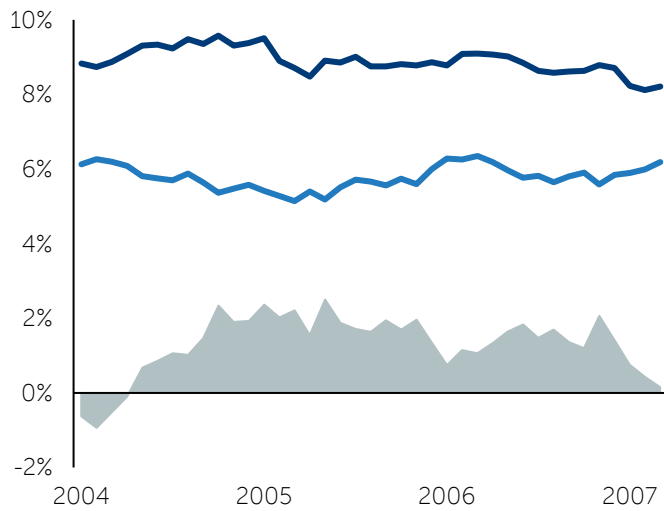
The Fed has already raised the fed funds rate twice since the start of the year, first by 0.25% in March and then by 0.50% in early May. More policy rate rises are expected as the Fed makes increasingly hawkish comments on inflation: the current market forecast is for the fed funds rate to peak at 3.3% in the middle of 2023.² And since early March 2022, the 10-year US Treasury yield has risen more than 100 basis points to breach 3%. But how far does the market expect rates to rise? Since the rate-rise cycle towards the end of the TMT bubble, every time the Fed has raised its policy rate to encourage an appropriate response from the market, the high point of the cycle has been lower.

Relative to previous cycles, this is an accelerated cycle given how far inflation is above the Fed's long-term target. However, we should acknowledge that higher inflation has been accompanied by above-trend US GDP growth as well as relatively strong corporate earnings growth. While nominal wage growth may affect the healthy state of the US economy, the persistency of that wage growth remains to be seen. Our expectation is that the 10-year US Treasury yield need not rise by more than 1.5% to 2% to have the intended effect on inflation. For this reason, we believe environments of strong growth and rising short-term or long-term rates, such as occurred between June 2004 and June 2006, as well as after the global financial crisis between December 2008 and March 2010, are good comparison periods.

Between June 2004 and June 2006, the Fed's effective policy rate increased from 1% to 5.25%; the 10-year yield increased more modestly, from 4.6% to 5.0%, leading the yield curve to invert briefly in February 2006 (and again, in a more pronounced way, between July 2006 and April 2007). DUSE's average bond exposure was 9.7%.³ There is no guarantee that the strategy will produce profits in any particular environment, and its cumulative outperformance was 8.3%; about two-thirds of this outperformance can be attributed to the bond exposure; in fact, the strategy had a persistent short position in bonds in both 2005 and 2006. In the first two charts below, we show our models' expected returns for equities and bonds during this period; the shaded area represents the difference (positive or negative) between equity risk premium and term premium (left-hand chart), and DUSE's exposure to equities, bonds, and cash (right-hand chart). In the third chart (next page), we show the cumulative performance of both DUSE and its benchmark, the S&P 500® (June 2004 = 100), together with the cumulative excess return of DUSE over the period in question.

Stock/Bond Expected Return Premia Spread*: June 2004 - June 2007

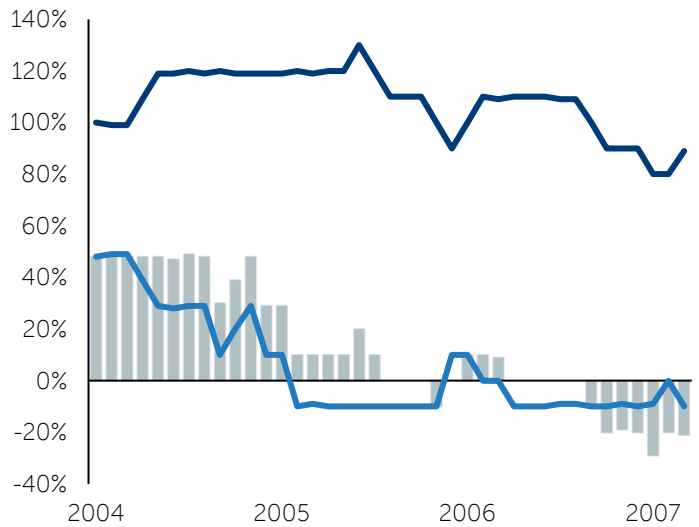
Premia Spread



Spread: Equity Risk Premium vs. Term Premium
 Stock Expected Return
 Bond Expected Return

Source: Newton, calculated on 4/1/22. *Stock expected returns are for the S&P 500. Bond expected returns are the yield-to-maturity of bonds with credit risks similar to that of long-term, single A-rated corporate securities.

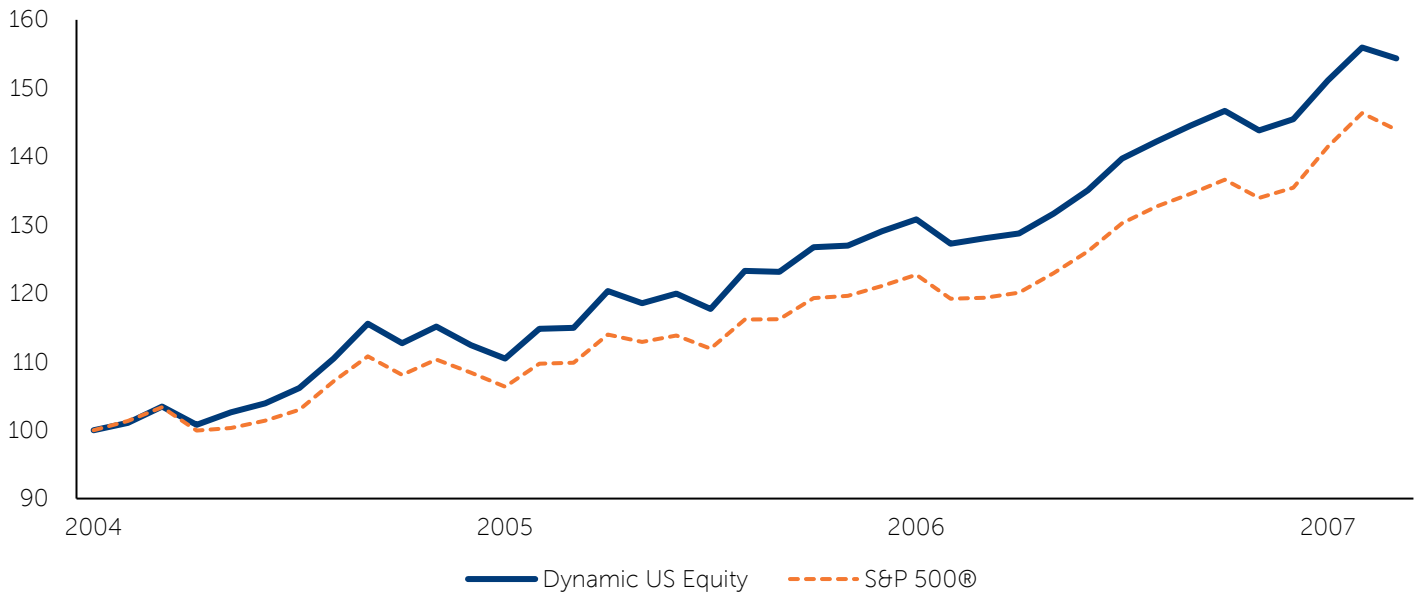
Dynamic US Equity Asset Class Positioning



Leverage
 Stock Allocation
 Bond Allocation

Dynamic US Equity Cumulative Return: June 2004 - June 2007

Index = 100 (June 2004)

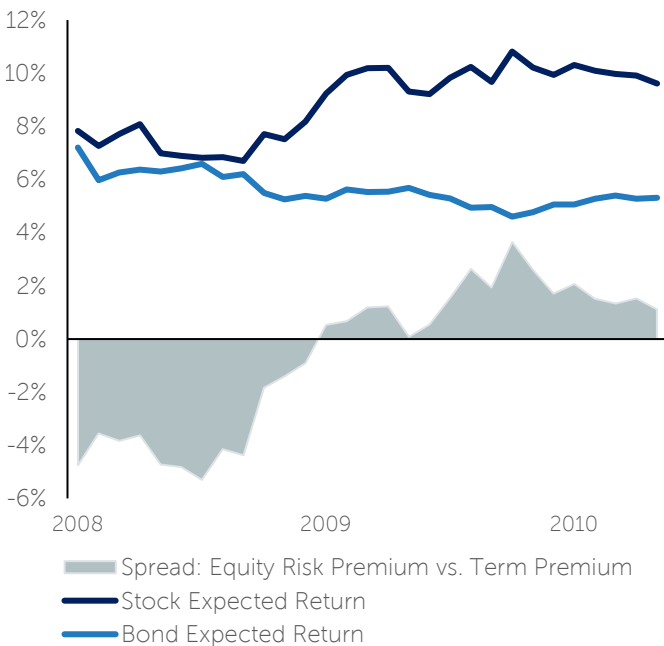


Source: Newton, Standard and Poor's, accessed 4/1/22. Past performance is not a guide to future performance. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested. The performance results shown are net of investment management fees and reflect the reinvestment of dividends and other earnings. The S&P 500 performance benchmark is used as a comparator for this portfolio. Information about the indices shown here is provided to allow for comparison of the performance of the portfolio to that of certain well-known and widely recognized indices. There is no representation that such index is an appropriate benchmark for such comparison. The investment advisory fees are described in Part 2 of the adviser's Form ADV, which can be obtained from the SEC.gov website or obtained upon request. See important information at the end of this paper.

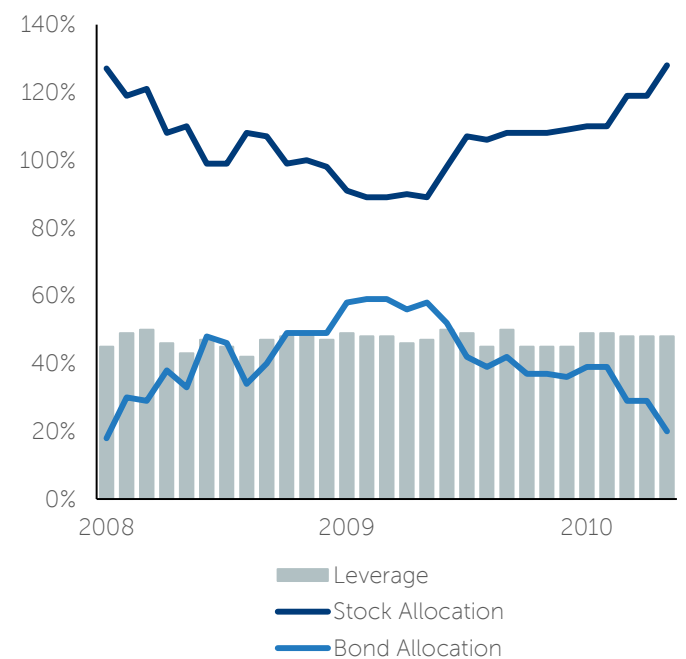
From December 2008 to March 2010, the Fed's effective policy rate was relatively flat, ranging from 0.16% to 0.20%. The 10-year Treasury yield, by contrast, and in response to the post-global financial crisis environment, increased from 2.4% to 3.7%. DUSE's average bond exposure over this period was 43% and its cumulative underperformance was 1.6%. The contribution from the bond exposure was effectively zero; all of the underperformance was due to the equity exposure. Once again, as risk premia stabilized, DUSE outperformed by 9.7% during the subsequent 12 months. As before, in the first two charts below, we show our models' expected returns for equities and bonds during this period; the shaded area represents the difference (positive or negative) between equity risk premium and term premium (left-hand chart) and DUSE's exposure to equities, bonds, and cash (right-hand chart). In the third chart, we show the cumulative performance of both DUSE and its benchmark, the S&P 500® (December 2008 = 100), together with the cumulative excess return of DUSE over the period in question.

Stock/Bond Expected Return Premia Spread*: December 2008 - March 2011

Premia Spread

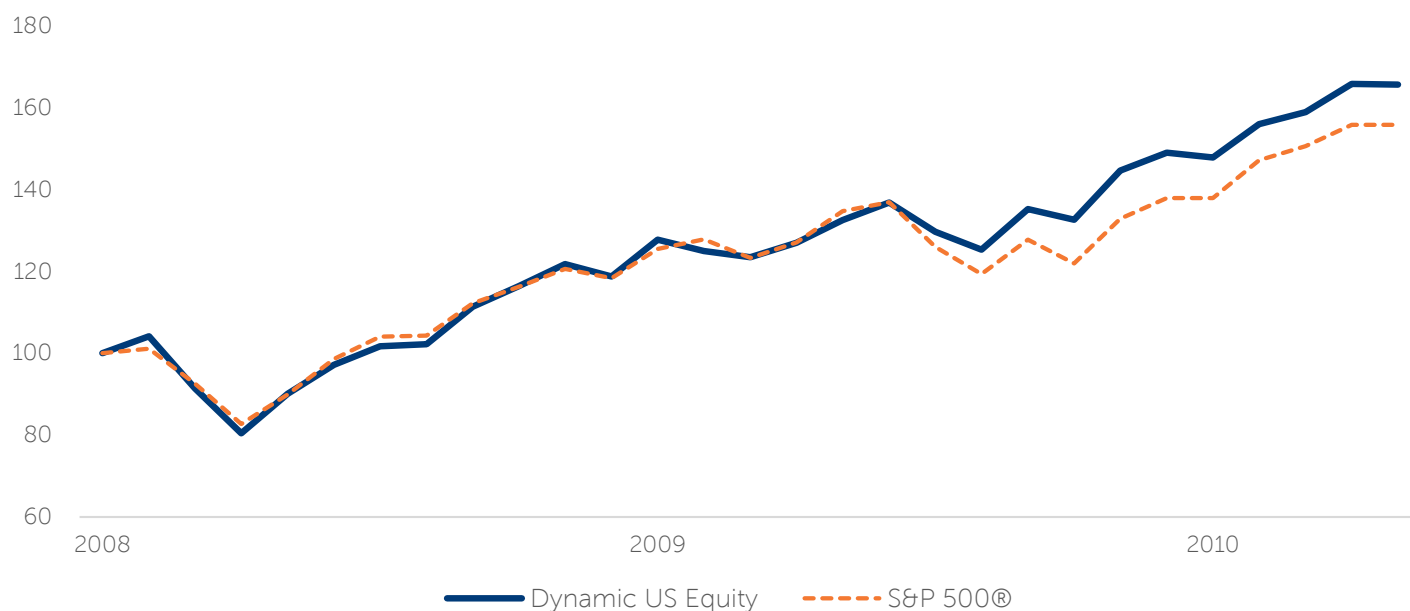


Dynamic US Equity Asset Class Positioning



Source: Newton, calculated on 4/1/22. *Stock expected returns are for the S&P 500. Bond expected returns are the yield-to-maturity of bonds with credit risks similar to that of long-term, single A-rated corporate securities.

Dynamic US Equity Cumulative Return: December 2008 - March 2011 Index = 100 (December 2008)



Source: Newton, Standard and Poor's, accessed 4/1/22. Past performance is not a guide to future performance. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested. The performance results shown are net of investment management fees and reflect the reinvestment of dividends and other earnings. The S&P 500 performance benchmark is used as a comparator for this portfolio. Information about the indices shown here is provided to allow for comparison of the performance of the portfolio to that of certain well-known and widely recognized indices. There is no representation that such index is an appropriate benchmark for such comparison. The investment advisory fees are described in Part 2 of the adviser's Form ADV, which can be obtained from the SEC.gov website or obtained upon request. See important information at the end of this paper.

Dynamic Equity: Current Positioning

We believe that the long-term framework of DUSE over the last 32 years should reassure investors that the strategy is well-placed to weather different economic environments and continue to generate excess returns over the long run. The strategy's exposures are calibrated to capture long-term market regimes and harvest relevant risk premia during these regimes.

Our expectation for short-term rates is for them to peak below 3% by the middle of 2023; we do not expect long-term rates to increase materially from their present level. Our forecast suggests higher intermediate inflation (as measured by the Consumer Price Index), but lower core inflation (as measured by Personal Consumption Expenditures, the Fed's favored measure). Rising rates create potential headwinds for longer-dated bonds. Consequently, the strategy's implemented bond exposure is 5%, somewhat below the 10% target implied by our models. Favorable equity conditions characterized by above-trend GDP growth and positive earnings growth forecasts through 2022 lead us to maintain an equity exposure of approximately 105%, with higher upside participation if equity markets recover from here, in line with the 110% target implied by our models.

While DUSE may struggle to capture the turning points between regimes—for example during rising rate environments—when the market re-establishes an equilibrium, it has generated positive excess returns and, in almost all cases (bar the great bond massacre of 1993-1994), the strategy has more than recovered any losses incurred during the turning point. For this reason, investors should bear in mind that DUSE is designed to harvest risk premia over the long term.

Want to find out more?

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Endnotes

¹Performance presented for measurement periods prior to September 1, 2021 represents the performance of the strategy when managed at Mellon Investments Corporation ("Mellon"), an affiliate of NIMNA. Performance presented for measurement periods prior to February 1, 2018 represents the portable performance results of a prior affiliated firm. Mellon was formed on January 31, 2018, through the merger of The Boston Company and Standish into Mellon Capital. is no guarantee that the strategy will produce profits in any particular environment.

²See the Atlanta Fed's <https://www.atlantafed.org/cenfig/market-probability-tracker>

³DUSE was short the long-dated Treasury by -10% from June 2005 to March 2006 and outperformed 2.21% over this period.

⁴There is no guarantee that the strategy will produce profits in any particular environment.

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Important information

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Newton Investment Management

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Year	Asset-weighted Gross	Asset-weighted Net	S&P 500®	Composite 3-Yr St Dev	Benchmark 3-Yr St Dev	Number of Portfolios	Composite Assets (\$mm)	Firm Assets (\$mm)	Composite Dispersion
2021	30.97	30.60	28.71	17.24	17.17	11	6,864	65,747	0.06
2020	19.63	19.22	18.40	19.30	18.79	11	5,794	601,427	0.12
2019	38.28	37.81	31.49	13.58	12.10	9	5,123	534,173	0.11
2018	-6.19	-6.52	-4.38	12.64	10.95	9	3,702	488,649	0.04
2017	28.50	28.06	21.83	11.40	10.07	≤ 5	1,967	376,540	N/M
2016	14.90	14.51	11.96	12.28	10.74	≤ 5	1,216	339,574	N/M
2015	0.42	0.07	1.38	12.55	10.62	≤ 5	1,042	349,089	N/M
2014	19.77	19.36	13.69	10.68	9.10	≤ 5	1,013	379,698	N/M
2013	39.08	38.61	32.39	13.44	12.11	≤ 5	628	348,634	N/M
2012	20.67	20.26	16.00	14.69	15.30	≤ 5	410	252,696	N/M

The Dynamic US Equity composite measures the total return of all fee-paying, discretionary, portfolios that actively allocates assets across the equity, fixed income and cash markets of the United States using a proprietary quantitative model. Typically, a combination of individual stocks, financial futures, and options are used to allocate to each of the asset classes. The composite may increase total notional asset class exposures up to 150% and may short bonds and cash up to 50%, with each asset class having its own allocation ranges. The use of derivatives is a characteristic of this investment strategy and may be used from time to time to obtain exposure, to provide liquidity for cash flows, to hedge accruals or for other purposes that facilitate meeting the composite's objective. The composite was created on August 31, 1995. The composite has an inception date of September 1, 1989. The performance of the composite is expressed in U.S. Dollars. A list of composite descriptions and a list of limited distribution pooled fund descriptions are available upon request. Policies for valuing investments, calculating performance, and preparing GIPS reports are available upon request.

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The Composite's benchmark is the S&P 500® Index. The S&P 500® Index measures the performance of the large-cap segment of the U.S. equity market.

The standard management fee for separately managed account in this strategy is 0.35% for first \$300M, 0.30% for the next \$200M, and 0.25% for the balance of assets under management. Net-of-fee returns are calculated using model fees which are equivalent to the standard fee schedule for each investment strategy. Composites containing broad distribution pooled funds apply a model fee equivalent to the investment management portion of the fund's total expense ratio. Fees are accrued monthly for each account according to their assets under management and the results are asset-weighted to arrive at the composite net-of-fee return. Additional information regarding historical net-of-fee returns calculation is available upon request.

Gross performance figures are time-weighted rates of return, which include the deduction of transaction costs. Performance results reflect the reinvestment of interest income and other earnings. Past performance is not an indication of future performance. Gross-of-fee performance figures for bank collective funds participating in the composite have been reduced by administrative fees in addition to trading expenses. Bank collective fund returns may exclude transaction costs associated with client-driven external contributions and withdrawals. The treatment of these trading expenses would have an impact on the fund return similar to as if a temporary new account was employed. Gross returns were used to calculate all risk measures presented in this GIPS Composite Report. Internal dispersion figures are an asset-weighted standard deviation of all portfolios that were included in the composite for the entire measurement period. Dispersion figures for years containing 5 or fewer Portfolios are considered Not Meaningful or "N/M".

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