NORTH SQUARE
INVESTMENTS

Active Insights Podcast – Strategies to Navigate a Rising Interest Rate Environment

Diane Merritt:

Welcome to North Square Investments Active Insights podcast. North Square Investments is dedicated to bringing differentiated, active investment strategies to financial advisors and investors through our multi-boutique asset management platform. Today, Mark Goodwin, Chief Executive Officer of North Square Investments will discuss the strategies Red Cedar Investment Management believes can enable income-oriented investors to navigate a rising interest rate environment. John Cassady, Chief Investment Officer and David Withrow Director of Portfolio Management with Red Cedar Investment Management will provide us with their insights. Red Cedar is a partner firm in the North Square platform and sub-advisor to North Square Strategic Income Fund (ticker symbol ADVNX). Mark, John and David, we look forward to your discussion.

Mark Goodwin:

Thanks Diane. As you mentioned at North Square, we seek out best-in-class active managers for our platform and our partners at Red Cedar are well positioned to help income-oriented investors address the challenges presented by the current environment. John, I'd like to start out first by welcoming you and to ask you generally about the current market. Red Cedar focuses on income solutions and has a highly experienced team. What's your view of the market right now? Do you see the extraordinary levels of proposed government spending combined with the expected return of the economy to some degree of normalcy combined to create the potential for interest rates to broadly rise over an extended period?

John Cassady:

Well, thanks for having us here, Mark. Yes, certainly the environment we see unfolding right now is this reflationary boom that's occurring right now. And for the, let's call it the short to intermediate term, we think what we see unfolding is positive for the economy—and if things are positive for the economy, interest rates can be rising for very good and valid reasons. And so, yes, we do think that the potential is there for rates to continue to rise. And they've risen a lot since August last year already, but the 10 year treasury is at a pretty low level at 1.62% as we speak here right now, and it's got a negative real yield.

So I think there's still potential for interest rates to rise and normalize more from this point. But so far, I think it's going to be for valid reasons. As long as there is good growth in the economy, and we think there will be—we think there's going to be 7%, 8% real GDP growth this year in the US and we think that continues over to the year 2022 at 5%, 5.5%. So as long as there's good growth and there's no reason interest rates cannot rise and certain aspects of the fixed income market and preferred market could continue to perform even in that environment.

Mark Goodwin:

Thanks, John. Turning to you David. Investors haven't seen a backdrop of rising rates for some time. What challenges does this present to income-oriented investors or investors seeking portfolio diversification from traditional fixed-income investments?

David Withrow:

Well, Mark you're right. It does create a challenge because you've got the situation right now where the traditional benchmark, the Barclays Aggregate Index for fixed income is at historical lows after a 30-, 40-year bull market. And the yield at historical lows along at the same time, the duration or interest rate sensitivity is at its greatest. And so you're going into a low-yielding environment with the potential to offset that if rates rise with price depreciation. And it's just not a great environment if you're looking for income in the portfolio. So that yield as prices go up or prices go down, excuse me, and that yield offset's not there, we have to look for alternatives in the marketplace.

And I think that's what investors are doing right now. And there are alternatives out there. There's high quality alternatives out there, but you have to be creative. And probably it's market sectors, which have worked over time, but many investors just have not sought at this moment, until this moment. And this has spurred everybody to look for creativity. Fortunately, we've been involved in many of these markets for 20 years as a team, but other investors are just finding these nuances available to them.

Mark Goodwin:

Thanks, David, in our introduction, we mentioned the North Square Strategic Income Fund that you sub advise, ticker ADVNX. This fund as a multi-sector bond fund has a broad range of potential investments. How do you see active management across the range of potential fixed income investments contributing to the ability to address these challenges that we're seeing?

David Withrow:

Well I would say you have to have active management in this world because otherwise you're taking risks you don't want to take, and you can take very specific risks with that as an active manager. I think first we talked about the interest rate sensitivity of the traditional benchmark, and we’re able to structure a portfolio with less interest rate sensitivity from the duration measure, which is a strict mathematical measurement of interest rate sensitivity, because we can find alternatives which are higher yielding and shorter duration or shorter interest rate sensitivity. And so duration management is the starting point. After that we can go into sectors such as the preferred, which we have a specific expertise in. Preferred securities are, it's a term of art, but really it includes a vast array of different types of securities. And we are able to go out and select across the capital structure all the way from senior debt to the equity of the company.

But in that little tier, middle tier is preferred securities, which tend to offer higher value because it tends to be an overlooked and inefficient part in the marketplace. So we look for opportunities to jump into these preferred securities. We look at structure, we look at interest rate sensitivity. We look at the credit of the underlying company and we can find opportunities to trade in and out of the securities, get a high yield, a higher yielding security in a company that may have an investment grade balance sheet, and that creates opportunities. But then even beyond that, we're able to find other securities in the international

market, which maybe have lower correlations to the US interest rate-sensitive markets, and maybe offer also higher yields as a starting point.

And then there's also periods of time where we can find individual securities, which maybe actually have inverse relationship to interest rates. So as interest rates go up, their prices may actually go up in lock step with that. So that ability to go across the capital structure, look for unique securities and doing a portfolio where actually we can buy individual securities which will impact the portfolio and not have to make macro bets, which I think some of our larger brethren out there have to do—is hit macro bets because individual security selection can’t impact their portfolios.

Mark Goodwin:

Thank you, David, turning back to you, John, you and your team have particularly strong expertise in the preferred securities arena. How would you expect preferreds to perform generally in a period of rising rates?

John Cassady:

So I think the big story here is certainly there is interest rate risk embedded in the preferred securities market, but there are plenty of other risk factors embedded in a preferred security. So it's not all about the interest rate risk and where I'm going with this is that they can perform well in a rising rate environment. And history has shown that they have. And just to give you an example here, the other risk factors involved that clearly there's credit risk involved there, some callability embedded in a lot of these structures, there's regulatory risk. And then even if there's a put option risk even in the European market. So there's all this confluence of risk factors that interplay with one another to determine the price of a preferred security. So yes, if you just looked at interest rate risk and said, "Yes, interest rates are rising, it's got a lot of interest rate risk," then you would say, "boy, those types of investments, maybe traditional fixed income, they could struggle in that environment."

But we identified several periods going back to the mid-nineties where interest rates have risen or where the Fed has actually been hiking rates and preferreds have had a positive return during those episodes. And in fact, we just had a recent one, a recent episode of rising rates. And if I go back to—I believe it's August 4th of 2020—when the yield curve in the US was at its flattest and go to the end of the first quarter of this year, the yield curve has steepened. The 2-year versus 10-year spread has steepened from 40 basis points to 150 basis points over that timeframe. Another way to look at it is the 10-year Treasury went from around 50 basis points to about 175 basis points.

So certainly a pretty protracted rate rising environment there. And during that time period, the fixed rate preferred index had a positive rate of return of 3.96% over that timeframe. So the reasons for that, there are several, some are the structures of the securities that we own. A lot of them happen to be in the banking industry. And if you think about what improves the bank fundamentally, it would be a steepening yield curve environment where they have the potential for higher net interest margins, better capital positions as they earn more and more, have better earnings over time. So these things all go into it. So credit spreads can be compressing while rates rise during that environment that I just described. And you can end up with a pretty decent reasonable return. So yeah, they can indeed provide a good return even while rates are rising.

Mark Goodwin:

Thank you, John, how do you think this compares to your expectations for other areas where investors have sought yield historically, in particular high yield securities and emerging market debt? As we know as rates continue to rise, the dollar oftentimes strengthens and that can provide a negative backdrop for the EM arena, but thoughts on high yield and EM debt is in this environment?

John Cassady:

Yeah, so you're absolutely right. If we look historically going back 15 years, preferred correlation to investment grade fixed income is 0.15. In other words, they're not very correlated at all, which is a positive for your preferred holdings if rates are indeed rising. But high yield can certainly be... has higher correlations and especially high yield investors can have higher correlations to the equity market, especially when things are going poorly in the high yield market. So you absolutely have to be concerned in high yield. I mean, it's a much lower credit profile than the preferred market. So you've got that to contend with, and as you mentioned, emerging markets, you can have much more volatility in high yield and emerging markets than you would in preferreds.

So it would give you perhaps a better return profile potentially with dampened volatility relative to emerging markets and high yield. And as you mentioned, yeah, you can have a strong dollar. You've got the currency risk to contend with when you're investing in emerging market fixed income as well. It's like the blitz in football. You live by it and die by it. Same thing can happen in the world of EM investing when you're sitting there taking currency risk. Sometimes it goes your way, but other times it might not.

Mark Goodwin:

We mentioned earlier the importance of active management in this environment. Are there specific nuances to the preferred space that would give an active manager an advantage?

John Cassady:

Yeah, absolutely, there are. And I would point to probably two things. Number one, the structure of each individual security. You absolutely have to pay attention to that. What are the callability features of it? And then once you get to the period when it is callable, typically some of the securities we invest in, they're called hybrids and they will be fixed rate for a period of time. And then when they get to the call date, they go to a floating rate, interest rate structure. So you have to pay attention to what type of floating rate are you getting? What are the margins? Are they skinny margins on the floating rate or are they nice, big ones? That all plays into our calculus on what to invest in. And then the other nuances I would say is certainly there's an interesting dichotomy between the $25 preferred market or what we'll call the retail preferred market and the more institutional market. What happens many times in the $25 preferred market is a lot of things in that marketplace can get mis-priced.

We've witnessed over the past, as long as we've been doing this, that mis-pricings occur when certain $25 structures will end up trading at negative yield to call, which does not make any economic sense. And so we've been able to, as a total rate of return manager, active manager, we can own $25 preferreds when they look cheap relative to their hybrid brethren and we'll own them and if they're rich enough and if they get to the point where they're trading at negative yield to call, we're happy to sell them and go into

cheaper bonds in the institutional space that have similar characteristics in terms of where they sit in the capital structure. But it's just the mis-pricing that takes place that we can take advantage of.

Mark Goodwin:

Thanks, John, would you say that your overall exposure to preferred securities provides a certain degree of diversification to your portfolios that investors might not get from more traditional fixed income investments?

John Cassady:

Yeah, definitely. I'd say that. And I went back to a comment I made earlier absolutely about the correlation benefits that you getting relative to traditional fixed income over the 15-year period preferred relative to investment grade domestic fixed income, have that 0.15 correlation to the Bloomberg Barclays Aggregate index. So you get a diversification there. And just once again, I think if you get an active manager involved, there are other ways that you can make total rate of return by investing in preferreds. So it's not as efficient as a marketplace as maybe some more highly traded fixed-income securities. So I think that's where you also get some diversification benefits.

Mark Goodwin:

Great. David turning back to you, as we mentioned earlier, you folks sub-advise, ADVNX, the North Square Strategic Income Fund. Thank you again for your partnership there. And could you comment about how the current portfolio for ADVNX is positioned?

David Withrow:

Sure. And Mark we've certainly enjoyed it. We've been managing similar strategies for most of our careers, and we think it's a great way to kind of showcase the best of the talent of the team. Currently, let me start with the bulk of it. So when you look at the fixed income space, which is really the core of the portfolio right now, you know, we went from a low, the range on preferreds. It's going to go anywhere from 30% to 50%, we went from a low in the crisis and during pandemic down near that low end of the range around 30%, and now we're closer to 45%. I want to get a little more fine tuned than that because John mentioned several different types of preferred and we really lump them into three buckets. There's the $25 preferred, which is probably what most retail clients are familiar with.

And it is geared toward a retail, kind of high net worth client base. Then you have hybrid securities, which look more like bonds. John mentioned a lot of them are fixed to floating. So they start off as a fixed rate coupon, they go to a floating rate and then we have the contingent claim AT-1 is kind of what the European banks have issued. So there's COCO, hybrid and $25 preferred. We used to be very heavily weighted towards the $25 preferred. Over the last year we've migrated to the hybrid. So hybrid is about 31% of that 44%. The COCOs are just under 8% and the $25 par around 6%. About 23% of the portfolio is in what we call securitized. So think residential mortgage, commercial mortgage, and asset backed consumer loan types of securities. It's probably not your garden variety type securities, but that's where we can find very unique opportunities.

Again, we're looking for unique securities that probably are under evaluated by the Street where we can find relative value that maybe the rest of the Street's not unearthing. And so that's about 20%, just under 24%. We do have about 8% equity exposure, which is towards the high end of the range, we max out at

10% there for equity exposure. We prefer, not that we won't take high yield, traditional high yield, but if we're looking at high yield exposure, which is heavily correlated to equity, we'd rather have the upside benefit of actually owning the equity. We're fairly bullish on the equity market right now, but we really are a bottom-up manager on there. So we have names in there that we really like. And so we were at 8%, REIT equity we're just about 5%. Interestingly enough, in that bucket, you'll find some interesting, they may not be your traditional REITs but they're called mortgage REITs.

Suffice to say, they provide a significant amount of income. A few months ago, we started buying. Sometimes their dividend yields were double digits, you know, 10% to 12%. Several of those have actually performed exceptionally well. And have been some of the biggest contributors on an individual name basis. And then we also have just about 5% exposure to non-dollar. And those are names of the Mexican bonds denominated in pesos, where we felt the yield advantage was significant to the US. We also felt that the peso could perform well against the dollar. And it actually worked for quite a while. Recently, that's tailed off a little bit, but that has provided very substantial performance, both on a yield basis and the appreciation on the currency with that one.

So we have exposure there again around 5%, we probably will be continuing to look to add to those positions because we can, I think again, when we can diversify the portfolio globally, we continue to diversify away from mainly a lot of interest rate risks we're trying to diversify away from. And that's a great opportunity to do that. We have hedged out some duration using derivatives, and these are simply treasury derivatives. The exposure there really is to get the duration. We're about three-and-a-half year duration, which is really just a measure of interest rate sensitivity. So those are really the broad buckets of the positioning. And I'm happy to go into more detailed notes, but I think that gives you a good idea of how we're positioned today.

Mark Goodwin:

Thanks David, for income-oriented investors that may be new to the Strategic Income Fund and Red Cedar's approach, how do you suggest they should think about your multi-asset income strategy as they look at it as a specific position in an overall investment portfolio?

David Withrow:

As I mentioned, we've been managing this strategy for a long time and we spend a lot of time thinking about that. And we believe that it really... As people are rethinking again, this is a theme right now with low interest rates, as people rethink, what does it mean to have a core fixed income strategy? The traditional views just don't work anymore. So we view this could be a core position in a portfolio, which might take the place of a traditional fixed-income strategy. And it doesn't make sense just to allocate it because historically this is what it's done. There is by nature, asymmetric risk in fixed income. And although it's a little bit been thrown out the window, you have this arbitrary, 0% yield as about as low as you can go. And why would you buy a negative yield like you have in Europe right now if you don't have to?

So this gives you an opportunity to get yield in a portfolio that has really low correlations to both equity and the fixed-income traditional products. Another way we've seen clients use this is as a compliment to other funds, which may source their alpha in a different direction, such as traditional high yield or emerging market. Again, we're not against those asset classes. It's just typically, not where we source the

alpha in our fund, but when you pair us with other funds who maybe use those asset classes, you see a pretty good, or in many cases, a pretty good risk paradigm emerges when you run the statistical measures on upside/downside capture and when they're outperforming versus when they're underperforming. And so pairing it with another fund, which may operate a different type of strategic income strategy is often found to be a good way to implement this.

Mark Goodwin:

Thanks, David, you had mentioned earlier about the potential for some of these securities to be called. How do you think we should think about call risks in this particular environment and in general, for preferred securities?

David Withrow:

You really have to view it as when we buy our preferred securities, sometimes it's viewed as call risk. We want the security to be called. We're buying it with the intention it's called. I would say most of the time, there are times when we don't want it to be called, but most times we're buying with an eye toward it being called. And many of the securities are structured with the intention that there will be incentive, the economic incentive is there to be called. It's not quite as the gentleman's handshake agreement it used to be in the marketplace where companies could call it at a whim, but there still is ways to buy securities where you have some certainty. Now when you're buying a fixed rate that's fixed for life, you have to do the same analysis on that, that you would have a callable bond.

There used to be a lot more callable bonds in the old days when I first got in this business and the negative convexity or the sensitivity where the bond performed exactly opposite, how you wanted it to. So we make sure that we have a good balance of the ones that go fixed to floating. That fixed to floating feature again, as an incentive, that even if you are holding onto the bond, they don't call it. Now that you're a floating rate, you're going to go with where interest rates go anyway. So we do actually own some floating rate bonds, which have converted to floating rate, which aren't going to be called, but we liked that sensitivity to the short part of the curve.

And then frankly, Mark, there's other bonds we've purchased where they're floating rate, but they're floating to the higher yield of either short-term rates, 10-year or 30-year rates. And you get the highest rate. So it really works well. There's a couple of scenarios where it doesn't perform well, but in the market scenario we're in now where you have 30-year yields rising and the front end of the curve held steady, it actually performs very well. All that becomes a part of our analysis. And it really goes back to what John was talking about, where active management is very important because you want to be fully aware of these covenant structures built into these securities.

Mark Goodwin:

Thanks, David, we're at an interesting inflection point particularly where the rally post the downdraft in the market last March has been really impressive and many investors might find themselves uncomfortably, overweight equities right now, but still a bit uncertain about moving more into traditional fixed-income investments, given the potential for rising rates. How do you see the Strategic Income Fund, ticker ADVNX, perhaps being in a better position to put them on good footing for a rising rate environment?

David Withrow:

And Mark, I think the ADVNX portfolio really speaks to that because you're right, it's hard to go from an equity portfolio. If you're trying to hit a target return or get any return, it's hard to justify selling equities right now to go into an aggregate benchmark, interest-rate sensitive, low-yielding portfolio. And it'd be hard for me to justify that in a portfolio. And what ADVNX provides is an opportunity to not sacrifice yield and actually probably pick up yield versus the S&P 500 in many cases, but also have some upside potential. So you're right, to go from equities to a traditional approach, it's a tough sell. And I don't know that I would sell that, but I think when you look at a portfolio like this, you don't have some of those same risks, especially with interest rate sensitivity, where we're call it a little more than half the duration risk of the traditional benchmarks. And so the interest rate sensitivity is much less.

We get an extra yield and that yield will cushion some of that price depreciation, even if rates do go up. And we also can buy securities, which are less sensitive and have a lower correlation to interest rates in general, some have negative correlations to the fixed income marketplace. All those really, I think, provide a great foundation to say, "Hey, if you're wanting to take back your risk a little bit, here's a way to do it and not kill your returns on your portfolio over time."

John Cassady:

Hey, can I just add, throw something else in here as well? There's a lot written about the traditional 60/40 portfolio is dead with interest rates where they're at, and it's going to be tough for fixed income to buffer you in the event you have a downdraft in the equity market. So to David's point, yeah, I think this is the way you would want to own fixed income. And I'll just tell you this, the Bloomberg Barclays Aggregate Index returned minus 3.4% for the first quarter. So down 3.4% in one quarter of the year, that is the worst start to the year ever for that index. Okay. So that speaks to is fixed income going to help you out. Clearly equities were doing their job during that timeframe so all is good, but a negative return on fixed income during the quarter. In this strategy, it had a positive return during the quarter.

It was now, albeit a positive seven basis points, but nonetheless, it had a positive sign and it's return when fixed income had it's worst quarter ever, or worst start to the year ever. So that's what I would add.

Mark Goodwin:

Thanks, John. As a capstone comment, I've enjoyed following you guys for a long time now. And I like multi-sector bond funds in general because it allows managers to be creative in what they do. I like the fact that managers in the space can go across the globe. And I especially like the fact that you guys can go across the capital structure very nimbly. So thank you so much for your time today. This has been a great conversation as always.

David Withrow:

Thanks, Mark. Appreciate the time.

John Cassady:

Thanks a lot.

Diane Merritt:

Thank you for tuning into our North Square Active Insights podcast. For more information on North Square Investments, our partners and investment solutions, please visit our website at www.northsquareinvest.com. Nothing contained in this communication constitutes tax, legal or investment advice. Investors must consult their tax advisor or legal counsel for advice and information concerning their particular situation. This podcast contains certain statements that may include forward looking statements. Although Red Cedar Investment Management believes that the expectations reflected in these forward-looking statements are reasonable, they do involve assumptions, risks, and uncertainties, and these expectations may prove to be incorrect. Actual events could differ materially from those anticipated in these forward-looking statements. As a result of a variety of factors, you should not place undue reliance on these forward-looking statements. This podcast reflects Red Cedar's views and opinions as of the date here in which are subject to change at any time based on market and other conditions. We disclaim any responsibility to update these views. These views should not be relied on as investment advice or an indication of trading intention.

Important Risks: The Fund invests in equities which are subject to market volatility and loss. The Fund invests in equities of large-cap companies which may be unable to respond quickly to new competitive challenges. The Fund invests in equities of small- and mid-cap companies, which may be subject to more erratic market movements than stocks of larger, more established companies. The Fund invests in value equities which may not appreciate in value as anticipated or may experience a decline in value. The Fund invests in foreign securities which carry the associated risks of economic and political instability, market liquidity, currency volatility and differences in accounting standards. The Fund invests in preferred stocks which are relegated below bonds for payment should the issuer be liquidated. The fixed dividend may be less attractive in a rising interest rate market.

The Fund invests in REITs; the risks are similar to those associated with direct ownership of real estate. Shareholders will indirectly bear the additional expenses of investing in REITs. The Fund invests in convertible securities which are subject to the risks of both debt securities and equity securities. The Fund invests in debt securities which can lose their value as interest rates rise and are subject to credit risk which is the risk of deterioration in the financial condition of an issuer and/or general economic conditions that can cause the issuer to not make timely payments of principal and interest also causing the securities to decline in value and an investor can lose principal. When interest rates rise, the price of debt securities generally falls. Longer term securities are generally more volatile. The Fund invests in investment grade debt securities which may be downgraded by a Nationally Recognized Statistical Rating Organization (NRSRO) to below investment grade status.

The Fund invests in non-investment grade debt securities which are considered speculative with respect to the issuers' ability to make timely payments of interest and principal, may lack liquidity and have had more frequent and larger price changes than other debt securities. The Fund invests in U.S. government and agency securities which are neither issued nor guaranteed by the U.S. Treasury and are not guaranteed against price movements due to changing interest rates. The Fund invests in mortgage-backed securities and asset-backed securities which are subject to the risks of prepayment, defaults, changing interest rates and, at times, the financial condition of the issuer. The Fund invests in other investment companies such as closed-end funds and ETFs which are subject to substantially the same risks as those associated with the direct ownership of the securities comprising the portfolios; however, the price movements of the investment companies may not track the underlying securities or market index; the

value of their shares may be lower than the value of the portfolio securities, and may be illiquid and shareholders will bear, indirectly, the additional expenses of investing in other investment companies.

The Fund invests in derivatives such as forward currency exchange contracts, futures contracts, options and swap agreements. Derivatives can be highly volatile, illiquid and difficult to value, subject to counterparty and leverage risks and there is risk that changes in the value of a derivative held in the Fund will not correlate derivative may be much greater than the original cost and potential losses may be substantial. The Fund may experience higher portfolio turnover which may lead to increased fund expenses, lower investment returns and higher short-term capital gains taxable to shareholders. Current and future portfolio holdings are subject to risk. The advisor engages the sub-advisor to manage the Fund's portfolio; the sub-advisor's judgment may impact the Fund's performance.

Before investing you should carefully consider the Fund's investment objectives, risks, charges and expenses. This and other information is in the prospectus, a copy of which may be obtained by calling 855-551-5521. Please read the prospectus carefully before you invest. Distributed by Compass Distributors, LLC. Member FINRA.

2020 North Square Investments, LLC.

Not FDIC Insured · May Lose Value · No Bank Guarantee

North Square Investments, LLC is an investment adviser registered with the U.S. Securities and Exchange Commission. Registration does not imply a certain level of skill or training. More information about the companies' investment advisory services can be found in their respective form ADV, which are available upon request. Past performance is not indicative of future results. The investment strategy or strategies discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances. Nothing discussed herein constitutes and offer to buy or sell a particular security or investment strategy. No assurance, representation, or warranty is made by any person that any of North Square's assumptions, expectations, objectives and/or goals will be achieved, Nothing contained in the document many be relied upon as a guarantee, promise, assurance, or representation as to the future.

NSI-2021-08