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Salient Tactical Growth Strategy as an Alternative to Bonds

Investors have used the Salient Tactical Growth Strategy as a potential cushion against equity market risk. But the strategy has historically also been able to help cushion portfolios against interest rate rises. The strategy has had a low correlation of 0.11 to bonds over the last decade and has had a negative correlation to bonds during the six significant periods of interest rate increases since 2009.[1] Additionally, the strategy has produced mostly positive returns during these periods of rising rates.[2]

Salient Tactical Growth has historically performed well during periods of interest rate rises in large part because monetary policy and credit conditions are a major component of the strategy's four-pillar process. The strategy's models are designed to monitor the rate of change of interest rates, credit spreads, commodity prices and other measures to identify the conditions that could adversely affect both the stock and bond markets.

As investors look to the future, they must consider the possibility of a rising interest rate environment. While bonds have provided a good store of value for many years, a rising rate environment would adversely affect the principal value of bonds.

Performance of Salient Tactical Growth Strategy During Periods of Rising Interest Rates

During the six periods of significant interest rates rises since 2009, the Salient Tactical Growth Strategy outperformed bonds, as measured by the Bloomberg Barclays U.S. Aggregate Bond Index, and produced positive returns in five of the six periods of rising rates compared with declines in the bond market.

Table 1. Six Periods of Significant Interest Rate Rises Since 2009

Periods of Rising Interest Rates	Bloomberg Barclays U.S. Aggregate Bond Index	Salient Tactical Growth Portfolio — Net	Difference
11/30/09 - 12/29/09	-1.47%	1.33%	2.80%
11/04/10 - 01/31/11	-1.65%	4.10%	5.75%
07/25/12 - 09/05/13	-3.57%	7.65%	11.22%
01/30/15 - 12/30/15	-1.37%	-0.98%	0.39%
07/08/16 - 11/08/18	-2.33%	13.31%	15.64%
08/04/20 - 02/26/21	-2.25%	3.28%	5.53%

Sources: Salient and Morningstar Direct, as of September 2021. *For illustrative purposes only. Past performance is not indicative of future results. No investment strategy can guarantee investment results.*

[1] Morningstar Direct, as of June 30, 2021
[2] Past performance is not indicative of future results. No investment strategy can guarantee performance results.

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In March 2021, the 10-year U.S. Treasury Note rose as high as 1.74%, its highest level in over a year. Prior to the pandemic, the 10-year U.S. Treasury Note reached over 3% in 2018 and almost 4% in 2010.[3]

A rise in interest rates to pre-pandemic levels would have a severe impact on bond portfolios.

But what if interest rates do not rise from current levels?

Investors can be comforted by the fact that in the 10 years ending September 2021, the Salient Tactical Growth Strategy has outperformed both the Bloomberg Barclays U.S. Aggregate Bond Index and the strategy's benchmark, the HFRX Equity Hedge Index.

Table 2. 10 Years of Performance as of September 2021

	Annual Return	Standard Deviation
Salient Tactical Growth Portfolio — Net	4.59%	6.39%
Bloomberg Barclays U.S. Aggregate Bond Index	3.01%	2.99%
HFRX Equity Hedge Index	3.74%	6.50%

Sources: Salient and Morningstar Direct, as of September 30, 2021. *For illustrative purposes only. Past performance is not indicative of future results. No investment strategy can guarantee investment results.*

The Four-Pillar Process and Interest Rates

The level, direction and rate of change of interest rates are major factors in the Salient Tactical Growth four-pillar investment process, including valuation, monetary policy and credit conditions, investor sentiment (from a contrarian perspective) and momentum. Interest rates drive equity valuations and equity valuations in turn have a direct impact on investor sentiment. The momentum and relative strength of the financial- and interest rate-related sectors often precede changes in overall stock and bond market direction. The investment team considers all these factors in determining an appropriate market exposure. The following is a summary of how the Salient Tactical Growth Strategy's four pillars relate to the possibility of further interest rate rises:

- **Equity valuations** are directly linked to the general level of interest rates. The lower the return on fixed-income assets, the more attractive the potential returns on equities become. A rise in interest rates—and a corresponding decline in bonds—alters the risk-reward ratio between stocks and bonds.
- **Monetary policy and credit conditions** are the major drivers of interest rates and intermediate- to long-term stock and bond prices. Historically, a rapid and meaningful rise in rates has often been a warning sign to potential market weakness. Credit spreads are also an important factor in assessing the risk posed by rising rates.
- **Investor sentiment** is important since the combination of rising interest rates and extreme optimism has often preceded stock and bond market weakness.
- **Momentum** and relative strength for interest rate-related sectors such as financials, home building and utilities often indicate when rising interest rates are beginning to impact the bond and stock markets. Weakness in these areas often precedes the onset of a "risk-off" environment.

[3] U.S. Department of the Treasury, October 2021

The Risk of Rising Interest Rates

Interest rates reached an all-time high in October 1981 when the yield on the 10-year U.S. Treasury Note hit over 15%.[4] Political turmoil in the Middle East led to an oil crisis and runaway inflation. It took the next 40 years for interest rates to unwind to their current low levels. As the coronavirus spread during the early spring of 2020, the 10-year U.S. Treasury Note touched an all-time low of 0.318% in overnight trading on March 9, 2020.[5]

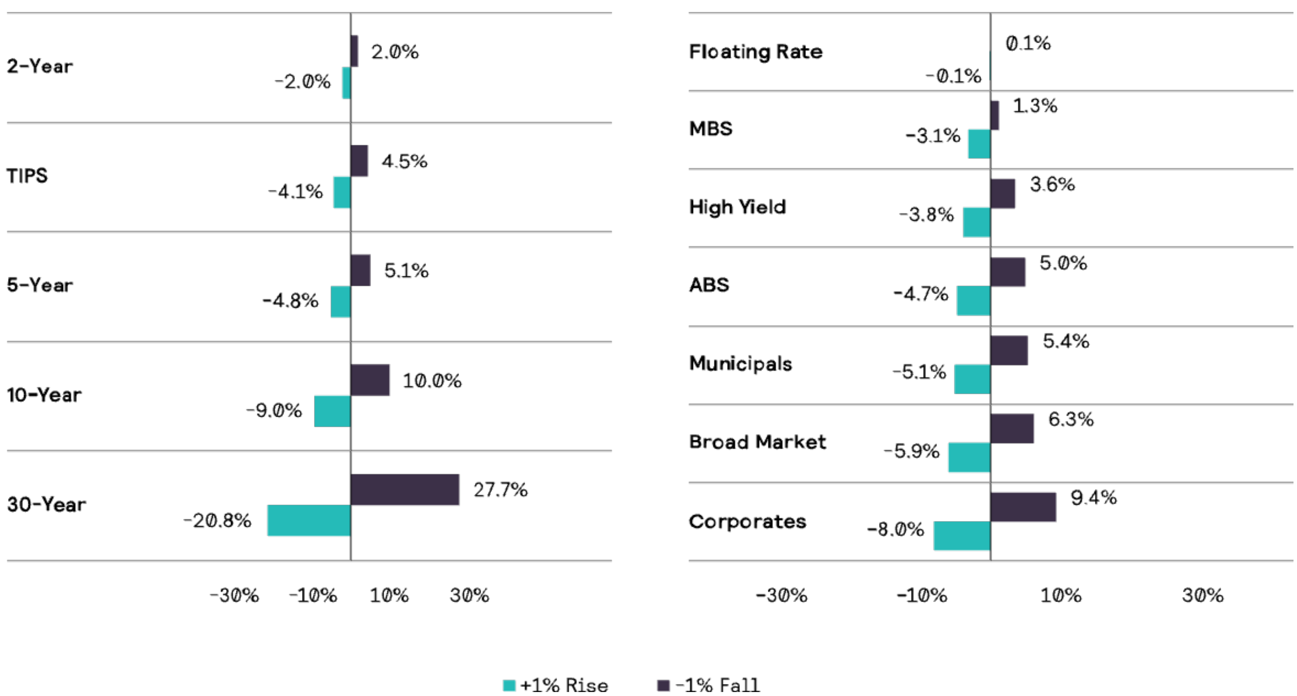
Investors have had to purchase bonds with longer maturities to obtain higher yields. Some investors have taken on more credit risk by purchasing "junk bonds," which are bonds that carry a higher risk of default than most bonds issued by corporations and governments. The average yield on junk bonds as measured by the Bloomberg Barclays U.S. Corporate High Yield Bond Index fell to 3.96% in February 2021, the lowest yield on record for this index.[6] Durations—a measure of interest rate risk—are now at or near all-time highs. The longer the duration of a bond, the longer investors must wait to be paid. This exposes investors to increased volatility due to changing interest rates.

The impact of a rise in interest rates on all fixed-income securities is meaningful. *Figure 1* shows the price declines for a variety of fixed-income securities for a 1% rise in interest rates.

Figure 1. Impact of Rate Changes on Fixed-Income Prices

Total Return Impact of a 1% Rise/Fall in Interest Rates

As of January 31, 2021



Sources: FactSet, Morgan Stanley Wealth Management GIC. The following Bloomberg Barclays indices were used for the sectors above: U.S. Aggregate Bond for Broad Market, U.S. Aggregate Securitized – MBS Index for MBS, U.S. Corporates for Corporate, Muni Bond 10-year Index for Municipals, Corporate High Yield Index for High Yield, US TIPS Index for TIPS, FRN (BBB) for Floating Rate, U.S. Convertibles Composite for Convertibles, and ABS + CMBS for ABS. Bloomberg Barclays U.S. Treasury benchmark indices used for U.S. Treasury data.

For illustrative purposes only. Past performance is not indicative of future results. Indices are unmanaged, and one cannot invest directly in an index.

[4] Bloomberg, October 2021
[5] Bloomberg, October 2021
[6] U.S. Department of the Treasury, October 2021

With a 1% rise in interest rates, the 10-year U.S. Treasury Note declines -9.0% and the 30-year U.S. Treasury Bond drops -20.8%.

Summary

Salient Tactical Growth Strategy's four-pillar process incrementally adjusts portfolio exposure between major market indices and cash and cash equivalents as the models of its four-pillar investment process indicate. While the investment process is equity-oriented, it has resulted in the strategy's outperformance during periods of rising interest rates, in large part because monetary policy and credit are such an integral part of the four-pillar process. These factors serve as a potential alert system to warn the Tactical Growth investment team of possible future market risks.[7]

While many investors have used bonds as the anchor of the traditional 60/40 equity-bond allocation, it may be time to consider the Salient Tactical Growth strategy as an alternative to that 40% bond allocation.

Long-Term Performance of the Salient Tactical Growth Portfolio

Performance as of 09/30/2021

	3Q 2021	YTD	1 Year	3 Year	5 Year	10 Year	Since Incep.*
Salient Tactical Growth Portfolio—Net	-0.89%	4.83%	8.83%	4.94%	5.88%	4.59%	4.27%
HFRX Equity Hedge Index	1.28%	9.24%	17.74%	4.96%	4.90%	3.74%	2.49%
S&P 500 Index	0.58%	15.92%	30.00%	15.99%	16.90%	16.63%	15.18%
Bloomberg Barclays U.S. Aggregate Bond Index	0.05%	-1.55%	-0.90%	5.36%	2.94%	3.01%	3.74%

Returns for periods greater than one year are annualized. Net returns are calculated using a 2.00% wrap fee, applied monthly.

* 08/01/09

Performance provided represents the annualized return of the portfolio and the indices over the period. Investing involves risk, including possible loss of principal. Past performance does not guarantee future results. Index returns are for illustrative purposes only and do not represent actual performance of any securities. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

[7] No investment process or system can protect against the loss of principal.

The **Tactical Growth composite** seeks to produce above-average, risk-adjusted returns, in any market environment, while exhibiting less downside volatility than the market itself. The strategy is designed to evaluate potential long and short investments in an attempt to isolate those securities believed to be undervalued or overvalued relative to their intrinsic value and offer the greatest risk-adjusted potential for returns. The portfolio primarily invests in ETFs of securities and security indices that can represent long, short, levered long or levered short positions in general asset classes of both U.S. and overseas equity markets. For comparison purposes, the composite's benchmarks are the HFRX Equity Hedge Index and the S&P 500 Index. The HFRX Equity Hedge Index is comprised of private funds with strategies that maintain both long and short positions primarily in equity securities and equity derivatives. The S&P 500 Index consists of 500 stocks chosen for market size, liquidity and industry group representation. It is a market value-weighted index and one of the most widely used benchmarks of U.S. stock performance. On January 1, 2019, the HFRX Equity Hedge Index replaced the S&P 500 Index as the strategy's primary benchmark index because the new index more closely aligns to the strategy's investment methodologies. Prior to December 31, 2018, the Morningstar Long/Short Equity Index was the secondary benchmark. It is no longer shown as the HFRX Equity Hedge Index more closely aligns to the portfolio's investment strategies.

Separately managed account strategies may not be appropriate or suitable for all investors. There is no guarantee that the strategy's objective will be achieved. It should not be assumed that investments in this strategy have been or will be profitable.

Past performance does not guarantee future results.

Other than levered and inverse ETFs, leverage or derivatives are not used. The use of levered and inverse ETFs is anticipated to be infrequent and may not materially impact returns.

The risks associated with ETFs are detailed in the individual ETF's prospectus, which will be provided upon request.

The portfolio is sub-advised by Broadmark Asset Management LLC, an independent registered investment advisor.

Salient is the trade name for Salient Partners, L.P., which together with its subsidiaries provides asset management and advisory services. Salient claims compliance with the Global Investment Performance Standards (GIPS®). Please call 800-994-0755 to obtain compliant presentation and/or a list of composite descriptions.

10-year U.S. Treasury Note is a debt obligation issued by the U.S. Treasury that has a term of 10 years.

30-year U.S. Treasury Bond is a long-term debt obligation issued by the U.S. Treasury that has a term of 30 years.

60/40 portfolio refers to a portfolio in which 60% of assets are invested in stocks and 40% are invested in bonds.

Bloomberg Barclays 10-Year Municipal Bond Index is an unmanaged index composed of a broad range of investment-grade municipal bonds with maturity dates of approximately 10 years.

Bloomberg Barclays Asset-Backed Securities (ABS) Index is the ABS component of the Bloomberg Barclays U.S. Aggregate Bond Index. It has three subsectors: credit and charge cards, autos and utility.

Bloomberg Barclays U.S. Aggregate Bond Index represents securities that are U.S. domestic, taxable and dollar denominated. The index covers the U.S. investment-grade, fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities and asset-backed securities.

Bloomberg Barclays U.S. CMBS Investment Grade Index measures the market of U.S. Agency and U.S. non-agency conduit and fusion CMBS deals with a minimum current deal size of $300 million.

Bloomberg Barclays U.S. Convertibles Composite Index tracks the performance of the USD-denominated convertibles market and includes all four major classes of convertible securities (i.e., cash pay bonds, zeros/OIDs, preferreds and mandatories).

Bloomberg Barclays U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market.

Bloomberg Barclays U.S. Corporate High Yield Bond Index covers the USD-denominated, noninvestment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Additional information about ratings can be found, respectively, at www.moodys.com, www.fitchratings.com and www.standardandpoors.com.

Bloomberg Barclays U.S. Floating-Rate Note Index measures the performance of U.S. dollar-denominated, investment-grade, floating-rate notes across corporate and government-related sectors.

Bloomberg Barclays U.S. Mortgage-Backed Securities Index tracks the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC).

Bloomberg Barclays U.S. TIPS Index is an unmanaged index that includes all publicly issued, U.S. Treasury inflation-protected securities that have at least one year remaining to maturity, are rated investment grade, and have $250 million or more of outstanding face value.

Correlation is a statistical measure of how two securities move in relation to each other.

Credit spread is the spread between Treasury securities and non-Treasury securities that are identical in all respects except for quality rating.

Duration is a measure of the sensitivity of the price of a fixed-income investment to a change in interest rates and is expressed as a number of years.

HFRX Equity Hedge Index is comprised of private funds with strategies that maintain both long and short positions primarily in equity securities and equity derivatives.

Junk bonds are bonds issued by companies that are financially struggling and that carry a higher risk of default than most bonds issued by corporations and governments.

Momentum is the rate of acceleration of a security's price or volume.

Monetary policy refers to the actions of a central bank, currency board or other regulatory committee that determine the size and rate of growth of the money supply, including a change in interest rates or the amount of money banks need to keep in bank reserves.

Principal value is the original sum used to purchase an investment excluding any earnings or interest.

Relative strength is a type of momentum investing that consists of selecting investments that have been outperforming their market or benchmark.

S&P 500 Index is an unmanaged index of 500 common stocks chosen to reflect the industries in the U.S. economy.

Standard deviation measures the degree to which a fund's return varies from its previous returns or from the average of all similar funds.

Valuation is the process of determining the value of an asset or company based on earnings and the market value of assets.

Volatility is a statistical measure of the dispersion of returns for a given security or market index.

Yield is the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost or on the U.S. government's debt obligations.

One cannot invest directly in an index.

Not FDIC Insured | No Bank Guarantee | May Lose Value

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