REDWOOD’S DEFENSIVE CREDIT STRATEGY: MINIMAL SHORT-TERM DRAWDOWNS, LONG-TERM FOCUS

Mission Statement
Redwood’s Defensive Credit Strategy seeks to realize non-correlated returns characterized by low volatility (more specifically downside volatility) and low drawdowns. The objective of the strategy is for minimum annual returns to exceed or match the “risk-free” returns of U.S. Treasury Bills, based on historical performance.

Strategy
Redwood’s Defensive Credit Strategy uses a quantitative approach that primarily seeks to identify the critical turning points in the high-yield corporate bond market (herein referred to as high-yield or high-yield bonds). The investment objective is to be invested in high-yield bond funds when the market is trending upwards, and conversely, invested in money market, money market funds, or short-term government bond funds when the market is trending downward. Redwood may invest up to 25% of net assets in other income oriented funds (including, but not limited to, emerging market debt, convertible bonds, preferred securities, and global bonds) on an opportunistic basis with flexibility for income generation, total return, and defensive positioning as macro and micro environments change. By initiating these tactical changes, Redwood seeks to reduce the drawdowns commonly associated with the high-yield bond market, while at same time seeking to capture the potential gains associated with the asset class’ bull market rallies. This approach strives to achieve absolute returns in both bull and bear markets.

There are unique characteristics of the high-yield bond asset class that we believe facilitate a more accurate quantitative approach compared to other asset classes. Our approach seeks to minimize discretionary biases when determining the best opportunities to allocate to high-yield securities.

Overview
As often experienced historically in the stock market, cyclical bull and bear markets have taken place in the high-yield asset class. There are popular misconceptions around high-yield bonds. This piece reviews the benefits and risks of the asset class, and why in our view a set of tactical risk-management tools is essential for investors looking to protect against significant loss of principal, while enhancing risk-adjusted returns.

CYCLICAL BULL AND BEAR MARKETS IN HIGH-YIELD | January 1, 1989 through December 31, 2016

To more clearly reflect the underlying trends in high-yield bond values, this chart tracks share prices only, and does not include the return from monthly or quarterly dividends - which have historically contributed to the majority of the total return.

Sources: Fasttrack, Redwood. For illustration purposes only. The High-Yield Bond Fund Blend represents a blend of 14 open-ended mutual funds, which were a result of the following objective criteria: Inception date prior to 1/1/1988; Total Assets of funds as of 12/31/16 as supplied by Morningstar greater than $1B; all searchable funds categorized in Morningstar as “Taxable High Yield Bond”; and available data.

Past performance is not a guarantee of future results. Please refer to important disclosures on last page.
High-Yield Bonds Broaden Portfolio Diversification

High-yield bonds represent a unique sector of the U.S. fixed income market. These corporate debt obligations are rated below investment-grade by nationally recognized rating agencies (i.e. BB or lower by Standard & Poor’s and Ba or lower by Moody’s or, if unrated, considered to be of comparable quality), and are commonly referred to as “junk bonds.” Numerous studies support the inclusion of high-yield bonds as a distinct asset class within an investment portfolio for three primary reasons:

1. Low historical correlation to other asset classes, including commodities, U.S. Treasuries, and investment grade debt.
2. Favorable risk-adjusted return comparison to other asset classes.
3. The added value of high relative dividend yields.

The chart below displays the historical yield of the high-yield bond asset class for the period 1989-2016. The chart illustrates the extraordinarily high yield, at times, of this asset class.

YIELD TO WORST OF BARCLAYS U.S. CORPORATE HIGH YIELD INDEX | January 1, 1987 through December 31, 2016

Risks Associated with High-Yield Bonds

We have found four primary kinds of risk that must be evaluated when considering an investment in high-yield bonds:

1. **Credit Risk:** Determined by the issuer’s ability to meet its obligations to make principal and interest payments when due. The assumption is that the lower a bond issue is rated by a rating agency, the greater the credit risk. Since high-yield securities are considered to carry more risk, it is generally perceived that their market prices will tend to fluctuate more than higher-grade securities. In order to compensate investors for assuming greater credit risk, lower-rated securities usually pay higher yields than investment-grade debt.

2. **Liquidity Risk:** High-yield securities tend to be much more illiquid than higher-grade securities. As an over-the-counter market, high-yield bonds are dependent on the availability and willingness to commit capital from the investment banking/broker-dealer community. At times of stress, the ability of the market to absorb imbalances in supply and demand can cause prices to be volatile. It is worth noting that the high-yield market has grown ten-fold since 1990 to approximately $1.7 trillion today. Over that same period, predominately due to Wall Street consolidations, the number of market-makers deploying meaningful capital has shrunk significantly. Consequently, dealer capital is limited in relation to the overall size of the market.

*This section continues on next page.*
SNAPSHOT FOR PRIMARY DEALER POSITIONS OF CORPORATE SECURITIES DUE GREATER THAN 1 YEAR

This chart clearly demonstrates that since the 2008 credit crisis, traders remain fearful of risk officers at their various broker dealers, and are unwilling to commit capital.

Source: Bloomberg. Dates: January 2, 2002 through March 27, 2013. Based on most current available data provided by Bloomberg as of 12/31/16. The end date is based on the last date Bloomberg provided this data. Other data illustrates that 2013-2016 have the same limited dealer positions.

3 **Macro Systematic Risk:** Because the high-yield market is regularly impacted by macro factors, it should come as no surprise that high-yield securities can exhibit fast and steep drawdowns even without bond or loan defaults. Large outflows from mutual funds and deleveraging within hedge funds can shake the market. Although often times high-yield bonds may decouple from the equity markets, during major down-drafts, broker-dealers' attitude toward risk taking (adding to their inventory positions) is correlated to the volatility in the equity markets. As a result, the high-yield market can be prone to significant corrections during major "risk-off" equity environments, irrespective of high-yield fundamentals.

4 **Interest Rate Risk:** When interest rates rise, newly issued bonds will have higher coupon yields than many existing bonds, putting downward pressure on the prices of outstanding bonds. However, the impact may not be as significant on high-yield bonds, than on higher-rated bonds.

**HIGH-YIELD PERFORMANCE IN A RISING RATE ENVIRONMENT**

Not all bond asset classes are created equally. As displayed in the table on the following page, over the last thirty years, there have been several periods when the 10-year U.S. Treasury yield has risen more than 100 basis points (1%), with the inclusion of the most recent rising rate environment where the rise was 99 basis points (0.99%). During these periods, high-yield bonds and leveraged loans had positive returns. Why?

- High-yield returns are more a function of default rates than of interest rates.
- Leveraged loans (also known as bank loans or high-yield loans) share the same credit risk as high-yield bonds and their floating rate coupons act as a potential hedge against rising interest rates.
- High-yield bonds' higher credit risk have exhibited a negative correlation to 5-year U.S. Treasuries as the greater spreads act as a cushion.

*This section continues on next page.*
HIGH-YIELD PERFORMANCE IN A RISING RATE ENVIRONMENT

<table>
<thead>
<tr>
<th>Period</th>
<th>10 Year U.S. Treasury Yield Move</th>
<th>High-Yield Bonds</th>
<th>Leveraged Loans</th>
<th>Investment Grade Bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aug 86 to Sep 87</td>
<td>+267 bps</td>
<td>6.08%</td>
<td>N/A</td>
<td>-0.53%</td>
</tr>
<tr>
<td>Sep 93 to Nov 94</td>
<td>+252 bps</td>
<td>1.97%</td>
<td>13.35%</td>
<td>-4.31%</td>
</tr>
<tr>
<td>Dec 95 to Aug 96</td>
<td>+137 bps</td>
<td>5.06%</td>
<td>5.42%</td>
<td>-2.16%</td>
</tr>
<tr>
<td>Sep 98 to Jan 00</td>
<td>+225 bps</td>
<td>4.12%</td>
<td>6.61%</td>
<td>-1.27%</td>
</tr>
<tr>
<td>May 03 to Jun 06</td>
<td>+177 bps</td>
<td>31.86%</td>
<td>21.99%</td>
<td>6.40%</td>
</tr>
<tr>
<td>Dec 08 to Dec 09</td>
<td>+163 bps</td>
<td>58.21%</td>
<td>44.87%</td>
<td>19.76%</td>
</tr>
<tr>
<td>Oct 10 to Feb 11</td>
<td>+100 bps</td>
<td>10.46%</td>
<td>7.40%</td>
<td>-0.04%</td>
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<tr>
<td>Aug 12 to Dec 13</td>
<td>+156 bps</td>
<td>13.84%</td>
<td>10.07%</td>
<td>0.88%</td>
</tr>
<tr>
<td>Aug 16 to Dec 16</td>
<td>+99 bps</td>
<td>4.57%</td>
<td>3.96%</td>
<td>-2.90%</td>
</tr>
</tbody>
</table>

Sources: Bloomberg, Federal Reserve Bank of St. Louis Economic Research. Indicated time periods are from the first day of the beginning month through the last day of the ending month. High-Yield Bonds are represented by the Barclays U.S. Corporate High Yield Index. Leveraged Loans are represented by the Credit Suisse Leveraged Loan Index. Investment Grade Bonds are represented by the BofA Merrill Lynch U.S. Corporate Master Index. “Bps” stands for basis points, and is a unit that is equal to 1/100th of 1%; 1% change = 100 basis points, and 0.01% = 1 basis point. All returns are total return calculated using monthly data.

HIGH-YIELD CORRELATION TO 5 YEAR U.S. TREASURIES BY CREDIT RATING

In the chart to the left, you can see that high-yield shows low-to-negative correlation to U.S. Treasuries over the given time period. The degree to which investors can expect to be protected from U.S. Treasury Bond moves depends on where their bonds are on a credit and spread basis. Naturally, lower rated credit securities generally have wider spreads, creating a cushion when rates rise. For example, a 50 basis points (0.5%) change in interest rates may have a significantly less impact on a security/fund with a 7% beginning yield than one with a 1.5% yield.

Additionally, as seen in the table below over the past 10+ years, high-yield bonds historically exhibited much lower correlations to movements in the 10-Year Treasuries (-0.20) versus investment grade bonds (0.49). Rising rates did not have the same impact on high-yield as they did for many other higher-grade (and lower yielding) fixed income asset classes.

CORRELATIONS AMONG VARIOUS ASSET CLASSES

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<table>
<thead>
<tr>
<th>Period</th>
<th>BofA ML 5-Year U.S. Treasury Index</th>
<th>BofA ML 10-Year U.S. Treasury Index</th>
<th>BofA Merrill Lynch U.S. High Yield Index</th>
<th>Barclays U.S. Corp Investment Grade Index</th>
<th>Credit Suisse Leveraged Loan Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>BofA ML 10-year U.S. Treasury Index</td>
<td>0.91</td>
<td>1.00</td>
<td></td>
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<td></td>
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<tr>
<td>Barclays U.S. Corp Investment Grade Index</td>
<td>0.40</td>
<td>0.49</td>
<td>1.00</td>
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</tr>
<tr>
<td>BofA Merrill Lynch U.S. High Yield Index</td>
<td>-0.22</td>
<td>-0.20</td>
<td>0.63</td>
<td>1.00</td>
<td></td>
</tr>
<tr>
<td>Credit Suisse Leveraged Loan Index</td>
<td>-0.44</td>
<td>-0.42</td>
<td>0.38</td>
<td>0.84</td>
<td>1.00</td>
</tr>
<tr>
<td>S&amp;P 500 Index</td>
<td>-0.31</td>
<td>-0.31</td>
<td>0.33</td>
<td>0.73</td>
<td>0.60</td>
</tr>
</tbody>
</table>

Sources: Zephyr, Redwood. Correlation is computed using 12-month trailing monthly data.

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Redwood’s Defensive Credit Strategy

Redwood’s Defensive Credit Strategy uses a quantitative approach that primarily seeks to identify the critical turning points in the high-yield bond market. The investment objective is to be invested in bond funds when the market is trending upwards, and conversely, invested in money market, money market funds, or short-term government bond funds when the market is trending downward. Redwood may invest up to 25% of net assets in other income oriented funds (including, but not limited to, emerging market debt, convertible bonds, preferred securities, and global bonds) on an opportunistic basis with flexibility for income generation, total return, and defensive positioning as macro and micro environments change. At Redwood, we believe any investment strategy that has a goal of protecting against significant loss of principal must have a mechanism that seeks to sidestep these unfavorable investment environments.

EXAMPLE: TACTICAL VS. BUY AND HOLD | January 1, 2000 - December 31, 2016

Macro Overlay

We determine the overall buy/sell bias by looking at daily inputs of a number of indicators. The strategy uses the daily net asset value (“NAV”) of several different open-end high-yield bond mutual funds to gauge the trend of high-yield bond prices. It is our conclusion that this is the best way to accurately track the price trend of high-yield bonds, rather than relying on a benchmark index or an exchange-traded fund. Since we have found the prices of high-yield securities to be influenced by longer-term interest rate trends and the behavior of the stock market, additional inputs include the price of the 20-year U.S. Treasury Bond and several broad stock market indices and statistics.

Our quantitative process seeks to minimize discretionary biases when determining the best opportunities to allocate to high-yield securities. Redwood constantly strives to improve the accuracy and reliability of our strategy, and to maintain our efficacy in a dynamic market environment.
Rationale

The highest risk period for high-yield securities has historically occurred when an economic slowdown threatens the ability of issuers to meet their interest and principal payments. Default rates are most directly related to the severity of economic contractions. The price of these securities will tend to undergo pronounced and extended declines during such periods, as was the case in 1989-1990, 2002-2003, and 2007-2008.

Additionally, with high-yield bonds (leveraged companies) being characterized as “risk” assets, macro factors have a significant effect on the pricing of high-yield securities. This was evident from August 1, 2011 to October 4, 2011. The high-yield market sustained considerable volatility and drawdowns due to the heightened technical factors (macro “risk-off” environment) rather than deterioration in the fundamental credit ratios. In many cases, market technicals overwhelm credit fundamentals. At a time where default rates remained benign (as of September 30, 2011, the high-yield default rate was 1.83% according to Credit Suisse), the Merrill Lynch High-Yield Master II Index experienced a negative 9.74% peak to trough drawdown (July 26, 2011 to October 4, 2011; sourced from Fasttrack).

Unique Characteristics of the High-Yield Market

There are certain unique pricing and behavior characteristics of the high-yield market that we believe facilitate a more accurate quantitative approach in determining the dominant trend of prices in this market as opposed to many other markets:

1. **The pricing mechanism of mutual funds dampens day-to-day price volatility** (see the two charts on the following page). Often times, the illiquidity of the high-yield market reduces the probability that any one security will trade on a given day. Nevertheless, a mutual fund must assign a price to each of its holdings in order to calculate its daily NAV. This encourages the pricing of a security that hasn’t traded to approximate its most recent price or to reflect the overall trend of high-yield prices on a given day. When this is done on a portfolio-wide basis, the end result tends to smooth out day-to-day fluctuations in the value of the portfolio. Naturally, the lower short-term price volatility, the easier it is to quantitatively measure the dominant trend in price movement.

2. **The market for high-yield securities tends to be homogeneous.** There can be little variation in price trends between different diversified mutual funds that faithfully adhere to a focus on the domestic high-yield market. This tendency of high-yield bonds to move in unison reinforces the clarity of the dominant trend and reduces the probability of losing “whipsaw” trades. With that said, there may be higher dispersion in the future.

3. **High-yield bond prices tend to be serially correlated,** as evidenced by the points made in paragraphs (1) and (2) above. Thus, we have found that a measurement of short-term price acceleration or deceleration using an indicator that is a second derivative of price (such as an oscillator based on a crossover of two moving averages) can exhibit a strong statistical predictability with regard to future price movement.

4. **The high coupon rate of high-yield bonds is a major component of the returns** realized from investment in this asset class. The historical experience of trading high-yield bond funds in conjunction with our strategy indicates that the impact of small capital losses as a result of fund NAV price depreciation can be minimized by accruing dividend income.

5. **Lower quality corporate bonds have historically tracked the longer-term cycles of the economy.** Buyers of these bonds typically have a long-term investment outlook and are most interested in the ability of the issuing corporation to redeem the bonds at maturity. They are not as concerned with short-term fluctuations in the markets or temporary economic dislocations. We believe this longer-term investment focus translates into a more trending asset class that tracks the longer-term cycles of the economy, with the potential for lower short-term volatility, thus making it easier to mathematically quantify the trend.
Lower Historical Day-to-Day Volatility of High-Yield Bond Mutual Funds

The following chart compares the day-to-day price percent change (excluding dividends), all plotted on the same Y-axis scale:

**DAY-TO-DAY VOLATILITY OF A BLEND OF HIGH-YIELD BOND MUTUAL FUNDS | January 1, 2003 - December 31, 2016**

The chart to the left plots the daily price-only percentage return (does not include dividends). The lowest volatility occurred in the price of the high-yield bond fund blend, by far. The tendency of open-end high-yield bond funds to exhibit lower daily volatility has lent itself to a trend-following quantitative approach with greater accuracy and reliability than would be the case for more volatile asset classes such as U.S. Treasury bonds and equities.

**TOP: High-Yield Bond Fund Blend**

**MIDDLE: Long Term Treasuries ETF (TLT)**

**BOTTOM: NASDAQ Composite ETF (QQQ)**

The high-yield bond fund blend displayed LOWER volatility than U.S. Long-Term Treasuries (TLT). On the face of it, a “riskier” asset class having lower volatility seems counter-intuitive, but the data/chart clearly demonstrates this.

Sources: Fasttrack, Redwood. For illustration purposes only. January 1, 2003 through December 31, 2016. The High-Yield Bond Fund Blend represents a blend of 14 open-ended mutual funds, which were a result of the following objective criteria: Inception date prior to 1/1/1988; Total Assets of funds as of 12/31/16 as supplied by Morningstar greater than $1B; all searchable funds categorized in Morningstar as “Taxable High Yield Bond”; and available data. TLT and QQQ were chosen due to their wide use to represent U.S. their respective asset classes by financial professionals. TLT and QQQ are not past or current Redwood holdings.

**50 DAY REALIZED VOLATILITY | December 31, 2010 - December 31, 2016**

The unique nature of the market for high-yield bonds has historically produced less volatile responses to events which sent shock waves through the markets for other asset classes. Redwood’s Defensive Credit Strategy has been able to accommodate paradigm shifts caused by fundamental changes in expectations for the economy and in regulation affecting high-yield bonds. For example, positive calendar year returns were generated after the bursting of the tech bubble and subsequent market decline of 2000-2002 and following the financial crisis of 2008, when virtually all asset classes became correlated in a broad-based market decline.

Past performance is not a guarantee of future results. Please refer to important disclosures on last page.
The Case For Mutual Funds

There are several advantages to investing in open-end high-yield bond mutual funds as opposed to investing directly in individual securities:

1 **Professional Management**: The larger mutual funds can offer the expertise of experienced portfolio managers to facilitate the process of individual securities selection. Professional management may significantly reduce the risk of issuer default by screening out the highest-risk securities.

2 **Diversification**: By investing in the securities of a broad array of issuers, mutual funds strive to mitigate the impact of any one default. Mutual funds may hold the securities of up to several hundred issuers and can avoid concentrating in any one industry.

3 **Liquidity**: Mutual funds offer liquidity on a daily basis. Assets can be transferred between shares of the high-yield bond fund and a money market or U.S. Treasury fund prior to 4:00 P.M. EST. Mutual funds buy and sell shares at the NAV (mutual funds reserve the right to modify or reject the exchange privilege at any time). This is not the case with individual bonds and exchange-traded funds where the price is based on a buyer and seller on the open market. Care is taken by Redwood to monitor positioning within the various fund families both in terms of frequency of trading and dollar amounts traded.

4 **Moderate transaction costs**: Sales charges are generally avoided by investing in no-load funds. In addition, Redwood has access to most load funds on a "load-waived" basis, as well as to various institutional funds, which generally have lower internal expenses. The operating expenses of the mutual funds are generally approximately 0.75% to 1% annually of assets, but may exceed that amount.
The Case For Leverage

A very compelling argument can be made for the use of leverage to enhance the returns of Redwood’s Defensive Credit Strategy for investors who seek higher returns and have a higher risk profile. Usually, more aggressive investors would gravitate towards riskier asset classes such as equities, futures, and/or options. However, we advocate the prudent use of leverage to enhance performance for certain qualified clients. We have generated returns that compare to riskier asset classes, while implementing a quantitative strategy that has limited downside volatility. Past performance is not an indication of future results.

Underpinning the logic of employing leverage is the generous spread between dividend yields and the borrowing rate. The spread of high-yield bond yields over 3-month LIBOR has averaged (from the below indicated time period) about 6.51%. The borrowing rate obtained from a bank is expected to be especially favorable in today’s low-interest rate environment.

YIELD TO WORST AND 3-MONTH USD LIBOR | January 1, 1987 through December 31, 2016

Conclusion

Redwood’s Defensive Credit Strategy has historically exhibited lower correlation to traditional investments, while seeking to generate absolute returns across market cycles. Investor demand for managed volatility and managed drawdown strategies has increased significantly in recent years, as the potential diversification benefits were highlighted during, and after, the 2008 credit crisis.

Trend followers, who make up the majority of quantitative strategies, have struggled to make money in the last 4-5 years in risk asset classes (such as equities), as sentiment moves from optimism to pessimism. This further highlights the unique durability of Redwood’s Defensive Credit Strategy as we seek to deliver long term satisfying risk-adjusted results, with the goal of minimizing drawdowns.

We believe the preceding analysis provides evidence that the unique characteristics of the high-yield market lend itself to a more accurate trend-following and quantitative approach. The viability of the Defensive Credit Strategy has been well tested. Despite going through first ever downgrade of the U.S. credit rating and significant countercurrent volatility in the U.S. equity markets in 2011, as well as the 2013 four-sigma move in the 10-year U.S. Treasury price in response to Fed tapering comments, the strategy has achieved cumulative total returns that have been reasonably attractive on a risk-adjusted basis.

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HYPOTHETICAL DISCLOSURE:
PERFORMANCE SHOWN IS HYPOTHETICAL AND BACK-TESTED. HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS SHOW IDEAS OR TRENDS. SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFIT OR LOSSES SIMILAR TO THOSE SHOWN. THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY ACHIEVED BY ANY PARTICULAR TRADING PROGRAM. ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE SIMULATION RESULTS, HYPOTHETICAL SIMULATION RESULTS DO NOT ACCOUNT FOR THE IMPACT OF FINANCIAL RISK AND DOES NOT TAKE INTO ACCOUNT THAT MATERIAL AND MARKET FACTORS MAY HAVE IMPACTED THE ADVISER’S DECISION MAKING IF THE ADVISER WERE ACTUALLY MANAGING CLIENT’S MONEY. NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR ADHERE TO A PARTICULAR TRADING PROGRAM IS ONE OF THE FEATURES NOT ACCOUNTED FOR IN ANY SIMULATION. NO PERFORMANCE RESULTS OR HYPOTHETICAL PERFORMANCE RESULTS CAN BE COMPLETELY ACCOUNTED FOR ON BEHALF OF ANY PARTICULAR TRADING PROGRAM WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS OF ALL WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS. EVERY EFFORT WAS MADE TO CONDUCT A SCIENTIFIC AND STATISTICALLY VALID SIMULATION. THE DATA SIMULATIONS CONDUCTED AS A SIMULATED TRADING PROGRAM AND NO WARRANTIES ARE MADE WITH RESPECT TO RESULTS OBTAINED IN ANY CALCULATION. Hypothetical performance results have been prepared with the use of past performance and past performance is no guarantee of future results. It should not be assumed that investors who actually invest in the strategy will be profitable, or equal either the hypothetical performance results reflected or any corresponding benchmark presented. In addition, performance can, and does, vary between individuals.

REDWOOD DEFENSIVE CREDIT DISCLOSURE:
The Redwood Defensive Credit Strategy is a strategy with results from a blend of actually managed trading accounts, which are historically representative of the strategy. Historical performance of the Defensive Credit Strategy is available upon request. Indices are shown for informational purposes only to display the return and risk statistics of each index; it is important to note that Redwood’s strategies differ from the indices displayed. Please see index descriptions below for more details.

DEFINITIONS, FUNDS, AND INDICES:
- Risk Adjusted Return: Generally refers to assets that have a significant degree of price volatility, such as equities, commodities, high-yield bonds, real estate and currencies. Risk Adjusted Return: The lowest potential yield that can be received on a bond without the issuer actually defaulting. The yield to worst is calculated by making worst-case scenario assumptions on the issuer by calculating the returns that would be received if provisions, including prepayment, call or sinking fund, are used by the issuer. Basis Point: A unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. For example, 100 basis points is equal to 1%. Leverage: The use of borrowed capital for an investment, expecting to increase the financial return, as well as risk, of an investment. Leveraging: When a company or individual attempts to decrease its total financial leverage. Borrowing Rate: The price paid for the use of borrowed money. The rate can be tied to an index such as Prime or the London Interbank Offered Rate. Correlation: Defined as a statistical measure of how two securities move in relation to each other. A positive correlation exists when both variables increase as the other variable increases, while a negative correlation exists when one variable decreases as the other variable increases. Volatility: Used to describe uncertainty or risk in terms of statistical measure of dispersion (variation in prices). Drawdown: A measure of peak to trough loss in a given period. Quantitative: Refers to economic, business or financial analysis that aims to understand or predict behavior or events through the use of mathematical measurements and research. High-Yield Bonds: Typically seek high levels of current income by investing in lower credit quality fixed income securities with varying maturities. Tactical: An asset allocation approach that seeks to minimize risk while taking advantage of opportunities, moving in and out of certain investments based on a risk/return evaluation.

DEFINITIONS, FUNDS, AND INDICES:
- Blending of 1/100th of 1%, and is used to denote the change in a financial instrument. For example, 100 basis points is equal to 1%. Leverage: The use of borrowed capital for an investment, expecting to increase the financial return, as well as risk, of an investment. Leveraging: When a company or individual attempts to decrease its total financial leverage. Borrowing Rate: The price paid for the use of borrowed money. The rate can be tied to an index such as Prime or the London Interbank Offered Rate. Correlation: Defined as a statistical measure of how two securities move in relation to each other. A positive correlation exists when both variables increase as the other variable increases, while a negative correlation exists when one variable decreases as the other variable increases. Volatility: Used to describe uncertainty or risk in terms of statistical measure of dispersion (variation in prices). Drawdown: A measure of peak to trough loss in a given period. Quantitative: Refers to economic, business or financial analysis that aims to understand or predict behavior or events through the use of mathematical measurements and research. High-Yield Bonds: Typically seek high levels of current income by investing in lower credit quality fixed income securities with varying maturities. Tactical: An asset allocation approach that seeks to minimize risk while taking advantage of opportunities, moving in and out of certain investments based on a risk/return evaluation. Technical: The analysis of a business’s financial statements; health; and its competitors and markets. Risk-On/Risk-Off: Refers to Manager’s performance of an asset class or strategy, without comparing it to any benchmark index. Risk-Adjusted Return: Refers to an investment’s return by measuring how much risk is involved in the strategy. Risk-Adjusted Return: The rate can be tied to an index such as Prime or the London Interbank Offered Rate. Correlation: Defined as a statistical measure of how two securities move in relation to each other. A positive correlation exists when both variables increase as the other variable increases, while a negative correlation exists when one variable decreases as the other variable increases. Volatility: Used to describe uncertainty or risk in terms of statistical measure of dispersion (variation in prices). Drawdown: A measure of peak to trough loss in a given period. Quantitative: Refers to economic, business or financial analysis that aims to understand or predict behavior or events through the use of mathematical measurements and research. High-Yield Bonds: Typically seek high levels of current income by investing in lower credit quality fixed income securities with varying maturities. Tactical: An asset allocation approach that seeks to minimize risk while taking advantage of opportunities, moving in and out of certain investments based on a risk/return evaluation.
Barclays U.S. Corporate High Yield Index: Tracks the performance of below investment grade U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market. 91-Day U.S. Treasury Bills: Government debt obligations issued by the U.S. Treasury with a maturity of 91 days. Vanguard Money Market Fund (VMFXX): Invests in U.S. government securities and seeks to preserve shareholders’ principal investment by maintaining a share price of $1. BofA Merrill Lynch U.S. Corporate Master Index: Includes publicly-issued, fixed-rate, non convertible investment grade dollar-denominated, SEC-registered corporate debt having at least one year to maturity and an outstanding par value of at least $250 million. A bond is considered investment grade if its credit rating is BBB- or higher by Standard & Poor’s or Baa3 or higher by Moody’s. Generally they are bonds that are judged by the rating agency as likely enough to meet payment obligations that banks are allowed to invest in them. BofA Merrill Lynch (ML) 5 Year U.S. Treasury Index: Tracks the performance of the U.S. 5-year Treasuries. BofA Merrill Lynch (ML) 10 Year U.S. Treasury Index: Tracks the performance of U.S. 10-year Treasuries. Credit Suisse Leveraged Loan Index: Designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market. BofA Merrill Lynch Single-B U.S. High Yield Index: An unmanaged index that tracks the performance of below investment grade debt, rated single B. BofA Merrill Lynch BB U.S. High Yield Index: An unmanaged index that tracks the performance of below investment grade debt, rated BB. BofA Merrill Lynch CCC & Lower High Yield Index: An unmanaged index that tracks the performance of below investment grade debt, rated CCC & lower. BofA Merrill Lynch High Yield (Master II) Index: An index that consists of U.S. corporate debt that are non-investment grade to reflect the performance of U.S. dollar denominated non-investment grade debt. Barclays U.S. Corporate (Corp) Investment Grade Index: An index that consists of U.S. corporate debt that are non-investment grade to reflect the performance of U.S. dollar denominated non-investment grade debt. S&P 500 Index: A stock market index based on the market capitalizations of 500 leading companies publicly traded in the U.S. stock market, as determined by Standard & Poor’s. TLT (iShares 20+ Year Treasury Bond ETF): An exchange-traded fund that seeks to track investment results of an index composed of U.S. Treasury bonds with maturities greater than 20 years. Used widely by investment professionals to track long-term treasuries. QQQ (Powershares QQQ Trust Series): An exchange-traded fund that tracks the performance of the Nasdaq 100 Index. Used widely by investment professionals to track the Nasdaq 100. PDPPCM1Y Index: An index that tracks the primary dealer positions of corporate securities that are due greater than 1 year.

UNLESS OTHERWISE NOTED, INDEX RETURNS REFLECT THE REINVESTMENT OF INCOME DIVIDENDS AND CAPITAL GAINS, IF ANY, BUT DO NOT REFLECT FEES, BROKERAGE COMMISSIONS OR OTHER EXPENSES OF INVESTING. INVESTORS CAN NOT MAKE DIRECT INVESTMENTS INTO ANY INDEX.

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