McKinley Quarterly Market Commentary

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Enclosed you'll find the key issues, themes, and indicators our investment team is following as we manage assets in world markets.

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McKINLEY CAPITAL
MANAGEMENT, LLC

Looking Ahead

1. Implementable Growth/Momentum are lagging
2. Higher rates are not always a headwind for growth investing
3. Pay attention to earnings announcements
4. More on earnings – what's down the road
5. Currency volatility as a major performance driver

The Q3 2022 global market was brutal. Sell-offs were rampant; global interest rates marched higher; inflation remained high despite some declines in oil, hard commodities, and home prices; yields on U.S. Treasuries were higher; and most currencies (except the U.S. Dollar), were lower; with some drastically lower. The U.S. Federal Reserve (Fed) continued its commitment to fight inflation and raised rates again. The Bank of England (BoE) had to intervene in its bond market to stabilize its market and the British Pound Sterling. All in all, the Bear Market came roaring back with a vengeance with negative returns across several leading indexes including: MSCI U.S. -5.09%, MSCI ACW X US -9.80%, MSCI ACW -6.71%, and MSCI Emerging Markets -11.42%. In general, market participants repriced the risk of recession and the likelihood of significant declines in earnings expectations in the coming quarters. These macro circumstances are some not seen in the entire careers of many market participants investing today; hence the spike in volatility as market participants try to figure out how to respond.

While these bouts are stressful and feel somewhat dire, they do pass. Our McKinley team has been managing investments for more than 32 years now, and we find our experience and the perspective it provides can be valuable during volatile times. For example, the economy is much better than it was a few years ago, consumers are still spending, travel is rebounding strongly, and even with the market declines, the S&P 500 is just back to its starting point from 2021. Despite the correction, we are still sitting at a market level from just last year. Valuations are also much lower, 15.8 times earnings for the S&P 500 today vs. 18.6 times earnings for the 5-year average. Many of the stocks we are closely watching have corrected back to good entry points, and most importantly, COVID-19 is now a fading memory. Learn more on the following pages about the key issues, themes, indicators our investment team is following as we manage assets in world markets.

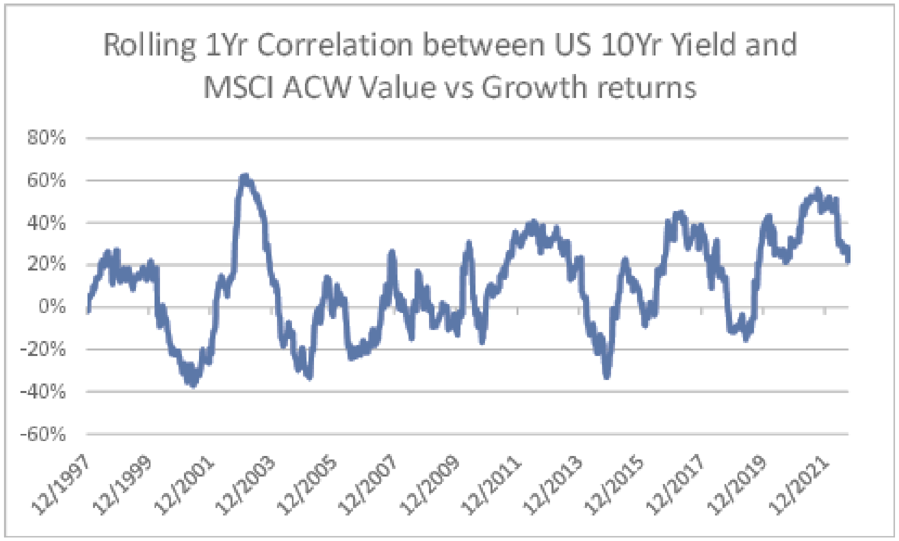
1. Implementable Growth/Momentum are Lagging

vs MSCI ACW ex U.S. Growth	YTD Return
MSCI ACW ex U.S.	5.4%
MCM ACW ex U.S. Rep Account	3.2%
Growth/Mom Blend	2.2%
Concentrated Growth/Mom Blend	0.2%

Source: McKinley Capital Management, LLC., FactSet Research, September 30, 2022

As a systematic global manager with a focus on Growth and Momentum exposure, McKinley's investment process closely monitors the performance of these two factors. However, a common issue is that many versions of these factors are unrealistic as investable portfolios. This can lead to notable spreads between non-implementable factor returns (i.e.: Axioma global factors) and more implementable Growth/Momentum portfolio strategies. In McKinley's investment team view, a good benchmark for Growth/Momentum portfolios is a cap-weighted index of the top 20% of stocks that rank highly on both Axioma Momentum and Axiom Growth factors. Year-to-Date, this hypothetical High Momentum/High Growth "Index" has outperformed the standard MSCI ACW ex U.S. Growth benchmark, but still strongly underperformed the MSCI ACW ex U.S. core benchmark. This is consistent with the performance of the Axioma factors, as Momentum has moderately outperformed YTD, primarily due to the short portion of the factor, while Growth has lagged. Most McKinley Capital Non-U.S. portfolios have led this hypothetical Growth/Momentum "Index," indicating that there has been alpha added beyond a simple factor strategy. This added alpha is even more apparent when we do a more apples-to-apples comparison of McKinley Capital Non-U.S. returns against a concentrated form of the hypothetical Growth/Momentum Blend (top 200 stocks). Overall, a simple investment in a hypothetical Growth/Momentum blend has generally outperformed standard Growth benchmarks YTD, but generally underperformed both Core benchmarks. So even though some non-investable versions of combining Growth and Momentum have seen better performance, **we find that a simple implementable investment in a hypothetical blended Growth/Momentum has notably underperformed the MSCI ACW ex U.S index.**

2. Higher Rates Not Always a Headwind for Growth Investing



Source: McKinley Capital Management, LLC., FactSet Research, September 30, 2022.

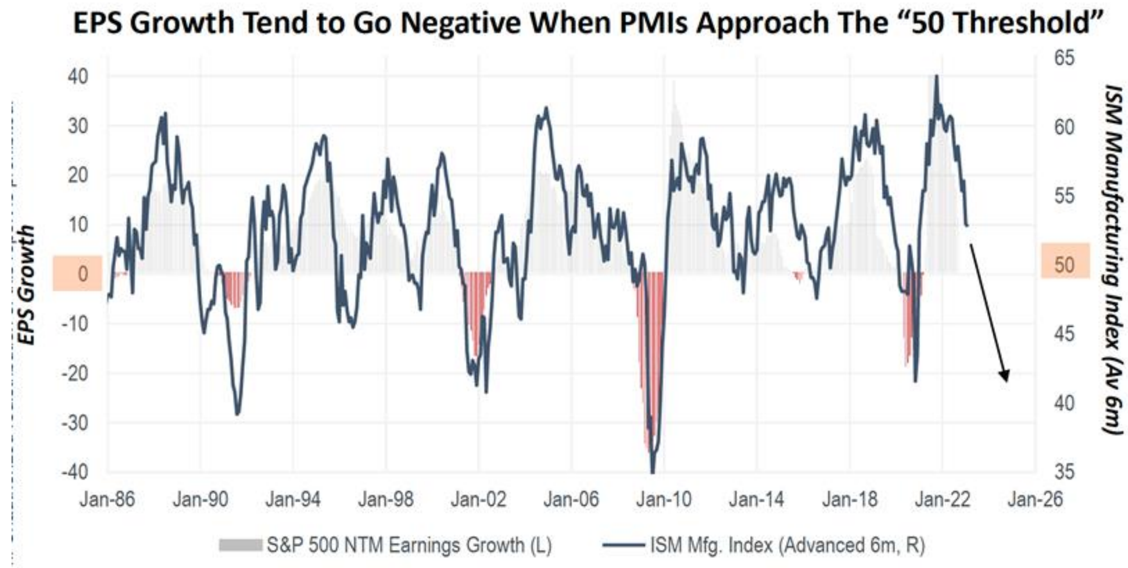
Since the beginning of 2022, the U.S. Treasury 10Yr yield has jumped from -1.5% to nearly +4%, while Growth stocks have strongly underperformed Value. The conventional wisdom is that rising rates are worse for Growth stocks due a longer duration of their cashflows, resulting in a tough environment for Growth as rates remain high. However, empirically the relationship between rates and Value vs. Growth performance is not so clear cut (see graph). Over the long-term, the correlation between changes in the 10Yr Yield and the relative return of the MSCI ACW Value vs MSCI ACW Growth indexes is highly volatile, and commonly turns negative. This means that in certain environments Growth stocks outperformed Value stocks even as long-term rates were rising. In our investment team's view, the real question is not whether rates are increasing, but why they are increasing. Recall that a discounted cash flow (DCF) is comprised of future cashflows based on an expected growth rates as well as a discount rate to bring those cashflows to present value. If rates are moving higher due to an improving long-term economic outlook, then we think the increase in expected cashflows could offset a higher discount rate, leading to stronger returns for Growth stocks. This market behavior was evident in March 2022, as Growth outperformed Value even as US 10Yr yields rose from 1.5% to 2.5% due to strong statements of economic optimism from U.S. Federal Reserve Chairman Powell. However, if economic growth expectations are waning while rates are rising (i.e.: the balance of 2022) than Growth will clearly lag Value. **We believe even if rates remain high in the medium-term, an improving economic growth outlook will likely drive Growth stocks higher.** This is especially true if earnings revisions are negative for the whole market, because companies that manage to avoid major declines tend to outperform the averages.

3. Pay Attention to Earnings Announcements

McKinley Capital's systematic investment process includes a review of corporate earnings – this review can happen in both our quantitative model, MQ, and in our Qualitative Review process (portfolio managers closely follow earnings surprises and analyst revisions). A key phenomenon we study is how prices react to earnings surprises. Short term, we've found performance can be erratic. Nevertheless, it can give you insight into market sentiment, the earnings cycle, and asset pricing. **We've learned that good earnings and good price follow-through can lead to better scores for Momentum and Growth characteristics that are key inputs in our proprietary investment factor, MQ.**

For example, here are a few notable earnings announcements in the past quarter. In mid-September 2022, FedEx reported quarterly profits -31% below analyst expectations, also cutting guidance by $500 million and warning of a worldwide recession. Some analysts noted this was likely impacted by the continued shift we are seeing in consumer spending patterns towards experiences and away from goods. Another company, JetBlue, raised its revenue per Available Seat Mile (ASM) outlook and provided a forecast of 'robust' travel demand. It is interesting to juxtapose these two results. Reaction to the FedEx announcement was brutal, with the stock -21.4% on the day of the announcement. On the other hand, we did not see much positive reaction to the JetBlue statement. The stock was down -2% on the day of the announcement. On the other hand, General Mills traded higher after reporting 10% earnings beat with margin upside on strong pricing power offsetting volume declines and also raised FY23 outlook. The ability of General Mills to offset cost inflation, and then some, was positively rewarded by the market with the stock trading +5.72% on the day. At the end of September, Nike reported seemingly okay headline numbers, however, the concern over inflated inventory levels carried the day. Inventories were up 44% y-o-y against sales growth of +3.6% y-o-y. This echoed a theme we have seen across many retailers in the last quarters, outsized inventory build. Nike, with arguably the best inventory management capabilities in the sector, and excellent management, failed to navigate the current environment. The stock had a significant decline of -12.81% on the day of the announcement. The implication is that excess inventory will have to be cleared and that will impact future profits. This is a small but informative sample, which may inform us that the economic environment is deteriorating, travel is still relatively healthy, retailers are in a risky position, and defensive companies with demonstrated pricing power are attractive in this environment. This type of read-through on earnings announcements is part of our investment process and requires patience and careful analysis by our portfolio managers.

4. More On Earnings... What's Down the Road?



Source: Piper Sandler

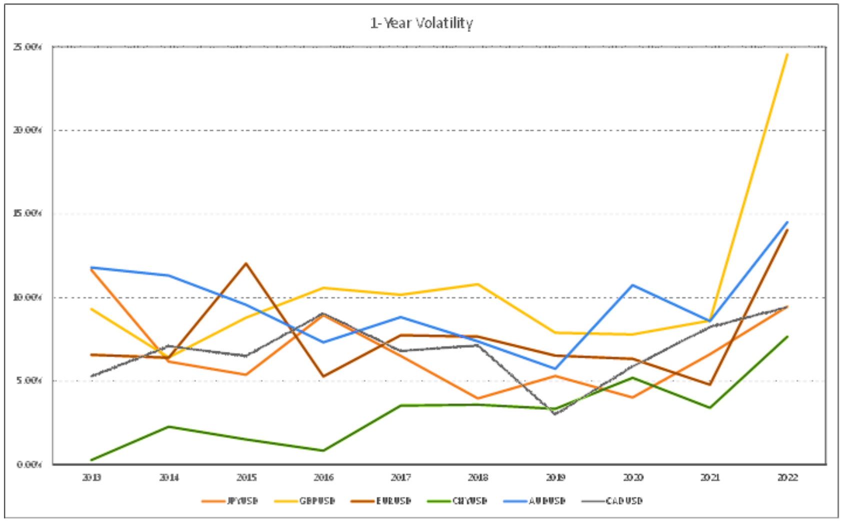
McKinley Capital's investment process aims to avoid the detrimental performance impact associated with negative earnings revisions and surprise. We have observed, in the past, that in environments where most stocks are seeing declines in revisions and earnings misses, the limited companies which succeed in avoiding those scenarios see better returns. Given the deteriorating macro economic environment and forward-looking earnings revision indicators, such as PMIs, it is likely that we are entering a period of weaker earnings. **In other words, we believe the upcoming period could see some favor for our specific type of investment discipline.** According to FactSet consensus estimates for the S&P 500 for Q3 2022, the estimated earnings growth rate for the S&P 500 is 3.2%. If 3.2% is the actual growth rate for the quarter, it will mark the lowest earnings growth rate reported by the index since Q3 2020 (-5.7%). Currently, we are seeing the most positive earnings revision profile coming through from the energy sector. On the other hand, we have seen some deterioration on the earnings revision side from the materials sector.

Looking Ahead

5. Currency Volatility as a Major Performance Driver

The high level of currency volatility has had a significant impact on earnings for numerous companies. This is due to companies having a currency mismatch between either their revenue and costs, or their revenue and debt. Also, the performance of equities held in McKinley Capital portfolios are translated back to the currency of the client; meaning foreign currency returns can greatly impact attribution by country/currency. So far this year, the U.S. Dollar has been one of the strongest performers and we have seen currency moves and volatility not seen in years. This has created dislocations at the stock level, but also has made many country's performance characteristics significantly worse than the U.S. Year-to date, major currencies are in deeply negative territory vs. the Dollar: Yen (-20.47%), British Pound (-17.45%), Euro (-13.79%), Australian Dollar (-11.88%), Chinese Renminbi (-10.65%) and Canadian Dollar (-8.61%). Stand out negatives also came from the crypto space with Bitcoin (-58.35%) and Etherium (-64.06%). These moves are rare as can be seen by the volatility over time of major currencies; most of whom spiked significantly in 2022. For example, the FTSE 100 in the UK's top 25 constituents make up 75% of the value and are almost entirely multi nationals. Despite the terrible returns of the British Pound, these UK companies are performing better on a relative basis – why? Because as much as 75% of that benchmark's earnings come from other currencies; namely the U.S. Dollar, while their costs are in British Pounds. Positive moves in the spread between these currencies brings better earnings to these companies (which our McKinley portfolios generally have a positive tilt toward). McKinley Capital's proprietary investment factor, MQ, focuses on Momentum in the currency of our clients (often U.S. and/or Canadian Dollars) and the earnings growth acceleration of the companies in which we invest. **We believe currency has been and will continue to be a major performance driver this year.**

Volatility for most major currencies is very high relative to history.



Source: McKinley Capital Management, LLC., FactSet Research, September 30, 2022.

Disclosure

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