WHAT MAKES A STOCK A FORTRESS?

by Henry Pasts, Executive Vice President and Analyst, BTS Asset Management, Inc.

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In our view, what makes a stock a "Fortress" in the broad sense is its ability to leverage existing assets to drive earnings growth and maintain substantial cash reserves, minimizing reliance on external conditions. An equity called a "Fortress" in the broad sense considers only its Internal Growth Rate (IGR) compared to other stocks. Later on, we will discuss a sub-strategy of the BTS Enhanced Equity Income Fund called BTS Equity Fortress, which aims to further sophisticate this broad concept of a "Fortress" stock discussed throughout this paper.

Companies that do not depend on current credit conditions for investments hold a competitive edge, as credit and economic cycles can be unpredictable. By avoiding reliance on debt, these "Fortress" companies may be better positioned to remain competitive in varying economic climates.

BTS believes investing in stocks with high debt burdens can be particularly risky during volatile credit and economic cycles, as opposed to investing in companies with minimal debt and strong cash reserves that can finance growth internally. BTS highlights the broader set of equities with strong internal growth rates and their subsequent ability to grow shareholder equity from within the company as "Fortresses".

During periods of economic uncertainty, companies burdened by significant debt may face difficulties in fulfilling their financial obligations, potentially leading to heightened volatility in their stock prices. In contrast, we think companies equipped with substantial cash reserves have a distinct advantage. They are less dependent on external financing conditions, including credit cycles and market sentiment, and are not reliant on their own credit quality to fund business growth. This financial independence may allow them to navigate economic downturns more smoothly and maintain stable investment profiles over the long run.

$$\textit{Internal Growth Rate (IGR)} = \frac{\textit{Return on Assets x Retention Ratio}}{\textit{1 - (Return on Assets x Retention Ratio)}}$$

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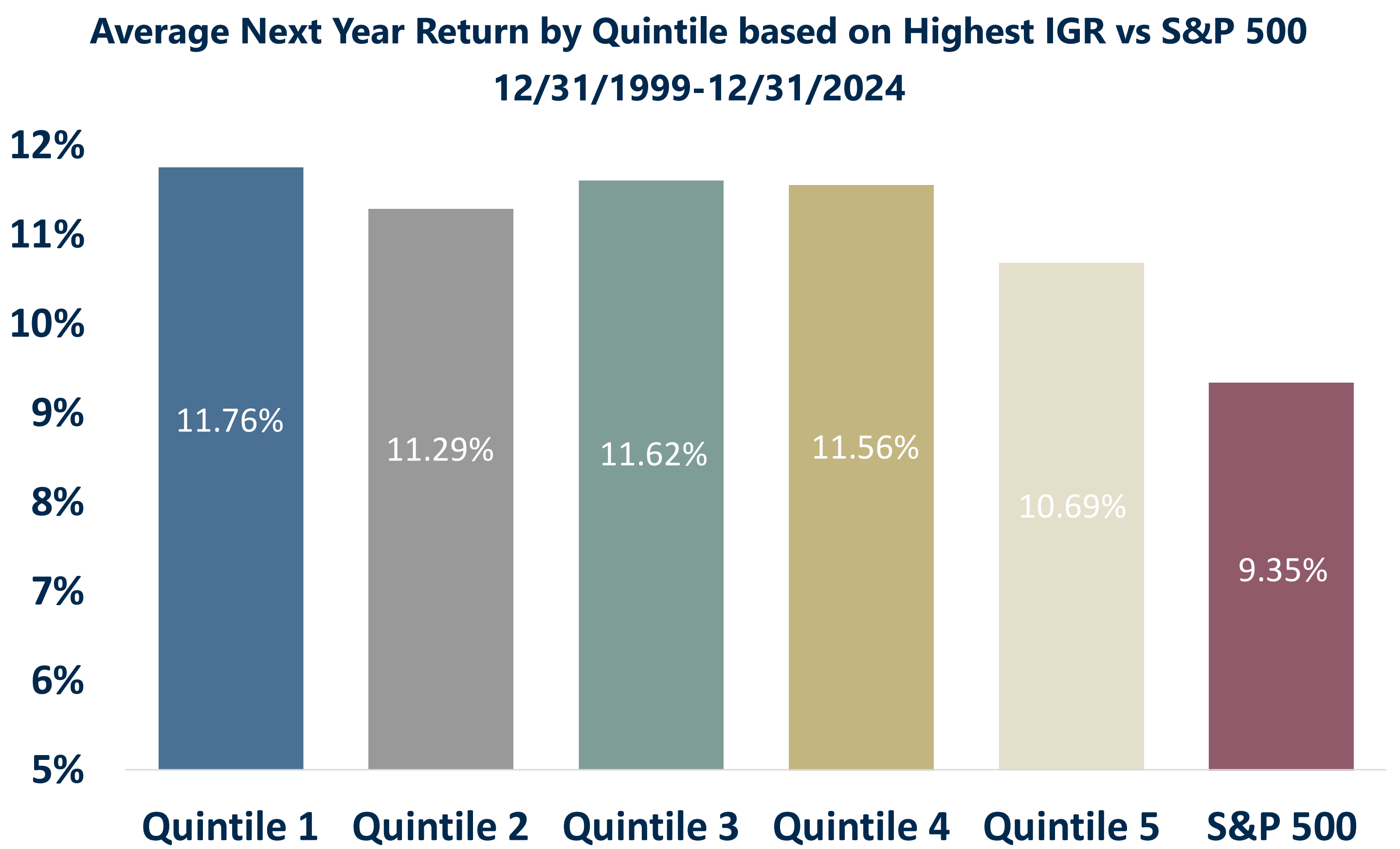
BTS believes that a stock's Internal Growth Rate (IGR) can measure the extent to which a stock is a considered a "Fortress". In the broad sense.

To illustrate the efficacy of IGR, consider breaking up the S&P 500 into quintiles at the end of each year based on highest IGR and calculating the average return over the next year for each security in each quintile. Then, average those yearly returns for each quintile. Below, we see that the top 80% of data has, on average, a higher yearly return than the bottom 20%. Compared to the market capitalization weighted S&P 500, the average yearly returns of each quintile are higher.



For illustration and informational purposes only. The performance shown above is not a recreation of any BTS Portfolios or products, nor a recreation of any investable product. The S&P 500 constituents are divided into five quintiles based on their Internal Growth Rate (IGR). Quintile 1 includes the top 20% of companies with the highest IGR values, Quintile 2 includes the next 20% of companies, Quintile 3 includes the middle 20% of companies, Quintile 4 includes the next 20% of companies, and Quintile 5 includes the bottom 20% of companies with the lowest IGR values. Each year, the quintiles are calculated with market data as of 12/31 and the Average Next Year Returns for each security is calculated. Then, the average Next Year Return for each quintile across all years is calculated and is shown above. An investment cannot be made directly in an index.

Internal Analysis. Data Source: Morningstar and Bloomberg (yearly returns)

Analyzing IGR across all of the S&P 500 constituents may result in insights into the competitive advantages certain stocks may have due to their strong cash holdings and ability to increase net income through existing assets. Since the S&P 500 is market capitalization weighted, certain sectors or stocks that may have strong internal growth rates may not contribute to the returns of the index in a beneficial manner.

Examining stocks with higher IGR ratios during any given year may be a good place to start searching for stocks well positioned to weather various economic cycles, especially when the S&P 500 may be overly concentrated in certain sectors or specific stocks. Of course the search for strong companies doesn't stop at IGR, but may offer an initial filter that identifies stocks with earnings potentials that are not dependent on external factors, such as growth or cyclical stocks.

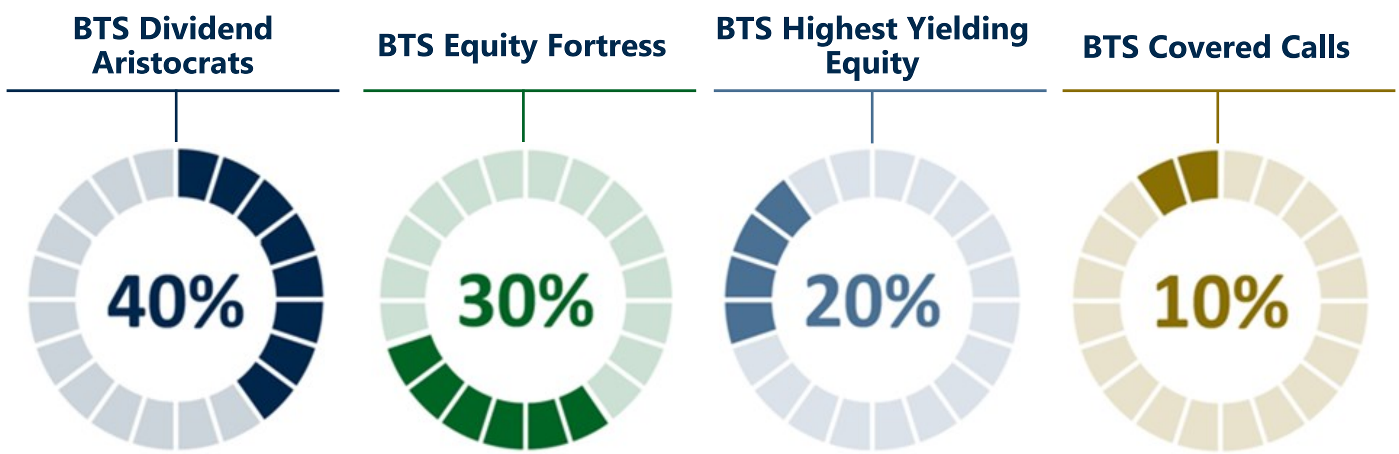
PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.

Key Takeaways

The period above, 12/31/1999 to 12/31/2023, experienced extreme volatility through economic and credit events such as the Dot Com Bubble, The Financial Crisis and Great Recession of 2008, as well as the Global Pandemic beginning in 2020. Higher IGR values may have higher returns, but further analysis with other financial ratios may help further distinguish stocks with strong underlying fundamentals. This approach may allow an investor to consider equities with strong underlying fundamentals to weather unpredictable economic conditions and participate in return streams of such companies that an investor may not participate in due to the market capitalization weighted nature of the S&P 500.

A More Sophisticated Solution

Up until now, we have looked at "Fortresses" in the broad sense, which considers only the Internal Growth Rate ratio. BTS took the simple concept of IGR illustrated above and amplified it by adding a proprietary set of optimal fundamental ratios and quantitative metrics to further vet companies, while optimizing for less risk across the 11 GICS Sectors and comparing selections against historical trends in their respective sectors to make over and under weight decisions. In the Enhanced Equity Income Fund, the BTS Equity Fortress sub-strategy consists of 30% of the Fund.



Disclosure

Investors should carefully consider the investment objectives, risks, charges, and expenses of the BTS Funds. This and other information about the Funds is contained in the prospectus and should be read carefully before investing. The prospectus can be obtained on our web site, www.btsfunds.com, by calling toll free 1-877-287-9820 (1-877-BTS -9820), or by calling your financial representative. The BTS Funds are distributed by Northern Lights Distributors, LLC, Member FINRA/SIPC. BTS Asset Management, Inc. is not affiliated with Northern Lights Distributors, LLC.

Past performance is no guarantee of future results.

Important Risks

Diversification does not ensure a profit or guarantee against loss. The Fund is newly formed and has a limited history of operations.

Mutual funds involve risk, including possible loss of principal. There is no assurance that the Fund will achieve its investment objective. Investors cannot invest directly in an index. Unmanaged index returns do not reflect any fees, expenses or sales charges.

The material provided herein has been provided by BTS Asset Management and is for informational purposes only and should not be construed as an offer to sell or the solicitation to buy securities or adopt any investment strategy, nor shall the commentary constitute investment advice. This commentary may contain opinions and assumptions that are forward-looking in nature. To the extent this material constitutes an opinion or assumption, recipients should not construe it as a substitute for the exercise of independent judgment. This material has been prepared from information believed to be reliable, but BTS Asset Management, Inc. makes no representations as to its accuracy or reliability. Past performance is no guarantee of future results. The views and opinions expressed herein are subject to change without notice and are the authors own and not necessarily that of BTS Asset Management, Inc.

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Equity Risk

Equity securities are susceptible to general stock market fluctuations and to volatile increases and decreases in value. The equity securities held by the Fund may experience sudden, unpredictable drops in value or long periods of decline in value. This may occur because of factors affecting securities markets generally, the equity securities of a specific sector, or a specific company.

ETF Risk

ETFs are subject to investment advisory fees and other expenses, which will be indirectly paid by the Fund. As a result, your cost of investing in the Fund will be higher than the cost of investing directly in the ETFs and may be higher than other mutual funds that invest directly in fixed income securities. Certain restrictions of the 1940 Act may limit the Fund's assets that can be invested in any one ETF. This limit may prevent the Fund from allocating its investments in the manner the Adviser considers optimal or cause the Adviser to select an investment other than that which the Adviser considers optimal. The strategy of investing in ETFs could affect the timing, amount and character of distributions and may increase the amount of taxes paid.

- **Covered Call Strategy Risk**

  Covered call ETFs receive premiums from the call options they sell but limit their opportunity to profit from an increase in the value of the underlying stock. If the underlying stock declines more that the option premium received by the ETF, there will be a loss on the overall position. Covered call ETFs are also subject to the risks of investing in equity securities.

Large Capitalization Company Risk

Large-cap companies may be unable to respond quickly to new competitive challenges, such as changes in technology and consumer tastes, and also may not be able to attain the high growth rate of successful smaller companies, especially during extended periods of economic expansion.

Issuer-Specific Risk

The value of a specific security can be more volatile than the market as a whole and can perform differently from the value of the market as a whole.

Management Risk

The Adviser's judgments about the attractiveness, value and potential appreciation of particular security in which the Fund invests or sells short may prove to be incorrect and may not produce the desired results.

Market and Geopolitical Risk

The increasing interconnectivity between global economies and financial markets increases the likelihood that events or conditions in one region or financial market may adversely impact issuers in a different country, region or financial market. Securities in the Fund may underperform due to inflation (or expectations for inflation), interest rates, global demand for particular products or resources, natural disasters, pandemics, epidemics, terrorism, international conflicts, regulatory events and governmental or quasi-governmental actions. The occurrence of global events similar to those in recent years, such as terrorist attacks around the world, natural disasters, social and political discord or debt crises and downgrades, among others, may result in market volatility and may have long term effects on both the U.S. and global financial markets. It is difficult to predict when similar events affecting the U.S. or global financial markets may occur, the effects that such events may have and the duration of those effects. Any such event(s) could have a significant adverse impact on the value and risk profile of the Fund.

Turnover Risk

A higher portfolio turnover may result in higher transactional and brokerage costs and taxes.

Definitions

Fortress and Fortresses are broad terms used to denote stocks with high Internal Growth Grates (IGR) relative to other stocks. The particular commentary considers stocks within the S&P 500 Index. The term "Fortress" should not be viewed as synonymous to the BTS Equity Fortress sub-strategy of the BTS Enhanced Equity Income Fund, nor should the performance of the IGR illustration on page 3 be viewed as indicative of the performance of the BTS Equity Fortress sub-strategy.

Annualized Return is the equivalent needed to obtain the same total return over the period.

Internal Growth Rate (IGR) is the highest level achievable for a business without obtaining outside financing. It is calculated as the most recently available Return on Assets metric multiplied by the trailing 12-month Retention Ratio, divided by 1 minus the same multiplication of Return on Assets and the 12-month Retention Ratio.

Return on Assets is an indicator of profitability and measures the trailing 12-month Net Income, or net profit, as a percentage of average assets over the past 12 months as reported on a stock's balance sheet.

Retention Ratio is 1 minus the trailing 12-month dividend payout ratio, where the 12-month dividend payout ratio is the trailing 12-month total common dividends divided by the trailing 12-month income.

Price To Earnings (P/E) Ratio is a ratio for valuing a company that measures its current share price relative to its earnings per share (EPS).

Internal Growth Rate w Lowest PE is the average rank of the highest IGR and the lowest Price to Earnings data available on 12/31 of each year. The top quartile of the average rank was used to display the returns of the stocks over the next year.

Sharpe Ratio measures risk-adjusted return, highlighting the average return earned in excess of the risk-free rate per unit of total risk. 2% is used as a proxy for the risk-free rate of return.

Market Capitalization refers to the total dollar market value of a company's outstanding shares of stock.

The S&P 500 is an index that includes 500 leading companies in leading industries of the U.S. economy and is a proxy for the total stock market. Returns shown are total returns with dividends reinvested.

The Global Industry Classification Standard (GICS) is an industry taxonomy developed in 1999 by MSCI and Standard & Poor's (S&P) for use by the global financial community. The GICS structure consists of 11 sectors, 25 industry groups, 74 industries and 163 sub-industries into which S&P has categorized all major public companies.

BTS Dividend Aristocrats is a sub-strategy of the BTS Enhanced Equity Income Fund that breaks the largest 1500 U.S. listed equities by Market Capitalization into their 11 GICS Sectors and then filters all securities that have 10-15 years of increasing dividends, based on which sector it is in. BTS may consider a security with less than 10 years of increasing dividends if there are less than 2 securities in any given sector with less than 10 years of increasing dividends. These securities are then run through a proprietary securities selection algorithm that is rule-based in nature and does not change. The top security is then compared against similar historical Dividend Aristocrats in its sector and a historical outperformance is calculated. The sector with the highest outperformance is overweighted, and the bottom 2 sectors are eliminated. BTS Dividend Aristocrats and Dividend Aristocrats are used interchangeably and refer to BTS' sub-strategy.

BTS Equity Fortress is a sub-strategy of the BTS Enhanced Equity Income Fund that breaks the largest 1500 U.S. listed equities by Market Capitalization into their 11 GICS Sectors and then filters the top 5-10 securities in each sector based on a proprietary Equity Fortress Model that considers how well the security can finance internal revenue and asset growth without taking on excess debt. These securities are then run through a proprietary securities selection algorithm that is rule-based in nature and does not change. The top security is then compared against similar historical Equity Fortress securities in its sector and a historical outperformance is calculated. The sector with the highest outperformance is overweighted, and the bottom 2 sectors are eliminated. BTS Equity Fortress and Equity Fortress are used interchangeably and refer to the BTS' sub-strategy.

BTS Highest Yielding Equity is a sub-strategy of the BTS Enhanced Equity Income Fund that breaks largest 1500 U.S. listed equities by Market Capitalization into their 11 GICS Sectors and then filters the top 5-10 securities in each sector based on highest Dividend Yield. These securities are then run through a proprietary securities selection algorithm that is rule-based in nature and does not change. The top security is then compared against similar historical Highest Yielding Equity securities in its sector and a historical outperformance is calculated. The sector with the highest outperformance is overweighted, and the bottom 2 sectors are eliminated. BTS Highest Yielding Equity and Highest Yielding Equity are used interchangeably and refer to BTS' sub-strategy.

Covered Call refers to a financial transactional in which the investor selling call options owns an equivalent amount of the underlying security. To execute this, an investor who holds a long position in an asset then writes (sells) call options on the same asset to generate an income stream. The investor's long position in the asset is the cover because it means the seller can deliver the shares if the buyer of the call option chooses to exercise.

BTS Covered Calls refers to the BTS Covered Call ETFs sub-strategy that invests in exchange-traded funds that deploy Covered Call strategies. BTS uses ETFs that follow S&P 500 and NASDAQ 100 Covered Call strategies in the BTS Enhanced Equity Income portfolio, namely JEPI and JEPQ.

All returns are calculated using data from Morningstar Direct and Bloomberg starting on 12/31/1999.

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