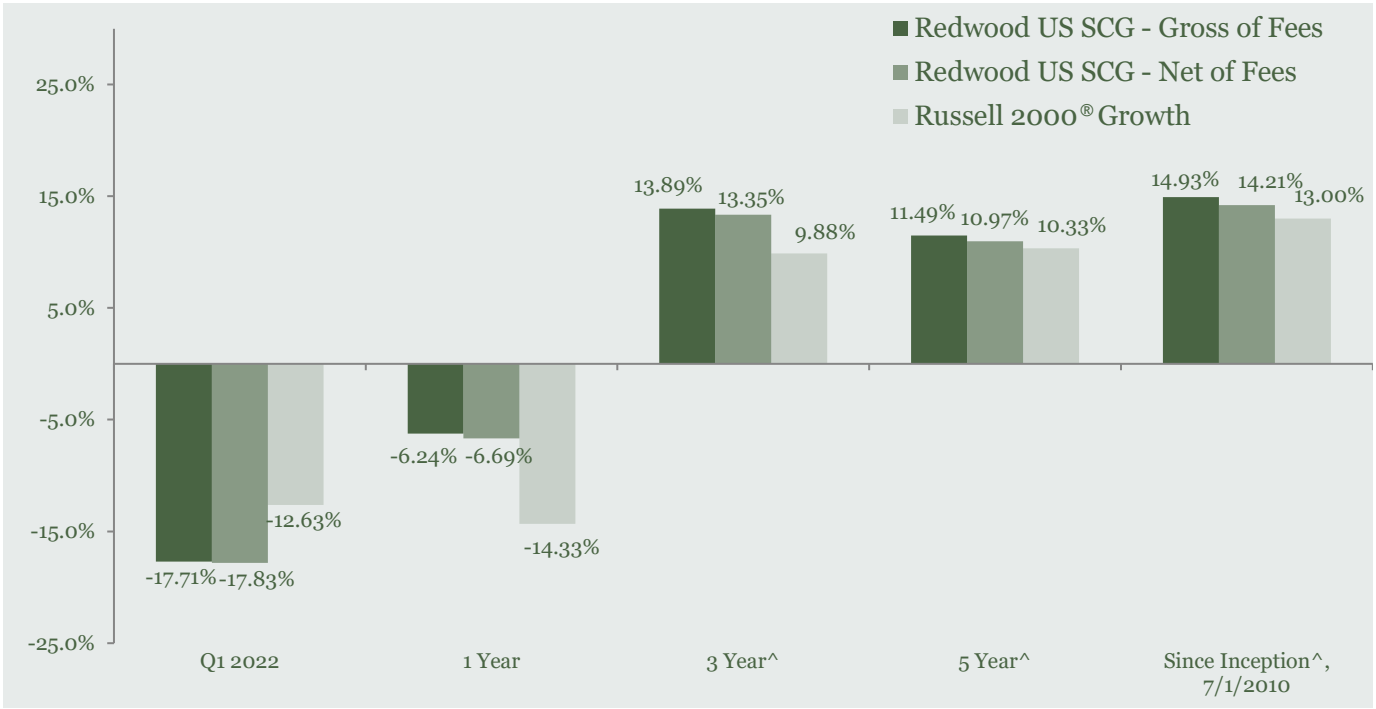
Redwood Small Cap Growth

Quarterly Letter, Q1 2022



All data as of: 3/31/2022; ^ denotes annualized performance. Past performance is no guarantee of future results.

Market Review

After two years of elevated market returns, US equity returns sagged in the first quarter of 2022. There was little place to hide as all broad equity markets declined. Investors had increasingly grown concerned over rising rates, increasing commodity prices and inflation. This sentiment cast a dark shadow over equity markets and specifically growth early in the first quarter. With respect to the Small Cap Markets specifically, the Russell 2000® Growth index returned -13.40% in January alone, underperforming the Russell 2000® Value index by ~790 bps. Growth continued to underperform in February and March, but the spread compressed with relative underperformance of ~120 and ~150 bps in each of the last two months of the quarter, respectively. The backdrop to this dramatic spread was the move in the 10-year yield that started the year at 1.52% and ended the quarter at 2.32%. In all, it was a volatile quarter with the Russell 2000® Growth index having a move greater than +/-1% in 49 of 62 trading days in the quarter. Stocks sold off indiscriminately on little negative earnings news as investor fears weighed on the markets.

Portfolio Review

The Redwood Small Cap Growth Composite declined -17.83 net of fees% over the first quarter of 2022 while the Russell 2000® Growth index declined -12.63%, still falling in the 45th percentile of reported returns for the eVestment US Small Cap Growth universe. Energy was the only sector in the Russell 2000® Growth index to register a positive return, +34.73% in the quarter, as it rose on climbing commodity prices throughout the quarter. All other sectors declined with the following five sectors having a return worse than the overall index return: Real Estate, Financials, Information Technology, Health Care, and Consumer Discretionary.

Portfolio Review (Cont.)

Within the Redwood Small Cap Growth portfolio, Consumer Staples had the only positive return in the quarter, +4.53%. Three sectors underperformed the overall portfolio return: Information Technology, Health Care and Materials, which declined -21%, -23%, and -46%, respectively. With the sharp downdraft in the quarter, the magnitude of the spread between growth and value, and the headwinds in the face of severe macroeconomic news, the types of growth stocks in which our approach invests tended to be out of favor in the quarter and there was little room for stock selection to shine through.

We have dissected the relative underperformance into the following three components: ~60% stock selection; ~20% allocation to growth cyclicals; and ~20% to fundamental disappointments. First, a majority of the underperformance was attributed to weakness in stock selection. We saw several of our holdings that had been strong performers in 2021 sell off sharply in the first quarter. In fact, seven of the ten worst performing stocks had been among the top contributors to relative return last year. They sold off on no fundamental concerns or changes to their investment outlook. In certain instances, where in a more normal environment of stock prices following earnings, companies that reported strong earnings saw their multiples compress. Though frustrating to see the impact on returns, in certain cases, we did use this as a buying opportunity on the price decline for those companies that continue to meet our hurdles for visibility and durability of earnings.

Second, performance in March was challenged and worsened from the more severe macro environment created as the Russia-Ukraine war started to rage. Our exposure to growth cyclicals was the wrong place to be in the quarter, and those types of stocks underperformed. Further, with the oil supply-demand imbalance and rising prices caused by the war, the portfolio's lack of exposure to energy detracted from relative returns. Historically, the exposure to energy in the small cap strategy had been quite small as it had not been a significant part of the small cap index. The war has created new perspectives around the investment opportunity in the energy sector given the needs to access traditional sources of energy, be less reliant/dependent on Russia, and oil and gas as the transition to renewables occurs in the future. The debate around investment in energy has started to shift as investors weigh the demand for energy – oil – to heat homes, to keep people warm and healthy, to provide means for cooking and so forth. As a result of the Russian invasion of Ukraine, we expect there to be a longer-term shift to domestic sources of oil/natural gas and structurally elevated prices of the commodities. Over the course of the quarter, we increased our allocation to the Energy sector with the investment in Ranger Oil Corp., where we believe the "ESG" discount will be adjusted as the definition and perceptions of responsible investing and ESG evolve following the outcomes on the global energy complex from the Russian invasion. Ranger is a high-quality US producer of oil and gas in favorable geographies for domestic use and exports. The combination of its balance sheet, disciplined production and hedging strategy and very favorable valuation presented the company as a compelling investment.

Third, the portfolio experienced a fundamental disappointment in its position of Astec Industries, Inc. We exited the position in Astec Industries during the first quarter as significantly higher input costs and supply chain issues, coupled with concerns over the pace of infrastructure spending due caused weakness in the stock. In addition, we became increasingly concerned about the company's ability to convert its backlog to revenue, which was key component of our investment thesis. With those issues appearing to be less short-term that previously assumed, along with Redwood's constant desire to continuously seek upgrades in the holdings of the SCG strategy, we exited the position entirely.

Outlook

Exiting the 1st quarter of 2022, investors are faced with several challenges – some unique over the last 25+ years – which are compounding to create a difficult market environment. In the US and many international economies, inflation has risen to levels not seen in decades, spurred by excess savings, shortage of labor, commodity prices, and supply chain disruptions. The ongoing Russia-Ukraine conflict has exacerbated this inflationary pressure, especially for European markets which depend largely on Russian gas. As global central banks embark on rate-hike cycles to tame this inflation, and as China battles a resurgent COVID, the odds of a global recession have increased.

Against this relatively morose backdrop, however, there are reasons for optimism: company reports and economic data suggest that consumer demand for experiences, for example, remains intact. Several global economies continue to reopen from COVID disruption, creating opportunities for economic activity. Unemployment rates are low, and household savings remain elevated. Valuations have contracted meaningfully in some segments of the market, and attractive entry points for longer-term investment theses appear to be increasingly prevalent. The immediate path forward is likely to be determined by the ability of Central Banks to manage their tightening to engineer a "soft landing" – the odds of which we do not try to forecast explicitly. Rather, amidst this rising uncertainty, we believe that advantaged and resilient businesses with multi-year opportunities to drive earnings and free cash flow growth ahead of market expectations should increasingly offer a port in the storm. This is especially and increasingly true as starting valuations improve.

Specifically, within the Redwood Small Cap Growth portfolio, we continue to build the portfolio with a bottom up, stock by stock approach, so the sector allocations are a fallout of the process. Regardless, with the underlying strength in the consumer and strong employment figures, the portfolio retains an overweight versus the index in the Consumer Discretionary and Staples sectors. Exposure to rate sensitive and financials stocks has increased over the quarter with modest overweight positions versus the index in Industrials and Financials. Some of the reduction in exposure has been in Information Technology and Health Care where the portfolio has moved to underweight versus the index.

For the better part of the last 15 months, growth has underperformed value quite significantly, and the spread has recently started to tighten which we believe will be further supportive for the small cap growth asset class. The compression in valuations is attractive as we continue to invest in companies with differentiated profiles, which can grow margins in this environment and exhibit the quality growth characteristics our approach favors. Regardless, we will continue to build and manage the portfolio stock by stock and believe that this market volatility will continue to refocus investors on what matters for long term relative performance – quality companies that can grow earnings above consensus expectations with a focus on valuation.

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Top 5 Contributors

AeroVironment, Inc. (AVAV)

AeroVironment is a developer of unmanned aircraft systems (UAS) and electric transportation solutions for predominately defense applications. UAS are a cost-effective way for existing civilian, government and defense organizations to accomplish and achieve capabilities that previously were limited due to human involvement limitations (e.g. G-force impacts), or cost issues due to fuel and support. The stock was relatively strong during the first quarter due to the combination of fundamental progress on long-standing product development and growth, but most immediately to the Russian invasion of Ukraine and the aggressive supply response of the US Government, which included significant numbers of the company's "Switchblade" armed drones.

Rada Electronic Industries Ltd. (RADA)

Rada Electronics manufacturers advanced radars for military vehicle active protection systems (APS) and air defense applications. Its APS products allow for the real-time recognition, tracking, and deployment of measures to counter-act and interdict incoming threats to vehicles and installations. The company is benefiting significantly from the strategic decision to advance-purchase components and inventory prior to the recent global supply chain issues.

Kinsale Capital Group, Inc. (KNSL)

During the quarter, Kinsale reported very strong fourth quarter 2021 earnings across all critical metrics – premiums written, losses and overall profitability. These results and bullish commentary drove the stock to outperform during a broadly difficult quarter for the markets. Many larger competitors are struggling with reserve additions as Kinsale continues to outperform and gain share in the Excess & Surplus insurance market. We continue to see upside through 2022 relative to overly conservative consensus estimates.

Sprout Social Inc. (SPT)

Sprout Social is Social Media Management (SMM) vendor enabling brands to serve and respond to their customers across the growing variety of engagement channels. During the 1st quarter, SPT reported an excellent quarter highlighted by strong momentum in Enterprise, with a record number of >$50k deals and the company's first 7-figure new engagement. The company also inked a deal with Salesforce to integrate its offering deeply into the company, which acts as a validation point and competitive advantage in addition to opening a new source for sales leads.

Air Transport Services Group, Inc. (ATSG)

During the quarter, the company reported the strong fourth quarter 2021 results that we were anticipating and guided above consensus for 2022. Along with its core businesses outperforming, the company announced a new initiative to bring engine maintenance in-house, driving an incremental $40-45M of EBITDA and increasing margins and free cash flow. With the stock trading at a discounted valuation, these announcements led to strong relative performance.

Redwood Small Cap Growth

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Bottom 5 Contributors

Calix, Inc. (CALX)

Calix, Inc. provides cloud and software platforms, systems and services required to build unified access networks with particular leverage to fiber-based broadband. After the stock meaningfully appreciated in 2021, the stock retraced some of those gains in the first quarter of 2022. Business trends continue to remain strong with extended order visibility that has the potential to drive stronger than expected revenue and earnings growth.

Astec Industries, Inc. (ASTE)

Astec Industries, Inc. is a manufacturer of equipment and components used for infrastructure development -- primarily road construction and road maintenance, equipment for the energy and mining industries and other related heavy construction efforts. During the first quarter, significantly higher input costs and supply chain issues, coupled with concerns over the pace of infrastructure spending debate caused weakness in the stock. With those issues appearing to be less short-term that previously assumed, along with Redwood's constant desire to continuously seek upgrades in the holdings of the Small Cap Growth strategy, we exited the position entirely.

Kornit Digital Ltd. (KRNT)

Kornit Digital Ltd. designs, manufactures and markets industrial and commercial 100% digital printing solutions for the garment, apparel and textile industries. With rising interest rates depressing the valuations for high growth/high valuation stocks, Kornit was caught in this broad-based multiple contraction. The company continues to expand its customer base and become the solution for global brands.

Fox Factory Holding Corp. (FOXF)

Despite two years outsized growth partly driven by COVID-19, Fox Factory again reported impressive fourth quarter 2021 revenue growth. However, COVID-related factory shutdowns and planned manufacturing changeover limited the upside potential. We view those factors as transitory especially considering the record backlog the company carried into the first quarter 2022. Guidance for 2022 provided good visibility and slowly improving supply chains. However, the Russia-Ukraine war has rekindled supply chain concerns further weighing on the stock.

Ranpak Holdings Corp. (PACK)

Ranpak experienced a transformative year in 2021, leaving the stock close to its all-time high entering 2022. During the quarter, management addressed shorter-term cost pressures and would expect further price action through the year if the inflationary costs persist. Coupled with these margin concerns, Russia's invasion of Ukraine created additional fears as the company sources ~15% of its raw materials for Europe from Russia. We see both concerns as overdone with the company's ability to increase prices and shift production to mills located throughout Europe. We believe the secular shift to paper-based packaging remains undeterred and the company's automation opportunity underestimated by the market.

The data presented on the top and bottom contributor pages of this letter is based on a representative Small Cap Growth account for the 1st quarter of 2022. The characteristics, asset size, composition, and risk characteristics of the proposed account may differ from the composite depicted in the presentation. Therefore, it cannot be assumed that another account would have the same performance or holdings even if following the same strategy. This representative account was chosen as it's inception date coincides with the inception date of the strategy and therefore in our view, it is the account within the strategy which most comprehensively reflects the portfolio management style of the strategy for the entire time period. Recommendations made in the last 12 months are available upon request. Past performance does not guarantee future results. Please refer to the Disclosure Statements at the end of this presentation for additional information.

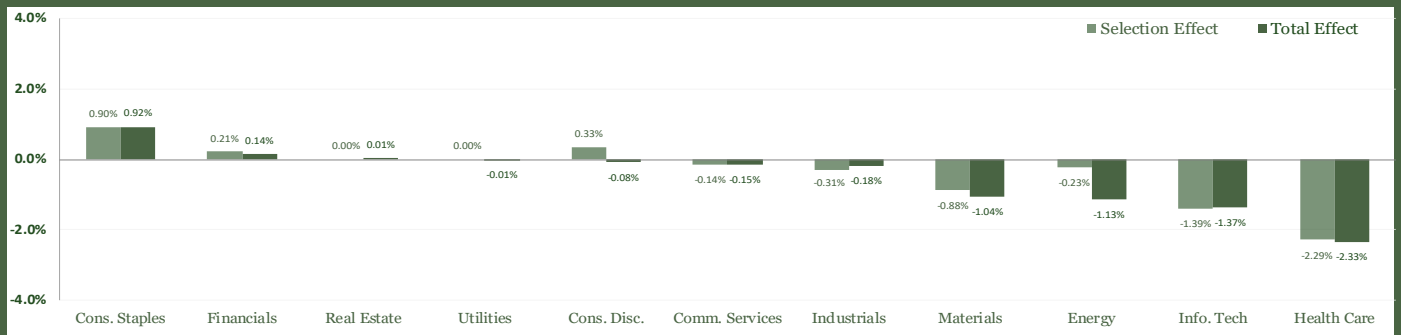
Redwood Small Cap Growth

Portfolio Attribution, Q1 2022

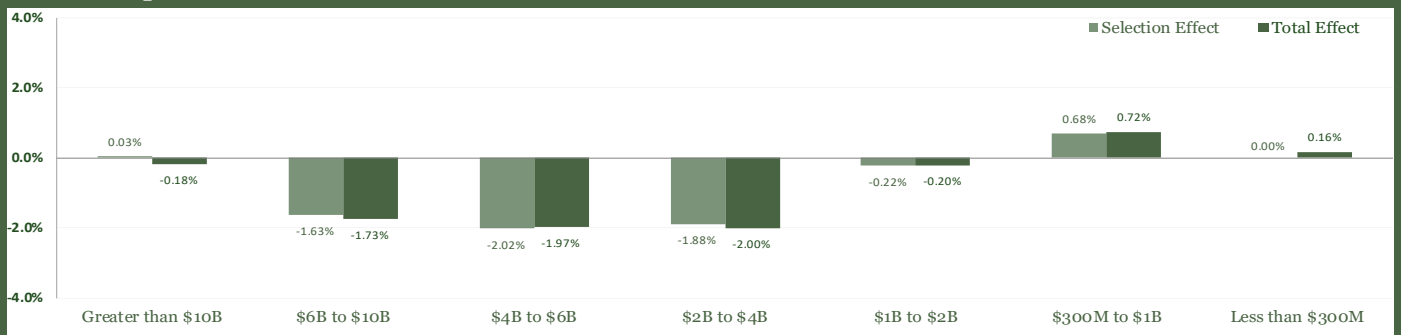
Top 10 Contributors	Sector	Average Weight	Total Return	Relative Contribution
AeroVironment, Inc.	Industrials	1.41%	51.77%	0.61%
Rada Electronic Industries Ltd.	Industrials	1.40%	47.88%	0.55%
Kinsale Capital Group, Inc.	Financials	1.42%	23.70%	0.38%
Sprout Social Inc	Information Technology	0.71%	32.34%	0.35%
Air Transport Services Group, Inc.	Industrials	2.11%	13.85%	0.32%
Castle Biosciences, Inc.	Health Care	1.61%	4.64%	0.23%
Freshpet Inc	Consumer Staples	2.00%	7.74%	0.17%
BJ's Wholesale Club Holdings, Inc.	Consumer Staples	3.08%	0.96%	0.11%
Clearfield, Inc.	Information Technology	0.66%	3.84%	0.09%
Aspen Aerogels Inc	Energy	0.14%	12.50%	0.08%
Total		**14.56%**		**2.88%**

Bottom 10 Contributors	Sector	Average Weight	Total Return	Relative Contribution
Calix, Inc.	Information Technology	3.03%	-46.34%	-1.67%
Astec Industries, Inc.	Industrials	2.44%	-35.88%	-1.36%
Kornit Digital Ltd.	Industrials	1.87%	-45.69%	-1.23%
Fox Factory Holding Corp.	Consumer Discretionary	2.77%	-42.42%	-1.19%
Ranpak Holdings Corp.	Materials	1.78%	-45.64%	-0.93%
InMode Ltd.	Health Care	1.64%	-47.70%	-0.89%
Synaptics Incorporated	Information Technology	3.22%	-31.09%	-0.86%
CryoPort, Inc.	Health Care	1.32%	-41.00%	-0.78%
Medpace Holdings, Inc.	Health Care	2.89%	-24.83%	-0.71%
Omnicell, Inc.	Health Care	2.48%	-28.24%	-0.68%
Total		**23.45%**		**-10.32%**

Sector Attribution



Market Cap Attribution



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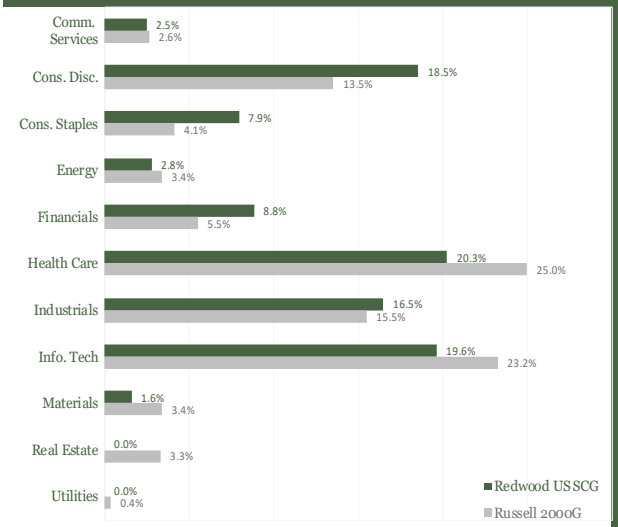
Redwood Small Cap Growth

Portfolio Positioning As of 3/31/2022

	Redwood US SCG	Russell 2000G
FCF Yield	4.1%	4.2%
P/E	16.5	15.1
EPS Revisions 6 Months	17.4%	19.0%
Historical EPS Growth 3 Yr	38.8%	19.2%
ROE	21.0%	11.4%
ROIC	7.8%	3.8%
Operating Margin	15.7%	6.0%
Weighted Avg. Market Cap. (M$)	$4,112	$3,656
# of Securities	49	1,244
Active Share	90.7%	
Beta: Predicted / Historical	1.05 / 0.99	
Tracking Error	5.68%	

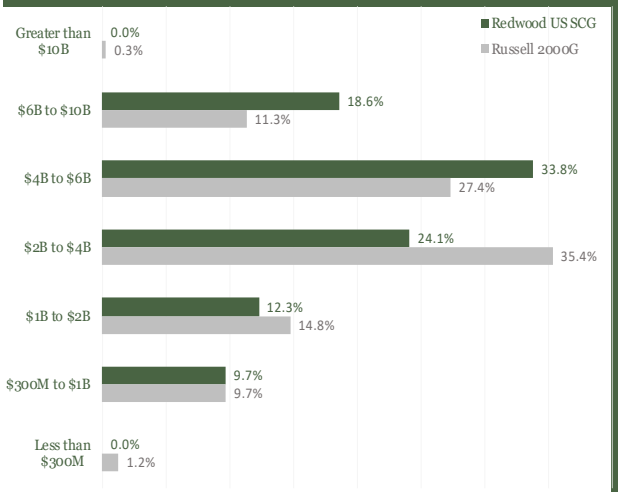
Sector Allocation



Top 10 Holdings	Portfolio Weight	Sector
Boyd Gaming Corporation	3.5%	0.0%
BJ's Wholesale Club Holdings, Inc.	3.4%	0.0
Simpson Manufacturing Co., Inc.	3.2%	0.0%
Synaptics Incorporated	3.0%	0.0%
Texas Roadhouse, Inc.	2.8%	0.0%
Onto Innovation, Inc.	2.7%	0.0%
Workiva Inc.	2.7%	0.0%
Asbury Automotive Group, Inc.	2.6%	$0
Kinsale Capital Group, Inc.	2.6%	0
Medpace Holdings, Inc.	2.5%	0.0%
Total	**28.9%**	

Source: FTSE Russell, Inc., Factset, Redwood.

Market Cap Allocation



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Reference to the Performance Table on Page 1 of this quarterly letter: The Redwood Small Cap Growth Composite includes all fee-paying discretionary portfolios invested in small capitalization securities primarily in the growth style. The strategy allows for equity exposure ranging between 90-100%. The account minimum for the composite is $150,000. The benchmark for the Redwood Small Cap Growth Composite is the Russell 2000® Growth Index. The Russell 2000® Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. This Index has been selected for comparison purposes only. Client account holdings may differ significantly from the securities in the indices and the volatility of the index may be materially different from client account performance. One cannot invest directly in an index. The Redwood Small Cap Growth Composite was created July 1, 2010.

Redwood Small Cap Growth

Composite Performance and GIPS Disclosures

Redwood Investments Small Cap Growth Composite

Year	Gross of Fees (%)	Net of Fees(%)	Russell 2000® Growth (%)	Number of Portfolios	Composite Dispersion	Total Composite Assets (Thousands)	Total Firm Assets (Thousands)	3 Year Standard Deviation	Benchmark 3 Yr. Standard Deviation
2021*	24.61	24.05	2.83	67	0.44	$1,077,665	$2,198,985	18.45	23.07
2020	41.79	41.24	34.63	42	1.80	$1,090,888	$2,238,905	21.37	25.10
2019	17.62	17.14	28.48	44	0.47	$996,795	$1,982,217	16.57	16.37
2018	-11.45	-11.86	-9.31	30	1.60	$658,226	$1,802,650	16.39	16.46
2017	17.98	17.43	22.17	66	0.84	$543,507	$2,208,766	14.01	14.80
2016	10.68	10.13	11.32	33	1.60	$247,921	$1,254,124	15.12	16.91
2015	6.07	5.37	-1.38	16	0.49	$86,246	$1,022,490	13.90	15.16
2014	4.32	3.32	5.60	13	0.44	$9,619	$734,498	13.86	14.01
2013	58.31	56.89	43.30	12	2.14	$11,578	$769,126	19.36	17.52
2012	17.20	16.15	14.59	5 or fewer	NA	$2,056	$675,236	NA	NA
2011	-9.56	-10.35	-2.91	5 or fewer	NA	$1,772	$674,952	NA	NA
2010 ^	39.70	39.42	33.14	5 or fewer	NA	$1,167	$558,742	NA	NA

NA – Information is not statistically meaningful due to insignificant number of portfolios in the composite. ^ Period from July 1, 2010 to December 31, 2010
*2021 GIPS performance is currently under review.

Redwood Investments, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Redwood Investments, LLC has been independently verified for the periods January 1, 2005 through December 31, 2020. The verification reports are available upon request.

A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.

Notes:

1. Redwood Investments, LLC is an investment manager that invests in U.S. and International securities. Redwood Investments, LLC is defined as an independent investment management firm that is not affiliated with any parent organization. Policies for valuing investments, calculating performance, and preparing GIPS reports are available upon request.
2. Composites
   A. Redwood Small Cap Growth: The Small Cap Growth Composite includes all fee paying discretionary portfolios invested in small capitalization securities primarily in the growth style. The strategy allows for equity exposure ranging between 90-100%. The account minimum for the composite is $150,000. The composite includes portfolios that pay zero commissions. The benchmark for the Small Cap Growth Composite is the Russell 2000® Growth Index. The Russell 2000® Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. This Index has been selected for comparison purposes only. Client account holdings may differ significantly from the securities in the indices and the volatility of the index may be materially different from client account performance. You cannot invest directly in an index. The Small Cap Growth Composite was created and incepted on July 1, 2010.
3. Valuations are computed and performance is reported in U.S. dollars.
4. Gross-of-fees returns are presented before management and custodial fees but after all trading expenses. The transaction costs for some portfolios in the composite are not known and must be estimated. The annual estimated transaction costs for these portfolios is 8.4 basis points. Composite and benchmark returns reflect the reinvestment of dividends and other income and are presented net of non-reclaimable withholding taxes. Net-of-fees returns are calculated by deducting actual management fees from the gross composite return. The standard management fee schedule is as follows: 1.00% on the first $5 million, 0.85% on the next $5 million, and 0.75% on the remainder above $10 million. Fees are negotiable.
5. A complete list of composite descriptions is available upon request.
6. Dispersion is measured by the equal-weighted standard deviation of annual gross returns of those portfolios that were included in the composite for the entire year. For periods prior to January 1, 2018, dispersion presented is measured by the asset-weighted standard deviation of annual gross returns of those portfolios that were included in the composite for the entire year.
7. The three-year annualized standard deviation measures the variability of the composite gross returns and the benchmark returns over the preceding 36-month period.
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