High Yield Market Update

Despite a marginal increase in volatility, the High Yield market posted its eighth straight quarter of positive returns. Risk assets were driven by positive economic data, strong corporate fundamentals, optimism surrounding the passage of the US tax bill, de-escalating tension in North Korea and the ongoing rally in commodities, especially WTI Crude oil, which rose 16.93% to a multi-year high. Late in the quarter, the Federal Open Market Committee (FOMC) implemented a third rate hike for 2017, which was largely anticipated and did not have a meaningful impact on markets. During the quarter, the US Dollar Index was down 1.02% and Treasuries ended the quarter with the 2-year up 41 basis points (bps) to 1.88% and the 10-year up by 8 bps to 2.41% as the yield curve flattened.

High yield technicals were mixed in Q4 as high yield and loan funds saw outflows but net supply was negative. High yield funds saw outflows of $9.2bn, and loan funds saw outflows of $2.7bn, as tracked by Lipper. For the quarter $67.9bn of new issuance was offset by $71.9bn of bond redemptions, with net supply at -$4.0bn for the period. The percentage of the market trading at distressed levels (below 70% of par) ended Q4 at 3.2%, per JP Morgan. The par-weighted twelve-month high yield bond default rate ticked lower to 1.65% at quarter-end, per BofA Merrill Lynch. Excluding commodities, the default rate was 1.53%.

The ICE BofAML US High Yield Index returned 0.41% in Q4, ending the period with an average price of 100.61, a 1.15 point decrease from the prior quarter. Credit spreads widened by 5 bps to 358 bps and the yield-to-worst was higher by 0.36% to 5.77%. High Yield underperformed investment grade corporates, as represented by the ICE BofAML US Corporate Index's 1.12% return, as well as small cap equities, as represented by the Russell 2000's 3.33%, and large cap equities, as represented by the S&P 500's 6.64% quarterly return. In High Yield, performance was positive across all credit qualities with the Double-B, Single-B and Triple-C sub-indices returning 0.35%, 0.37% and 0.73%, respectively. By sector, Utilities was the top performer with a 2.33% return, while Telecom was the bottom-performing sector, posting -2.18%.

Portfolio Performance

Portfolios managed by SKY Harbor according to our Unconstrained **Broad High Yield Market Strategy** (BHYM) outperformed the benchmark in the fourth quarter of 2017. By risk type (defined by duration and yield to worst) both security selection and allocation were positive contributors to relative performance. The primary drivers of outperformance were security selection within the shortest duration, most defensive parts of the market and the most speculative, equity-like part of the market. By sector, strong selection in Energy and Basic Industry were sources of outperformance as well as an underweight to the bottom-performing Telecom sector. This was partially offset by weaker selection in Telecom.

On a representative basis, the largest positive contributor was Approach Resources Inc. (AREX) which was last quarter's largest bottom contributor, trading up in Q4 along with the rally in oil. Last quarter's top contributor, Ahern Rentals Inc. (AHEREN) 7.375% notes due 2023 was again among top contributors, continuing momentum following another quarter of solid results and a positive outlook. The largest negative contributor was Rex Energy Corp (REXX) 8% notes due 2020, which traded down on market technicals.

Broad High Yield Market Strategy: Performance

	SKY Harbor BHYM Strategy Performance (%)			
	Gross of Fees	ICE BofAML US HY Index	Alpha	Net of Fees
Q1 2017	2.66	2.71	-0.04	2.59
Q2 2017	2.07	2.14	-0.07	2.00
Q3 2017	2.04	2.04	0.00	1.96
October 2017	0.54	0.39	0.16	0.52
November 2017	-0.18	-0.27	0.09	-0.21
December 2017	0.53	0.29	0.24	0.51
Q4 2017	0.90	0.41	0.49	0.82
Full Year 2017	7.89	7.48	0.40	7.56
Three Years (annl)	6.37	6.39	-0.02	6.05
Five Years (annl)	5.98	5.80	0.18	5.66
SI Return (annl)	8.17	8.10	0.07	7.83

Performance includes reinvestment of dividends and other earnings. Gross performance does not reflect the deduction of management fees. Fees disclosed in SKY Harbor's Form ADV, Part 2A or applicable offering documents. Past performance is not indicative of future results.
SI=Since Inception. Broad High Yield Market Composite inception date: 9/30/11.

Unconstrained **Short Duration High Yield Strategy** (SDHY) portfolios posted solid returns for the quarter, outperforming the broader US high yield market return (as measured by the ICE BofAML US High Yield Index). A duration shorter than the broad high yield market helped to reduce some of the volatility experienced by the overall high yield market during the period. From a sector standpoint, Energy and Basic Industry were among top performers, together contributing more than half of the Q4 return. All sectors posted positive returns with the exception of Telecom and Media, which were a modest drag on performance.

On a representative basis, at quarter-end our SDHY portfolios had a yield-to-worst of 4.67% (81% of the broad market yield). Exclusive of cash, the average coupon was 6.72% (vs. the market average of 6.41%) and the duration-to-worst was 1.7 (or 47% of the broad market). Holdings (328 issues, representing 244 issuers) comprised 34% bonds with maturities of less than three years and 66% in longer maturities but expected to be early take-outs inside this three-year period. This is a slight shift in favor of the latter group and represents our view that we continue to find greater value in the yield-to-call opportunities. Nevertheless, we value the relative price stability the short maturity group can offer in volatile periods in the market. Overall credit quality decreased slightly during the quarter. At quarter-end Double-B rated holdings represented 34.5% of the portfolio, Single-Bs were 53.0% and Triple-Cs were 10.0%.

Short Duration High Yield Strategy: Performance

	SKY Harbor SDHY Strategy Performance (%)				Annualized Daily Volatility		
	Gross of Fees	High Yield Market[1]	Market Capture	Net of Fees	SKY SDHY Strategy	High Yield Market[1]	Relative Volatility
Q1 2017	1.59	2.71	59%	1.50	1.5	2.9	52%
Q2 2017	1.36	2.14	63%	1.27	0.9	1.6	54%
Q3 2017	1.29	2.04	64%	1.21	0.8	1.7	49%
October 2017	0.49	0.39	127%	0.46	0.5	1.0	55%
November 2017	-0.13	-0.27	50%	-0.16	1.6	3.1	53%
December 2017	0.28	0.29	95%	0.25	0.5	0.8	63%
Q4 2017	0.63	0.41	155%	0.54	1.0	1.9	54%
Full Year 2017	4.96	7.48	66%	4.60	1.1	2.1	52%
Three Years (annl)	4.14	6.39	65%	3.77	2.0	4.0	51%
Five Years (annl)	3.72	5.80	64%	3.34	2.0	3.7	54%
Since Inception (annl)	4.56	7.20	63%	4.17	1.9	4.7	54%

1. The Short Duration High Yield strategy is not a benchmarked strategy. The HY Market index shown (ICE BofAML US HY Index) is used solely as a relative market indicator. Short Duration High Yield Composite Inception date: 10/31/11
Performance includes reinvestment of dividends and other earnings. Gross performance does not reflect the deduction of management fees. Fees disclosed in SKY Harbor's Form ADV, Part 2A or applicable offering documents. Past performance is not indicative of future results.

Outlook

We maintained a consistent view of market risks and opportunities for most of the second half of 2017 and, as a result, our risk positioning has been generally unchanged. While various geopolitical risks remain, markets are benefiting from the strongest corporate earnings growth in the last five years and the default rate has fallen from the peak reached early in 2017. However, while the high yield market has not hit cycle tight spreads, parts of the market have or are approaching cycle tights. We believe further spread compression is possible, absent a general spike in risk premiums from a risk that is currently underappreciated in the market. Interest rate expectations seem to be rising, although in our view not meaningfully enough to completely derail the most rate and spread sensitive parts of the market that benefit from crossover buyers. We expect high yield issuance to remain tilted towards better quality and refinancing, but generally be demand driven and sensitive to fund flows. Our conviction that fundamentals will continue to improve and high yield defaults have peaked remains high and the strongest driver of portfolio positioning. However, while corporate fundamentals are strong, we believe we are generally not being paid to take "equity-like" risk at current market levels due to the underlying secular and/or cyclical changes that much of the remaining higher-yielding part of the market faces. Based on our view of risks and valuations across the market, we continue to believe Single-B rated credit offers the best opportunity for attractive returns through credit picking.

Entering 2018, we believe our Broad High Yield Market portfolios remain well positioned for the current market environment. We have moderated our underweight to the

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Portfolio Characteristics

Representative Broad High Yield Market Portfolio

Characteristics	Portfolio[1]	HY Market
Avg Years to Maturity	6.3	6.2
Yield to Worst	5.76%	5.77%
Current Yield	6.77%	6.37%
Duration to Worst	3.4	3.7
OAS	355	358
Avg Coupon	6.98%	6.41%
Number of Issuers	268	872
Number of Issues	347	1881
Average ML Rating	B2	B1
Average Price	103.1	100.6

Distribution by ML Rating	Portfolio[1]	HY Market
A Holdings	0.0%	0.0%
BBB Holdings	1.3%	0.0%
BB Holdings	27.9%	47.2%
B Holdings	49.9%	39.1%
CCC or Under	21.0%	13.7%

Distribution by Issue Size	Portfolio[1]	HY Market
0 - 250M	7.5%	1.8%
250 - 500M	35.4%	27.7%
500 - 750M	22.4%	21.1%
750 - 1000M	10.3%	15.5%
1000+M	24.4%	33.8%

Distribution by Sector	Portfolio[1]	HY Market	SKY as % of HY Market
Basic Industry	19.4%	12.1%	159%
Energy	14.5%	14.1%	103%
Capital Goods	9.1%	5.2%	176%
Technology & Electronics	8.9%	5.9%	151%
Media	8.1%	11.4%	71%
Services	6.9%	5.4%	128%
Healthcare	6.8%	10.2%	67%
Telecommunications	6.7%	9.2%	72%
Leisure	4.4%	4.5%	100%
Financial Services	2.8%	3.8%	74%
Automotive	2.7%	2.3%	119%
Banking	2.4%	3.3%	72%
Consumer Goods	2.0%	2.7%	75%
Real Estate	1.4%	0.7%	206%
Transportation	1.3%	0.9%	137%
Utility	1.0%	2.5%	41%
Retail	0.9%	4.9%	19%
Insurance	0.7%	1.0%	68%

Top 5 Holdings by Weight	BofA ML Rating	Issue Size ($mil)	Current Price	BofA ML Industry	Duration to Worst	Yield to Worst (%)	% of Portfolio
American Axle & Manuf. 6.500% 01-Apr-2027	B1	500.0	105.75	Automotive	5.70	5.50	1.02
Sprint Corporation 7.875% 15-Sep-2023	B2	4,248.9	106.50	Telecommunications	4.50	6.49	0.94
Xerium Technologies Inc. 9.500% 15-Aug-2021	B2	479.5	101.75	Basic Industry	2.21	8.95	0.93
QUAD/GRAPHICS 7.000% 01-May-2022	B2	300.0	103.00	Media	3.67	6.19	0.92
Mastec Inc. 4.875% 15-Mar-2023	BB3	400.0	102.00	Services	2.91	4.20	0.92

Representative Short Duration High Yield Portfolio

Characteristics	Portfolio[1]	HY Market[2]	SD Universe[3]
Avg Years to Maturity	3.5	6.2	3.4
Yield to Worst	4.67%	5.77%	4.59%
Current Yield	6.48%	6.37%	6.03%
Duration to Worst	1.7	3.7	2.1
OAS	274	358	264
Avg Coupon	6.72%	6.41%	6.19%
Number of Issuers	244	872	362
Number of Issues	334	1881	577
Average ML Rating	B1	B1	BB3
Average Price	103.74	100.61	102.67

Distribution by ML Rating	Portfolio[1]	HY Market[2]	SD Universe[3]
A Holdings	0.0%	0.0%	0.0%
BBB Holdings	2.6%	0.0%	0.0%
BB Holdings	34.5%	47.2%	51.5%
B Holdings	53.0%	39.1%	48.5%
CCC or Under	10.0%	13.7%	0.0%

Distribution by Issue Size	Portfolio[1]	HY Market[2]	SD Universe[3]
0 - 250M	7.0%	1.7%	0.0%
250 - 500M	35.9%	27.6%	23.7%
500 - 750M	20.0%	21.1%	26.6%
750 - 1000M	13.1%	15.5%	13.5%
1000+M	24.0%	34.1%	36.1%

Distribution by Sector	Portfolio[1]	HY Market[2]	SD Universe[3]
Basic Industry	16.6%	12.1%	13.2%
Energy	12.8%	14.1%	14.0%
Media	9.8%	11.4%	11.8%
Telecommunications	8.2%	9.2%	8.8%
Healthcare	7.9%	10.2%	7.8%
Technology & Electronics	7.4%	5.9%	4.5%
Capital Goods	7.1%	5.2%	5.9%
Financial Services	6.6%	3.8%	8.4%
Services	5.1%	5.4%	3.8%
Leisure	4.5%	4.5%	5.1%
Transportation	3.6%	0.9%	1.9%
Automotive	2.3%	2.3%	2.0%
Retail	2.0%	4.9%	4.0%
Consumer Goods	2.0%	2.7%	2.1%
Utility	1.4%	2.5%	2.1%
Real Estate	1.1%	0.7%	1.2%
Banking	1.1%	3.3%	2.8%
Insurance	0.4%	1.0%	0.6%

Top 5 Holdings by Weight	BofA ML Rating	Issue Size ($mil)	Current Price	BofA ML Industry	Duration to Worst	Yield to Worst (%)	% of Portfolio
Scientific Games Int'l 7.000% 01-Jan-2022	B1	2,100.0	105.50	Leisure	0.96	4.89	0.82
Sprint Nextel Corporation 7.000% 15-Aug-2020	B2	1,500.0	106.00	Telecommunications	2.34	4.54	0.81
Sprint Corporation 7.250% 15-Sep-2021	B2	2,250.0	105.88	Telecommunications	3.18	5.47	0.75
HCA Inc. 6.500% 15-Feb-2020	BB1	3,000.0	106.50	Healthcare	1.94	3.54	0.73
DISH DBS Corporation 5.125% 01-May-2020	BB3	1,099.6	102.25	Media	2.17	4.16	0.68

1 Exclusive of Cash. 2,3 The Short Duration High Yield strategy is not a benchmarked product; The HY Indices shown are provided solely as a relative market indicators.
This comparison of selected characteristics of representative SKY Harbor portfolios on or about December 31, 2017 is provided for illustrative purposes only and is subject to change without notice in accordance with the strategies' stated objectives and the sole discretion of SKY Harbor's portfolio management team.
Source: SKY Harbor, FactSet, Ice BofAML US High Yield indexes H0A0 and JVC4.

Outlook *(cont.)*

better quality, more spread sensitive segment of the market such that we have reached our target positioning. We continue to look for opportunities to benefit from credit picking among the higher-yielding segments of the market although will remain underweight this segment.

In our Short Duration High Yield Strategy, we believe portfolios are well positioned to take advantage of any potential volatility associated with changing geopolitical situations or rising concerns related to increasing rates. Natural turnover, created by calls, tender and maturities, should be high considering the large amount of front-end maturities and expected near-term calls held in the portfolios, which will allow us to be continually optimizing the portfolio for the current market environment. Overall, we believe the SDHY portfolios have attractive income per unit of duration, which positions them well within the asset class.

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