

High Yield Market Update

High Yield suffered its first negative returning quarter since the lockdown-stricken start to 2020. Multiple factors were behind the broad-based risk off sentiment during the quarter. An increasingly hawkish US central bank did the most damage, but investors had to integrate Russia's invasion of Ukraine, a highly transmissible COVID variant that put additional stress on already pressured supply chains, the downside risk to China's growth, and high oil prices into their assessment of forward economic conditions. Crude oil prices rose steadily throughout Q1 ultimately ending the quarter with WTI Crude up \$25.07/bbl (or 33.33%) to \$100.28/bbl. Treasuries ended the period with the 2-year up 161 basis points (bps) to 2.34% and the 10-year up by 83 bp to 2.34% and the US Dollar Index was up 2.76%.

High yield market technicals were mixed with mutual fund outflows and negative net supply. High yield funds and ETFs had outflows of \$25bn while loan funds saw inflows of \$19.8bn, as tracked by Lipper and reported by Barclays. Q1 bond new issuance was sharply lower, with \$43.3bn pricing in the quarter, offset by \$48.7bn of bond redemptions or upgrades, leaving net supply at -\$5.4bn for the period, per Barclays. The percentage

of the market trading at distressed levels (below 70% of par) ended the quarter at 1.2%; the comparable figure for the loan market (below 80% of par) was 1.7%, per JP Morgan. The par-weighted twelve-month high yield bond default rate increased to 0.5% by quarter-end, per BofA Merrill Lynch.

The ICE BofA US High Yield Index returned -4.51% in Q1, ending the period with an average price of 97.052, a 6.33-point decrease from the prior quarter. Credit spreads widened by 29 bps to 336 bps and the yield-to-worst (YTW) increased by 1.65% to 5.93%. High yield outperformed small cap equities, represented by the Russell 2000's -7.80% return, as well as large cap equities, as represented by the S&P 500's -4.95% return, and investment grade corporates, as represented by the ICE BofA US Corporate Index's -7.74% quarterly return. In high yield, the Double-B, Single-B and Triple-C sub-indices returned -5.37%, -3.46% and -3.72%, respectively. Returns were negative across all sectors for the quarter with Energy the top performing sector in Q1'22, returning -2.40% while the duration heavy Consumer Goods sector was the weakest sector of the quarter, returning -8.24%.

Portfolio Performance

Our **Broad High Yield Market** (BHYM) portfolios posted negative returns in Q1 but were less negative than the index. By risk type (defined by yield and duration to worst), allocation was a source of outperformance while security selection had a muted impact. The primary drivers of relative returns were underweights to the bottom-performing long duration part of the market and the better quality, most rate sensitive (yielding 0-5%) part of the market. Outperformance was slightly moderated by weaker selection within intermediate risk securities (yielding 7-8%). By sector, strong selection in Consumer Goods and Media were positive contributors to relative returns, partially offset by our significant underweight to Energy. By rating, strong selection in and an overweight to higher performing Single-Bs drove relative returns but was partially reduced by weaker selection within Double-Bs.

Portfolios managed according to our unconstrained **Short Duration High Yield** Strategy (SDHY) were not immune to the uncharacteristic weakness to begin the year, posting negative returns but outperforming the broader US high yield market return (as measured by the ICE BofA US High Yield Index) and doing so with substantially less volatility. By risk type, the shortest duration, most defensive securities outperformed longer duration (within the context of short duration) and the most speculative securities. By sector, Leisure and Services led while Financial Services and Basic Industry lagged though all sectors were negative for the quarter. By rating, Single-Bs and Double-Bs outperformed Triple-Cs. Looking forward, we continue to focus on maintaining a relatively high current income as we believe credit spread tightening can resume, though not necessarily in a linear manner.

SKY HARBOR CAPITAL MANAGEMENT

Portfolio Characteristics

Representative Broad High Yield Market Portfolio

Characteristics	Portfolio ¹	HY Market	Distribution by Sector	Portfolio ¹	HY Market	SKY as % of HY Market
Avg Years to Maturity	5.57	6.19	Capital Goods	18.3%	6.0%	305%
Yield to Worst	6.81%	5.94%	Basic Industry	12.8%	7.2%	177%
Current Yield	6.94%	5.84%	Media	11.1%	8.4%	132%
Duration to Worst	3.8	4.5	Services	10.1%	6.2%	162%
OAS	414	336	Technology & Electronics	7.7%	4.2%	182%
Avg Coupon	6.80%	5.66%	Healthcare	7.4%	9.8%	76%
Number of Issuers	110	961	Leisure	5.6%	6.8%	83%
Number of Issues	132	2099	Retail	4.7%	5.1%	92%
Average ML Rating	B2	B1	Consumer Goods	4.3%	4.6%	94%
Average Price	98.0	97.0	Transportation	4.0%	1.8%	217%
			Energy	3.6%	13.6%	26%
			Real Estate	2.8%	4.3%	66%
			Financial Services	2.5%	4.7%	53%
			Telecommunications	2.4%	7.4%	32%
			Automotive	2.2%	4.3%	51%
			Insurance	0.7%	1.4%	46%
			Utility	0.0%	2.8%	0%
			Banking	0.0%	1.3%	0%

Distribution by Rating	Portfolio ¹	HY Market
A Holdings	0.0%	0.0%
BBB Holdings	0.0%	0.0%
BB Holdings	18.8%	52.9%
B Holdings	55.1%	36.5%
CCC or Under	25.6%	10.6%

Distribution by Issue Size	Portfolio ¹	HY Market
0 - 250M	2.1%	0.5%
250 - 500M	41.5%	24.1%
500 - 750M	22.8%	22.1%
750 - 1000M	11.7%	17.6%
1000+M	21.9%	35.7%

Top 5 Holdings by Weight	BofA Rating	Issue Size (\$mil)	Current Price	BofA Industry	Duration to Worst	Yield to Worst (%)	% of Portfolio
Foxtrot Escrow Issuer LLC 12.25% 15-Nov-2026	B3	761.8	108.16	Capital Goods	0.57	8.29	2.26
Interface Inc. 5.500% 01-Dec-2028	B1	300.0	97.13	Basic Industry	5.39	6.03	2.09
Rocket Software Inc 6.500% 15-Feb-2029	CCC2	575.0	90.75	Technology & Electronics	5.31	8.29	2.00
Titan International Inc. 7.000% 30-Apr-2028	B3	399.1	100.32	Capital Goods	3.40	6.91	1.83
Cengage Learning Inc. 9.500% 15-Jun-2024	CCC2	620.0	99.75	Services	1.90	9.61	1.81

Representative Short Duration High Yield Portfolio

Characteristics	Portfolio ¹	HY Market ²	SD Universe ³	Distribution by Sector	Portfolio ¹	HY Market ²	SD Universe ³
Avg Years to Maturity	4.1	6.2	3.4	Basic Industry	13.3%	7.2%	5.8%
Yield to Worst	6.13%	5.94%	5.35%	Services	12.0%	6.2%	5.7%
Current Yield	6.72%	5.84%	6.03%	Capital Goods	10.6%	6.0%	7.4%
Duration to Worst	2.6	4.5	2.3	Media	9.8%	8.4%	5.1%
OAS	364	336	291	Technology & Electronics	8.9%	4.2%	3.1%
Avg Coupon	6.73%	5.66%	6.06%	Healthcare	8.7%	9.8%	8.0%
Number of Issuers	149	961	466	Financial Services	6.8%	4.7%	7.1%
Number of Issues	183	2099	681	Telecommunications	6.3%	7.4%	6.5%
Average Rating	B2	B1	BB3	Automotive	5.7%	4.3%	3.9%
Average Price	100.16	97.05	100.55	Retail	3.9%	5.1%	5.1%
				Transportation	3.4%	1.8%	3.8%
				Leisure	3.4%	6.8%	7.8%
				Consumer Goods	3.4%	4.6%	3.3%
				Real Estate	3.2%	4.3%	6.2%
				Other	0.4%	0.0%	0.0%
				Energy	0.0%	13.6%	15.6%
				Utility	0.0%	2.8%	2.6%
				Insurance	0.0%	1.4%	1.0%
				Banking	0.0%	1.3%	1.9%

Distribution by Rating	Portfolio ¹	HY Market ²	SD Universe ³
A Holdings	0.0%	0.0%	0.0%
BBB Holdings	0.8%	0.0%	0.0%
BB Holdings	25.3%	52.9%	53.9%
B Holdings	61.4%	36.5%	46.1%
CCC or Under	12.5%	10.6%	0.0%

Distribution by Issue Size	Portfolio ¹	HY Market ²	SD Universe ³
0 - 250M	5.0%	0.5%	0.0%
250 - 500M	36.4%	24.0%	19.6%
500 - 750M	19.5%	22.0%	26.1%
750 - 1000M	17.8%	17.5%	15.9%
1000+M	21.2%	36.0%	38.4%

Top 5 Holdings by Weight	Average Rating	Issue Size (\$mil)	Current Price	BofA Industry	Duration to Worst	Yield to Worst (%)	% of Portfolio
Townsquare Media Inc. 6.875% 01-Feb-2026	B2	550.0	102.99	Media	0.80	3.21	1.83
American Airlines Inc. 11.750% 15-Jul-2025	B1	2,500.0	116.73	Transportation	2.72	6.06	1.56
Neon Holdings Inc 10.125% 01-Apr-2026	B3	495.0	104.00	Services	1.79	7.92	1.40
Avaya Inc. 6.125% 15-Sep-2028	B1	1,000.0	98.62	Technology & Electronics	5.24	6.39	1.34
Uber Technologies, Inc. 8.0% 01-Nov-2026	B3	1,500.0	106.27	Technology & Electronics	0.56	3.84	1.31

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 June 30, 2021 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 BofA US High Yield Index "H0A0" (HY Market) and ICE BofA 1-5 Year BB-B US Cash Pay High Yield Constrained Index "JC4" (SD Universe).

Outlook

We hope that our investors are receiving our Weekly Briefings as we use those briefs to give timely insights into how we see high yield risks and opportunities evolving during this period of heightened volatility.

Since the beginning of the year, the sell-off has been driven by the dual impact of the Fed's push to remove accommodation and normalize monetary policy after pandemic-induced extraordinary measures to stabilize the economy and markets AND the current and projected impact associated with war in Ukraine. Our portfolios are generally well positioned for the threat of rising rates. We are biased towards shorter duration risk taking and the bonds of issuers that we believe have sustainable operating trends despite current headwinds. Portfolios have been less well-positioned for the extended conflict-induced spike in energy commodities. Our

underweight to the Energy sector is a tough headwind as that sector outperforms.

Like in all periods of excess volatility, we are challenging our assumptions, debating potential outcomes and supporting our discussions with quantitative analysis to quantify specific risks and opportunities. We acknowledge that war-related risks are unique in today's world and history is not a perfect guide and are moderating our conviction levels overall, bringing down our high conviction weights in some cases where we see protracted headwinds or new risks. High yield balance sheets are sufficiently strong and default risk remains low. Our bias away from low-coupon, longer duration risk is steadfast although we find opportunities to add this type of risk as it reprices to levels that we think are consistent with long-term value.

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