

## High Yield Market Update

Investor perception of risk shifted somewhat in the third quarter although risks associated with inflation remained the most often identified risk according to the BofA Merrill Lynch Credit Investor Survey. Risks associated with China rose sharply over the period and investors became more comfortable with the path towards higher interest rates, leading to a notching lower of rate-related concern. Concern surrounding COVID-19 remained elevated as the Delta variant led to a rise in hospitalizations and deaths in areas of the country characterized by low vaccination rates and limited mask mandates. Investors generally factored the consequences of inflation, China self-imposed restrictions, rates, and the lingering pandemic, into conviction that interest rates will rise as monetary policy is normalized. The high yield market outperformed other notable risk assets. Treasuries ended the period with the 2-year up 3 basis points (bps) to 0.28% and the 10-year up by 2 bp to 1.49% and the US Dollar Index was up 1.94%.

Technical moves were not a significant contributor to directional moves in the third quarter of 2021 with minimal inflows and positive net supply. High yield funds and ETFs had inflows of \$1.9bn while loan funds saw inflows of \$8.1bn, as tracked by Lipper and reported by Barclays. Q3 bond new issuance was slightly down, with \$108.9bn pricing in the quarter, offset by

\$100.3bn of bond redemptions, leaving net supply at \$8.6bn for the period, per Barclays. The percentage of the market trading at distressed levels (below 70% of par) ended the quarter at 0.8%; the comparable figure for the loan market (below 80% of par) was 1.3%, per JP Morgan. The par-weighted twelve-month high yield bond default rate decreased to 1.3% by quarter-end, per BofA Merrill Lynch.

The ICE BofA US High Yield Index returned 0.94% in Q3, ending the period with an average price of 104.64, a 0.65-point decrease from the prior quarter. Credit spreads widened by 11 bps to 310 bps and the yield-to-worst (YTW) increased by 0.23% to 4.00%. High yield outperformed small cap equities, represented by the Russell 2000's -4.60% return, as well as large cap equities, as represented by the S&P 500's 0.23% return, and investment grade corporates, as represented by the ICE BofA US Corporate Index's -0.06% quarterly return. In high yield, the Double-B, Single-B and Triple-C sub-indices returned 1.08%, 0.69% and 1.01%, respectively. Returns were positive across all sectors for the quarter: Energy was the top performing sector in Q3'21, bolstered by rising crude and natural gas pricing with WTI Crude closing up \$1.56/bbl (or 2.12%) to \$75.03/bbl. the top performer was Energy, while Automotive was the bottom-performing sector as investors interpreted supply chain disruption to mean lower near term operating results.

## Portfolio Performance

Portfolios managed according to our Unconstrained **Broad High Yield Market Strategy** (BHYM) posted strong relative returns in Q3. By risk segment (defined by yield and duration to worst), security selection was a source of outperformance while allocation was a source of underperformance. Strong selection within the shortest duration part of the market and the better quality, more rate sensitive part of the market drove returns. Outperformance was somewhat reduced by an underweight to the top-performing, longest duration part of the market and weaker selection in the intermediate risk part of the market (yielding 6-7%). By sector, strong selection in Media, Financial Services, Transportation, Capital Goods and Media was a strong contributor to returns, partially offset by an underweight to Energy and weaker selection in Services. By rating, strong selection in Single-Bs and Double-Bs continues to be a positive contributor to relative returns but outperformance was reduced by an underweight to Double-Bs. BHYM portfolios continue to benefit from high

conviction credit holdings, as 11 of the representative portfolio's top 20 holdings had total returns which exceeded the portfolio return for the quarter.

SKY Harbor's Unconstrained **Short Duration High Yield Strategy** (SDHY) portfolios posted positive returns in Q3, capturing over 90% the US high yield market return (as measured by the ICE BofA US High Yield Index). By risk type, intermediate duration (2-3 years) continues to outperform the shortest duration, more defensive securities. All sectors were positive for the quarter, led by Transportation and Financial Services while Automotive and Leisure lagged. By rating, the portfolios' Triple-C securities outperformed Double-Bs and Single-Bs. Lower rated credits continue to drive strong performance as positive earnings momentum lowers the expected default rate over the next 12 months. Looking forward, we continue to focus on maintaining a relatively high current income by selling when valuations are too tight or negative convexity limits further upside and rotating into issuers that align with our FASST positioning.

## Portfolio Characteristics

### Representative Broad High Yield Market Portfolio

Characteristics	Portfolio <sup>1</sup>	HY Market	Distribution by Sector	Portfolio <sup>1</sup>	HY Market	SKY as % of HY Market	
Avg Years to Maturity	6.1	6.5	Basic Industry	18.6%	7.8%	237%	
Yield to Worst	5.13%	4.00%	Capital Goods	15.2%	6.0%	254%	
Current Yield	6.53%	5.50%	Media	13.4%	8.5%	157%	
Duration to Worst	3.2	3.7	Services	10.9%	6.0%	182%	
OAS	422	310	Retail	6.8%	4.9%	139%	
Avg Coupon	6.78%	5.75%	Real Estate	4.7%	4.2%	112%	
Number of Issuers	105	934	Automotive	4.5%	5.0%	92%	
Number of Issues	120	2117	Transportation	4.1%	1.9%	220%	
Average ML Rating	B2	B1	Leisure	3.9%	6.7%	59%	
Average Price	103.9	104.6	Financial Services	3.7%	4.4%	83%	
			Energy	3.5%	13.7%	26%	
			Technology & Electronics	3.4%	4.4%	77%	
			Healthcare	3.1%	9.0%	35%	
			Consumer Goods	2.7%	4.8%	56%	
			Telecommunications	1.4%	7.1%	20%	
			Insurance	0.0%	1.2%	0%	
			Utility	0.0%	3.0%	0%	
			Banking	0.0%	1.4%	0%	
Distribution by Rating	Portfolio <sup>1</sup>	HY Market					
A Holdings	0.0%	0.0%					
BBB Holdings	0.6%	0.0%					
BB Holdings	19.5%	55.2%					
B Holdings	55.5%	33.3%					
CCC or Under	24.4%	11.4%					
Distribution by Issue Size	Portfolio <sup>1</sup>	HY Market					
0 - 250M	5.2%	0.5%					
250 - 500M	40.9%	24.0%					
500 - 750M	27.1%	22.1%					
750 - 1000M	12.9%	17.4%					
1000+M	13.9%	36.0%					
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	105.25	Media	1.27	2.83	2.39
Cengage Learning Inc. 9.500% 15-Jun-2024	CCC2	620.0	102.33	Services	0.66	6.05	2.32
United States Steel Corp 6.875% 01-Mar-2029	B2	750.0	106.62	Basic Industry	3.79	5.18	2.27
QUAD/GRAPHICS 7.000% 01-May-2022	B3	238.7	101.37	Media	0.56	4.56	2.27
Park-Ohio Industries Inc. 6.625% 15-Apr-2027	CCC1	348.8	99.88	Capital Goods	4.44	6.65	2.24

### Representative Short Duration High Yield Portfolio

Characteristics	Portfolio <sup>1</sup>	HY Market <sup>2</sup>	SD Universe <sup>3</sup>	Distribution by Sector	Portfolio <sup>1</sup>	HY Market <sup>2</sup>	SD Universe <sup>3</sup>
Avg Years to Maturity	4.3	6.5	3.4	Capital Goods	12.4%	6.0%	7.7%
Yield to Worst	3.74%	4.00%	3.10%	Basic Industry	12.3%	7.8%	7.5%
Current Yield	6.48%	5.50%	5.79%	Media	11.9%	8.5%	5.2%
Duration to Worst	1.6	3.7	1.8	Services	10.0%	6.0%	5.1%
OAS	331	310	270	Technology & Electronics	8.9%	4.4%	4.5%
Avg Coupon	6.80%	5.75%	6.11%	Automotive	7.2%	5.0%	4.3%
Number of Issuers	153	934	453	Healthcare	7.0%	9.0%	7.4%
Number of Issues	196	2117	673	Telecommunications	5.2%	7.1%	5.2%
Average Rating	B2	B1	BB3	Transportation	4.6%	1.9%	4.2%
Average Price	105.00	104.64	105.53	Leisure	4.5%	6.7%	8.1%
				Financial Services	4.5%	4.4%	7.1%
				Retail	4.3%	4.9%	4.9%
				Real Estate	3.8%	4.2%	5.2%
				Consumer Goods	2.9%	4.8%	3.1%
				Other	0.5%	0.0%	0.0%
				Utility	0.0%	3.0%	2.5%
				Insurance	0.0%	1.2%	0.6%
				Banking	0.0%	1.4%	1.9%
				Energy	0.0%	13.7%	15.5%
Distribution by Rating	Portfolio <sup>1</sup>	HY Market <sup>2</sup>	SD Universe <sup>3</sup>				
A Holdings	0.0%	0.0%	0.0%				
BBB Holdings	0.8%	0.0%	0.0%				
BB Holdings	22.3%	55.2%	56.2%				
B Holdings	62.3%	33.3%	43.8%				
CCC or Under	14.6%	11.4%	0.0%				
Distribution by Issue Size	Portfolio <sup>1</sup>	HY Market <sup>2</sup>	SD Universe <sup>3</sup>				
0 - 250M	5.7%	0.5%	0.2%				
250 - 500M	32.5%	23.9%	18.3%				
500 - 750M	21.5%	22.0%	26.4%				
750 - 1000M	15.9%	17.4%	15.7%				
1000+M	24.3%	36.2%	39.3%				
Top 5 Holdings by Weight	Average Rating	Issue Size (\$mil)	Current Price	BofA Industry	Duration to Worst	Yield to Worst (%)	% of Portfolio
Meredith Corp 6.875% 01-Feb-2026	CCC1	1,022.8	103.25	Media	0.33	2.19	2.06
American Airlines Inc. 11.750% 15-Jul-2025	B1	2,500.0	123.75	Transportation	3.10	4.81	1.65
Avaya Inc. 6.125% 15-Sep-2028	B1	1,000.0	105.15	Technology & Electronics	3.49	4.68	1.42
TENNECO INC 5.375% 15-Dec-2024	B3	225.0	99.92	Automotive	2.46	5.39	1.21
Plastipak Holdings Inc. 6.250% 15-Oct-2025	B3	500.0	101.78	Capital Goods	0.08	3.57	1.20

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 relative market indicators.

This comparison of selected characteristics of representative SKY Harbor portfolios on or about September 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 "HOAO" (HY Market) and ICE BofA 1-5 Year BB-B US Cash Pay High Yield Constrained Index "JCV4" (SD Universe).

## Outlook

Investors in credit assets remain torn between a focus on the generally improving fundamentals of corporate issuers as the economy pushes through various headwinds and the threat associated with rising interest rates. US fiscal policy is creating drama and presents a clear and present danger should the game of brinkmanship being played around the debt ceiling spiral out of control.

In our view, current valuations are broadly supported by fundamentals which have benefited from a strong recovery in earnings and generally strong aggregate economic data. Default risk is rapidly normalizing, and the credit ratings cycle is swinging to the positive after a pandemic-induced downgrade cycle. We continue to believe that there remains

an opportunity around spread compression based upon lower defaults and strong economic and market conditions.

We believe the market has excess return opportunity associated with carry, sector allocation and credit picking and are mindful of tighter valuations across better quality segments of the market that are vulnerable to a duration-based sell-off as rates move somewhat higher. Unlike last year where picking bonds with recovering results and attractive valuations was a key driver of returns, this year we expect returns will be a function of avoiding companies that stumble and are related to higher yields. Our valuation work suggests a bias towards lower rated credit that typically is lower duration and shorter duration assets in general.

---

### Disclaimers and Additional Disclosures

**This analysis and the opinions expressed herein are intended solely for institutional and professional investors that are responsible for assessing their own risk tolerances under prevailing market conditions.** SKY Harbor Capital Management, LLC ("SKY Harbor") provides this document for informational purposes only. The information herein is intended solely for the person to whom it has been delivered. Nothing contained in this document is or should be construed as an advertisement, or an offer to enter any contract, investment advisory agreement, a recommendation to buy or sell securities of any kind, a solicitation of clients, or an offer to invest in any particular fund, product, investment vehicle, or derivative.

This document contains forward-looking statements that are based on SKY Harbor's current views and assumptions. Forward-looking statements such as the findings of our analytical research, our outlook for interest rates, central bank policy, the economy, high yield markets and the like, illustrations of ESG integration in our fundamental credit analysis, or our intended adjustments to the portfolios within our strategies are all subject to inherent risks, biases and uncertainties that are beyond SKY Harbor's control and may cause actual results to differ materially from the expectations expressed herein.

The information contained herein is subject to change, and SKY Harbor is under no obligation to update any information contained herein. Certain information contained in this document has been obtained from third-party sources and, although believed to be reliable, has not been independently verified, and its accuracy or completeness cannot be guaranteed.

Broad High Yield Market Strategy portfolios may include 6%-12% of USD-denominated below-investment-grade corporate debt securities that are not included in the ICE BofA US High Yield Index ("Index"). These securities may have variable coupon schedules, scheduled maturity of less than one year, USD-listed issuers domiciled outside the US, issues with less than \$250 million in debt outstanding and new-issue securities not yet in the Index due to routine timing lag. The Index reflects no deductions for fees, expenses or taxes.

Investing in securities involves risk of loss and past performance is not necessarily indicative of future results. Fixed income securities, especially high yield debt securities, are subject to loss of income and principal arising from credit risk, which is the risk that the issuer will be unable to make interest and principal payments when due. Material risks in investing in high yield debt securities also include, but are not limited to, opportunity cost (the risk that an issuer's credit trends deteriorate resulting in a higher level of compensation demanded by the market relative to the initial investment), interest rate risk, liquidity risk, selection risk, and overall market risk. In general, issuers of high yield debt securities have a greater likelihood of defaulting on the payment of interest or principal than issuers of investment grade bonds. There can be no assurance that the investment objectives described herein will be achieved or that substantial losses can be avoided.

Gross performance results do not reflect the deduction of investment management fees, which would reduce an investor's actual return. For example, assume that \$1 million is invested in an account with the Firm, and this account achieves a 6% compounded annualized return, gross of fees, for five years. At the end of five years that account would grow to \$1,338,226 before the deduction of management fees. Assuming management fees of 0.55% per year are deducted annually from the average annual AUM, the value of the account at the end of five years would be \$1,302,846, which is the equivalent of an annual compounded rate of 5.43%. For a ten-year period, the ending dollar values before and after fees would be \$1,790,848 and \$1,697,408, respectively. These calculations do not include custodial fees or transaction costs. SKY Harbor's asset-based fees are generally billed monthly or quarterly in arrears. Please refer to SKY Harbor's ADV Part 2A or applicable Offering Documents for more information on fees. Consultants supplied with gross results are to use this data in accordance with SEC, CFTC, NFA or the applicable jurisdiction's guidelines.

The ICE BofA Index data referenced herein is the property of ICE Data Indices, LLC ("ICE BofA") and/or its licensors and has been licensed for use by SKY Harbor. ICE BofA PERMITS USE OF THE ICE BofA INDICES AND RELATED DATA ON AN "AS IS" BASIS, MAKES NO WARRANTIES REGARDING SAME, DOES NOT GUARANTEE THE SUITABILITY, QUALITY, ACCURACY, TIMELINESS, AND/OR COMPLETENESS OF THE ICE BofA INDICES OR ANY DATA INCLUDED IN, RELATED TO, OR DERIVED THEREFROM, ASSUMES NO LIABILITY IN CONNECTION WITH THE USE OF THE FOREGOING, AND DOES NOT SPONSOR, ENDORSE, OR RECOMMEND SKY Harbor or ANY OF ITS PRODUCTS OR SERVICES. SKY Harbor is not a tax or legal advisor. Prospective investors should consult their tax or legal advisors before making tax-related investment decisions.

SKY Harbor is not a tax or legal advisor. Prospective investors should consult their tax or legal advisors before making tax-related investment decisions.

© 2021 SKY Harbor. This document may not be reproduced or transmitted, in whole or in part, by any means, to third parties without prior written consent of SKY Harbor. For more information, contact SKY Harbor Capital Management, LLC at +1 203 769 8800 or email [info@skyhcm.com](mailto:info@skyhcm.com)