

High Yield Market Update

High yield market returns were negative through the first two months of the quarter and were pushed back into positive territory by a December rally. Coronavirus variants, supply chain disruptions, less-transitory-than-expected inflation, and the threat of rising rates weighed on risk assets in general early in the quarter. The month of December has historically registered above-average high yield market returns and this year's December did not disappoint. Despite rising COVID cases and the persistent threat of a more hawkish Fed, December's return marked the strongest monthly return for the year with the final week of the year an even more significant return outlier, outpacing the all-week average by a factor of nearly 4:1. Crude oil prices fluctuated throughout Q4 but ultimately ended the quarter relatively flat with WTI Crude up \$0.18/bbl (or 0.24%) to \$75.21/bbl with Energy providing the second highest returns by sector, returning 1.43%. Treasuries ended the period with the 2-year up 45 basis points (bps) to 0.73% and the 10-year up by 2 bp to 1.51% and the US Dollar Index was up 6.37%.

Technicals were a headwind in the fourth quarter of 2021 with mutual fund outflows and positive net supply. High yield funds and ETFs had outflows of \$1.7bn while loan funds saw inflows of \$10.6bn, as tracked by Lipper and reported by Barclays. Q4 bond new issuance was down, with \$72.0bn pricing in the

quarter, offset by \$53.1bn of bond redemptions or upgrades, leaving net supply at \$18.9bn for the period, per Barclays. The percentage of the market trading at distressed levels (below 70% of par) ended the quarter at 0.9%; 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 0.4% by quarter-end, per BofA Merrill Lynch.

The ICE BofA US High Yield Index returned 0.66% in Q4, ending the period with an average price of 103.38, a 1.26-point decrease from the prior quarter. Credit spreads tightened by 3 bps to 307 bps and the yield-to-worst (YTW) increased by 0.28% to 4.28%. High yield underperformed small cap equities, represented by the Russell 2000's 1.86% return, as well as large cap equities, as represented by the S&P 500's 10.65% return, but outperformed investment grade corporates, as represented by the ICE BofA US Corporate Index's 0.17% quarterly return. In high yield, the Double-B, Single-B and Triple-C sub-indices returned 0.72%, 0.82% and -0.18%, respectively. Returns were mixed across the sectors for the quarter with Automotive the top performing sector in Q4'21, returning 2.13% while Telecom was the weakest sector of the quarter, returning 0.50%.

Portfolio Performance

Portfolios managed according to our **Unconstrained Broad High Yield Market Strategy** (BHYM) posted strong relative returns in Q4. By risk segment (defined by yield and duration to worst), security selection was the dominant source of relative performance and allocation was a minor, albeit positive, driver of relative returns. Security selection was positive across most risk segments most significantly within the shorter duration segment of the portfolio where a number of key high conviction holdings outperformed on continued credit momentum. On a representative basis, the average performance of the portfolio's top 20 holdings was 1.2%, with income being the primary driver of returns in many cases. Outperformance was moderated by an underweight to the longest duration part of the market that benefited from the outperformance of a number of energy-relative Rising Star candidates.

Short Duration High Yield (SDHY) portfolios posted strong returns in Q4, outperforming the broader US high yield market (as measured by the ICE BofA US High Yield Index) and did so with substantially less volatility. By risk type, the longest duration (within the context of short duration) and most speculative securities outperformed the shortest duration securities. All sectors were positive for the quarter, led by Automotive and Capital Goods while Real Estate and Retail lagged. By rating, the portfolios benefited from their lower quality credit, with Triple-C securities outperforming Single-Bs and Double-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 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	5.82	6.43	Basic Industry	17.4%	7.8%	223%
Yield to Worst	5.22%	4.28%	Capital Goods	16.7%	6.0%	279%
Current Yield	6.66%	5.49%	Media	14.4%	8.2%	175%
Duration to Worst	3.2	3.8	Services	8.3%	6.2%	135%
OAS	405	359	Technology & Electronics	7.1%	4.1%	172%
Avg Coupon	6.86%	5.67%	Leisure	4.6%	6.4%	72%
Number of Issuers	100	968	Transportation	4.6%	1.8%	254%
Number of Issues	119	2138	Healthcare	4.6%	9.8%	46%
Average ML Rating	B2	B1	Automotive	4.2%	4.5%	94%
Average Price	103.0	103.4	Real Estate	4.2%	4.1%	100%
			Retail	4.0%	5.2%	77%
			Financial Services	3.4%	5.0%	68%
			Consumer Goods	3.1%	4.7%	65%
			Energy	1.9%	13.3%	14%
			Telecommunications	1.5%	7.2%	20%
			Insurance	0.0%	1.4%	0%
			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	18.0%	53.8%
B Holdings	58.7%	35.2%
CCC or Under	23.3%	10.9%

Distribution by Issue Size	Portfolio ¹	HY Market
0 - 250M	5.0%	0.5%
250 - 500M	43.1%	24.3%
500 - 750M	23.0%	22.4%
750 - 1000M	13.9%	17.6%
1000+M	15.1%	35.3%

Top 5 Holdings by Weight	BofA 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	106.13	Media	1.03	1.17	2.51
QUAD/GRAPHICS 7.000% 01-May-2022	B3	235.7	101.25	Media	0.33	3.12	2.27
Titan International Inc. 7.000% 30-Apr-2028	B3	399.1	106.50	Capital Goods	3.69	5.30	2.12
Danaos Corp 8.500% 01-Mar-2028	B2	300.0	109.50	Transportation	1.93	5.64	2.10
Foxtrot Escrow Issuer LLC 12.25% 15-Nov-2026	B3	761.8	112.38	Capital Goods	0.83	4.56	2.08

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	4.4	6.4	3.4	Basic Industry	13.1%	7.8%	6.5%
Yield to Worst	4.17%	4.28%	3.44%	Services	11.7%	6.2%	5.6%
Current Yield	6.54%	5.49%	5.81%	Capital Goods	11.3%	6.0%	7.4%
Duration to Worst	1.8	3.8	1.8	Media	10.3%	8.2%	4.4%
OAS	330	307	265	Healthcare	8.7%	9.8%	8.0%
Avg Coupon	6.82%	5.67%	6.08%	Technology & Electronics	8.7%	4.1%	3.7%
Number of Issuers	148	968	458	Automotive	6.1%	4.5%	4.2%
Number of Issues	183	2138	664	Financial Services	6.0%	5.0%	7.9%
Average Rating	B2	B1	BB3	Transportation	4.5%	1.8%	4.1%
Average Price	104.28	103.38	104.57	Real Estate	4.5%	4.1%	5.1%
				Telecommunications	4.3%	7.2%	6.0%
				Retail	4.2%	5.2%	4.8%
				Leisure	3.5%	6.4%	7.8%
				Consumer Goods	2.6%	4.7%	3.2%
				Other	0.5%	0.0%	0.0%
				Energy	0.0%	13.3%	15.6%
				Utility	0.0%	2.8%	2.7%
				Insurance	0.0%	1.4%	1.0%
				Banking	0.0%	1.3%	2.0%

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	21.2%	53.8%	55.8%
B Holdings	65.4%	35.2%	44.2%
CCC or Under	12.6%	10.9%	0.0%

Distribution by Issue Size	Portfolio ¹	HY Market ²	SD Universe ³
0 - 250M	4.9%	0.5%	0.0%
250 - 500M	34.4%	24.3%	20.0%
500 - 750M	21.1%	22.3%	25.9%
750 - 1000M	18.2%	17.5%	16.6%
1000+M	21.4%	35.4%	37.5%

Top 5 Holdings by Weight	Average Rating	Issue Size (\$mil)	Current Price	BofA Industry	Duration to Worst	Yield to Worst (%)	% of Portfolio
American Airlines Inc. 11.750% 15-Jul-2025	B1	2,500.0	123.38	Transportation	2.86	4.53	1.67
Townsquare Media Inc. 6.875% 01-Feb-2026	B2	550.0	106.13	Media	1.03	1.17	1.59
Avaya Inc. 6.125% 15-Sep-2028	B1	1,000.0	106.00	Technology & Electronics	1.59	4.19	1.44
Neon Holdings Inc 10.125% 01-Apr-2026	B3	495.0	106.53	Services	0.25	3.90	1.38
Powerteam Services LLC 9.033% 04-Dec-2025	B3	986.7	105.79	Basic Industry	2.64	6.92	1.29

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 "JCV4" (SD Universe).

Outlook

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 has normalized, and the credit ratings cycle has swung to the positive after a pandemic-induced downgrade cycle. The volume of Rising Stars, however, has disappointed over the last 12-month period, with agencies seemingly more willing to boost issuer ratings among the lower-quality cohort of the high yield market. We expect an uptick in Rising Star volumes in 2022, but trading levels in our view leave little in the way of total return opportunity. In fact, the market may once again be disappointed at the size and pace of upgrades into the investment grade space, much like 2021. We continue to believe lower rated credit is likely to have more spread compression potential associated with a post COVID-surge related recovery of certain industries such as Autos and

Capital Goods that lagged the largely beta rally of late 2021.

The opening of the new year has been marked by a significant repricing of rate-related risk that saw the high yield market give back much of the late December returns. The sell-off was most dramatic for longer duration, higher rated credit. Our underweight to that type of risk has been a significant driver of outperformance generally. The repricing however, has given us the opportunity to modestly increase our exposure to higher rated credit that we believe has strong operating momentum despite pervasive headwinds AND have strong sustainability behaviors that we expect will be increasingly valued by investors over the coming year.

We hope that our investors are receiving our Weekly Briefings which are our opportunity to share some of the themes that support our risk-taking on a real-time basis.

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