High Yield Market Update

The positive start to the year gave way in late January to the highest equity market volatility seen in almost a decade. Despite continued strong corporate earnings reports, the combination of rising inflation fears, ongoing turmoil within the Trump administration, escalating trade war fears, and tech giants coming under pressure due to self-inflicted wounds in the case of Facebook and Tesla and President Trump's attack on Amazon drove risk assets to the first negative quarterly return in two years. WTI Crude Oil bucked the negative market trends and continued its positive momentum, ending the quarter up $4.52 (or 7.48%) to $64.94/bbl. During the quarter, the US Dollar Index was down 2.33% and Treasuries ended the quarter with the 2-year up 40 basis points (bps) to 2.28% and the 10-year higher by 33bps to 2.74% as the yield curve flattened.

While loan funds saw continued inflows of $2.9bn, high yield mutual funds saw outflows of $23.6bn. Fortunately for the market, net supply was negative in the first quarter of 2018, as tracked by Lipper and reported by Barclays, providing supportive technicals. For the quarter, bond new issuance moved lower to $62.9bn, offset by $78.2bn of bond redemptions, leaving net supply at -$15.3bn for the period. The percentage of the market trading at distressed levels (below 70% of par) ended Q1 at 2.6%; the comparable figure for the loan market (below 80% of par) was 2.3%, per JP Morgan. The par-weighted twelve-month high yield bond default rate ticked lower to 1.43% at quarter-end, per BofA Merrill Lynch. Excluding commodities, the default rate was 1.29%.

The ICE BofAML US High Yield Index returned -0.91% in Q1, ending the period with an average price of 98.22, a 2.39 point decrease from Q4 2017. Credit spreads widened by 20 bps to 378 bps and the YTW was higher by 61bps to 6.38%. High Yield outperformed investment grade corporates, as represented by the ICE BofAML US Corporate Index's -2.20% return, but under-performed small cap equities, as represented by the Russell 2000's -0.08%, and large cap equities, as represented by the S&P 500's -0.76% quarterly return. In High Yield, performance was marked by outperformance of Triple-C rated credit with the rate-sensitive BB segment leading the market lower. Double-B, Single-B and Triple-C sub-indices returned -1.65%, -0.46% and 0.36%, respectively. By sector, Transportation was the top performer with a 0.43% return, while Banking was the bottom-performing sector, posting -2.63%.

Portfolio Performance

Portfolios managed according to our Unconstrained **Broad High Yield Market Strategy** (BHYM) outperformed the benchmark for the quarter. By risk type, allocation was a source of outperformance while security selection was a source of underperformance. An overweight to the higher-performing shortest duration segment of the market and an underweight to the lower-performing better-quality, more rate-sensitive part of the market were primary drivers, partially offset by weaker security selection within the most speculative, equity-like part of the market. By sector, weaker selection in speculative Energy was a source of underperformance but was offset by strong selection in Basic Industry and Technology.

On a representative basis, the largest positive contributor was Ahern Rentals Inc. (AHEREN) 7.375% notes due 2023, which traded up during the quarter on strong Q4 results and a positive outlook. Last quarter's largest contributor, Approach Resources Inc. (AREX) was among the bottom contributors to returns this quarter. The largest negative contributor was Rex Energy Corp. (REXX) 8% notes due 2020 for the second consecutive quarter, which declined following a perceived restructuring.

The above contributor paragraph is corrected.

Broad High Yield Market Strategy: Performance

	SKY Harbor BHYM Strategy Performance			
	Gross of Fees	ICE BofAML US HY Index	Alpha	Net of Fees
January 2018	0.58	0.64	-0.06	0.55
February 2018	-0.89	-0.93	0.04	-0.91
March 2018	-0.46	-0.62	0.16	-0.48
Q1 2018	-0.77	-0.91	0.14	-0.85
Last 12 Months	4.28	3.69	0.58	3.96
Three Years (annl)	5.42	5.18	0.24	5.09
Five Years (annl)	5.03	5.01	0.02	4.71
SI Return (annl)	7.72	7.63	0.09	7.39

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.

In a period of concern over rising interest rates, it was a positive quarter for SKY Harbor's Unconstrained **Short Duration High Yield Strategy** (SDHY). This came despite the overall high yield market (as defined by the ICE BofAML US High Yield Index) posting a negative return for Q1. And while the shorter duration portion of the market was not completely immune to the selloff in Q1, it did exhibit substantially less volatility due to its more defensive positioning. From a sector standpoint, Telecom and Healthcare led, together contributing nearly 60% of the quarterly return. Media and Real Estate lagged with slightly negative contributions although no single sector cost the portfolios more than two basis points. By rating, generally lower quality led, with Triple-C securities outperforming Single-Bs and Double-Bs.

On a representative basis, at quarter-end our Short Duration High Yield portfolios had a yield-to-worst of 5.25% (82% of the broad market yield). Exclusive of cash, the average coupon was 6.65% (vs. the market average of 6.35%) and the duration-to-worst was 1.9 (or 47% of the broad market). Holdings (333 issues, representing 247 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 overweight to the latter group continues to show that we find greater value in the yield-to-call opportunities. Nevertheless, we do value the relative price stability the short maturity group can offer in volatile periods in the market.

Overall credit quality decreased slightly during the first quarter. At quarter-end Double-B rated holdings represented 31.7% of the portfolio, Single-Bs were 58.2% and Triple-Cs were 9.3%.

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
January 2018	0.57	0.64	89%	0.54	1.0	2.2	43%
February 2018	-0.21	-0.93	23%	-0.24	2.5	4.8	52%
March 2018	0.07	-0.62	-11%	0.04	1.0	2.0	49%
Q1 2018	0.43	-0.91	-47%	0.34	1.6	3.2	50%
Last 12 Months	3.76	3.69	102%	3.40	1.1	2.2	51%
Three Years (annl)	3.79	5.18	73%	3.42	2.0	4.1	50%
Five Years (annl)	3.41	5.01	68%	3.04	2.0	3.7	54%
Since Inception (annl)	4.45	6.77	66%	4.07	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

Despite the dramatic increase in volatility, we maintain a consistent view of high yield market risks and opportunities and see little evidence to change our positioning at this point. Our greatest conviction remains around strong corporate fundamentals. We have acknowledged that valuations are fair, though more compelling after this last round of spread widening, and rising rates present potential risks, but believe high yield could have further spread compression as volatility stabilizes.

Near-term fundamentals of high yield issuers remain strong and we expect returns to benefit from the market income opportunity and below-average default losses so long as risks outside the high yield market remain in balance (e.g., trade wars do not escalate, etc.). As a result, our positioning has not substantially changed over the last month although we have been opportunistic purchasers of better-quality, rate-sensitive risk that has repriced during the market selloff.

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Portfolio Characteristics

Representative Broad High Yield Market Portfolio

Characteristics	Portfolio[1]	HY Market
Avg Years to Maturity	6.2	6.1
Yield to Worst	6.31%	6.39%
Current Yield	6.86%	6.47%
Duration to Worst	3.7	4.0
OAS	370	378
Avg Coupon	6.90%	6.35%
Number of Issuers	278	885
Number of Issues	348	1904
Average ML Rating	B2	B1
Average Price	100.6	98.2

Distribution by ML Rating	Portfolio[1]	HY Market
A Holdings	0.0%	0.0%
BBB Holdings	0.6%	0.0%
BB Holdings	26.9%	47.3%
B Holdings	55.8%	38.9%
CCC or Under	16.6%	13.8%

Distribution by Issue Size	Portfolio[1]	HY Market
0 - 250M	6.7%	1.7%
250 - 500M	37.2%	28.4%
500 - 750M	20.9%	20.6%
750 - 1000M	10.8%	16.1%
1000+M	24.3%	33.2%

Distribution by Sector	Portfolio[1]	HY Market	SKY as % of HY Market
Basic Industry	18.8%	11.8%	158%
Energy	11.4%	14.9%	76%
Capital Goods	9.7%	5.3%	181%
Technology & Electronics	9.4%	5.7%	164%
Healthcare	8.3%	10.2%	82%
Services	8.2%	5.5%	150%
Media	7.6%	11.2%	68%
Telecommunications	6.9%	9.4%	73%
Leisure	5.0%	4.1%	123%
Automotive	2.9%	2.0%	146%
Financial Services	2.7%	3.8%	72%
Consumer Goods	2.0%	2.8%	73%
Banking	1.6%	3.1%	51%
Retail	1.4%	4.7%	29%
Transportation	1.3%	1.0%	131%
Real Estate	1.2%	0.9%	128%
Utility	1.0%	2.6%	39%
Insurance	0.6%	1.0%	64%

Top 5 Holdings by Weight	BofA ML Rating	Issue Size ($mil)	Current Price	BofA ML Industry	Duration to Worst	Yield to Worst (%)	% of Portfolio
Ahern Rentals Inc. 7.375% 15-May-2023	B3	550.0	97.25	Services	4.06	8.10	1.23
Mastec Inc. 4.875% 15-Mar-2023	BB3	400.0	99.00	Services	4.34	5.11	0.99
American Axle & Manufacturing 6.5% 01-Apr-2027	B1	496.0	99.50	Automotive	6.16	6.50	0.98
Universal Hospital Services 7.625% 15-Aug-2020	B3	645.0	101.00	Healthcare	0.36	5.51	0.97
Hearthside Food Solutions 6.5% 01-May-2022	CCC1	300.0	99.75	Consumer Goods	3.44	6.57	0.94

Representative Short Duration High Yield Portfolio

Characteristics	Portfolio[1]	HY Market[2]	SD Universe[3]
Avg Years to Maturity	3.5	6.1	3.4
Yield to Worst	5.25%	6.39%	5.21%
Current Yield	6.48%	6.47%	6.08%
Duration to Worst	1.9	4.0	2.3
OAS	287	378	282
Avg Coupon	6.65%	6.35%	6.15%
Number of Issuers	247	885	378
Number of Issues	333	1904	590
Average ML Rating	B1	B1	BB3
Average Price	102.51	98.22	101.22

Distribution by ML 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	31.7%	47.3%	51.1%
B Holdings	58.2%	38.9%	48.9%
CCC or Under	9.3%	13.8%	0.0%

Distribution by Issue Size	Portfolio[1]	HY Market[2]	SD Universe[3]
0 - 250M	8.7%	1.6%	0.0%
250 - 500M	38.2%	28.2%	24.2%
500 - 750M	19.9%	20.5%	25.4%
750 - 1000M	11.4%	16.0%	13.0%
1000+M	21.8%	33.6%	37.3%

Distribution by Sector	Portfolio[1]	HY Market[2]	SD Universe[3]
Basic Industry	18.3%	11.8%	13.2%
Energy	13.2%	14.9%	14.7%
Media	10.3%	11.2%	12.3%
Healthcare	8.6%	10.2%	7.7%
Capital Goods	7.5%	5.3%	6.8%
Telecommunications	7.2%	9.4%	8.8%
Technology & Electronics	7.0%	5.7%	4.8%
Financial Services	5.8%	3.8%	7.7%
Services	5.7%	5.5%	4.1%
Transportation	3.3%	1.0%	1.8%
Leisure	3.1%	4.1%	3.4%
Automotive	2.9%	2.0%	1.8%
Retail	2.1%	4.7%	3.5%
Utility	1.4%	2.6%	2.8%
Consumer Goods	1.3%	2.8%	2.0%
Real Estate	1.2%	0.9%	1.3%
Banking	0.7%	3.1%	2.6%
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
Sprint Nextel Corporation 7.000% 15-Aug-2020	B2	1,500.0	104.25	Telecommunications	2.16	5.18	0.85
DISH DBS Corporation 5.125% 01-May-2020	B1	1,099.6	100.00	Media	1.91	5.18	0.71
Softbank Group Corp 4.500% 15-Apr-2020	BB1	2,485.0	102.00	Telecommunications	1.90	3.48	0.70
CSC Holdings LLC 6.750% 15-Nov-2021	B2	1,000.0	104.25	Media	3.12	5.48	0.66
DISH DBS Corporation 6.750% 01-Jun-2021	B1	2,000.0	100.75	Media	2.75	6.52	0.64

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 March 31, 2018 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.)*

Our Broad High Yield Market portfolios remain underweight the better-quality, more rate-sensitive segment of the market. We continue to look for opportunities to add income through credit picking among companies with improving earnings. 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.

Turning to our Short Duration High Yield strategy, we continue to believe these SDHY portfolios offer an attractive yield per unit of duration and are well positioned to take advantage of any potential volatility or curve repricing associated with more aggressive rate assumptions. In our view, 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 portfolio, which will allow us to continue to optimize the portfolios as the market environment evolves.

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