High Yield Market Update

No financial market was spared as volatility from the COVID-19 crisis exploded, causing the High Yield market to have its worst quarter since 2008. The shutdown of global activity and restrictions on populations around the world drove central banks and governments to equally unprecedented policy responses. Markets began to stabilize towards the end of the quarter with details of a broad-based US stimulus package emerging and the primary market opening back up and putting a price on risk that is directly impacted by the COVID-19 crisis. Oil sold off drastically during the quarter due in part to a production conflict between Saudi Arabia and Russia as well as a decline in global demand. WTI Crude closed Q1 down $40.58/bbl (or -66.46%) to $20.48/bbl, dragging the Energy sector down with it. For the quarter the US Dollar Index was up 2.76% and Treasuries ended the period with the 2-year down 133 basis points (bps) to 0.25% and the 10-year lower by 145 bps to 0.67% as the yield curve steepened.

Technicals were mixed in 2020's first quarter as big outflows were cushioned by a slowdown in new issuance, leading to negative net supply. High yield funds and ETFs had outflows of $17.5bn while loan funds saw continued outflows of $12.7bn, as tracked by Lipper and reported by Barclays. Q1 bond new issuance was steady, pricing $70.7bn in the quarter, offset by $72.1bn of bond redemptions, leaving net supply at -$1.4bn for the period, per Barclays. The percentage of the market trading at distressed levels (below 70% of par) ended the quarter at 17.4%; the comparable figure for the loan market (below 80% of par) was 26.0%, per JP Morgan. The par-weighted twelve-month high yield bond default rate increased to 4.0% by quarter-end, per BofA Merrill Lynch. Excluding commodities, the default rate was 1.87%.

The ICE BofA US High Yield Index returned -13.12% in Q1, ending the period with an average price of 86.03, a 14.63-point decrease from the prior quarter. Credit spreads widened by 500 bps to 859 bps and the yield-to-worst (YTW) was higher by 3.65% to 9.02%. High yield outperformed small cap equities, represented by the Russell 2000's -30.89% return, as well as large cap equities, as represented by the S&P 500's -20.00% return, but underperformed investment grade corporates, as represented by the ICE BofA US Corporate Index's -4.05% quarterly return. In high yield, the Double-B, Single-B and Triple-C sub-indices returned -10.23%, -14.09% and -22.43%, respectively. Returns were negative across all sectors for the first quarter: the top performer was Technology, which saw a -5.1% return, while Energy was the bottom-performing sector, posting a -39.6% return.

Portfolio Performance

Portfolios managed according to our Unconstrained **Broad High Yield Market Strategy** (BHYM) outperformed during the quarter with significantly less negative performance on the down days and somewhat lagged performance on the up. Going into the downturn, BHYM portfolios were generally biased away from global growth dependent commodities and trade-related headwinds and positioned to benefit from a strong US consumer-driven economy. We were overweight front-end high yield risk and underweight the most speculative end of the high yield market where we believed default risk was on the rise in secularly challenged sectors such as Energy, Retail and parts of the Telecom sector. We owned less market risk and more credit risk with a bias towards companies benefiting from M&A, restructuring and other "self-help" measures. During the quarter, we chose to sell some risk that we believe is potentially impaired due to longer-term consequences associated with the pandemic. Our view is that global business travel will be slow to recover, commercial real estate will be under some extended pressure, and there will be certain regional restrictions on large gatherings for a more protracted period of time, and we are factoring these views into our fundamental analysis. We added across the portfolio where our stress-testing demonstrated the ability to withstand near-term operating pressures and longer-term shifts in consumer and business behaviors. Cash remained sufficient throughout which allowed us to be rational sellers and opportunistic buyers.

Broad High Yield Market Strategy: Performance

	SKY Harbor BHYM Strategy Performance			
	Gross of Fees	ICE BofA US HY Index	Alpha	Net of Fees
January 2020	-0.09	0.00	-0.09	-0.11
February 2020	-1.11	-1.55	0.44	-1.13
March 2020	-11.03	-11.76	0.73	-11.05
Q1 2020	-12.10	-13.12	1.03	-12.16
Last 12 Months	-6.06	-7.45	1.39	-6.34
Three Years (annl)	0.97	0.55	0.42	0.67
Five Years (annl)	2.95	2.67	0.28	2.63
SI Return (annl)	5.69	5.54	0.16	5.36

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.

On a representative basis, the top contributor to BHYM returns was Sprint Corp. (S) 7.875% notes due 2023 which traded up during the quarter on news that the acquisition by T-Mobile had been cleared by regulators. We have since sold this position for a modest gain. Last quarter's largest contributor, Tenneco Inc. (TEN) 5% notes due 2026, was among this quarter's bottom contributors, trading down sharply as higher relative leverage accelerated pressure felt by auto parts suppliers given COVID-19 related shutdowns. The largest bottom contributor to quarterly returns was Hertz Corp. (HTZ) 7.125% notes due 2026, which traded down on weak Q4 earnings and concerns that COVID-19 travel disruptions are likely to pressure earnings for the foreseeable future. We have reduced our exposure to Hertz and will continue to opportunistically liquidate. Last quarter's bottom contributor, Party City (PRTY) 6% notes due 2026, was liquidated at the end of Q4.

SKY Harbor's Unconstrained **Short Duration High Yield Strategy** (SDHY) portfolios were not immune to the historic selloff in Q1, posting negative returns but with a market capture of around 60% of the negative return of the broader US high yield market (as measured by the ICE BofA US High Yield Index) on a gross-of-fee basis. A bias towards shorter-dated securities of generally well-capitalized companies helped to dampen the volatility relative to the broad market as concern over rising default risk took hold. By risk type, generally shorter duration, more defensive securities were less negative than longer duration (within the context of short duration) and more speculative securities which fell sharply during the period. By sector, Energy was the worst-performer though our minimal weight going into the crisis helped to minimize the negative impact. We took risk elsewhere trying to take advantage of the previously strong US economy, which led to a market weight in Leisure, though our shorter duration and credit selection led to less negative returns. Commercial real estate was another area of concern and we have been bringing exposure down. By rating, the portfolio benefited from our up-in-quality exposure. And while Triple-Cs were the worst-performing ratings category, we went into the period well below our historical average and would look to remain this way.

On a representative basis, at quarter-end our SDHY portfolios had a YTW of 7.92%, (88% of the broad market yield). Exclusive of cash, the average coupon was 6.15% vs. the market average of 6.24%. The duration-to-worst rose to 2.8, or 66% of the broad market duration. Holdings (290 issues, representing 205 issuers) comprised 35% bonds with maturities of less than three years and 65% in longer maturities that are trading to expected early take-outs inside this three-year period. Overall credit quality decreased: at quarter-end Double-B rated holdings represented 41% of the portfolio, Single-Bs were 48% and Triple-Cs were 10%.

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 2020	0.10	0.00	NM	0.07	1.2	3.0	42%
February 2020	-0.70	-1.55	45%	-0.73	2.6	5.1	50%
March 2020	-7.52	-11.76	64%	-7.55	20.6	30.5	68%
Q1 2020	-8.08	-13.12	62%	-8.15	12.2	18.2	67%
Last 12 Months	-4.22	-7.45	57%	-4.53	6.2	9.4	66%
Three Years (annl)	1.48	0.55	286%	1.14	3.8	5.6	64%
Five Years (annl)	2.40	2.67	90%	2.05	3.3	5.5	60%
Since Inception (annl)	3.46	4.87	71%	3.09	2.8	4.6	60%

1. The Short Duration High Yield strategy is not a benchmarked strategy. The HY Market index shown (ICE BofA 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 believe that investors are shifting their focus from the pace of global COVID-19 cases and fatalities to aggregate economic data to develop scenarios around how deep a recession we might have and what does the recovery look like when it eventually comes. Concern around the shape of the plot of economic activity in fact now completely overshadows all other sources of risk although for sure there will be some voices that express concern around eventual inflation and political instability.

We are focused on consumer and business behavior as restrictions are lifted around the globe to support our risk-taking. We believe current positioning suggests good potential market capture to the upside so long as Energy is not the driver of the upside but are mindful that low dollar bonds are likely to gap higher in the absence of further selling pressure. Given the large overhang of IG energy downgrades, secular and cyclical demand destruction, and historically low oil prices, we do not see speculative (*cont. p.4*)

Portfolio Characteristics

Representative Broad High Yield Market Portfolio

Characteristics	Portfolio[1]	HY Market
Avg Years to Maturity	6.0	6.0
Yield to Worst	8.65%	9.02%
Current Yield	7.67%	7.25%
Duration to Worst	4.3	4.2
OAS	819	859
Avg Coupon	6.90%	6.24%
Number of Issuers	146	831
Number of Issues	171	1818
Average ML Rating	B2	B1
Average Price	90.1	86.0

Distribution by Rating	Portfolio[1]	HY Market
A Holdings	0.0%	0.0%
BBB Holdings	0.0%	0.0%
BB Holdings	23.0%	52.6%
B Holdings	52.7%	36.9%
CCC or Under	24.3%	10.5%

Distribution by Issue Size	Portfolio[1]	HY Market
0 - 250M	6.3%	1.0%
250 - 500M	43.2%	25.6%
500 - 750M	15.8%	20.6%
750 - 1000M	10.4%	15.7%
1000+M	24.3%	37.1%

Distribution by Sector	Portfolio[1]	HY Market	SKY as % of HY Market
Basic Industry	16.5%	10.5%	157%
Healthcare	12.5%	11.0%	114%
Services	10.2%	5.9%	173%
Capital Goods	10.4%	6.7%	156%
Technology & Electronics	10.2%	5.6%	183%
Media	7.9%	11.5%	69%
Consumer Goods	5.6%	5.7%	98%
Telecommunications	4.0%	10.5%	38%
Leisure	3.4%	4.8%	71%
Retail	3.9%	4.7%	82%
Transportation	2.2%	0.9%	237%
Automotive	3.4%	1.9%	180%
Insurance	3.0%	1.1%	276%
Financial Services	3.1%	4.5%	68%
Real Estate	2.1%	1.6%	132%
Banking	1.1%	1.7%	64%
Energy	0.4%	8.7%	5%
Utility	0.0%	2.7%	0%

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. 6.500% 01-Apr-2023	B3	280.1	95.00	Media	2.66	8.03	2.74
Unisys Corporation 10.750% 15-Apr-2022	B1	440.0	105.38	Technology & Electronics	0.04	0.08	2.40
Great Lakes Dredge & Dock Corp. 8% 15-May-2022	B3	325.0	98.00	Transportation	1.85	9.11	2.24
CPG Merger Sub LLC 8.000% 01-Oct-2021	CCC2	315.0	97.38	Basic Industry	0.00	0.00	2.06
Bausch Health Americas, Inc. 9.250% 01-Apr-2026	B2	1,500.0	105.00	Healthcare	3.33	7.58	1.85

Representative Short Duration High Yield Portfolio

Characteristics	Portfolio[1]	HY Market[2]	SD Universe[3]
Avg Years to Maturity	3.8	6.0	3.2
Yield to Worst	7.92%	9.02%	9.28%
Current Yield	6.51%	7.25%	6.81%
Duration to Worst	2.8	4.2	2.5
OAS	760	859	903
Avg Coupon	6.15%	6.24%	6.03%
Number of Issuers	205	831	419
Number of Issues	290	1818	646
Average Rating	B1	B1	BB3
Average Price	94.49	86.03	88.53

Distribution by Rating	Portfolio[1]	HY Market[2]	SD Universe[3]
A Holdings	0.0%	0.0%	0.0%
BBB Holdings	1.6%	0.0%	0.0%
BB Holdings	40.6%	52.6%	58.8%
B Holdings	48.2%	36.9%	41.2%
CCC or Under	9.6%	10.5%	0.0%

Distribution by Issue Size	Portfolio[1]	HY Market[2]	SD Universe[3]
0 - 250M	3.7%	1.0%	0.0%
250 - 500M	31.5%	25.4%	22.4%
500 - 750M	19.6%	20.4%	25.4%
750 - 1000M	11.9%	15.6%	13.3%
1000+M	33.3%	37.5%	38.9%

Distribution by Sector	Portfolio[1]	HY Market[2]	SD Universe[3]
Media	13.9%	11.5%	11.5%
Financial Services	11.0%	4.5%	6.0%
Basic Industry	10.2%	10.5%	12.4%
Capital Goods	9.2%	6.7%	7.2%
Telecommunications	9.1%	10.5%	8.0%
Healthcare	8.7%	11.0%	10.5%
Services	6.9%	5.9%	4.9%
Technology & Electronics	5.8%	5.6%	5.5%
Leisure	5.1%	4.8%	4.0%
Consumer Goods	4.4%	5.7%	4.2%
Real Estate	3.5%	1.6%	2.0%
Retail	3.3%	4.7%	4.5%
Transportation	3.3%	0.9%	2.5%
Automotive	2.8%	1.9%	1.5%
Utility	0.8%	2.7%	1.9%
Energy	0.6%	8.7%	10.5%
Insurance	0.5%	1.1%	1.0%
Other	0.4%	0.0%	0.0%
Banking	0.4%	1.7%	1.9%

Top 5 Holdings by Weight	Average Rating	Issue Size ($mil)	Current Price	BofA Industry	Duration to Worst	Yield to Worst (%)	% of Portfolio
Sprint Corporation 7.250% 15-Sep-2021	B2	2,250.0	103.00	Telecommunications	1.37	5.03	0.87
Kennedy Wilson Inc 5.875% 01-Apr-2024	BB3	1,150.0	88.88	Real Estate	3.44	9.07	0.85
LPL Holdings Inc. 5.750% 15-Sep-2025	BB3	900.0	96.00	Financial Services	4.58	6.64	0.85
Quicken Loans Inc. 5.750% 01-May-2025	BB2	1,250.0	99.51	Financial Services	4.25	5.86	0.84
Bausch Health Companies Inc 6.125% 15-Apr-2025	B2	3,250.0	99.25	Healthcare	4.15	6.48	0.84

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, 2020 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 (*cont.*)

Energy being a driver of sustained upside returns. The bonds of higher-quality leisure-related issuers have the potential to be the driver of returns in a recovering market and we are focused on prudently adding these opportunities.

Our central scenario has not changed. We expect rising default risk in the energy, leisure and potentially the transportation sectors despite an eventual stabilization of coronavirus-related impact to demand in the second half of the year. US fiscal stimulus appears to be increasingly targeted and is well received though the reality of "shelter in place" orders and homeschooling for kindergarten through college is starting to be deeply felt across the globe. We also see the risk of fallen angels entering the high yield market in sectors that have protracted earnings headwinds. The offset to this potential supply is that we believe higher-rated companies are likely to be aggressive buyers of their near-term maturities in the open market, repeating behavior we saw during the global financial crisis. That being said, we believe even the most well-capitalized issuer will be focused on preserving liquidity in the short run and buy neither equity nor debt back in the open market until end market conditions become more projectable.

While we acknowledge strong relative performance during this period of volatility, we are mindful that "pensioners cannot eat relative returns" when those relative returns are negative. As a result, we are highly focused on preservation of principal and creating a sustainable income stream that rewards our investors for their risk-taking.

We believe in the resilience of the people that are behind markets and economies and we are ourselves optimistic by nature. That said, the reality of the moment is without precedent and we will continue to be as transparent around risks and opportunities as possible as we move deliberately forward investing funds on behalf of our clients around the globe.

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