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SKY HARBOR
CAPITAL MANAGEMENT

The Case for US Short Duration High Yield

SKYView: The Case for US Short Duration High Yield

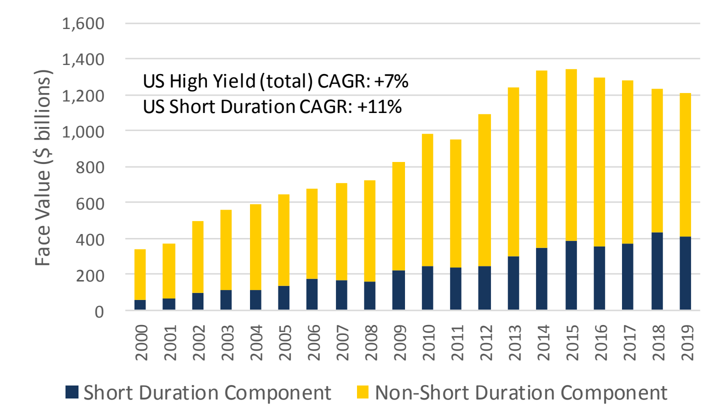
Over the last two decades, the short duration component of the US high yield market has grown in size and diversity, and offers investors the opportunity to obtain credit exposure to some of the most well-known domestic corporations. By virtue of limited correlation to other asset classes, US short duration high yield bonds can reduce overall portfolio volatility while increasing total returns, with the strength of issuer coupons leading to high breakevens and relatively low drawdown risk even in periods of acute market stress. High natural turnover and avoidance of principal loss through default have allowed SKY Harbor short duration high yield strategies to capture over 2/3 of the total return of the broad high yield index with substantially less volatility – making the product attractive from a risk/return perspective, in our view. In the charts that follow, we provide an overview of the US short duration high yield market, and detail some of its primary attributes.

US Short Duration High Yield Market Basics

The US short duration high yield market has evolved into its own asset class niche, expanding in size and scope over the last two decades. Most often defined as bonds within the US high yield market with a maturity of 1-5 years (or a duration of 0-3), the short duration universe has expanded at a compound annual growth rate of 11% since the year 2000. US short duration high yield debt now consists of nearly 700 bond issues worth in aggregate over $400 billion. Below is a depiction of the market's evolution over the past 20 years.

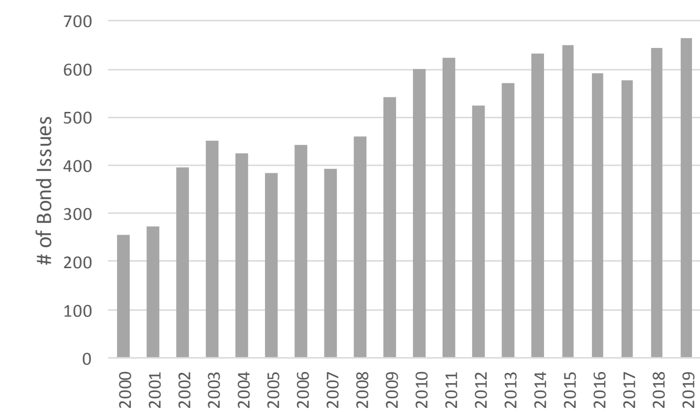
ICE BofA US High Yield Index Size

annual data, face value



US Short Duration High Yield Issue Count

annual data

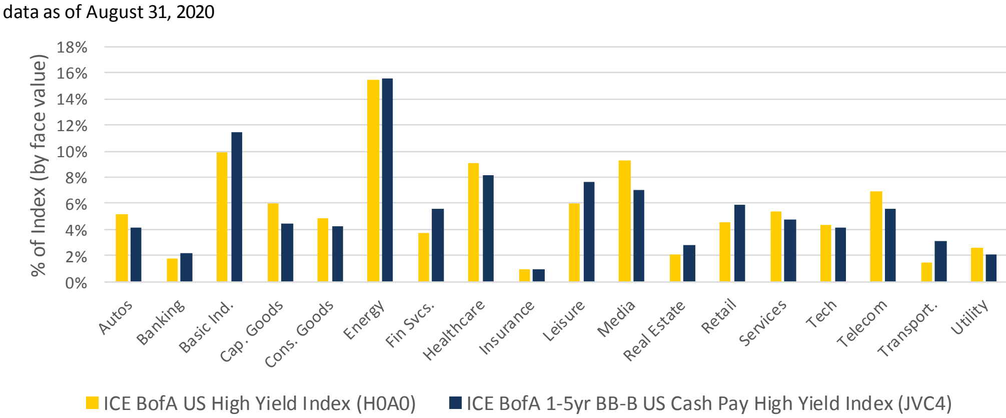


Source: SKY Harbor, ICE BofA Indices

On a sector basis, US short duration (we use the ICE BofA 1-5 Year BB-B US Cash Pay High Yield Index, ticker JVC4, as a proxy) is as diversified as the overall US high yield market (we use the ICE BofA US High Yield Index, ticker H0A0). Additionally, the short duration portion of the index is also home to many well-regarded and well-known names in the corporate space. The table below provides a sample of several globally recognized companies that are within the investable short duration high yield universe.

Sector Diversity by Index

data as of August 31, 2020



Source: SKY Harbor, ICE BofA Indices, Bloomberg

Representative US High Yield Issuers

index constituents as of August 31, 2020

Ford Motor Company
LTM Revenue = $130 billion

Netflix Inc.
LTM Revenue = $23 billion

Uber Technologies
LTM Revenue = $14 billion

Kraift Heinz Co.
LTM Revenue = $25 billion

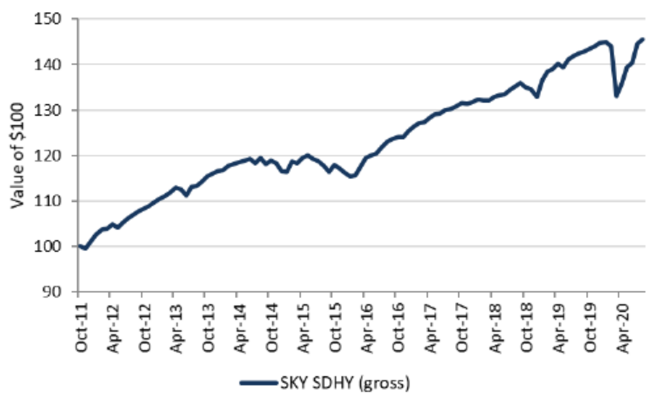
Sprint Corp.
LTM Revenue = $32 billion

ArcelorMittal
LTM Revenue = $58 billion

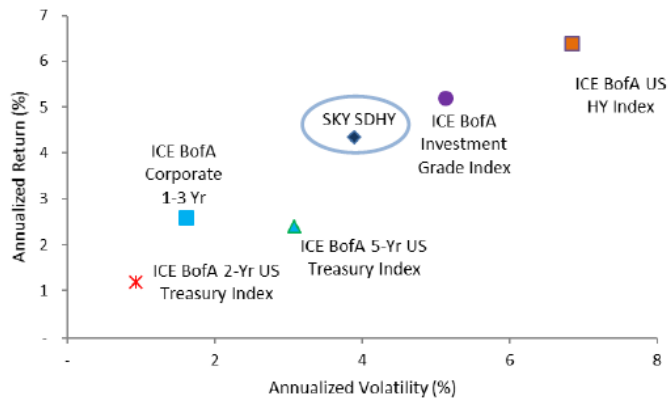
Key Attribute #1.) Attractive Return Capture

Over a market cycle, we expect short duration high yield portfolios to net approximately 2/3 to 3/4 of the return of the full high yield index with lower volatility, resulting in greater risk-adjusted performance. As demonstrated below, our Short Duration High Yield Strategy composite performance since 2011 (SKY Harbor inception) has generated, on an annualized basis, ~ 68% of the return of the US high yield market, with ~ 61% of the volatility.

Short Duration High Yield Composite – Growth of $100



Gross Return and Risk Comparison



	2011*	2012	2013	2014	2015	2016	2017	2018	2019	Q1'20	Q2'20	Jul'20	Aug'20	YTD	LTM	3 Yrs (ann'l)	5 Yrs (ann'l)	Since Incept. (ann'l)
Composite	0.99	8.63	6.28	-0.02	-0.24	7.86	4.96	0.90	9.05	-8.08	5.49	2.90	0.74	0.51	2.17	3.81	4.34	4.34
Mkt Capture	464%	55%	85%	-1%	5%	45%	66%	NM	63%	62%	57%	61%	75%	67%	59%	85%	69%	68%
Relative Volatility	48%	53%	58%	65%	54%	49%	52%	55%	49%	67%	65%	53%	59%	66%	66%	64%	61%	61%
HY Market	0.21	15.58	7.42	2.50	-4.64	17.49	7.48	-2.26	14.41	-13.12	9.61	4.78	0.98	0.75	3.71	4.51	6.28	6.40

Short Duration High Yield Strategy displayed in the above table is gross of management fees and based on the actual composite performance results during the period 10/31/11 to 8/31/20.
Gross performance does not reflect the deduction of management fees. Net performance would be lower. See integral full disclosure at end of this presentation.
Annualized figures are based on monthly returns for the stated period. Returns assume reinvestment of distributions. Data displayed may not sum due to rounding.
Past performance is not indicative of future results. The SDHY Strategy is not a benchmarked strategy. The ICE BofA US High Yield Index is used solely as a relative HY market indicator.
Volatility is Annualized Daily Volatility. NM = Not meaningful.
* Partial year, not annualized.
Click here for http://www.skyhcm.com/GIPS_Report.pdf

Key Attribute #2.) Low Correlation to Treasuries

Similar to broad and ratings constrained high yield, the short duration high yield strategy (we use the ICE BofA 1-5 Year BB-B US Cash Pay High Yield Constrained Index, ticker JVC4, as a proxy) maintains a low / negative correlation to treasuries, as demonstrated by the 10 year matrix below:

Asset Class Correlation Matrix - 10 Years
(monthly returns through August '20)

Ticker	*Index Name*	*ICE BofA Current 10-Year US Treasury Index*	*ICE BofA US High Yield Index*	*ICE BofA BB-B US High Yield Index*	*ICE BofA 1-5 Year BB-B US Cash Pay High Yield Constrained Index*	*ICE BofA US Corporate Index*	*ICE BofA US Mortgage Backed Securities Index*	*Standard & Poor's 500*	*Russell 2000*
GA10	ICE BofA Current 10-Year US Treasury Index	1.00							
H0A0	ICE BofA US High Yield Index	(0.23)	1.00						
H0A4	ICE BofA BB-B US High Yield Index	(0.18)	1.00	1.00					
JVC4	ICE BofA 1-5 Year BB-B US Cash Pay High Yield Constrained Index	(0.26)	0.98	0.98	1.00				
C0A0	ICE BofA US Corporate Index	0.45	0.66	0.69	0.65	1.00			
M0A0	ICE BofA US Mortgage Backed Securities Index	0.83	(0.01)	0.03	(0.06)	0.53	1.00		
SPXT	Standard & Poor's 500	(0.44)	0.77	0.76	0.76	0.34	(0.19)	1.00	
RTY	Russell 2000	(0.50)	0.74	0.73	0.75	0.27	(0.25)	0.90	1.00

Source: SKY Harbor, ICE BofA Indices, Bloomberg

Key Attribute #3.) Outperformance During Periods of Acute Stress

US short duration high yield strategies have historically outperformed short & broad US high yield indices and the S&P 500 during periods of acute stress, with less severe drawdowns as denoted by the chart below.

Time Period	Event	Short Duration High Yield[1]	Short Duration US High Yield Index[2]	US High Yield Index[3]	S&P 500 Index[4]
Oct 2008	Credit Crisis 2008	-7.68%	-13.18%	-16.30%	-16.79%
Mar 2020	COVID-19 Shutdown	-7.52%	-10.75%	-11.76%	-12.35%
Nov 2008	Credit Crisis 2008	-2.58%	-4.91%	-8.43%	-7.18%
Sep 2008	Credit Crisis 2008 (Lehman Default 9/15/08)	-2.54%	-6.14%	-8.30%	-8.91%
Feb 2009	Credit Crisis Bottom	-1.51%	-1.87%	-3.47%	-10.65%
Dec 2014	Oil prices plummet post OPEC meeting	-1.44%	-1.00%	-1.47%	-0.26%
Dec 2018	Q4'18 Selloff (fear that Fed misstep and slowing global growth could lead to recession)	-1.36%	-1.57%	-2.19%	-9.03%
Jun 2013	Fear of Rising Rates (Taper Tantrum)	-1.20%	-1.66%	-2.64%	-1.34%
Sep 2015	Commodity Crisis Continues	-1.19%	-1.88%	-2.59%	-2.47%
May 2010	Escalation of Sovereign Debt Crisis	-1.10%	-1.90%	-3.52%	-7.99%
Sep 2014	Oil price selloff accelerates	-1.04%	-1.17%	-2.10%	-1.40%
Mar 2005	Market prepares for Ford and GM downgrade into HY	-1.02%	-1.43%	-2.73%	-1.77%
Jul 2007	Sub-prime fears return	-1.00%	-1.41%	-3.14%	-3.10%

1 The US Short Duration High Yield Strategy displayed herein is gross of management fees and based on the SKY Harbor SDHY composite (incepted October 31, 2011) and actual composite performance results during the period 4/30/2004 to 5/31/2011 (the "Pre SKY Harbor period"). Net performance would be lower. For a more complete explanation, see the Disclaimer page at the end of this presentation.
2 ICE BofA 1-5 Year BB-B US Cash Pay High Yield Constrained Index, ticker JVC4
3 ICE BofA US High Yield Index, ticker H0A0
4 S&P 500 Index including gross dividends
Past performance is not indicative of future results.

Source: SKY Harbor, ICE BofA Indices, Bloomberg

Key Attribute #4.) Active Manager Outperformance

The most popular ETFs in the short duration US high yield space are SHYG and SJNK, the popularity of which have allowed combined assets to now surpass ~ $8 billion. Below, we compare risk-adjusted ETF returns to the short duration high yield index (JVC4) and a data set of applicable active managers (using the eVestment Global Database, SKY Harbor created a data set of > 30 managers with short duration US high yield strategies). On a rolling basis through the end of 2019, both SHYG and SJNK have provided weaker risk-adjusted returns in all periods relative to the 25th percentile and median manager in our data set. As such, we would say that short duration high yield ETF risk-adjusted returns are in line with 3rd quartile active manager performance over the long run, and well below median.

Median Active Short Duration HY Manager vs. iShares 0-5 Yr High Yield Corporate Bond ETF (SHYG) and SPDR Bloomberg Barclays Short Term High Yield Bond ETF (SJNK)
monthly data, since 2014

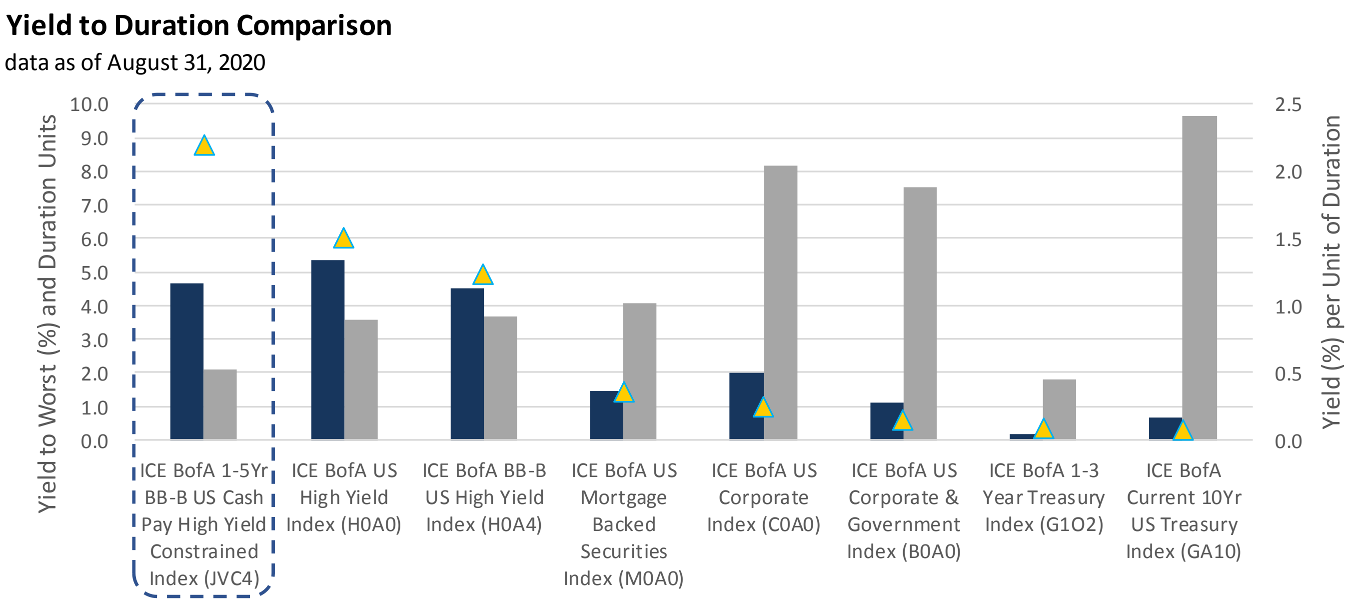
Returns	2014	2015	2016	2017	2018	2019	U/P vs. Median Mgr. % of Periods
Median Short Duration Manager (net of fees)	1.2%	-0.3%	9.7%	4.7%	0.3%	12.3%	
SHYG Capture	28%	1175%	129%	109%	6%	81%	67%
SJNK Capture	-108%	1962%	146%	112%	-79%	77%	67%

Standard Deviation of Returns	2014	2015	2016	2017	2018	2019	U/P vs. Median Mgr. % of Periods
SHYG Capture	121%	151%	107%	135%	140%	127%	100%
SJNK Capture	135%	165%	167%	145%	152%	127%	100%

Source: SKY Harbor, ICE BofA Indices, Bloomberg, eVestment Global Database; data through June 30, 2020
Note: ETF returns are calculated on a price basis; JVC4, ETF, and manager returns and standard deviations are calculated using monthly data

Key Attribute #5.) Attractive Yield per Unit of Duration

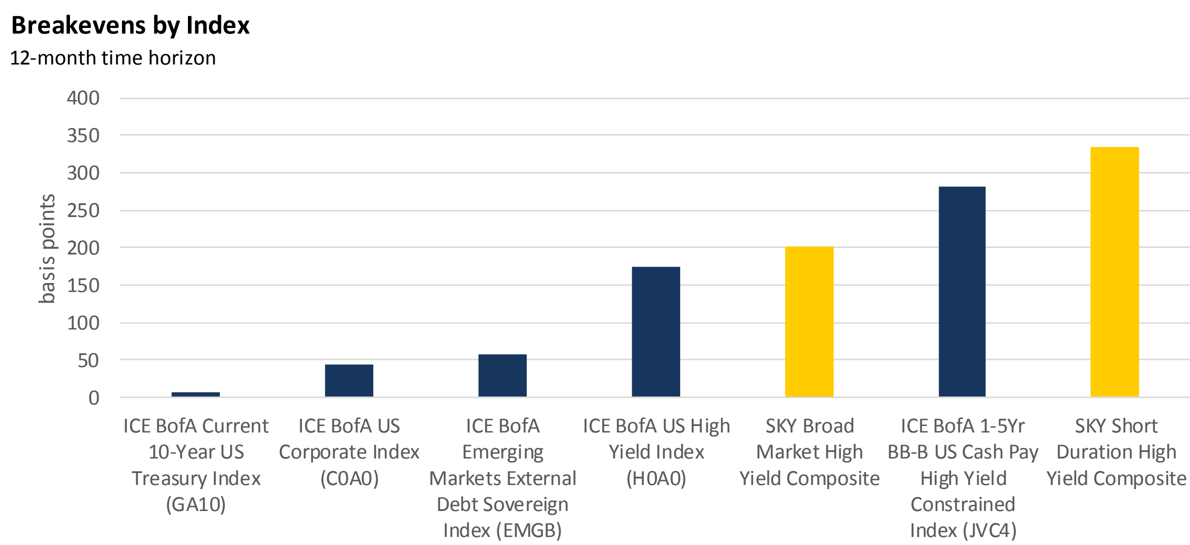
Furthermore, we would note that a short duration high yield strategy possesses attractive yield relative to other fixed income products, particularly when viewed in the context of sensitivity to interest rate risk. For example, JVC4 (the ICE BofA 1-5 Year BB-B US Cash Pay High Yield Constrained Index) currently captures 87% of the yield of the full high yield index (ICE BofA US High Yield Index, ticker H0A0) with only 60% of the duration. As shown below, short duration high yield has the most attractive yield per unit of duration characteristics when viewed against other high yield products, investment grade corporates, mortgages, and various government securities.



Source: SKY Harbor, ICE BofA Indices, Bloomberg; data as of August 31, 2020

Key Attribute #6.) Downside Protection via Sizeable Breakevens

Our findings show both broad and short duration US high yield to be better positioned than adjacent fixed income indices (10-yr Treasuries, investment grade corporates, EM, etc.) to generate breakeven returns in a rising yield and/or risk premium environment. For example, a recently conducted simulation estimates that the ICE BofA 1-5 Year BB-B US Cash Pay Constrained Index (JVC4) could absorb over 280 bps of linear yield widening over a 12-month period and still generate a total return of 0%. In contrast, the ICE BofA US Corporate Index (C0A0, a proxy for investment grade credit) could only absorb < 50 bps of linear yield widening over a 12-month period before returns fall below 0%. The chart below plots breakevens for several fixed income indices (assumptions listed in the footnotes). Note that we further delineate breakevens for SKY Harbor broad and short duration US high yield strategy composites in gold.



Source: SKY Harbor, ICE BofA Indices, data as of August 2020; Assumptions are as follows (12 month investment horizon, increases in yield are linear in nature and across all asset classes and occur in equal monthly increments, no credit losses via defaults, coupons are reinvested in their respective strategies, no absorption of increased Treasury yields through spread compression and vice versa, no impact from roll-down as we assume active management repositioning of portfolios)

Key Attribute #7.) Consistent Return Profile

For investors who seek to minimize volatility and achieve a more consistent set of monthly returns over time, a short duration high yield strategy stacks up favorably in comparison to adjacent fixed income and equity products. The analysis below measures monthly returns of short duration high yield (JVC4), broad high yield (H0A0), investment grade corporate credit (C0A0), and the S&P 500 Index (SPX). Using a data set of index performance since 2011 (SKY Harbor inception), short duration high yield shows the greatest consistency of monthly returns and the greatest percentage of positive return months.

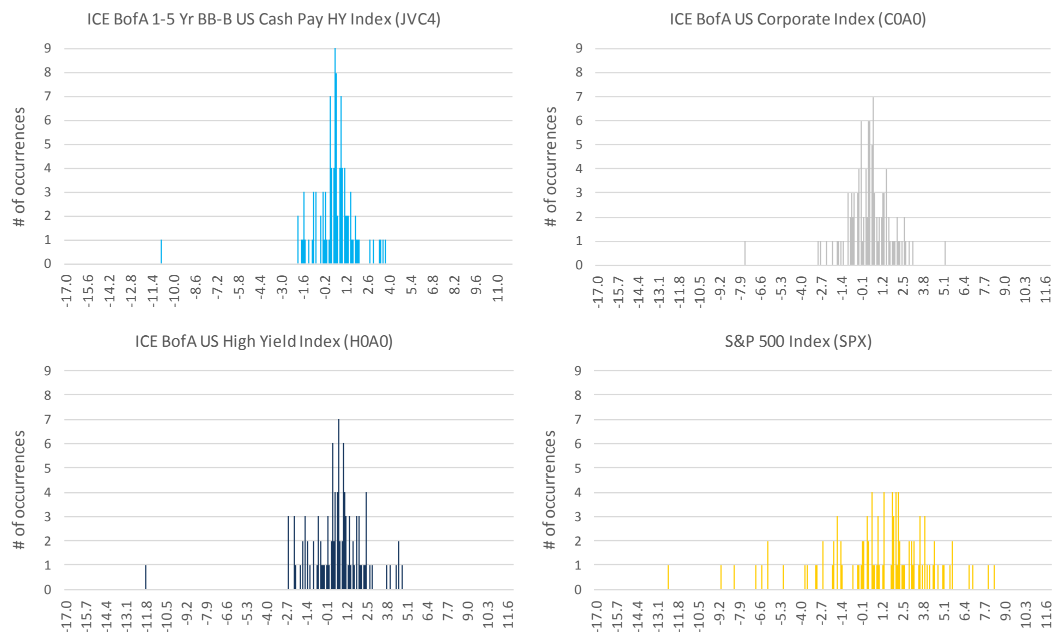
Return Consistency of Asset Class

monthly data, since 2011

	ICE BofA US High Yield Index (H0A0)	BB-B US Cash Pay HY Constrained Index (JVC4)	ICE BofA US Corp Index (C0A0)	S&P 500 Index SPX
Number of Observations	105	105	105	105
Average Monthly Return	0.53	0.44	0.45	1.16
# of Positive Months	74	79	69	77
# of Negative Months	31	26	36	28
% Positive Months	70%	75%	66%	73%

Monthly Return Histograms

since 2011



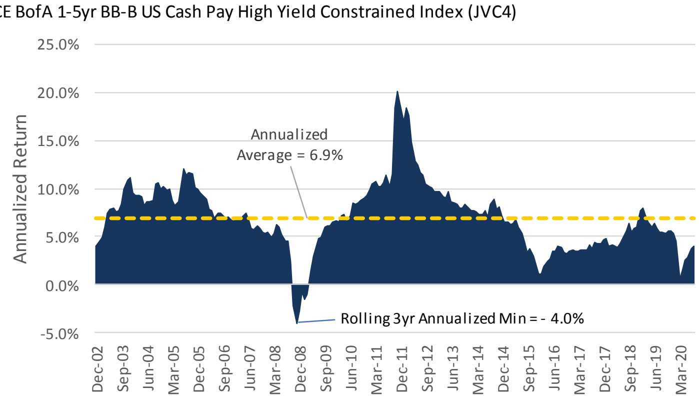
Source: SKY Harbor, ICE BofA Indices, Bloomberg

Key Attribute #8.) Limited Drawdown Risk Over Time

Short duration US high yield has also provided consistent annualized returns over multi-year periods. As demonstrated below, the JVC4 index has generated average annualized returns of 6.9% over rolling 3 and 5-year periods, with only moderate drawdowns. Put another way, a five year investment in short duration high yield has almost always led to positive annualized returns. If you invested at the absolute worst period in time (going back to January 2000), your resulting 5-year average annualized return would have been -0.1%. In our view, this dynamic significantly reduces the risk of timing the market poorly, and highlights the value of the strategy as a strategic – not a tactical – allocation with strong risk / return attributes.

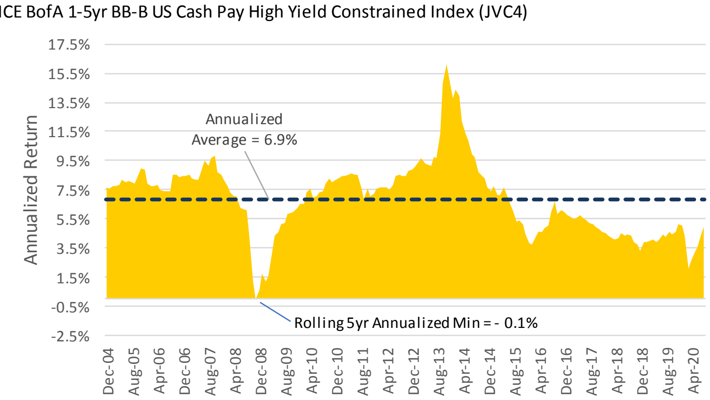
Annualized Monthly Rolling 3-Year Short Duration High Yield Returns

ICE BofA 1-5yr BB-B US Cash Pay High Yield Constrained Index (JVC4)



Annualized Monthly Rolling 5-Year Short Duration High Yield Returns

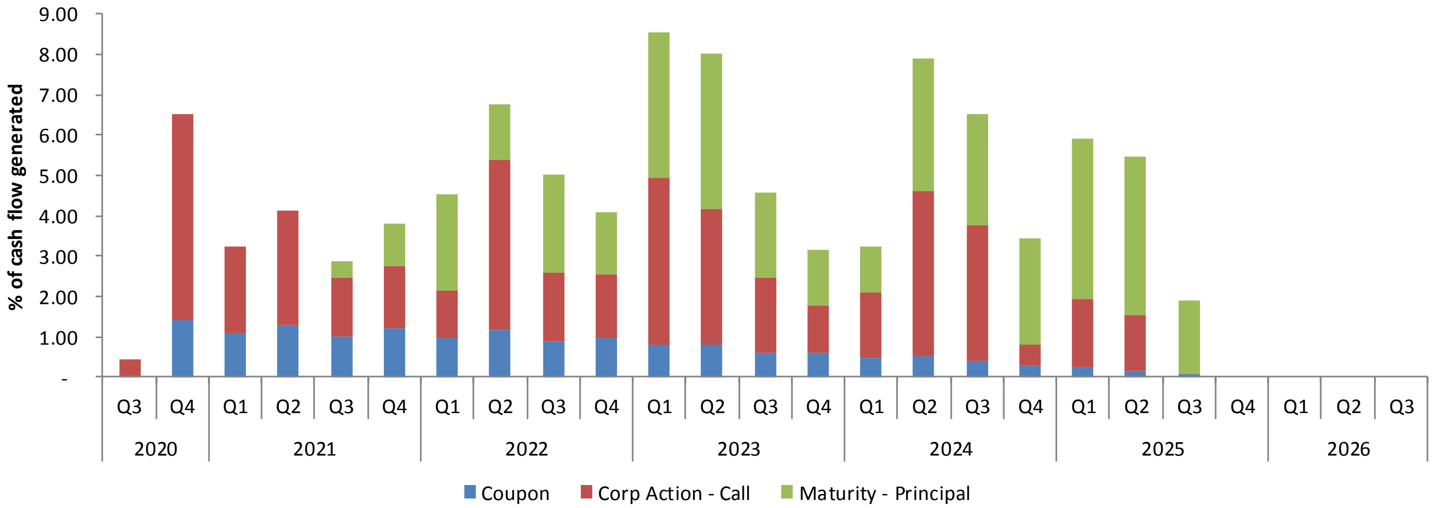
ICE BofA 1-5yr BB-B US Cash Pay High Yield Constrained Index (JVC4)



Source: SKY Harbor, ICE BofA Indices, Bloomberg

Key Attribute #8.) High Natural Turnover Allows for Consistent Portfolio Construction Optimization

As an illustration of the benefits of high natural turnover, we look to the ICE BofA 1-5 Year BB-B US Cash Pay High Yield Constrained Index (JVC4) as of September 23, 2020. The high expected natural turnover generated through calls, tenders and maturities allow for portfolio optimization amidst changing economic, fundamental, and volatility expectations in an efficient and costless manner. Below is an estimate of the cash expected to be generated from corporate actions if the securities are redeemed according to current market expectations.



Source: Source: SKY Harbor, based on the ICE BofA 1-5 Year BB-B US Cash Pay High Yield Constrained Index (JVC4) as of September 23, 2020

Key Attribute #9.) History of Avoided Principal Losses

Since inception (late 2011), only 4 defaults have been experienced in SKY Harbor short duration high yield strategies, modest in comparison to 282 defaults within the ICE BofA US High Yield Index (H0A0) over the same time period. In our view, an intense process of bottom-up credit research, a focus on sustainable business models, and strong selling discipline have led to robust principal protection over time.

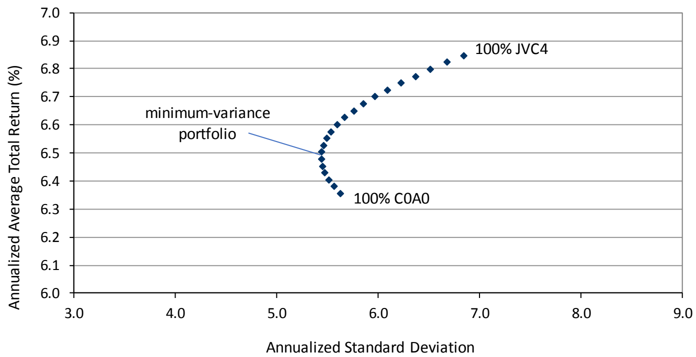
	Last-Twelve-Month Annual Par-Weighted Default Rates		Last-Twelve-Month Number of Issuer Defaults	
Year	SKY Harbor Global Funds– US Short Duration High Yield Fund	ICE BofA US HY Index	SKY Harbor Global Funds– US Short Duration High Yield Fund	ICE BofA US HY Index
1H 2020	0.00%	6.6%	0	50
2019	0.00%	3.40%	0	29
2018	0.00%	2.00%	0	24
2017	0.02%	1.30%	1	26
2016	0.16%	5.80%	2	58
2015	0.13%	3.20%	1	36
2014	0.00%	1.80%	0	20
2013	0.00%	0.60%	0	15
2012	0.00%	1.70%	0	24

Source: SKY Harbor, ICE BofA US High Yield Index as of June 30, 2020

Key Attribute #10.) Benefits of Diversification

By virtue of limited correlation to other asset classes, short duration high yield can improve portfolio diversification. As demonstrated below, an allocation to short duration high yield can expand the efficient frontiers of investment grade corporate, mortgage backed, and 10-year treasury portfolios. Additionally, exposure to short duration high yield can reduce the volatility of a large-cap equity portfolio with minimal return concession.

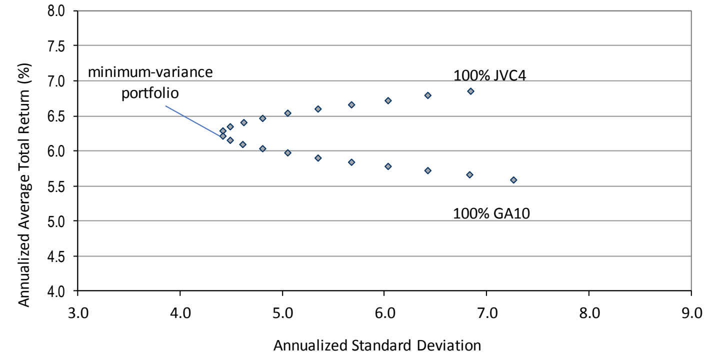
Short Duration High Yield (JVC4) vs. Investment Grade Corporates (C0A0)
monthly data, trailing 20 years



Portfolio %																					
JVC4	1.00	0.95	0.90	0.85	0.80	0.75	0.70	0.65	0.60	0.55	0.50	0.45	0.40	0.35	0.30	0.25	0.20	0.15	0.10	0.05	0.00
C0A0	0.00	0.05	0.10	0.15	0.20	0.25	0.30	0.35	0.40	0.45	0.50	0.55	0.60	0.65	0.70	0.75	0.80	0.85	0.90	0.95	1.00
Ann. Return	6.8	6.8	6.8	6.8	6.7	6.7	6.7	6.7	6.7	6.6	6.6	6.6	6.6	6.5	6.5	6.5	6.5	6.4	6.4	6.4	6.4
Ann. St. Dev.	6.8	6.7	6.5	6.4	6.2	6.1	6.0	5.9	5.8	5.7	5.6	5.5	5.5	5.5	5.4	5.4	5.4	5.5	5.5	5.6	5.6

Portfolios along the efficient frontier
Minimum-variance portfolio

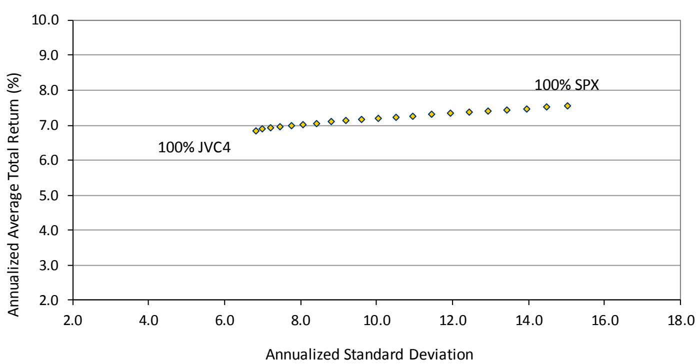
Short Duration High Yield (JVC4) vs. 10-Year Treasury Index (GA10)
monthly data, trailing 20 years



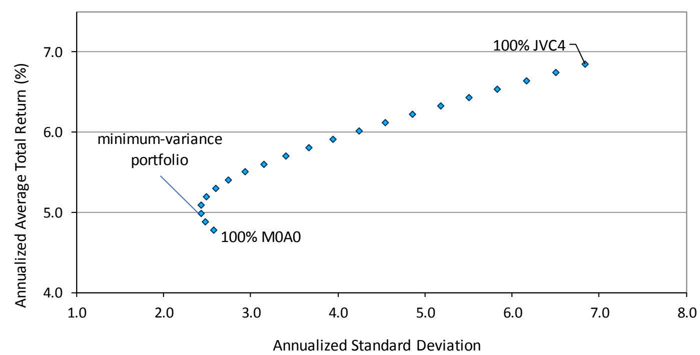
Portfolio %																					
JVC4	1.00	0.95	0.90	0.85	0.80	0.75	0.70	0.65	0.60	0.55	0.50	0.45	0.40	0.35	0.30	0.25	0.20	0.15	0.10	0.05	0.00
GA10	0.00	0.05	0.10	0.15	0.20	0.25	0.30	0.35	0.40	0.45	0.50	0.55	0.60	0.65	0.70	0.75	0.80	0.85	0.90	0.95	1.00
Ann. Return	6.8	6.8	6.7	6.7	6.6	6.5	6.5	6.4	6.3	6.3	6.2	6.2	6.1	6.0	6.0	5.9	5.8	5.8	5.7	5.7	5.6
Ann. St. Dev.	6.8	6.4	6.0	5.7	5.4	5.1	4.8	4.6	4.5	4.4	4.4	4.5	4.6	4.8	5.1	5.3	5.7	6.0	6.4	6.8	7.3

Portfolios along the efficient frontier
Minimum-variance portfolio

Short Duration High Yield (JVC4) vs. S&P 500 Index (SPX)
monthly data, trailing 20 years



Short Duration High Yield (JVC4) vs. Mortgage Backed Securites Index (M0A0)
monthly data, trailing 20 years



Portfolio %																					
JVC4	1.00	0.95	0.90	0.85	0.80	0.75	0.70	0.65	0.60	0.55	0.50	0.45	0.40	0.35	0.30	0.25	0.20	0.15	0.10	0.05	0.00
M0A0	0.00	0.05	0.10	0.15	0.20	0.25	0.30	0.35	0.40	0.45	0.50	0.55	0.60	0.65	0.70	0.75	0.80	0.85	0.90	0.95	1.00
Ann. Return	6.8	6.7	6.6	6.5	6.4	6.3	6.2	6.1	6.0	5.9	5.8	5.7	5.6	5.5	5.4	5.3	5.2	5.1	5.0	4.9	4.8
Ann. St. Dev.	6.8	6.5	6.2	5.8	5.5	5.2	4.9	4.5	4.2	3.9	3.7	3.4	3.2	2.9	2.7	2.6	2.5	2.4	2.4	2.5	2.6

Portfolios along the efficient frontier
Minimum-variance portfolio

Source: SKY Harbor, ICE BofA Indices, Bloomberg

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Gross performance results do not reflect the deduction of investment advisory 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. SKY Harbor's asset-based fees are generally billed monthly or quarterly in arrears. Please refer to the 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.

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