# US High Yield Fund

February 29, 2020

SKY HARBOR GLOBAL FUNDS

## Monthly Commentary

### Market

During the first few weeks of February, the High Yield market was able to shrug off concerns about the COVID-19 outbreak. Markets were initially held up by better-than-expected Q4 earnings and a belief that any negative effect of the coronavirus would be localized and only a temporary disturbance. Risk assets turned sharply lower as the month progressed and more details on the extent of the outbreak came out. Initial hopes that the virus would be contained were dashed by the rapid increase in the number of cases outside China. The selloff in risk assets led to HY having its first negative monthly return since May 2019. Oil continued its downturn in February with concerns about a decline in global demand causing WTI Crude to close the month down $6.80/bbl (or -13.19%) to $44.76/bbl, dragging the Energy sector down with it. The US dollar was up 0.76% on the month, and the US Treasury curve steepened as the 2-yr Treasury decreased 45 basis points (bps) to 0.90% and the 10-yr Treasury yield decreased 39 bps to 1.13%.

Technicals were mixed in February with supply of new paper slowing down after a record January and funds seeing outflows. High yield mutual funds/ETFs saw outflows of $2.4bn, while loan funds experienced outflows of $1.7bn, as tracked by Lipper. High yield new issuance was $27.9bn, as tracked by Barclays, while $24.4bn in bonds were redeemed or upgraded, leaving net supply at $3.5bn. The loan primary market slowed down in February after a record January as $71.8bn priced during the month, according to JP Morgan. The percentage of the high yield bond market trading at distressed levels (below 70% of par) increased to 5.9%; the comparable figure for the loan market (below 80% of par) increased to 5.5%. The par-weighted twelve-month high yield bond default rate was 3.4% at month-end, per BofA Merrill Lynch, and the loan market par-weighted trailing default rate decreased to 1.70%, per JP Morgan.

The ICE BofA US High Yield Index returned -1.55% in February while the Credit Suisse Leveraged Loan Index returned -1.35%. The yield-to-worst (YTW) for the high yield index increased 64 basis point to 6.19% and spreads increased 104 bps to 503 bps. By rating, the BB, B and CCC bond sub-indices returned -1.41%, -1.47% and -2.37%, respectively. Sector returns were mixed for the month with Telecom the top performer, returning 1.90%, while Energy was the bottom performer, posting -7.40%. Across risk types (defined by duration and yield to worst) shorter duration more defensive securities outperformed longer duration and more speculative securities. High yield underperformed investment grade corporate bonds, represented by the ICE BofA US Corporate Index's 1.29% return, but outperformed large cap equities, represented by the S&P 500's -8.23% return, as well as small cap equities, represented by the Russell 2000's -11.13% return.

### Strategy

SKY Harbor Global Funds–US High Yield Fund outperformed its benchmark in February, capturing only 70% of the negative return of the index on a gross-of-fee basis and excluding currency impact. By risk type, both allocation and security selection were sources of outperformance. The primary drivers of relative performance were an underweight to and strong selection within the most speculative part of the market (yielding >9%). Outperformance was partially offset by weaker selection within the top-performing, better-quality part of the market (yielding 6-7%). By sector, a significant underweight to bottom-performing Energy and strong selection in Media were sources of outperformance, somewhat reduced by an underweight to top-performing Telecom and weaker selection in Basic Industry.

The largest positive contributor to returns was Sprint Corp (S) 7.875% notes due 2023, which traded up on news that the acquisition by T-Mobile had been cleared by regulators. Last month's top contributor, Beazer Homes (BZH) 7.25% notes due 2029, was down slightly in February. The largest bottom contributor to monthly returns was Hertz Corp (HTZ) 7.125% notes due 2026, which traded down on Q4 earnings that fell below expectations. Last month's bottom contributor, Bombardier Inc. (BBDBCN) 7.875% notes due 2027, rallied in February after trading down sharply in January, ending the month among the top contributors.

**Investment Objective**

This is an active strategy that seeks to outperform the broad US high yield market over a full market cycle with less volatility through investing across the full maturity spectrum of the US below-investment-grade debt market. The Fund principally invests in a diversified portfolio of high yield debt securities issued by companies domiciled or listed in the US.

**Benchmark**

ICE BofAML US High Yield Index (H0A0)

At least 2/3 of the Fund's debt security holdings will be components of the H0A0 Index, but the Investment Manager may use its discretion to invest in companies or sectors with different weights than the Index or are included in the Index in order to take advantage of specific investment opportunities.

**Portfolio Management**

Lead PM: Hannah H. Strasser, CFA
Trevor Kaufman, CFA

**Fund Detail**

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|---|---|
| Fund Inception | Apr 05, 2012 |
| Fund AUM | $72.5mn |
| Order Cut-off | 12:00 CET |
| Settlement | T+3 |
| Dealing Frequency | Daily |
| Valuation Frequency | Daily |

Statistics on performance, risk measures and portfolio characteristics are presented in share class Fund Factsheets available online at:
http://skyharborglobalfunds.com/funds/ushighyield.shtml

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## Outlook

Broad High Yield Market (BHYM) portfolios continue to weather market volatility with less negative performance for significant outperformance YTD. We do think that current positioning suggests sufficient market capture to the upside so long as Energy is not the driver of the upside. Given the large overhang of IG energy downgrades and historically low oil prices, we do not see speculative Energy being a driver of 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 although 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 projectible.

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.

### About SKY Harbor Capital Management

SKY Harbor Capital Management, LLC ("SKY Harbor"), an independent investment manager registered with the US Securities and Exchange Commission, is the appointed Investment Manager for SKY Harbor Global Funds. SKY Harbor offers a range of US high yield and leveraged loan strategies for global institutional investors and private wealth advisors. Senior leadership and co-founders Hannah Strasser and Anne Yobage have managed high yield investments as a team through multiple market cycles for nearly 30 years. SKY Harbor's process is grounded in fundamental analysis, then refined by quantitative and technical assessment, to identify income potential while effectively managing risk. SKY Harbor is based in Greenwich, CT USA. Visit www.skyhcm.com.

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