US High Yield Fund

October 31, 2018

SKY HARBOR GLOBAL FUNDS

Monthly Commentary

Market

As we near the end of the third-quarter earnings reporting cycle, it's clear that corporate profitability remains robust. However, equity markets traded sharply lower and risk assets generally sold off as investors became increasingly concerned that US corporate earnings are peaking as wage inflation, labor shortages and the negative impact associated with tariffs and rising interest rates threaten profit margins. While slowing earnings growth has less impact for credit metrics – which continue to improve for high yield bond issuers – the widening of risk premiums and resetting of future discount rates was a headwind for the high yield market, which suffered its worst monthly return since the Energy crisis in Q4 2015. Dampening global growth expectations further pressured most commodities, especially oil, which was lower in October with WTI Crude down $7.94/bbl (or 10.84%) to $65.31/bbl. The US dollar rallied, up 2.10% on the month, and interest rates continued to rise. The slope of the US Treasury curve steepened as the 2-yr Treasury was higher by 5 bps to 2.87% and the 10-yr Treasury yield increased 10 bps to 3.16%.

Market technicals remained modestly supportive for the high yield asset class. Investor flows were consistent with the trends of the last year, as loan funds received inflows of $1.1bn, while HY mutual funds saw outflows of $5.5bn. Net supply shifted back to negative in the month, as tracked by Lipper and reported by Barclays, with HY bond new issuance at $12.2bn in October, offset by $13.2bn in redemptions, for net supply of -$1.0bn, per Barclays. The loan primary market increased, as $64.8bn priced during October, according to JP Morgan. The percentage of the HY bond market trading at distressed levels (below 70% of par) increased to 2.7%; the comparable figure for the loan market (below 80% of par) was 2.3%. The par-weighted twelve-month HY bond default rate was 1.06% at month-end, per BofA Merrill Lynch, and the loan market par-weighted trailing default rate increased to 1.92%, per JP Morgan.

The ICE BofAML US High Yield Index returned -1.64% for October while the Credit Suisse Leveraged Loan Index returned 0.01%. The YTW for the HY index increased 58 bps to 6.80% and spreads increased 53 bps to 376 bps. By rating, the BB, B and CCC bond sub-indices returned -1.36%, -1.58% and -2.81%, respectively. Returns were negative across all sectors with Utility being the top performer, returning -0.65%, while Energy was the bottom, posting -2.56%. Across risk types (defined by duration and yield to worst), generally shorter duration, more defensive segments led while longer-duration, more speculative lagged although all risk segments were negative for the month. High Yield outperformed large cap equities, represented by the S&P 500's -6.84% return, as well as small cap equities, represented by the Russell 2000's -10.86% return, but underperformed investment grade corporate bonds, represented by the ICE BofAML US Corporate Index's -1.35% return.

Strategy

SKY Harbor Global Funds–US High Yield Fund modestly underperformed the benchmark in October on a gross-of-fee basis and excluding currency impact (see link at right for details). By risk type, security selection was a source of underperformance while allocation was a source of outperformance. Primary drivers of underperformance were security selection in the most speculative and intermediate risk parts of the market. This was offset by an overweight to the better-performing short duration part of the market and an underweight to the bottom-performing most speculative part of the market. By sector, weaker selection in Energy and Services were sources of underperformance, partially offset by strong selection in Basic Industry and Healthcare.

The largest positive contributor to returns was Automation Tooling Systems (ATACN) 6.5% notes due 2023, which was modestly positive for the month while much of the market sold off. Last month's top contributor, Ahern Rentals (AHEREN) 7.375% notes due 2023 was among the fund's largest bottom contributors this month. The largest bottom contributor, Approach Resources (AREX), traded down in tandem with the selloff in oil. Last month's largest bottom contributor, SandRidge Energy (SD) was liquidated in September.

Investment Objective

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)

Portfolio Management

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

Fund Detail

Fund Inception	Apr 05, 2012
Fund AUM	$202.4mn
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

While conscious of the changing environment for risk assets, the selloff has not fundamentally changed our view of high yield market risks, but rather has improved the opportunity as valuations have become less of a headwind. Our greatest conviction remains around strong corporate fundamentals, and despite somewhat reduced forward guidance, we expect corporate profitability to be supportive of improving credit metrics for high yield bond issuers and default rates to remain low. Strong technicals associated with lower issuance on the bond side and strong investor demand on the loan side should also continue to provide support for the market. We have been concerned about valuations, but post-selloff we believe the potential for spread compression based on continued fundamental strength remains. Taken in whole, we have not substantially altered our risk positioning, although we are mindful of the potential for markets to begin to reflect a peaking profit cycle and the associated shift higher in risk premiums.

Our Broad High Yield Market portfolios remain underweight the better-quality, more rate-sensitive segment of the market. We continue to use volatility to reduce our current underweight to higher-rated longer-duration bonds with a focus on those industry groups that are best positioned for sustainable growth in an aging economic cycle. The market repricing has also given us the opportunity to add income through credit picking among companies with improving earnings. Our BHYM portfolios remain more concentrated in high conviction holdings than has been the case in recent years and are benefiting from outperformance by this part of the portfolio generally. 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.

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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Supplementary Information for Swiss Investors

The state of the origin of the fund is Luxembourg. In Switzerland, the Swiss Representative is ACOLIN Fund Services AG, Affolternstrasse 56, CH-8050 Zurich, whilst the paying agent is Banque Cantonale Vaudoise, Place Saint-François 14, 1001 Lausanne, Switzerland. The Prospectus, the Key Investor Information Documents, the articles of incorporation as well as the annual and semi-annual reports may be obtained free of charge from the Swiss Representative. In respect of the units distributed in or from Switzerland, the place of performance and jurisdiction is at the registered office of the Swiss Representative. Past performance is no indication of current or future performance. The performance data do not take account of the commissions and costs incurred on the issue and redemption of units.