SKY HARBOR
CAPITAL MANAGEMENT

Period ending April 30, 2020

Performance (%)	1 Week	MTD	Q1	YTD
SHGF-SDHY USD A Cap (net)	0.04	1.63	-7.30	-5.79
ICE BofA US HY Index	0.33	3.80	-13.12	-9.82
Relative Capture	*12%*	*43%*	*56%*	*59%*

Key Characteristics	YTW	MTD Δ	YTD Δ	DTW	MTD Δ	YTD Δ	OAS	MTD Δ	YTD Δ
SHGF-SDHY	6.82	-1.10	3.31	2.53	-0.27	1.32	653	-107	469
ICE BofA US HY Index	8.23	-0.88	2.86	4.00	-0.24	1.06	781	-84	422

One-day Fund Commentary

As a note, we do not expect to continue with daily Fund commentary after today's month-end wrap-up. We will reinstitute the practice should volatility spike again. As always, if you have specific questions, please reach out to your SKY Harbor relationship manager.

The risks associated with lifting shelter-in-place restrictions and the restart to economies around the globe is the dominant risk at present. We see some growing market concern around China trade as the US administration seeks to assign blame to China for the spread of the virus in the US. In the final day of trading for the month the risks that are most impacted by COVID-19 led market returns higher although the exception was airline bonds which were sharply lower, taking aerospace down as well. Ad-supported media is also increasingly an area of investor concern and was weaker as more companies highlight reduced ad spending as part of their COVID-19 cost reduction programs. The focus away from Energy, Transportation and Media was the fallen angels that will be fully captured by HY market indices tomorrow. In the Fund, we did one small trade in a BB rated apparel company.

MTD Fund Commentary

The news of the day for the tri-state region-centric financial markets was that it was a sunny spring day. Coincidentally or not, there were no new issues announced. The market was up modestly, supported by investor inflows and the lack of new issuance. More companies are reporting Q1 results that showed strength leading right up until regional shelter-in-place orders took hold. In general, very few companies are willing to provide forward guidance although they are providing insight into fixed versus variable expense and cash burn rates along with liquidity summaries. Unlike the GFC, there was no ambiguity around the seizing up of economic activity and companies took immediate action, utilizing common strategies around employee furloughs, management and board compensation cuts, travel and cost restrictions and business restructurings to facilitate working from home ("WFH"), contactless transactions and social distancing where relevant. As a result, we believe companies—those that survive—will be far more efficient with profitability improved by reduced labor and other input cost pressures that were impacting margins in recent years. We continue to focus on defensive, up-in-quality exposure and to look to lighten up in the Financial sector, although we did almost no trading on the day.

It's hard to know where bonds will be priced on any given day given wide bid-ask spreads, but today's market tone was viewed as positive despite the modest negative return and spread widening. Investors were most focused on how businesses planned to restart operations and the timetable for operational ramp-ups. Even New York and the tri-state area are beginning to talk about a timetable for the resumption of certain activities. IG issuance led the market while the HY calendar stayed empty, although the expectation is that tomorrow will see a reloading with potentially more issuers that are downstream of the domestic auto manufacturers and Boeing following guidance on their reopening plans. We continued to take advantage of market weakness to source up-in-quality, more defensive type risk. To that end, we initiated a position in a semiconductor-related company. We already owned a longer maturity bond in the capital structure in our BHYM portfolios. We also added to our high conviction exposure in a diversified environmental solutions provider as well as added to a recent secured Ti02 new issue. On the sale side, we reduced our exposure to one infrastructure and transportation equipment owner where we believed end-market exposure to energy and aviation markets would create extended headwinds, and further reduced our exposure to one commercial real estate owner.

The market closed out the week negative largely on pressure from the steady supply of new issuance that was generally the focus of market activity throughout the week. A number of new issues failed to move much beyond issue price when free to trade, leaving market participants cautious about the clearing price for certain types of risk in the current environment. Certainly, investor fatigue is a reoccurring theme impacting trading volumes and liquidity on Fridays in particular. We largely sat on the sidelines on Friday, doing only one trade: we sold down a small amount of bonds in a credit card related company.

Volatility remained and the total return for the week was negative with sectors that had led the market higher earlier in the month generally being a drag on market performance. COVID-19 news generally tracked expectations in terms of the number of new cases and fatalities around the globe tracking expectations. Discussions around the path of lifting shelter-in-place orders and restrictions on commerce accelerated and several US states began the opening of certain types of businesses. Even the New York tri-state area has begun to talk about a path to some lifting of restrictions. Despite the positive around the developing line of sight to the starting line of the reopening of global economies, it is indeed just that: the starting line. The non-partisan Congressional Budget Office (CBO) released its expectations for the evolution of GDP and unemployment that suggested a sharp contraction in Q2 and a slow U-shaped recovery that would leave unemployment at double-digit levels through 2021. Market technicals were a challenge with more issuers pressing to raise funds to bolster liquidity. While $12bn of new issuance was still somewhat lower than the prior-week's tally, the new supply was enough to put pressure on secondary market levels given estimated inflows of $2bn. Bifurcation in the market continues with credit that is less impacted by COVID-19 headwinds closing in on pre-COVID-19 levels and risk that is more directly impacted by COVID-19 moving to distressed levels. Oil prices also certainly were a source of investor concern as prices for near term deliveries WENT NEGATIVE early in the week to rebound to positive territory as the week went on. Other sectors benefited from COVID-19 updates and the beginning of quarterly reporting.

The prior week wrapped up with more new issuance, bringing the high yield total to almost $16bn on the week. Most were BB rated although generally were for companies with large COVID-19 headwinds so hard to know where ratings end up. This included an $8bn three-tranche deal for Ford Motor – the auto producer rather than the credit sub – and $500mn secured debt for struggling AMC Entertainment. The large issuance was matched by record weekly inflows of $7.7bn for the week ended April 15, according to Refinitiv Lipper, surpassing the prior record set with the week ending April 1. On the negative side, WTI was lower, putting pressure on the Energy sector. Lagging participant human capital energy levels at the end of the week led to substantially lower trading volumes although there was a clear willingness to take on risk going into the weekend despite reports of historically low economic activity earlier in the week. It seems the focus has shifted to reopening of economies around the globe – including parts of the US – which allows for debate around the shape of the recovery at the same time support for additional US stimulus to further help small business, healthcare and eventually state and local governments. In the Fund, we continue to work to efficiently invest excess cash to minimize transaction costs and build portfolio income. We were add-on buyers to recent new issues and to bonds with expected take-outs in early to mid-2021 as well as opportunistic incremental buys to several existing positions. We also moved to reduce exposure to the homebuilder sector with a focus on less liquid names and also further reduced exposure to the global Ti02 market.

Companies that have been hanging on in recent years by issuing secured debt, exchanging near-term maturities, buying in discounted bonds and selling assets appear to be willing to use COVID-19 as the opportunity to right-size their balance sheets through full restructurings. Neiman Marcus, Frontier, JC Penny, CEC Entertainment (Chuck E. Cheese) as well as several energy companies have skipped interest payments and/or declared their intent to restructure over the last several weeks. There seems to be even a bit of a race to hire advisors and take advantage of the general level of uncertainly to push forward discussions with debtholders. Historic uncertainty appears to be also creating at least a momentary pause on risk-taking. The HY market is bifurcating as companies that have established they can adapt their operating model for current challenges and have sufficient financial flexibility to withstand headwinds until as late as 2022 are benefiting from strong market support and their capital structures are repricing back to levels approaching mid-February. For other issuers, investors are looking for some guidance during upcoming quarterly calls and their bonds are drifting lower. While valuations appear to price in a lower default rate than what seems realistic at this moment, additional fiscal stimulus is likely to further support business and stabilize consumer and business confidence to put a floor on corporate bankruptcies and technicals and time will drag risk premiums lower. For the Fund, we participated in the new issue activity that is biased towards 5-year issuance and rounded out positions in the secondary market. We continued to be able to source add-on positions at reasonable prices although acknowledge difficulty sourcing large blocks. We did the same sale trade to bring down our exposure in one of the more leveraged homebuilders and exited the residual car rental exposure that we had been methodically reducing.

Quarterly Fund Commentary

The human toll of the COVID-19 crisis is unprecedented. The shutdown of global economic activity and restrictions on populations around the world drove central banks and governments to equally unprecedented policy response. No financial market was spared as volatility exploded and all asset class correlations jumped to near 1.0. High yield spreads moved from their tightest quartile early in the quarter to their widest decile as default expectations spiked higher. Credit curves flattened and bid-ask spreads widened for even BB rated issues. Details around broad-based US fiscal stimulus measures put a floor on the HY market at levels approaching those reached at the weakest point during the 2002 recession. The market was further stabilized by the primary market opening up and putting a price on risk that is directly impacted by COVID-19 shutdowns.

The Fund outperformed the overall high yield market during the quarter, with significantly lower volatility and a capture rate that was within historical norms. Our shorter overall duration combined with over 20% of the portfolio in the more defensive 0-3 maturity bucket helped to dampen some of the sharp decline experienced across the broader high yield market.

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 also reduced our energy exposure to under 1% of the portfolio holdings and are closely assessing the remainder. When possible, 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.

SHGF-SDHY: Sector			
MTD	Average Weight (%)	Total Return (%)	Contribution to Return (%)
Energy	0.2	9.71	0.02
Retail	4.2	5.74	0.23
Leisure	5.4	4.59	0.22
Transportation	3.0	-1.39	-0.04
Financial Services	8.5	-0.28	-0.05
Insurance	0.6	-0.10	-0.01

US High Yield Index: Sector			
MTD	Average Weight (%)	Total Return (%)	Contribution to Return (%)
Energy	9.3	15.07	1.34
Banking	1.8	5.48	0.10
Leisure	4.9	4.44	0.21
Transportation	1.1	-1.71	-0.02
Financial Services	4.4	0.03	-0.01
Services	5.7	0.27	0.02

The Fund's low weight to the energy sector has been a large driver of underperformance MTD, but with the historic drop in WTI we see limited opportunity for much of the sector to reduce or refinance near-term maturities. Leisure and Retail (largely restaurants) have been outperformers as more self-help deals get done in the high yield market to give these companies longer runways to withstand the COVID-19 related shutdowns. On the negative side, transportation, although a small weight, is negative on a MTD basis due to our airline exposure. And Financial Services has also been a modestly negative contributor due to our exposure to commercial real estate lending and credit cards; a sector we continue to sell down.

SHGF-SDHY: Rating			
MTD	Average Weight (%)	Total Return (%)	Contribution to Return (%)
BBB	1.6	0.28	0.00
BB	39.9	2.34	0.91
B	42.9	2.02	0.88
CCC	8.8	1.20	0.11
Non Rated	0.9	1.31	0.01
Cash	5.9	0.01	0.00
FactSet Return USD – Gross of Fees	**100.0**	**1.91**	**1.91**

US High Yield Index: Rating			
MTD	Average Weight (%)	Total Return (%)	Contribution to Return (%)
BBB	0.0	0.0	0.0
BB	51.8	4.9	2.5
B	35.5	3.3	1.2
CCC	12.7	0.6	0.1
Total	**100.0**	**3.80**	**3.80**

On a month-to-date basis, Double-B credits have outperformed other ratings groups. And while Triple-Cs have been the worst-performing ratings category within HY, we went into the period well below our historical average and would look to remain this way. Our goal remains to increase BB and reduce CCC holdings when supported by fundamentals and valuations.

SHGF-SDHY: Risk			
MTD	Average Weight (%)	Total Return (%)	Contribution to Return (%)
Maturities within 3 years	21.6	1.28	0.29
Shortest duration (<1)	1.7	0.97	0.01
Intermediate duration (1-2)	4.3	1.23	0.06
Longer duration (2-3)	6.8	1.36	0.10
Extended duration (>3)	34.8	2.55	0.87
Speculative (9+ YTW)	23.7	2.51	0.55
New Issue & Exchanged	1.2	3.32	0.03
Cash	5.9	0.01	0.00
FactSet Return USD - Gross of Fees	**100.00**	**1.91**	**1.91**

US High Yield Index: Risk			
MTD	Average Weight (%)	Total Return (%)	Contribution to Return (%)
More Speculative (ex-energy)	24.3	2.38	0.58
Speculative Energy	7.7	15.81	1.22
Intermediate Risk	15.0	3.59	0.54
Interest Rate Sensitive	36.8	3.14	1.16
Short Duration	16.0	1.91	0.31
Total	**100.00**	**3.80**	**3.80**

The rally has meant that our longer duration securities have seen the best recovery. Looking forward, we are most focused on the best risk-adjusted opportunities, which are typically in bonds maturing in 5 years or less and trading with durations of less than 3.0.

Forward Outlook

We believe that investors have progressively shifted their focus from initially tracking the pace of global COVID-19 metrics, to monitoring fiscal and monetary stimulus measures, to then assessing the impact of shelter-in-place orders on economic activity, to now a vision for what reopening entails for different sectors and regions of the global economy and what new treatment efforts or vaccines are in the pipeline that might mitigate reopening risks.

To support our risk-taking, we are focused on consumer and business behavior as restrictions are lifted around the globe. 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 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, retail, leisure and potentially the transportation sectors despite an eventual stabilization of coronavirus-related impact to demand in the second half of the year. Fiscal and monetary stimulus around the globe appears ready to resize and evolve on an as-need basis.

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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