SKY Harbor Global Funds

Responsible Investing for a Sustainable Future

Staying the Course on Sustainability

People, Planet, Purpose, Profits & Politics

Our Purpose

To grow our clients' assets by investing in high yield sustainable corporations that have committed to benefit all their stakeholders and society as a whole.

How We Do It

By compounding current income over time, protecting principal and giving our clients the returns they expect and the information they need.

Why We Do It

We believe that Sustainable Corporations will prosper over the long term, attract lower cost capital, and generate superior returns to their investors.

Sustainability SKYSights February 2021:

Channeling Churchill

Our study on COVID-19 responses by High Yield issuers

Recent ESG developments in US and Europe

"This is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning."

Sir Winston Churchill, November 10, 1942

Channeling Churchill

When Winston Churchill uttered these words after the British turned back Rommel's forces at El Alamein, Egypt, in the autumn of 1942, Churchill was obviously not addressing a global pandemic — but he may as well have been. Viewed today, his famous words seem aptly pertinent concerning recent efforts to combat COVID-19 and redress the economic and social deprivations left in its wake. The unprecedented speed in developing effective vaccines and the start of widespread vaccinations in the US and other countries — despite shortages in supply — has brought hope to many that the light at the end of the tunnel has finally emerged after endless months of darkness. In conjunction with the new administration in the US and the soon-to-be passed $1.9 trillion federal relief package, the US financial markets have been buoyant if not downright exuberant. All welcome developments no doubt. Nevertheless, Churchill's eloquent manner in managing expectations seems especially apropos under the current circumstances.

Financial market risks (which we address elsewhere in our regular commentaries) remain and may emerge suddenly as the meandering path of the recovery unfolds. Similarly, much remains to be done with respect to matters of ESG. That is, while the worst of the public health impact of the unabated spread of COVID-19 may be coming to an end, preparations for the next pandemic — and there will be a next — and the lingering problems of economic deprivation, social and gender inequality, racial injustice, and moribund climate action that this pandemic all too clearly revealed will continue in search of long-lasting solutions. Channeling Churchill, perhaps the events of 2020 can be thought of as the beginning chapter in a story of how the pandemic brought these critical issues to our collective consciousness, which the new year brings to an end, but a much longer and yet to be written story remains to be told.

We take it as a matter of faith . . .

As many of our investors, clients and readers of our sustainability commentaries may recall, we wrote in the October 2020 issue that in our view COVID-19 can be viewed as a test of how well or poorly companies have responded in their treatment of essential stakeholders. As we previously stated, we believe that "actions taken by a company in response to the pandemic may be viewed as a manifestation of a company's commitment to a sustainable business model, which depending on how it is perceived could positively or negatively affect its ability to attract capital and achieve lasting profitability." Moreover, as we have stated in our *Sustainability Policies and Procedures*,[1] our commitment to sustainable companies extends beyond long-term financial performance in investee companies, as obviously and critically important as that is. In our judgment, the explicit consideration of Sustainability Factors in the investment process can realize benefits beyond the high yield asset class. We take it as a matter of faith that the benefits of corporate sustainability extend beyond the financial markets by increasing the resilience of the real economy and the stability of the global financial system, which ultimately benefits society as a whole. Perhaps nowhere has the relationship between corporate

[1] Available at: www.skyharborglobalfunds.com/sustainability. The *SKY Harbor Global Funds Sustainability Policies and Procedures* is a document intended to satisfy the sustainability-related disclosures set forth in Regulation (EU) 2019/2088 of the European Parliament and the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (also known as the "SFDR"). In addition, the Eurosif European SRI Transparency Code and other related SKY Harbor sustainability commentary and thought leadership are also posted on the aforementioned link.

sustainability and the ultimate benefit to society as a whole been more keenly on display than by the corporate response to the COVID-19 pandemic.

Our study on COVID-19 corporate responses

In the October 2020 commentary we foreshadowed our study of COVID-19 responses by companies. We briefly noted a range of responses drawn from a review of public disclosures and media sources. In this month's commentary, among other sustainability developments, we delve into more detail of our study.

Our study began in the summer of 2020, well after the shelter-in-place and other measures by government, public and private entities were taking hold and as the rate of infection began escalating seemingly without an end in sight. We looked at over 350 companies specifically for their COVID 19 response. This accounts as about a third of the entire universe of US corporate high yield issuers and provides a robust sample size across sector, industry and type of company.

COVID-19: a once in a lifetime test of corporate leadership

As the pandemic ravaged its way through global economies during the spring and summer of 2020, we wanted to better understand how high yield issuers reacted to the pandemic, specifically in terms of safety and wellness with respect to their employees, customers, suppliers, and communities. The study was driven by our thesis that a company's response to the pandemic-induced needs of its critical stakeholders at a time of unexpected crisis reveals its underlying commitment or lack thereof to the notion of stakeholder primacy. Relatedly, our interest was piqued by the emerging notion of resiliency, a term that found increasing usage as the pandemic worked its way through the entire business model of many companies, starting with its customers and employees and straight through the supply chain.

To the extent financial actions had a direct impact on the health, safety and welfare of employees, customers and communities — such as layoffs, furloughs or inadequate overtime and hazard pay — we took note. We also took note of controversial activities or simply what we viewed as bad behavior, although thankfully those instances were relatively uncommon. We believe that companies who treated their employees, customers and communities well during this period will be more resilient, remembered and rewarded in the face of future labor shortages or challenges to brand and customer loyalty. Conversely, companies lack of or poorly conceived responses may have tarnished their reputations and impaired future resilience when future support from neglected stakeholders is needed.

The results of our sample

Most companies in our sample appeared to have immediately prioritized safety, particularly with respect to employees and customers. Among the roughly 350 high yield issuers we reviewed an encouragingly high percentage (over 80%) had provided public information addressing COVID-19 safety precautions. Most of these measures were what one would expect: social distancing, masking, increasing hygiene protocols, cleaning, suspending nonessential travel, quarantine procedures, remote work, flexible hours, and the like. A few also set up crisis management teams and information centers to keep employees informed of the latest developments. There was no particular trend in terms of the sector or industry as nearly every company in the sample followed similar initiatives with some variations in those industries most acutely affected such as in the transportation, retail, consumer, leisure and energy sectors.

We also found slightly more than half the sampled companies made attempts during this period to step up or continue with corporate social responsibility ("CSR") initiatives. These efforts included outright cash donations to various local organizations or social causes such as hunger relief, donations of goods and services (e.g., food for homeless), donations of PPE or sanitary products. Some of the tech sector companies offered free internet or other online resources for limited periods, free software collaboration to educational institutions, flexibility in late fees for people affected by the pandemic, and similar efforts.

The sectors perhaps most affected by COVID-19 — retail, consumer goods, leisure, transportation, and energy —showed a high percentage response with respect to safety precaution initiatives: These five sectors comprised almost 30% of our 351-company sample and over 88% of the high yield companies in these sectors had disclosed their safety precautions. About 60% had indicated CSR initiatives related to COVID-19.

The tension between stakeholder primacy and the exigencies of business economics, however, was plainly seen in the category of employee support. While some companies attempted to provide additional employee support, more than a few companies engaged in furloughs or permanent layoffs. Some of the attempts to provide support to employees included voluntary leave options, executive pay cuts, additional paid sick leave for symptomatic employees, mental health resources, additional family care benefits, housing assistance, and the like. In the end, no sector was completely immune to the pressures of trying to balance the desire to keep as many people employed against the need to remain solvent during this once-in-a-lifetime crisis.

Survival of the Fattest

A core thesis of our study is the concept of resilience, a term that has been gaining increasing traction in the aftermath of the pandemic. In a simplified example we posited the idea that companies which focused on their employees' health, safety and wellness at the expense of short-term profit during the crisis may build sufficient social capital to weather a future period of labor shortages stemming from an overheated economy or some other unexpected disruption.

In this regard, we draw our readers' attention to a working paper posted last month by the European Corporate Governance Institute ("ECGI") entitled *COVID-19 and Comparative Corporate Governance* by Professor Martin Gelter of Fordham University School of Law and Julia M. Puaschunder of Columbia University and the New School for Social Research, Working Paper 563/2021 (hereinafter referred to as the "Paper").

The Paper argues that the pandemic was an exogenous shock with the potential to change not only many aspects of the economy but will further push corporations away from shareholder primacy and accelerating the shift in three trends that the Paper writes has been underway for the last decade, namely: 1. Firms will shift away from "efficient" practices in favor of "resilient" practices (e.g., less cross-border just-in-time supply chains in favor of holding inventory close on hand; fewer share repurchases in favor of cash reserves; fewer contract workers in favor of full-time employees and supplemented by healthy human capital); 2. The impact of nationalism and/or protectionism on corporate law — including direct government intervention — will increase as companies will seek to wean themselves off from dependencies on "politically tainted supply chains" that risk shortages of valuable goods and services

(e.g., medical supplies, PPE)[2]; and 3. The notion of stakeholder primacy (which the Paper refers to as "stakeholderism") will find increasing global support particularly with respect to the interests of labor and employee health & safety but also animated by two key public policy issues: economic inequality and climate action.

The core concept of the Paper is the notion that many heretofore efficiency-oriented business structures (such as cross-border just-in-time supply chains or low-wage contract workers) do well in normal economies operating in "calm waters" but may not be best suited to survive exogenous events such as the pandemic or other events that impact entire economies. The Paper cites a term coined by Chicago economist Luigi Zingales as "survival of the fattest" for the notion that in "uncertain times, significant reserves may thus make a firm more resilient to shocks."

Apropos of our own study, the Paper also concludes that: "More than ever before in the history of the modern workforce do employers nowadays care about the overall well-being and physical interaction of their labor cadre in a hygienic environment. Respective preventive medical care of the workforce and community-building around monitoring of one's own and other's health but also learning how to enhance hygiene in teams will gain more attention in the COVID-19-struck workplace and will have lasting changes enacted." The high percentage of companies that issued health and safety protocols and community-based CSR initiatives in our own study appears to support these observations.

In sum, our study of the COVID-19 response by a sample of high yield issuers showed a large percentage responding to the pandemic with robust safety, health and wellness responses with respect to their employees and customers, but not a uniform response in avoiding layoffs and furloughs of varying intensity and duration. What was less evident also was information concerning how the pandemic has affected suppliers or whether and how the pandemic may have altered the business model in terms of the supply chain, particularly with respect to cross-border supply chains. Nevertheless, to the extent that substantially bolstered concern for worker safety and wellness and community CSR initiatives can be viewed as manifestations of the shift toward stakeholderism, our study shows a significant portion of the high yield issuers in our sample are headed in that direction despite the inevitable choices by some most hard-hit by the pandemic to have resorted to furloughs or enacted reductions in force. Concededly, only time and circumstance will tell whether the shift toward stakeholderism will, as expected, correlate positively with longer-term financial viability. That said, we nevertheless intend to keep tracking these ESG markers in parallel with financial performance in the months and years ahead.

Sustainability Developments in the US

As we noted last month in our *Sustainability Outlook 2021*, the SEC will play a greater role under the Biden-Harris administration with respect to ESG transparency and disclosure. Although it may not result immediately in a prescriptive set of standardized ESG disclosure metrics for the reasons we outlined last month, nevertheless, actions by the SEC in the past several weeks clearly signal an open mind and receptiveness to the topic of ESG generally and ESG disclosure specifically.

The SEC announced on February 1, 2021 the appointment of Satyam Khanna as Senior Policy Advisor for Climate and ESG in the office of Acting Chair Allison Herren Lee. The new position will advise the SEC on ESG matters and advance related new initiatives across its offices and divisions. President Biden's

[2] A prescient observation: at the time of this publication, according to press reports, President Biden plans to order a broad review of supply chains for critical materials from semiconductor to pharmaceuticals and rare earth minerals, in an effort to spur domestic production and strengthen ties with allies.

nomination of Gary Gensler as SEC Chair has not yet been confirmed by the US Senate but it is widely expected that, when confirmed, Mr. Gensler will be supportive of ESG-related rulemaking. The appointment of the new ESG advisor and President Biden's recent executive orders prioritizing climate action bodes well for progress in this area after years of lagging Europe in promoting greater ESG disclosure among publicly listed companies and investment funds. Given these developments, we expect some form of SEC rulemaking with respect to ESG to emerge in coming months, although the SEC's final decision on the NASDAQ proposed rule change (which we highlighted in our *Sustainability Outlook 2021* last month) to adopt listing requirements related to board diversity[3] may be a hint of how far the agency may be willing to go.

The absence of US regulators in promoting sustainability reporting frameworks has encouraged a number of entities to promote their own reporting frameworks. The SASB (in which SKY Harbor is a SASB Alliance member), the TCFD (of which SKY Harbor is a signatory), GRI and CDP are just a few examples in an increasingly crowded field. Joining the group is the World Economic Forum, which on February 1, 2021 announced that 61 companies signed the organization's "Stakeholder Capitalism Metrics," a set of ESG metrics and disclosures that measure long-term enterprise value creation for corporate stakeholders. The metrics are intended to serve as universal comparable disclosures regardless of industry or region. While yet another reporting framework will find traction remains to be seen, the appetite for a universally accepted disclosure framework appears unabated among companies and investors alike. And the moniker of "Stakeholder Capitalism" echoes the aforementioned ECGI Working Paper's prediction that the shift away from shareholder primacy in favor of stakeholderism and public policy issues will continue to gain momentum.

Au courant à Europe

Less than two weeks remain before March 10, 2021, when the principal-based obligations of Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial sector (the "SFDR") become effective.

SKY Harbor Global Funds complies with Article 8 of the SFDR

In response to investor inquiries, we are pleased to confirm our view that SKY Harbor Global Funds and all its sub-funds (collectively the "Fund") comply with Article 8 under the SDFR, and accordingly we intend for the Fund to comply with all applicable provisions of the SFDR. For SDFR-compliant sustainability-related disclosures, please see the Prospectus and SKY Harbor Global Funds *Sustainability Policies and Procedures* currently available on the Fund's website at: www.skyharborglobalfunds.com. An Article 8 financial product is one that "promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices," and complies with applicable disclosure obligations under the SDFR. Please contact your SKY Harbor representative with any questions.

[3] See Federal Register Vol. 85 No. 239, 80472, December 11, 2020 (*inter alia* proposed Rule 5605(f) would require Nasdaq-listed companies, subject to certain exceptions, (A) to have at least one director who self-identifies as a female, and (B) to have at least one director who self-identifies as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, two or more races or ethnicities, or as LGBTQ+, or (C) to explain why the company does not have at least two directors on its board who self-identify in the above listed categories). The proposed rule changes require the SEC's approval.

ESAs issue a slimmed-down revised RTS

In a related development, on February 4, 2021 the three European Supervisory Authorities ("ESAs") issued the final report to the European Commission, which included the draft (Level 2) Regulatory Technical Standards ("RTS") that promulgates further regulation on the content, methodologies and presentation of disclosures under the SFDR. Readers may recall that the RTS, which were originally intended to become effective this year, were postponed last fall because of significant feedback from stakeholders, particularly concerning disclosure of principal adverse impacts ("PAI"). Notably, the revised RTS is not scheduled to become effective on the date the SFDR becomes effective on March 10, 2021. The proposed effective date for financial market participants to comply with the detailed provisions of the revised RTS is January 1, 2022.

Generally, the revised RTS is streamlined and abandons some of the more burdensome aspects of the original draft. For instance, the revised version has significantly cut the number of PAI indicators from 32 mandatory indicators (plus 18 additional optional indicators) to 14 indicators. The revised RTS also requires at least one additional PAI indicator on a climate or other environmental related sustainability factor and at least one additional PAI indicator related to social, employee, human rights, anti-corruption or anti-bribery sustainability factor.[4] Participants and supporters of the UN Global Compact (in which SKY Harbor Capital is a signatory) will of course recognize that the additional PAI indicators are part and parcel of the Compact's Ten Principles.

ESMA calls for regulating ESG ratings and assessment tools

The growth of the ESG ratings industry has attracted regulators' attention. On January 29, 2021 the European Securities and Markets Authority ("ESMA") called for greater regulation and expressed its view that the unregulated growth in demand for products purported to rate and assess ESG poses increased risk of "greenwashing, capital misallocation and products mis-selling." Among its proposals, ESMA believes there "should be a common definition of ESG ratings that cover the broad spectrum of possible assessments currently on offer."

Regulators naturally want to regulate, but the complexity of ESG ratings and the myriad of providers and methodologies suggests this will be no easy task. Without delving into the merits of such proposed regulation at this time, we highly recommend to our readers with a professional interest in ESG ratings a paper by Florian Berg, Julian F. Koelbel and Roberto Rigobon entitled *Aggregate Confusion: The Divergence of ESG Ratings*, May 17, 2020, MIT Sloan School Working Paper 5822-19, an electronic copy available at: https://ssrn.com/abstract=3438533.

Questions or comments are welcome.

Gordon Eng

geng@skyhcm.com

[4] For additional details, see: www.esma.europa.eu/press-news/esma-news/three-european-supervisory-authorities-publish-final-report-and-draft-rts.

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This document contains forward-looking statements that are based on SKY Harbor's current views and assumptions. Forward-looking statements such as the findings of our analytical research, our outlook for interest rates, central bank policy, the economy, high yield markets and the like, illustrations of ESG integration in our fundamental credit analysis, or our intended adjustments to the portfolios within our strategies are all subject to inherent risks, biases and uncertainties that are beyond SKY Harbor's control and may cause actual results to differ materially from the expectations expressed herein.

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Gross performance results herein do not reflect the deduction of investment management 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. These calculations do not include custodial fees or transaction costs. SKY Harbor's asset-based fees are generally billed monthly or quarterly in arrears. Please refer to 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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For more information, contact SKY Harbor Capital Management, LLC at +1 203 769 8800 or email info@skyhcm.com