SKY HARBOR
CAPITAL MANAGEMENT

Period ending March 24, 2020

Performance (%)	1 Week	MTD	YTD
SHGF-USHY USD A Cap (net)	-7.35	-15.27	-16.31
ICE BofA US HY Index	-7.62	-18.47	-19.73
Alpha	*0.26*	*3.20*	*3.42*

Key Characteristics	YTW	MTD Δ	YTD Δ	DTW	MTD Δ	YTD Δ	OAS	MTD Δ	YTD Δ
SHGF-USHY	10.09	3.98	5.22	4.55	1.05	2.20	947	458	642
ICE BofA US HY Index	11.18	4.99	5.81	4.36	0.90	1.42	1059	556	700

Performance Commentary MTD

Talk of a bipartisan stimulus package and more details around Fed support took the market higher, with ETF buying leading the way. Our Broad HY Fund lagged the market while Short Duration generally had strong market capture. On the BHYM side, a number of our larger positions are not subject to ETF-induced pricing volatility and were unchanged or even marked down on no trading. For the Broad HY Fund, we sold down our weights in two up-in-quality names where valuations were less supportive and worked to reduce modestly our exposure to a travel-related issuer that has significant challenges should the shutdown continue beyond Q2. We were active buyers, however, and added to holdings across the board with a low dollar price of 69.5 and a high of 96.3. Our target purchases were in one case add back of higher-quality risk that we had sold early on at higher prices, the bonds of several large HY market issuers that we are under-exposed to, and add-ons to low dollar price bonds that were selling-pressure pushed to levels that we believe to be fair value despite operating headwinds.

Prior Commentary (Note we eliminated the prior week of daily commentary. Please refer to prior versions for daily recap since the inception of this report.)

Trading operating models across the Street continue to slow trading down although should start to improve as policies and procedures are streamlined. We also have increasingly found liquidity using electronic exchange MarketAxess – a trend that was in place prior to this period of extreme volatility. The failure of Congress to pass a stimulus package and the skyrocketing coronavirus cases in the NYC tri-state area weighed on the market. We raised a small amount of cash in the Broad HY fund to provide for opportunistic buying of more beaten-down parts of the market. Our three sale candidates were up-in-quality positions that the market has assumed to have limited direct COVID-19 negative impact (or some benefit, in fact), leaving yields valuations less attractive given the overall market pricing.

Friday market activity reflected the reality of full remote trading across most desks and exhaustion after a week of historic volatility. There was also limited interest in adding risk before a weekend with US case numbers likely to skyrocket and the upcoming political debate around the details of fiscal stimulus likely to not lack drama. We sold one higher-rated position with exposure to middle market lending and leasing despite their sufficient funding sources as we believe this risk can continue to reprice lower. Risk that we would add to at present is generally up-in-quality with either exposure to stabilizing China economic activity or limited direct exposure to the ramifications of the shutdown.

The Fund was generally biased towards those companies that we believed would benefit from a strong US economy with a focus on more domestic business tied to US consumers and a bias away from exposure to weak global commodity markets going into this downturn. That being said, we had remained disciplined with respect to valuation and had reduced exposure to the part of the market that was trading at very tight spreads as investors crowded into those sectors such as leisure, gaming and hospitality. We continued to take risk in the tech sector and elsewhere where we thought companies were positioned to benefit from recent acquisitions and a focus on de-leveraging.

SHGF-USHY: Sector

MTD	Average Weight (%)	Total Return (%)	Contribution to Return (%)
Transportation	2.6	-4.40	-0.11
Technology	10.0	-11.49	-1.15
Telecommunications	3.7	-13.05	-0.50
Energy	0.6	-52.58	-0.32
Automotive	3.1	-24.25	-0.73
Services	11.2	-20.88	-2.35

Index: Sector

MTD	Average Weight (%)	Total Return (%)	Contribution to Return (%)
Utility	2.6	-10.64	-0.27
Technology	5.3	-11.98	-0.63
Consumer Goods	5.4	-13.08	-0.72
Energy	10.1	-38.84	-4.25
Leisure	5.0	-25.35	-1.30
Real Estate	1.7	-19.24	-0.34

Our overweight and solid credit picking in Technology has been a notable source of relative performance, offset by our overweight and weaker credit selection in Automotive. Our automotive-related holdings are where we believe "self-help" measures associated with synergies from recent M&A and asset sales are supportive of continued exposure. Within Transportation we own no direct airline exposure with our weight being largely related to a marine infrastructure service provider that we believe is unimpaired by the current shutdown of economic activity. While our Energy holdings have been aggressively repriced, our weight is residual and is spread across four issuers, two of which are biased towards natural gas and the remaining two have near-term liquidity.

SHGF-USHY: Rating

MTD	Average Weight (%)	Total Return (%)	Contribution to Return (%)
BBB	0.6	-9.75	-0.05
BB	22.0	-14.02	-3.24
B	51.5	-16.54	-8.44
CCC	19.0	-17.90	-3.40
Non Rated	1.2	-17.61	-0.23
Cash	5.7	0.03	0.00
FactSet Return	**100.0**	**-15.36**	**-15.36**

Index: Rating

MTD	Average Weight (%)	Total Return (%)	Contribution to Return (%)
BBB	0.0	0.00	0.00
BB	51.8	-16.31	-8.41
B	37.1	-19.33	-7.19
CCC	11.1	-24.94	-2.86
Total Return	**100.0**	**-18.46**	**-18.46**

Performance in the market across ratings has remained well-ordered. The Fund continues to outperform across all ratings categories. Our purchases MTD were originally biased towards up-in-quality and is now shifting to more opportunistic purchases of higher-yielding bonds of issuers that we have stress-tested liquidity for weak near-term operating results and any longer-term consequences of the contagion. We are assessing opportunities in the IG market given the potential for QE and the generally greater liquidity of larger investment grade rated issuers.

SHGF-USHY: Risk

MTD	Average Weight (%)	Total Return (%)	Contribution to Return (%)
More Speculative (ex-energy)	8.8	-18.55	-1.63
Speculative Energy	0.4	-42.73	-0.16
Intermediate Risk	14.2	-26.39	-3.74
Interest Rate Sensitive	30.6	-16.59	-5.08
Short Duration	39.4	-11.67	-4.60
Cash	5.7	0.03	0.00
New Issue & Exchanged	0.9	-12.43	-0.15
FactSet Return	**100.0**	**-15.36**	**-15.36**

Index: Risk

MTD	Average Weight (%)	Total Return (%)	Contribution to Return (%)
More Speculative (ex-energy)	10.4	-24.26	-2.53
Speculative Energy	4.0	-52.36	-2.12
Intermediate Risk	6.7	-26.15	-1.76
Interest Rate Sensitive	42.3	-17.36	-7.34
Short Duration	36.5	-12.91	-4.72
Total Return	**100.00**	**-18.46**	**-18.46**

Market returns continue to be less well-ordered, using our Custom Market Risk Segmentation framework, although short duration continues to outperform the overall market as is typical for periods of market volatility and stress. ETF selling of on-the-run market risk has been a drag on mid-tier credit. As the market has repriced, the Fund's risk positioning has moved from its pre-volatility overweight to short duration and underweight to more speculative risk with highly limited speculative energy risk to an underweight to SDHY and more rate sensitive, longer duration higher-quality risk and an overweight to credit-sensitive, higher-yielding opportunities. At current levels, we are willing to add to our key higher-yielding holdings and are, in fact, willing to sell up-in-quality to buy higher yielding opportunities.

Forward Outlook

The portfolio continues to weather market volatility with less negative performance for significant outperformance YTD. We do think that current positioning suggests good potential 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 the 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.

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