

Monthly Commentary

Market

The Fed's hawkish commentary reversed out the risk on sentiment that had moved risk assets higher early in the month. Chairman Powell's clear and convincing Jackson Hole speech led to better alignment between market expectations and the path of the Fed Funds rate as outlined in the June 2022 FOMC Survey of Economic Projections-higher for longer. Oil prices continued to come down in August, with WTI Crude closing down \$9.07/bbl (9.20%) to \$89.55/bbl. The US dollar was up 2.64% on the month, and US Treasury curve flattened slightly with the 2-yr Treasury increasing to 3.50 and the 10-yr Treasury yield increasing to 3.20%.

High Yield market technicals were a tailwind in August with funds seeing inflows along with negative net supply for the month. High Yield mutual funds/ETFs saw inflows of \$335mm, while loan funds experienced outflows of \$2.5bn, as tracked by Lipper and reported by Barclays. High yield new issuance remained low in August at \$8.1bn, as tracked by Barclays, with \$10.1bn in bonds were redeemed or upgraded, leaving net supply at -\$2.0bn for the month. The percentage of the market trading at distressed levels (below 70% of par) ended the month at 4.8%; the comparable figure for the loan market (below 80% of par) was 3.9% at month end, per JP Morgan. The par-weighted twelve-month high yield bond default rate increased to 1.17% at month-end, per BofA Merrill Lynch, and the loan market par-weighted trailing default rate ended August at 1.36%, per JP Morgan.

The ICE BofA US High Yield Index returned -2.40% in August while the Credit Suisse Leveraged Loan Index returned 1.53%. The yield-to-worst (YTW) for high yield was higher at 8.40% and spreads increased 24 bps to 500. By rating, the BB, B and CCC bond sub-indices returned -3.00%, -2.34% and 0.31%, respectively. Returns were negative across all sectors for the month with Energy the top performer, returning -0.91%, while Healthcare was the bottom performer, posting -4.84%. Across risk types (defined by duration and yield to worst), the more speculative securities and outperformed the better quality, most rate sensitive part of the market. US High yield underperformed investment grade corporate bonds, represented by the ICE BofA US Corporate Index's -2.18% return, but outperformed large cap equities, represented by the S&P 500's -4.24% return, and small cap equities, represented by the Russell 2000's -2.66% return.

Strategy

SKY Harbor Global Funds US Short Duration Sustainable High Yield Fund posted a negative return in August but outperformed the broader US high yield market return (as measured by the ICE BofA US High Yield index). By risk type, the most defensive securities (maturing within 3 years) and the more speculative securities (yielding >9%) outperformed longer duration securities (within the context of short duration). By sector, Basic Industry led with modestly positive total returns for the month while Media and Healthcare lagged. By rating, Single-Bs continue to outperform Double-Bs and Triple-Cs.

The YTW on the Fund rose 48 bps to 7.78% and captured 93% of the broader US high yield market yield at month-end. The duration-to-worst increased slightly to 2.8 and was 63% of the broad market duration. The average coupon came down slightly to 6.25% but was still 53 bps above the average coupon in the broad market. Exclusive of cash, Fund holdings (189 issues, representing 155 issuers) comprised 38% bonds with maturities of less than three years and 62% in longer maturities but trading to expected early take-outs inside this three-year period. Overall credit quality continues to increase modestly in the Fund: at month-end double-B rated holdings represented 43.7% of the portfolio, Single-Bs were 47.2% and Triple-Cs were 5.4%.

Investment Objective

ESG socially responsible active investment strategy seeking to generate a high level of current income with lower volatility by diversified investments in US dollar-denominated high yield corporate bonds expected to mature, be called or otherwise be redeemed within three years.

Benchmark

Active strategy not managed in reference to a benchmark index.

Portfolio Management Group

Anne C. Yobage, CFA
David Kinsley, CFA
Ryan Carrington, CFA

Fund Detail

Fund Inception	Apr 05, 2012
Fund AUM	\$2,153.3 mn
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/usshortdurationsustainablehighyield.shtml>

Outlook

While Chairman Powell's speech at Jackson Hole had the effect of realigning the market's expectation of higher rates for longer, it did not materially change SKY Harbor's expectations for the path of rates over the next twelve months. Over the near term, we see limited risk of recession. Exceptions would be geopolitical induced shocks like a China-Taiwan conflict, further significant China Covid lockdowns, an extreme winter season in Europe combined with energy shortages and more aggressive behavior from Russia, forcing a larger conflict. In the intermediate term, we believe that inflation will continue to recede but prove sticky at the 4-5% level if labor markets remain tight. At that point, the Fed would need to either accept higher inflation for some period of time while acknowledging the longer term 2% path or reset expectations for further rate hikes. With additional rate pressure, business expansion and related hiring would likely flounder – tipping the economy into a recession by 2024 but creating labor market slack and eventually a lower rate of overall inflation.

Good, not great second quarter earnings also did not impact our forward view of corporate profitability over the next 6 months. We continue to believe that consumer focused industries, particularly retail, will remain under pressure as companies work through excess inventory. We expect current trends in consumer spending will deepen as the cost of heating for the winter season further pressures discretionary spending. The sectors where pricing power remains are also likely to ultimately be forced to roll back prices, although the negative impact on margins may be less severe if costs have been adequately managed. We expect some sectors to remain resilient, like those that are tied to government funded programs, such as semiconductor chip manufacturing on-shoring, EV battery production, and infrastructure build-out. Our focus is less on sector and industry-based risk taking and more on identifying those companies that have demonstrated solid execution in the face of what is now well-known headwinds and who have positioned their business for market share gains in a more constrained economy.

We still see the market spread of 500 bps as tight to fair value although are willing to adjust our recessionary spread target lower for a market that is higher in quality with more secured debt issuance and a lower average dollar price. Our probability-weighted scenario analysis moves from 630 to 600 when adjusted for "what's different" about today's high yield market although we acknowledge that projecting fair value spreads is an inexact science given the dynamic nature of the component of credit spreads that is not directly attributable to default risk.

We are biased towards up in quality but also mindful that when there is broad-based sentiment to "stay up in quality" that lower rated credit valuations become attractive even when discounted for economic and market headwinds. As a result, we remain disciplined credit pickers – opportunistic across the full investment universe and believe that the broad portfolio repositioning we did in the second quarter positions our portfolios for attractive risk-adjusted returns over the next twelve months.

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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www.skyharborglobalfunds.com

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