YORKTOWN FUNDS
Multi-Sector Bond Overview

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Macro Update

May picked up where April left off with asset prices continuing to rally. Fixed income, equities (value more than growth), real estate and commodities were all well bid into the economic re-opening, which featured the United States reaching a 50% vaccination rate. Markets were mostly unfazed in the face of the usual monthly blips, which for May included a disappointing jobs report, a regional gas shortage from the Colonial Pipeline hack and shutdown, and large corrections in cryptocurrency prices.

The biggest questions for market participants continue to center around the trajectories of U.S. growth and inflation. Debate is ongoing as to whether the Federal Reserve may need to act earlier than anticipated to combat potential economic overheating. Commodity prices and material costs have soared, creating resource competition and scarcity in several areas of the economy. However, the Fed has maintained that inflation is not a credible threat at this point and the aforementioned higher costs are temporary, due to supply chain issues, shortages, and pent up industrial and consumer demand as we emerge from a pandemic. Mid-month, the Consumer Price Index (CPI) data release showed a reading of 4.2% (beating expectations by 0.6%) which is the highest point since before the financial crisis. While the Fed's inflation target is 2%, the central bank does not believe the recent data to be a warning sign for a persistent or longer-term change. The surprisingly weak non-farm payrolls report on May 7th was taken as a potential sign the Fed would stay accommodative, yet various hints (coming both before and after the jobs report) have highlighted the possibility of the Fed addressing a tapering of its monthly asset purchases, including mention in the minutes from its last meeting. There does seem to be a variance of opinion on the necessity and timing of potential Fed action among the central bank members themselves, creating natural uncertainty. In the meantime, congress continues to work on infrastructure and transportation bills, and the markets don't seem to have a solid feel yet for sizes and impacts, and whether reconciliation will be implemented for passage.

Stocks advanced worldwide as the only highly prominent index to experience a month-over-month decline was the NASDAQ (-1.5%). The Dow Jones was up 1.9% and the S&P was better by 0.5%. Asian markets were robust, led by the Shanghai Composite (+4.4%), with the Nikkei up 1.1% and Hong Kong's Hang Seng Index at +1.3%. In Europe, the STOXX 600 Index improved by 2.6% and the German DAX and French CAC were higher by 2.5% and 3.4%, respectively. The VIX, measuring U.S. equity volatility, declined slightly from 19 to 17, reaching its lowest point in over a year.

U.S. Treasury yields moved a few basis points lower across the curve. The 10-year ended May at 1.59%, rallying by 3 basis points (bps). The top UST performer was the 5-year note which finished 5 bps lower, at 80 bps. The 2s-10s portion of the curve bull flattened 3 bps while the 5s-30s curvature finished 3 bps higher into a bull steepening as the 30Y rallied just 1 bp and underperformed the belly. Additionally, AAA agency debt and Mortgage-Backed Securities (MBS) (having either a government guarantee or an implied guarantee) finally widened out a bit after a year-long rally. The MOVE Index, representing UST volatility, declined from 58 to 52, having quieted a bit after exhibiting higher volatility in February and March.

In U.S. corporate credit, the IG index moved tighter from 88 to 84 bps. AAA through BBB spreads were all better by 3-5 bps and the BBB spread index finished at 104 bps. On the other hand, high yield was mixed this month, with the overall index wider from 291 to 296 bps while energy finished tighter (from 438 to 435 bps). BBs were out by 12 bps to 226 bps, while Bs were nearly unchanged at 321 bps, and CCCs improved by 8 bps to 493 bps.

In commodities and alternatives, oil moved higher by 4.3% to $66 per barrel. Gold, as a possible inflation hedge, performed well, improving 7.6% and ending the month at $1,903 per ounce. Bitcoin fell by more than $21,000, for a move of -38%, to finish at $35,218.

Yorktown Funds Fixed Income Focus – Money Market Funds

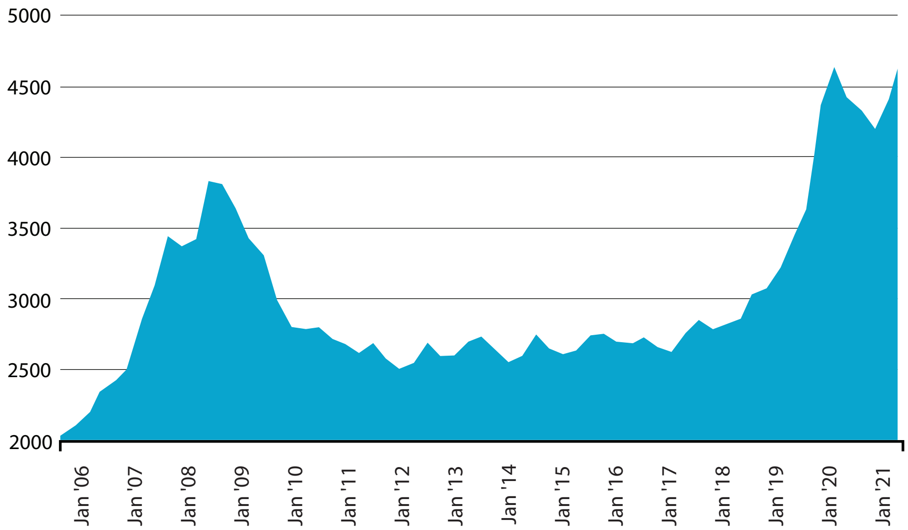
"Water, water, everywhere,
And all the boards did shrink;
Water, water, everywhere,
Nor any drop to drink."
— Samuel Taylor Coleridge

Sometimes too much of a good thing becomes uncomfortable. When you are a kid, it never dawns on you that you can eat too much ice cream; then you do, and your stomach hurts. For investment management firms, the capturing of assets to manage is obviously important, yet sometimes even that too can be uncomfortable. Over the past year, there have been countless stories of private equity firms raising large amounts of money to take advantage of what they were sure was going to be an opportunity to buy distressed assets at heavy discounts after the fallout from the pandemic. Recently, there have been follow-up stories about the billions raised sitting idly because there just aren't enough assets to invest in. Thus, there is a great deal of money available to invest with no discernable targets to be found. One might see this issue as one which only afflicts the exotic, off-the-run, darker parts of the capital markets. Yet this same situation has developed not in the more exotic world of private equity, but rather in the more staid, conservative part of the fixed income market: money market funds.

Money market funds are largely considered the conservative places to park cash, especially during turbulent times. There is a perception of safety and liquidity, albeit with no real return. While there might be some truth to that when considering government money market funds, we have seen that may not be so true when considering those listed as prime money market funds, or the credit sector within the money market funds space. With portfolios concentrated in illiquid securities such as CDs and commercial paper, there is always the risk of large redemptions during stressful times causing havoc with their Net Asset Value (NAV). Indeed, as most market participants can recall in 2008, the Fed launched numerous programs to combat the financial crisis, with a few meant to safeguard money market funds. Chief amongst those was the Money Market Mutual Fund Liquidity Facility, which was meant to help money market funds weather large redemptions on the funds. Post financial crisis, the Fed and the SEC moved to implement more rules and guidelines to help insulate the sector from that happening again. As we saw during the pandemic, there's still some work to do, made evident when the Fed re-established the liquidity facility.

Nevertheless, similar to what we witnessed during the rockiest of times (the Great Financial Crisis and the Covid-19 pandemic), large flows of cash have made their way into money market funds. While there are most likely more than a few reasons, some of the more obvious are: 1) a perceived flight away from more risky investments out of fear; 2) a flow of cash into advisors who park it in the money market funds simply as a placeholder to be allocated later to more opportunistic and higher yielding investment ideas; 3) corporate treasuries who rushed to drawdown on credit facilities at the beginning of the pandemic and then have hit the new issue fixed income market to take advantage of demand and now find they have a great deal of extra cash; 4) in the sign of the times, pandemic federal relief monies sent to municipalities who will later need those funds for budgetary expenditures. Regardless of the reasons, one thing is for sure, there is a historic level of cash sitting in money market funds. This comes with several problems for the investment managers in that space.

Money Market Fund Assets

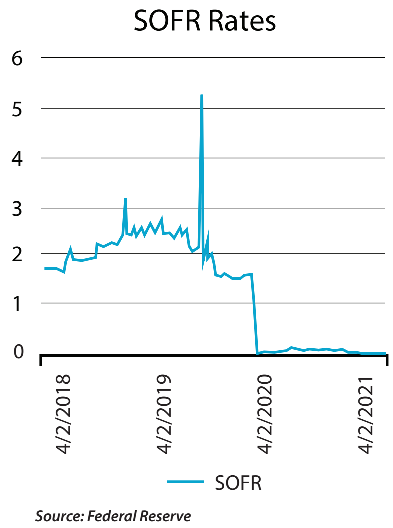


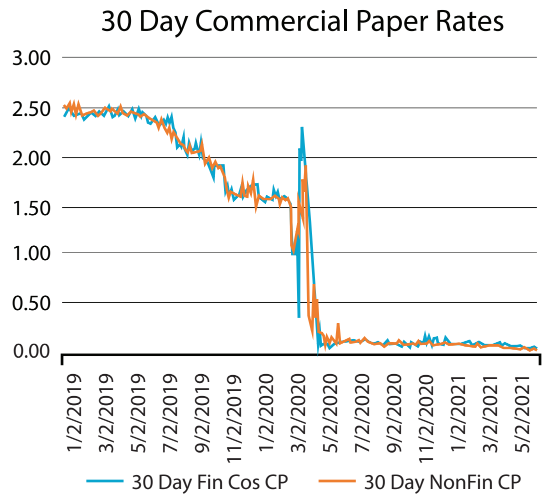
Source: Federal Reserve

One of the more obvious issues for those managing money market funds suddenly buried in large amounts of cash is, "what can I invest in?". It would seem to be a simple enough question, and what surely should be a simple answer; but it isn't. Similar to most sectors, there seems to be plenty of demand but that demand is finding that there is a limited supply of product. Furthermore, there is a concern that the inflow could become an outflow pretty fast. A staple for money market funds is typically commercial paper (CP). Money market funds, despite their focus on liquid instruments, tend to invest a great deal in illiquid investments such as CDs and CP. In fact, CP generally comprises around 30% - 35% of a typical prime money market fund portfolio.

As can be seen below, CP issuance seems up. In fact, CP has reached new levels of issuance of late, after plummeting during the initial months of the pandemic when that part of the capital markets came to a grinding halt. Yet while issuance seems robust (representing a solid recovery for that instrument), it is not nearly enough to match the total assets money market funds are now dealing with. In January 2018, total money market funds assets were reported around $2.8 trillion, and outstanding CP was $1.13 trillion. Today, total money market fund assets are reported to be $4.6 trillion, a nearly $2.0 trillion amount of growth in assets, but CP outstandings are only up around $100 billion. So, the pace of outstandings (even at high water marks) is severely under where the pace of total assets growth is.

Another issue for investment managers of money market funds is yield, or lack thereof; there is simply no yield to be found. Similar to what we witnessed in the Great Recession, with rates this low, money market funds must cut fees simply to "gift" a few bps returns to their shareholders. In essence, every dollar brought in sitting in money market funds becomes more and more expensive for the manager to hold. There doesn't seem to be a great deal of relief in sight. As can be seen in the charts below, rates are at or near historic lows. As of the end of May 2021, the Secured Overnight Financing Rate (SOFR) was reported at 1 bps, which means overnight repo (another favorite for money market funds as an investment type for excess cash) was generating 1 bps of return. Overnight CP for tier 1 names was also around 1 bps. If one wants to be adventurous and take unsecured risk in CP out to 30 days, your reward is around 2 bps in the tier 1 names the rules that govern money market funds demand they limit their risk to.



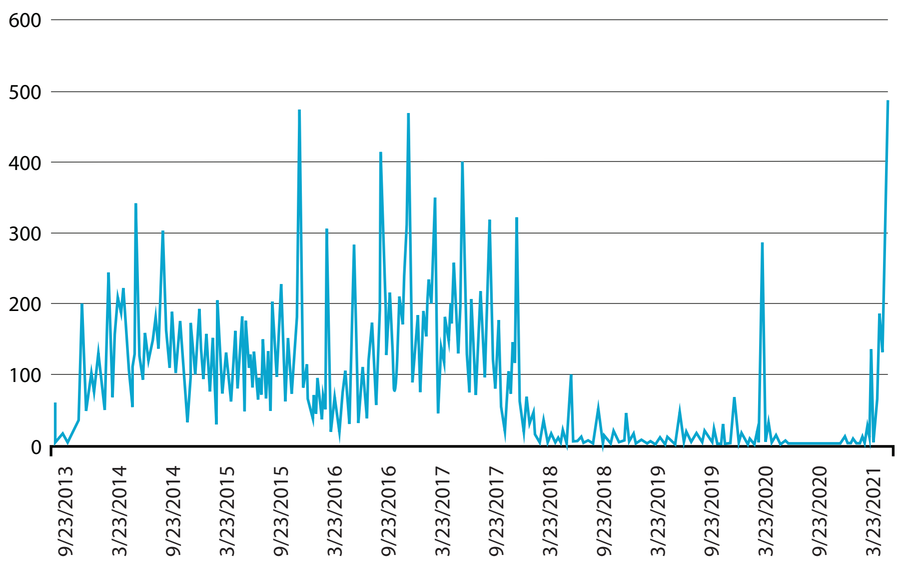


A knee-jerk reaction for investment managers faced with this conundrum would be to go out longer and longer maturity-wise, and perhaps reach for credit just to pick up some yield. Even that is an issue for money market funds. As mentioned above, they are limited by governing rules as to how much credit risk they can take, and maybe more importantly, how far out they can go to take that risk. Prior to the Great Recession, money market fund portfolios were limited to weighted-average maturities of 90 days, but since that time governing rules have been modified and shortened to 60 days.

Of course, this also simply ignores the real issue with credit and maturities for money market funds, which is that there really isn't any sense for when those monies are going to be needed by their shareholders. The investment managers understand the influx in cash is temporary, but they don't know for how long. Generally, managers of these funds know what their in-flows and out-flows are meant to look like. This comes with operating these funds over time, and getting a feel for the monthly, weekly, and seasonal flows of their shareholder base. However, these are not "normal" times, given the large in-flows they were witness to since the beginning of the pandemic. As such, managers are hesitant to invest these monies too far out as there is a concern that the speed it came in will be matched by the speed it goes out. Thus, they don't want to be in the position of having to sell large amounts of securities to meet unexpected outflows. The more prudent thing from their point of view is to simply keep maturities short.

So, with a large amount of investable cash but limited supply of investable securities, no real yield available, and a fear of redemptions on the horizon, where do money market funds go? Well, apparently, the Federal Reserve Reverse Repo Facility. Created as a means to control short term interest rates, the Fed, which used to only do repo with primary dealers, opened up the reverse repo facility to utilize qualified counterparties, including money market funds. Money market funds usage of the Facility has reached historic levels. As of the end of May, the Fed reported usage of the Facility as having reached nearly $500 billion.

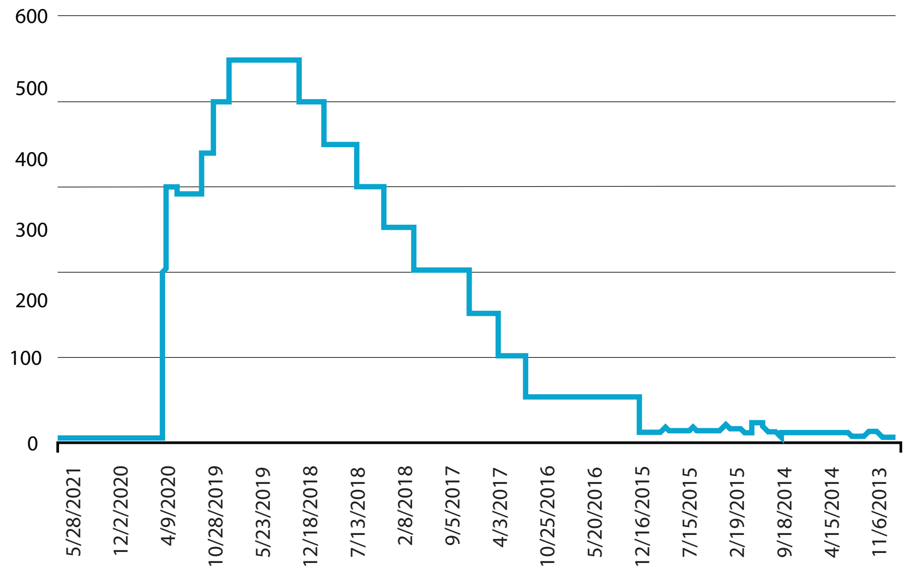
Federal Reserve Reverse Repo Facility Outstandings ($B)



Source: Federal Reserve

It would seem to be some sort of advantage to have such a Facility available to handle this glut of cash, but the rates offered actually make it quite disappointing as an investment option. Years ago, when the Facility was launched, usage by money market funds was initially sporadic, and so there was a slight premium in terms of yield offered to attract market participation. Those days are long gone, however, and today, the Fed can and does use the Facility to effectively control short term interest rates. Today, that means the Facility is currently offering 0% as a return. As such, that means money market funds find themselves with historic levels of cash to invest, and the only real option to invest in is one that is guaranteed to offer no yield whatsoever. Accepting 0% might seem a little confusing, but it stops being so when you realize that buying treasury bills or utilizing repo with dealers has recently meant getting a negative return.

Federal Reserve Reverse Repo Facility Rates (%)



Source: Federal Reserve

Money market funds are finding themselves in a tough spot. At a moment where assets under management are reaching historic levels, they are boxed in by rules that limit investment options, faced with limited supply of things they could invest in, and are finding no yield available in the things they can find. Simply put, it can be hard to justify fees when you can't generate a return.

Investors looking for an alternative for a cash option are finding opportunities in funds that can target a slightly longer duration. Given the market conditions mentioned above, the pick-up in yield found in short-term bond funds seems to be attractive option versus what is currently offered in money market funds. Certainly, this requires a great deal of work in order to keep the NAV as stable as possible, while also being vigilant about liquidity and credit. It is the dominant reason we spend so much time and effort focused on credit and rate risk, as well as diversity and liquidity. In times such as these, those efforts, we feel, provide an option to investors yearning for an alternative cash option.

Multi-Sector Bond

Credit continues to find an eager investor base, as the theme from the most recent past few months continues. New issue is met with heavy interest, and anything with yield attached to it is doubly in demand. There continues to be heavy issuance with corporations eagerly stepping forward to refinance old, more expensive debt and to issue more debt for "general corporate" purposes, which for some of the more aggressive firms can simply mean to raise cash to increase share buyback efforts. Despite the occasional rating agency saber rattling that the increased debt load could shift ratings downward, corporations are not deterred from taking advantage of low rates and historically high demand. The only thing that seems to give pause in the past few months to this playbook has been those days when rates have ticked higher. At that point, we have been witness to corporations simply delaying the issuance a few days, waiting for the storm to blow over and then flooding the market once that occurs with new issuance. There seems to be a pattern thus far where rate fears make a weekly appearance and then dissipate days after. We continue to have a constructive view on credit, expecting the economy to continue to do well with a slant toward overperformance in the next 6-months to a year. This leads to having a positive bias toward those sectors that are now just emerging from a pandemic downward pressure and ones we expect to ride the improving economy toward recovery; leading to overperformance for stronger firms within those sectors, including leisure, hotels and secured aircraft. Beyond those targeted sectors we continue to remain true to our approved issuer list and targeted firms and sectors we feel are core to our performance.

With rates still in the forefront of concerns for us, we continue to remain vigilant in our assessment of direction of the portfolio duration. As part of that, we prefer amortizing assets, such as those found in ABS, and Floating Rate Notes (FRNs). FRNs continue to provide solid value in certain credits, with newer issue in SOFR based FRNs not finding the investor interest one would expect. We do find value in certain SOFR based issuance, and also find some value in vintage FRNs that are Libor-based, keeping in mind the end line for that benchmark to be used in the financial markets. A focus on credit is expressed in our finding value in Collateralized Loan Obligations (CLOs). Similar to the last few months, CLOs continue to offer not only access to express a bias toward credit risk, but to do so in a structured format that provides mitigation to credit concerns. Furthermore, spreads in CLO paper (down to single A) continue to provide an area of overperformance in the right manager and loan type, such as broadly syndicated loans. Corporates remain heavily in demand, with opportunities best witnessed in less frequent issuers or first-time issuers. Diversification and performance benefits are available in those names. Agency MBS provides liquidity value, but remain a more neutral sector for us as we focus on very specific characteristics in order to mitigate extension risk and maintain yield bogeys. Asset Backed Securities (ABS) is a preferred sector, with a consistent focus on the liquid auto ABS sub-sector (considered a core holding), and a preference for shipping, rail and container deals where issuance continues to feed demand.

Energy has found a resurgence, especially with CCC spreads grinding in to historic tights, due to the above investor enthusiasm for higher-yielding paper, no matter what the sector. We continue to avoid the sector, given its volatility and our expectation that spreads will revert in the near term. Renewables, however, are a solid value play and we add positions in secured structures when we find top performing names. Commercial real estate has been finding more footing, but recent anecdotal evidence that vulture funds and distressed investors are adding some support to the sector provides us fodder to continue to stay away and wait for that investor base to establish a floor. Given that news we would expect some uncertainty to remain and still some tail risk. The preferred space has found a larger base of investors who despite the rate risk are finding value in the longer duration paper. We have preferreds as a neutral sector, and while we typically like the sector, we feel it is becoming overbought and new issuance coupons and yields are not reflective of the credit and rate risk (given the longer maturities).

The volatility in rates remains a daily concern, with the curve steepening almost considered a given at this point. As such, we continue to remain biased toward a shorter duration. There is some value in certain high-quality names further out on the curve, but those investments remain selective. With a shorter duration, we favor longer floating rate securities, and a targeted maturity in the range of 5 to 10 years for most high-yield credits. Our maturity focus remains within parameters of the past few months: maturities 0.5 years to 3 years in credit sensitive names and sectors. We rely on an increasing exposure to FRNs and amortizing ABS structures to help mitigate some of the duration risk as well.

Multi-Sector Bond Overview June, 2021

Download Fact Sheet

Download Holdings

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Barry D. Weiss, Portfolio Manager, is responsible for fixed income strategies at Yorktown Funds.

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John Tener, Portfolio Manager, is responsible for risk management strategies at Yorktown Funds.

You should carefully consider the investment objectives, potential risks, management fees, charges and expenses of the fund before investing.

The fund's prospectus contains this and other information about the fund and should be read carefully before investing. You may obtain a current copy of the fund's prospectus by calling 800-544-6060.

The fund itself has not been rated by an independent rating agency. Ratings (other than U.S. Treasury securities or securities issued or backed by U.S. agencies) provided by Nationally Recognized Statistical Rating Organizations (NRSRO's) including Standard & Poor's, Moody's, Fitch, Kroll, Morningstar DBRS, A.M. Best, and Egan-Jones. This breakdown is not an S&P credit rating or an opinion of S&P as to the creditworthiness of such portfolio. This breakdown is provided by Yorktown Management & Research. When calculating the credit quality breakdown, the manager selects the middle rating when three or more rating agencies rate a security. When two agencies rate a security, the higher of the two ratings is used, and one rating is used if that is all that is provided. A rating of BB and below would represent below investment-grade. Ratings apply to the credit worthiness of the issuers of the underlying securities and not the fund or its shares. Ratings may be subject to change.

Per the most current prospectus, (1) Fund total operating expense ratios are: Class A, 0.89%; Institutional Class, 0.89% until at least May 31, 2021. (2) In addition, the Adviser has entered into contractual expense limitation agreement with the Trust, effective April 1, 2020, so that the Fund's ratio of total annual operating expenses are limited to 1.54% for Class L Shares until at least May 31, 2021.

Fixed income investments are affected by a number of risks, including fluctuation in interest rates, credit risk, and prepayment risk. In general, as prevailing interest rates rise, fixed income securities prices will fall.

Past performance is no guarantee of future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. There is no guarantee that this, or any, investing strategy will succeed. Diversification does not ensure a profit or guarantee against loss.

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Definition of Terms

Basis Points (bps) - refers to a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%, or 0.0001, and is used to denote the percentage change in a financial instrument.

Curvature - A yield curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity.

Mortgage-Backed Security (MBS) - A mortgage-backed security is an investment similar to a bond that is made up of a bundle of home loans bought from the banks that issued them.

Collateralized Loan Obligation (CLO) - A collateralized loan obligation is a single security backed by a pool of debt.

Commercial Real Estate Loan (CRE) - A mortgage secured by a lien on commercial property as opposed to residential property.

CRE CLO - The underlying assets of a CRE CLO are short-term floating rate loans collateralized by transitional properties.

Asset-Backed Security (ABS) - An asset-backed security is an investment security—a bond or note—which is collateralized by a pool of assets, such as loans, leases, credit card debt, royalties, or receivables.

Option-Adjusted Spread (OAS) - The measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is then adjusted to take into account an embedded option.

Enhanced Equipment Trust Certificate (EETC) - One form of equipment trust certificate that is issued and managed through special purpose vehicles known as pass-through trusts. These special purpose vehicles (SPEs) allow borrowers to aggregate multiple equipment purchases into one debt security

Real Estate Investment Trust (REIT) - A company that owns, operates, or finances income-generating real estate. Modeled after mutual funds, REITs pool the capital of numerous investors.

London InterBank Offered Rate (LIBOR) - a benchmark interest rate at which major global banks lend to one another in the international interbank market for short-term loans.

Secured Overnight Financing Rate (SOFR) - a benchmark interest rate for dollar-denominated derivatives and loans that is replacing the London interbank offered rate (LIBOR).

Delta - the ratio that compares the change in the price of an asset, usually marketable securities, to the corresponding change in the price of its derivative.

Commercial Mortgage-Backed Security (CMBS) - fixed-income investment products that are backed by mortgages on commercial properties rather than residential real estate.

Floating-Rate Note (FRN) - a bond with a variable interest rate that allows investors to benefit from rising interest rates.

Consumer Price Index (CPI) - a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

Net Asset Value (NAV) - represents the net value of an entity and is calculated as the total value of the entity's assets minus the total value of its liabilities.

Duration Risk - the name economists give to the risk associated with the sensitivity of a bond's price to a one percent change in interest rates.