YORKTOWN FUNDS
Multi-Sector Bond Overview

May 2022

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Macro Update

It was an April rout for markets and few asset classes were spared. Monthly declines in domestic equities were among the worst in a long time as volatility rose sharply. The S&P was down 8.8% and the NASDAQ was off 13.3% (its largest monthly drop since 2008). Corporate credit spreads widened out with U.S. investment grade +19 basis points (bps) and high yield +54 bps. Spreads on agency Mortgage-Backed Securities (MBS) and benchmark debentures softened as well. The key drivers of the selloff remained the impending action of the Federal Reserve, inflation, and the war in Ukraine, as well as new worries over the impacts of emerging COVID waves in China.

The relentless selloff in Treasuries has not shown signs of abating. However, after six months of bear flattening, the yield curve moved differently in April; this time bear steepening by 22 bps. The 2Y was 38 bps higher while the 10Y sold off 60 bps. Much of this has been attributed to a recent rise in long term inflation projections, as consumer demand has entrenched itself as a significant driver of inflationary pressure, in addition to supply chain challenges. That said, many believe that sharp monthly inflation readings may be peaking. With the world hoping for a soft landing for the U.S. economy, the Fed finds itself under a microscope. Inflation is too high, and unemployment is too low due to a red-hot jobs market. The big question is, just how far behind the curve is the Fed in its tightening plans? Even with 1.50%+ worth of rate hikes being forecasted in the coming three months, supplemented by tightening from significant upcoming balance sheet reduction, investors are nervous. Noted Deutsche Bank economist Jim Reid rattled markets in late April when he stated his belief that the Fed is as far behind the curve as it's been in 40 years. Reid indicated that a 5-6% Fed Funds target range may be required to reach neutral. While this report made headlines because it is extreme compared to consensus, investors took note given the relative prominence of the author.

U.S. Credit	4/30/2022	3/31/2022	Change
IG Index OAS	1.35%	1.16%	19 bps
IG Index Yield	4.31%	3.60%	71 bps
HY Index OAS	3.79%	3.25%	54 bps
HY Index Yield	6.98%	6.01%	97 bps
HY Energy Index OAS	3.75%	3.54%	21 bps

U.S. Credit by Rating	4/30/2022	3/31/2022	Change
AAA	0.69%	0.61%	8 bps
AA	0.79%	0.68%	11 bps
A	1.12%	0.94%	18 bps
BBB	1.63%	1.42%	21 bps
BB	2.73%	2.32%	41 bps
B	4.00%	3.42%	58 bps
CCC	7.11%	6.25%	86 bps

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U.S. Yield Curve & Rates	4/30/2022	3/31/2022	Change
UST 2Y	2.71%	2.33%	38 bps
UST 10Y	2.93%	2.34%	60 bps
2s10s Slope	0.22%	0.00%	22 bps
UST 5Y	2.95%	2.46%	50 bps
UST 30Y	3.00%	2.45%	55 bps
5s30s Slope	0.04%	-0.01%	5 bps
3m LIBOR	1.33%	0.96%	37 bps
SOFR	0.28%	0.29%	-1 bps

U.S. High Quality Spread	4/30/2022	3/31/2022	Change
Agency MBS Basis	1.21%	1.09%	12 bps
FNMA 10Y Bench. Index	0.27%	0.24%	3 bps
AAA Auto ABS	0.84%	0.68%	16 bps

Equities	4/30/2022	3/31/2022	Change
S&P 500	4,132	4,503	-8.8%
Dow Jones Industrial Avg.	32,977	34,678	-4.9%
NASDAQ Composite	12,335	14,221	-13.3%
Shanghai Composite	3,047	3,252	-6.3%
Nikkei 225 (Japan)	26,848	27,821	-3.5%
Hang Seng (Hong Kong)	21,089	21,997	-4.1%
STOXX Europe 600	450	456	-1.2%
EURO STOXX 50	3,803	3,903	-2.6%
DAX (German)	14,098	14,415	-2.2%
CAC (France)	6,534	6,660	-1.9%
MSCI Emerging Markets	1,076	1,142	-5.7%

Commodities	4/30/2022	3/31/2022	Change
Oil (WTI)	$104.69	$100.28	4.4%
Gold (oz.)	$1,912	$1,949	-1.9%
Bitcoin	$38,560	$45,768	-15.7%

Volatility	4/30/2022	3/31/2022	Change
MOVE Index (Rate Vol)	128	107	20.1%
VIX Index (U.S. Equity Vol)	33	21	62.5%

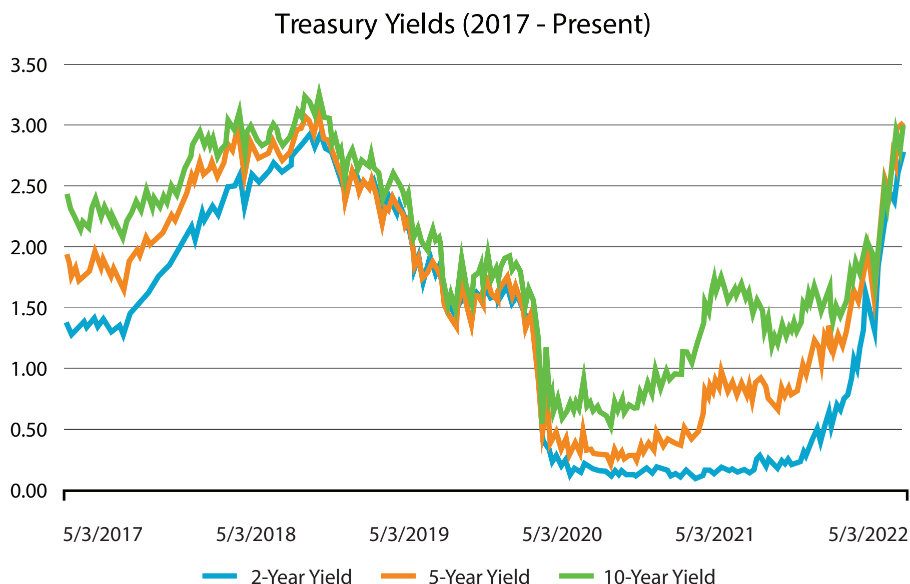
Yorktown Funds Fixed Income Focus – Forest for the Trees

"The world is full of obvious things which nobody by any chance ever observes."

-Sherlock Holmes (Sir Arthur Conan Doyle)

It's been a miserable spring so far. Maybe it's no different than most springs. We have such high hopes for spring. We are so anxious to get away from the cold of winter, and it always seems to disappoint. Anyone who has kids playing spring sports knows the disappointment and misery of spring. Standing outside in heavy coats, battling rain, sometimes snow (snow!), and doing your best to turn your body enough to at least shield your face from a breeze that refuses to go away. I find myself questioning whether spring is overvalued as a season, with its value relying entirely on being a bridge to summer, and the promise of warm weather and shorts. Is that enough? Maybe. Its value is hidden, buried in the April showers, the freak snowstorm and the cool air, showers providing a foundation for things just out of our sight. Sometimes it is hard to forget those times are right around the corner when I'm cold, wet and tired, and honestly, too overwhelmed in my misery to care. But once I step back, get in the car and warm up, it dawns on me; better times are right around the corner.

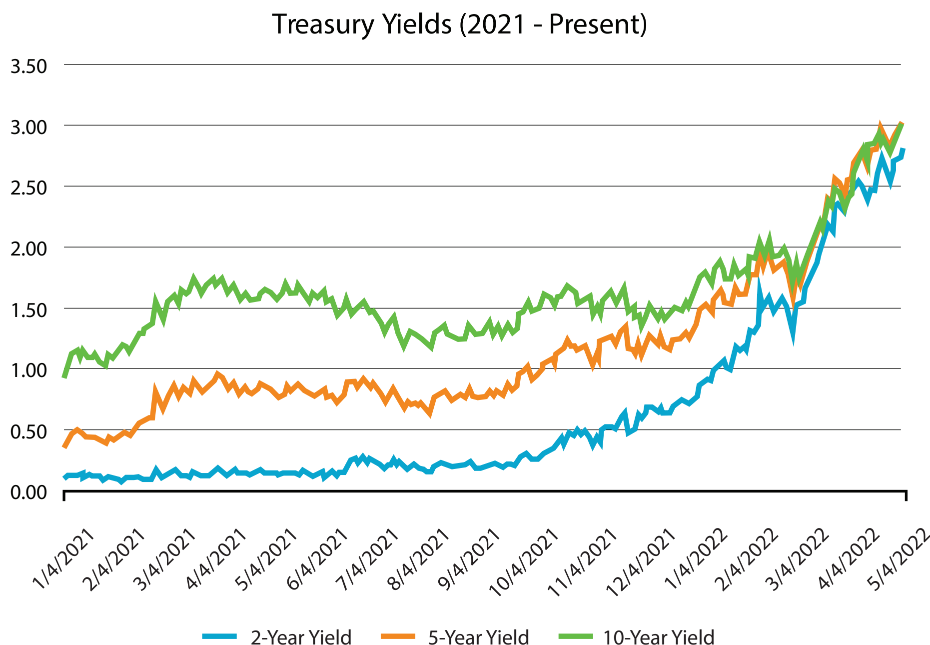
Over the past 6 months, interest rates have been at the forefront of everyone's mind, and rightfully so. The volatility, the market putting the Fed under a microscope. Is the Fed being too hawkish? Has the Fed been too slow to act? Has the market lost confidence in the Fed? The market more or less going it alone, with a daily sell-off in rates, especially punishing for the belly of the curve: the 2 year to the 5 year. All the while, the volatility and rate sell-off is playing with valuations in both fixed income and equities. And then in the next breath, we begun to consider the fact that maybe we are pushing ourselves into a recession as we aggressively raise rates, then leading to the need to cut rates…..



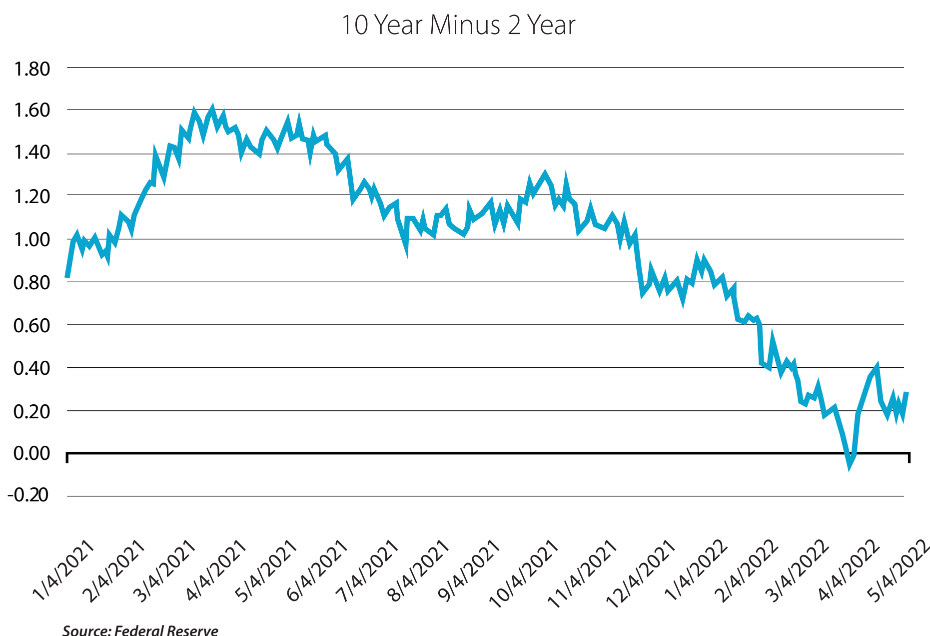
Source: Federal Reserve

It's been quite a ride, one that has mostly occurred in a relatively short burst since the end of the third quarter in 2021. In fact, since October 1st to the end of April 2022, the 2-year treasury yield has increased by 233 bps, the 5 year treasury yield has increased by 200bps and the 10 year treasury yield has increased by 150 bps. All of which has led to an inversion

not only between the 5 year and 10 year for a brief time at month's end in April 2022, but also an inversion was witnessed between the 10 and 2 year treasury sometime in the beginning of the month.



Source: Federal Reserve

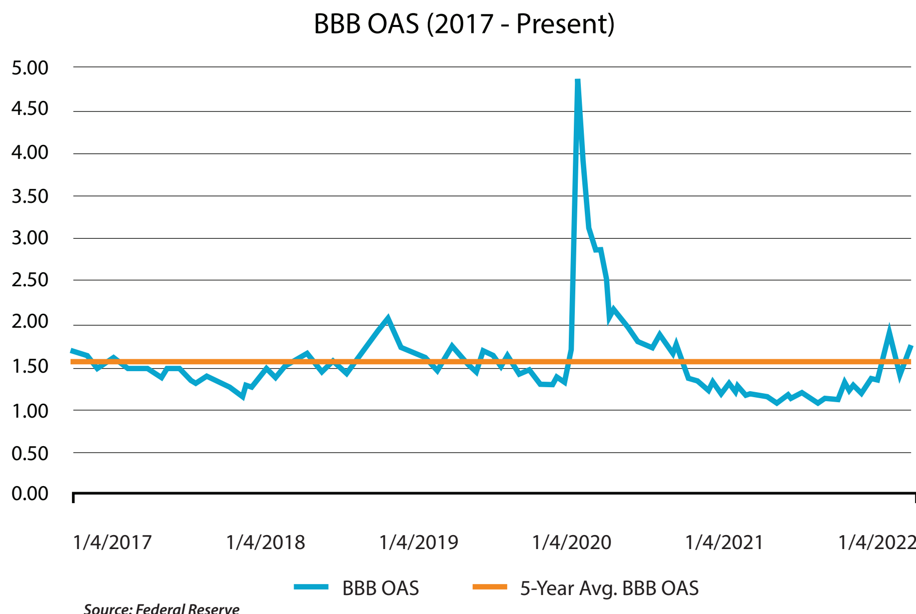


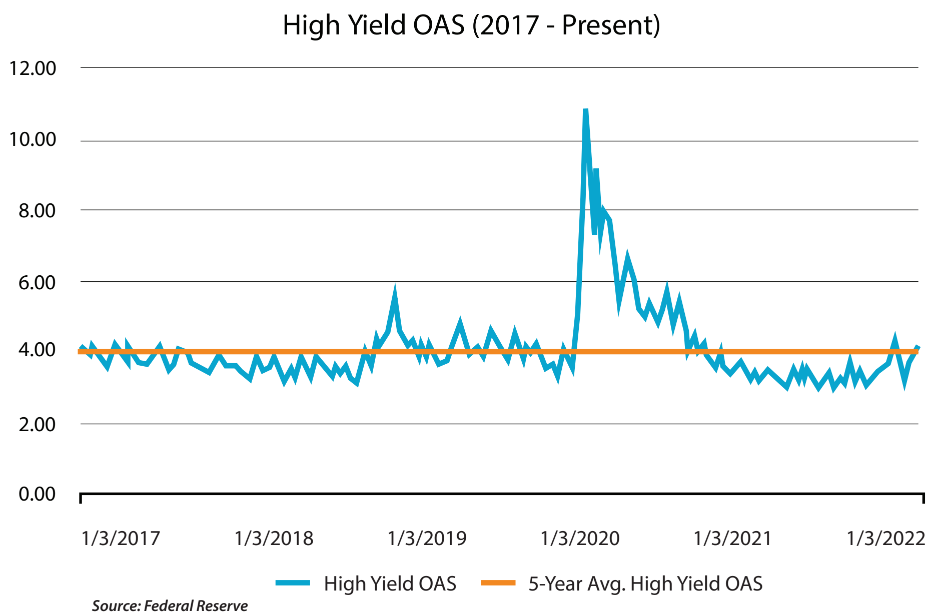
Source: Federal Reserve

The movement in rates has everyone focused on a number of things, especially on the negative impact on valuations in fixed income. But that isn't the sole reason for the negative movement in bond prices, rather it is a combination of rates and credit spread widening. An interesting shift given that one of the reasons we are seeing such a movement in rates is the red-hot job market, the expanding economy, excessive spending and inflationary pressures. Yet, corporate profits and margins in many segments are doing just fine. Thus, much like we have stated previously, at least for the current moment, credit itself is in a relatively benign moment. We aren't seeing large defaults and we don't expect

bankruptcies to spike in the near-term. The consumer themselves also seem to be in solid shape. Furthermore, we are not witnessing large scale downgrades or warnings from the credit rating agencies. Yet, credit spreads are widening.

High grade credit spreads, represented here by the BBB option adjusted spreads (OAS), ended April around 171 bps, some 54 bps wider than this same time in 2021. And the story is similar, if not weaker, in sub-investment grade land with high yield OAS reported at end of April 2022 at 397 bps, around 69 bps wider than a year prior.



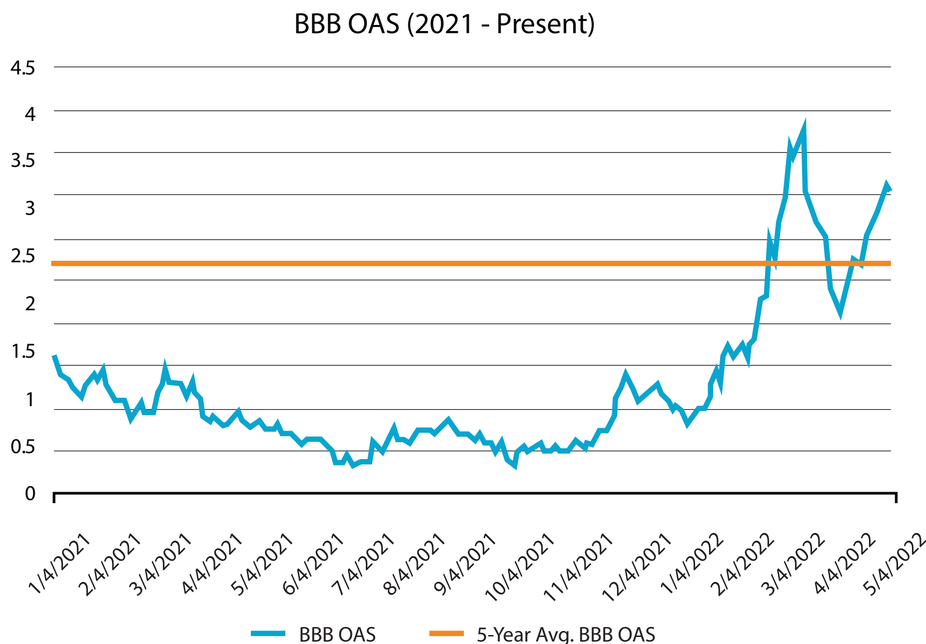


Perhaps it is more of a reversion to the mean than anything else. Certainly, that argument might be more applicable to high yield than high grade right now, but given the lack of noticeable credit pressures in the market, something else seems to be occurring. Indeed, what we feel we are seeing is more a combination of liquidity needs and resulting pressure on flows. For the first quarter of 2022, Barrons is reporting around $90 billion of

negative flows for bond funds (both mutual and ETFs), and for just the month of April, ICI has reported an additional $44 billion of total outflows for bond funds (taxable and non-taxable). These types of outflows have caused most investors to be in more a selling mode than buying. Additionally, we are seeing dealers' balance sheets pulling back. This puts a little more pressure on spreads which leads us to classify the credit spread movement we are seeing as more of an ancillary response, or more a liquidity pressure response than credit alone. Simply put, buyers are becoming more aggressive in their bids leaving sellers in a position whereby they have to be willing to widen their offers in a conciliatory manner to make the smaller amount of trades materialize. This makes sense, but as we know from experience, it also creates opportunity.

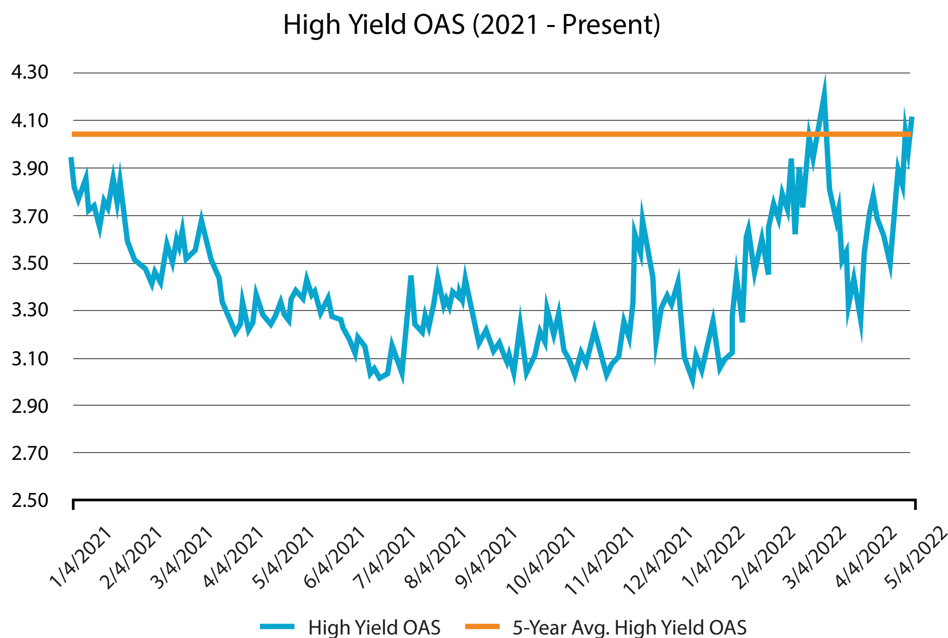
Much like most moments we have seen in the past when markets show a bit of stress, being in the position of selling liquidity is always an advantage. This opportunity isn't just a trade opportunity, but rather a moment where future outperformance can be captured across portfolios. As we consider that, most have capitulated to the idea that yields on treasuries will rise as rate pressures in the market play out. Some think opportunity can be had by aggressively attacking how many hikes will be actually accomplished, but that comes with plenty of risk and can lead one to be far offsides if your assumptions prove to be incorrect. Playing chicken with the Fed hasn't been a winning strategy in the past. Thus, we tend to prefer to keep to our mantra of staying as neutral to rates as possible. Instead, we feel far more opportunity exists by focusing on credit spreads.

As illustrated below, if one hones in on rate movement in high grade, or BBB OAS, one can see the bulk of the credit spread widening has occurred since the beginning of the year. In fact, BBB OAS has now spiked well above its 5 year average. This would lead us to conclude that by remaining true to our targeted issuers, and focusing on stronger credits, there is plenty of contracting that should occur and lead to overperformance in this area in the short to near-term. One would expect that once some normalcy returns to the markets and flows stabilize across the fixed income space, this type of contraction should happen at a fairly quick pace. As buyers swoop in to pick up value bonds and the demand drives the OAS closer to the 5 year average, perhaps we'd come closer to levels witnessed at the beginning of the year.



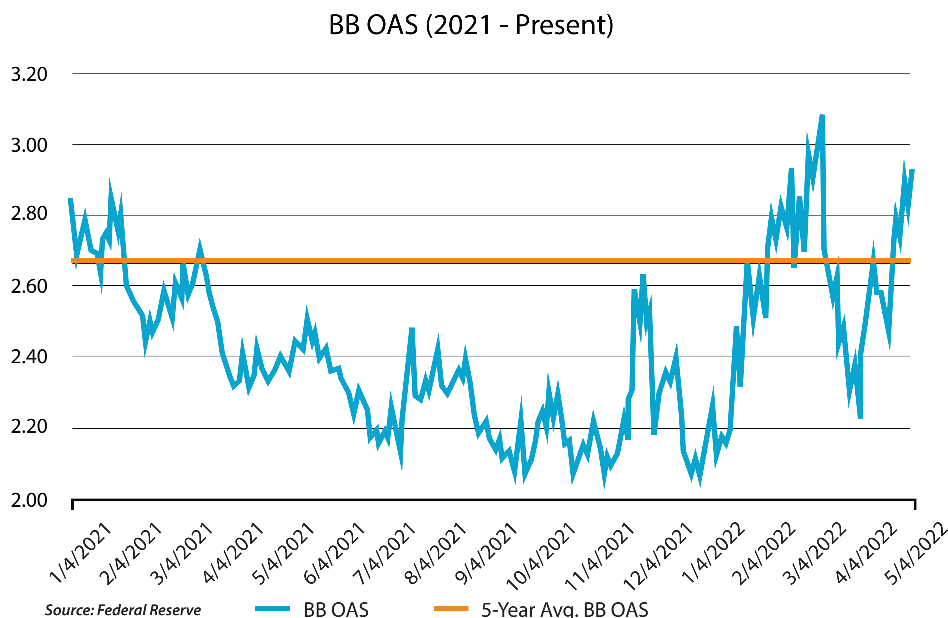
Source: Federal Reserve

In terms of high yield, it would seem at first glance a more limited opportunity for that. As one can see below, even when one focuses on the one-year movement in OAS, it would seem high yield is just now sort of settling into its 5-year average. One would then need a tightening back to previous levels that were even tighter than the 5-year average. Thus, one would surmise that the expected contraction we mention in high grade above simply isn't available in sub-investment grade credits. But that would be incorrect.



Source: Federal Reserve

High yield has several layers to it. For instance, over the past few years, sub-sector CCC credits have had an historic run in terms of tight credit spreads, hitting a low somewhere around 570 bps, but have since blown out a little over 300 bps to over 900 bps. This type of movement on one side compressed the spreads for the overall index and has since obviously pushed the average out as it widened out. Let's look at a sub-sector, the BB OAS, which was often underweighted during the past few years as investors chased yield during the low-rate environment (a contributing factor to CCCs outperforming during this period as mentioned above). What we have is a previously underweighted sub-sector of the high yield index, but the best quality within that stack. When we take a quick look at that, we indeed can see opportunity does seem to be available.



Source: Federal Reserve

As of the end of April, the BB OAS was reported at 285bps, which is wide to its 5-year average of 267bps, as illustrated above. Thus, assuming high yield overall is still widening out (mostly from the bottom up), the better end of the high yield spectrum would seem to indicate that value can be had in a similar manner as that of the high grade space. Opportunity to lock in favorable performance for the rest of the year, as such, is available for those with liquidity to take advantage of it.

Sometimes the hardest part of investing in turbulent times isn't knowing when to leave or step out of the way, but rather when to come back in. It's always easier to say no than yes in times like this. However, history and experience tell us that looking into issues such as these can lead to overperformance and value down the road. All the negative valuation movement isn't purely rate driven. Partly, liquidity pressures are also to blame, and identifying the right targets to take advantage of in terms of future credit spread tightening while everyone is so focused on rates can typically pave the road to future overperformance. Sometimes it's as simple as taking a deep breath and embracing the cold weather, because it means you'll appreciate what is coming next all the more.

Multi-Sector Bond

As we barreled toward the May 4th Fed meeting, the market expected a 50bps hike, with additional pressure building such that a full 10 hikes have been priced in for December 2022. Hawkish? We clearly have sped past that line without so much as cracking a window to let some air in. There are some market thoughts that perhaps inflation has peaked, but no direct confirmation of that just yet. As such, inflation is still foremost in the mind for the majority of the market. With that the case, there is some hope that once the May 4th meeting comes and we get a clearer picture of what to expect going forward, that the daily pressure on rates accompanied by seemingly weekly spikes will subside.

In an almost contrarian or counterintuitive manner, credit spreads continue to leak a few basis points on a daily basis (see above). Thus far, it would seem high yield is more under pressure than high grade, but high grade is not immune. Crude oil seems to have settled in at around $100 a barrel, as of the end of April 2022 and with the war in Ukraine still raging, one would expect those levels going forward. The only possible dampening to that would be the fact that China has seemed to have had a few hiccups in its financial health, as it finds itself under pressure from outbreaks of COVID, as well as negative issues in its real estate markets and banking.

The market during the month of April finally seemed to stiffen some. There continued to be a "buy the dip" mentality over the past few months helping the equity market, but that seemed to wane as April drew to a close. In fixed income, the volatility in rates and the widening credit spreads, have dampened market enthusiasm for new issue. The markets continue to operate, and new deals are getting done, but the days of deals seeing heavy oversubscription have stopped for the time being. Indeed, the new high yield Carvana deal had notable difficulty garnering enough interest, resulting in large concessions in terms of price and yield taking place and the need for private equity to come in and save the deal. Those are obviously important data points for current market conditions on the primary side. On the secondary side, there appears to be sufficient liquidity, but bids can find a less attractive audience under wrong names and circumstances and on the offer side, many investment managers are choosing not to sell at bargain prices and playing a waiting game until more clarity can be had.

We have been opportunistic sellers when we have seen targeted sectors or issuers available. Otherwise, we continue to keep a consistent outlook with regards to rates and

our duration continues to be at the level we have reported over the past 9 months. More simply put, a duration we feel is more neutral to current rates and expectations. Credit continues also to be consistent with our view of current and near-term expectations of the credit environment remaining benign. Long-term we do expect some credit pressure, especially in high yield if we slip toward recession and the portfolio credit targets and credit ladders are structured with that viewpoint in mind.

Noted asset sector target or bias this month includes:

- Overall asset backed securities (ABS) continues to offer value for a variety of reasons, including credit and additive performance for the portfolio. We continue to see Auto ABS as a core holding. However, we have shifted in terms of targets and found more value in secondary, seasoned bonds where known performance history and paydown speeds present solid upside to that of new issue where perhaps underwriting and residual values might be more aggressive.

- A slight shift in terms of floating rate securities. We continue to like the space overall, but have found more upside of late with Secured Overnight Financing Rate (SOFR) floaters than LIBOR-based. Additionally, with rate pressures driving pricing on longer, hybrid floaters, we have found price levels attractive and have sold into the rally, preferring some targeted, shorter paper which we feel has more upside. With most still clinging to legacy LIBOR due to its familiarity, we prefer the SOFR which should embrace the speed of rate hikes more quickly.

- Agency MBS has been upgraded to attractive for us. The space has been hit especially hard over the past 6 months with the rate move. We have long preferred the space due to its high degree of liquidity, which, despite its performance lacking over the past 6 months, has remained strong and an important and desired characteristic. However, with the recent rate pressures, the sector has migrated in a negative fashion, hurting its performance. Nevertheless, the sector seems to have reached a point where one can now see upside in its pricing and prepay speeds and near-term we expect it to outperform on an overall basis.

- Leveraged loans have started to wear out their welcome. With the market stepping back in terms of interest, that in turn has had a secondary impact on collateralized loan obligation (CLO) paper. We continue to like seasoned CLO paper, especially higher up in the capital stack with shorter re-investment risk. However, CLO new issue has started to leak in terms of spread and that has impacted pricing on secondary paper as well. From a credit standpoint and a liability structure, the CLO paper continues to be additive. However, with market dynamics shifting some, we scaled back activity in the area and remain content with current holdings, waiting for new issuance to pick up again and spreads to contract.

- The pandemic trade of re-opening the economy sectors such as aircraft and leisure has begun drifting, as the allure of wider spreads and high yields has started to shrink as more and more investors entered the space. As such, many dealer research reports have pushed it to neutral in terms of weighting. However, we continue to see value in the space and with some moving away from the area, there is some slippage in terms of spread available. We have used the moment to add positions to credits in the space that recently had become too expensive, but now with this pullback by others, presented opportunity again. Unappreciated upside for the structure of the Enhanced Equipment Trust Certificate (EETC) market, and its sinking fund features, once again is

additive in terms of yield to call and return of principal, allowing for reinvestment at a faster clip than competing corporate bullets.

- Corporates remain a neutral sector for us. Sub-sectors like big name retail or liquidity strong names like UPS or Home Depot remain attractive to us for their liquidity benefits. Some movement in utilities has been noticed, which remains a solid add sector for us, as we like the liquid names and feel upside is available if we move into a recessionary phase. However, certain names in the space still present downside risk in terms of seasonal pressures and negative headlines come wildfire season. Beyond that, only new issue/new name or infrequent issuers carry some upside in our view, but with the new issue market slowed by rate volatility those opportunities are not as abundant as they had been even 7 months ago.

All eyes continue to be on the Fed. The market seems to be in waiting mode. Hikes are expected near-term, but the follow-up language will be just as important. If there is any indication that hikes won't be as aggressive then market dynamics could shift quickly. Either way, we continue to manage consistently with a neutral viewpoint toward rates. That provides us some stability in how we look at duration in the context of current talk but upside available if some of the more aggressive scenarios do not play out. We continue to hold a high percentage of floating rate securities and continue to focus on amortizing assets to help us take advantage of the rising yields.

Download Fact Sheet

Download Holdings

Barry D. Weiss, CFA

Portfolio Manager, Yorktown Management & Research

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

John Tener, CFA

Portfolio Manager, Yorktown Management & Research

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

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.

Definition of Terms

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.

Federal Open Market Committee (FOMC) - the branch of the Federal Reserve System (FRS) that determines the direction of monetary policy specifically by directing open market operations (OMO).

United States Treasury (UST) - the national treasury of the federal government of the United States where it serves as an executive department. The Treasury manages all of the money coming into the government and paid out by it.

High Yield (HY) - high-yield bonds (also called junk bonds) are bonds that pay higher interest rates because they have lower credit ratings than investment-grade bonds. High-yield bonds are more likely to default, so they must pay a higher yield than investment-grade bonds to compensate investors.

Investment Grade (IG) - an investment grade is a rating that signifies that a municipal or corporate bond presents a relatively low risk of default.

Exchange Traded Fund (ETF) - an exchange traded fund (ETF) is a type of security that tracks an index, sector, commodity, or other asset, but which can be purchased or sold on a stock exchange the same as a regular stock.

Federal Family Education Loan Program (FFELP) - a program that worked with private lenders to provide education loans guaranteed by the federal government.

Business Development Program (BDC) - an organization that invests in small- and medium-sized companies as well as distressed companies.

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Per the most current prospectus, (1) Fund total operating expense ratios are: Class A, 0.88%; Class L, 1.53%; Institutional Class, 0.88% until at least May 31, 2022. (2) In addition, the Adviser has entered into contractual expense limitation agreement with the Trust so that the Fund's ratio of total annual operating expenses are limited to 0.84% for Class A shares and Institutional Class shares and 1.49% for Class L Shares until at least May 31, 2022.

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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