

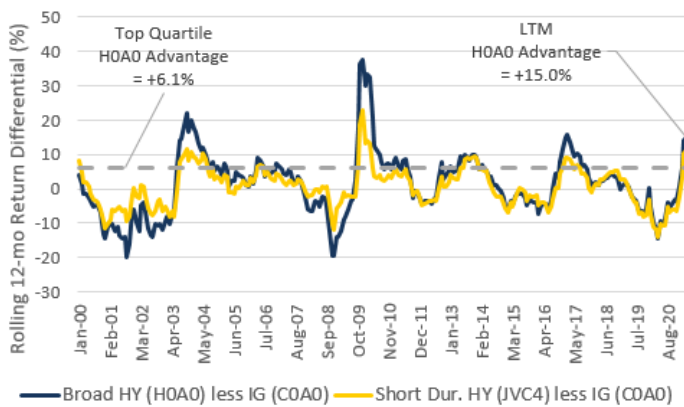
SKYView: An Investment Grade Alternative

Investment grade credit returns continue to languish in the current market environment, with the benefits of stronger corporate earnings growth and improving sentiment far outweighed by inflationary pressures and the risk of higher rates. Compressed spread levels, real negative yields (by virtue of 10-Year Inflation Breakeven rates now in the 2.5% range), and increasingly longer average duration have compelled investors to search for alternative sources of return. With this in mind, we focus our efforts in this *Weekly Briefing* on the identification of asset allocation strategies that we believe are more optimal and better suited than investment grade credit in the current market environment.

On a year-to-date basis (through May 19, 2021), US Investment Grade (we use the ICE BofA US Corporate Index, ticker COA0, as our proxy) has generated total returns of -3.63%, well below broad US high yield (we use the ICE BofA US High Yield Index, ticker HOA0, as our proxy) and short duration US high yield (we use the ICE BofA 1-5Yr BB-B High Yield Constrained Index, ticker JVC4, as our proxy) returns of +1.78% and +2.30%, respectively. In fact, **rolling last-twelve-month total returns favor high yield (HOA0) over investment grade (COA0) by 15% through April, a top decile differential based on data over the last two decades.** What is causing the outsized difference in return streams? First, based on historical data, we know that riskier assets tend to outperform when earnings and upgrade rates rise (and are expected to continue to rise) and when default rates and leverage metrics fall (and are expected to continue to fall). Second – and perhaps most relevant given the fear of rising rates that is prevalent across US markets – is **the positive correlation between rolling 12-month return differentials (high yield less investment grade) and rolling 12-month changes in Treasury yields** (right chart below).

HY Continues to Outperform Investment Grade Credit

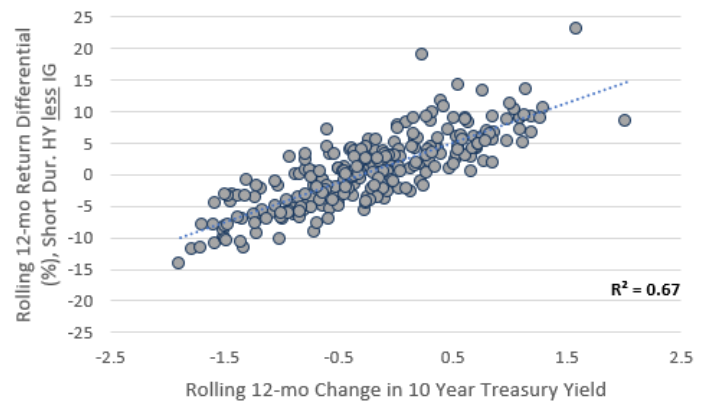
monthly data, rolling 12-month return differentials



Source: SKY Harbor, ICE Data Indices. HY means high yield. IG means investment grade.

Differential Driven by Fundamental Momentum & Rising Rates

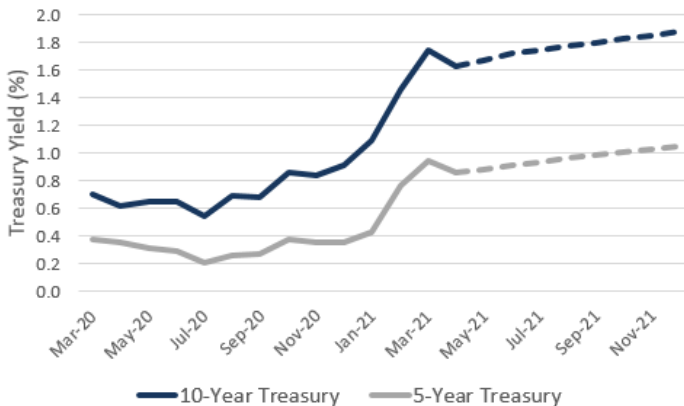
monthly data



Given significant investment grade underperformance over the last several months, are we likely to see an inflection in trend any time soon? In our view, a near-term reversal is unlikely. As demonstrated below (left side), **high yield started to outpace investment grade returns when Treasury yields began their post-COVID move upward in the second half of 2020.** With a clearly positive relationship between high yield outperformance and rates over the long run, and due to consensus expectations for Treasury yields to continue to rise, the outlook for investment grade remains weak, in our view. Additionally, **the inherently longer-duration nature of the investment grade index has not diminished over the last few years.** In fact, the duration differential relative to high yield has increased. As demonstrated below (right side), investment grade duration (COA0) has risen from ~ 7.1 to ~ 8.0 over the last three years, while broad high yield (HOA0) has declined from ~ 4.2 to ~ 3.6, and short duration high yield (JVC4) has declined from ~ 2.5 to ~ 1.9.

Treasury Yields Expected to Rise Further by Year End

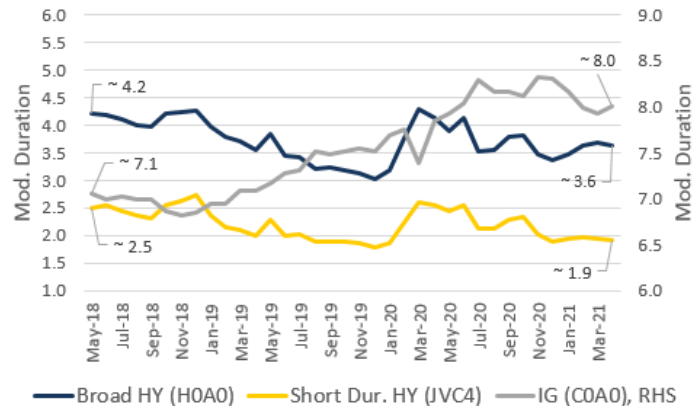
monthly data; dotted lines represent consensus expectations



Source: SKY Harbor, Bloomberg, ICE Data Indices

HY Duration Has Declined, IG Duration Has Risen

monthly data, trailing 3 years



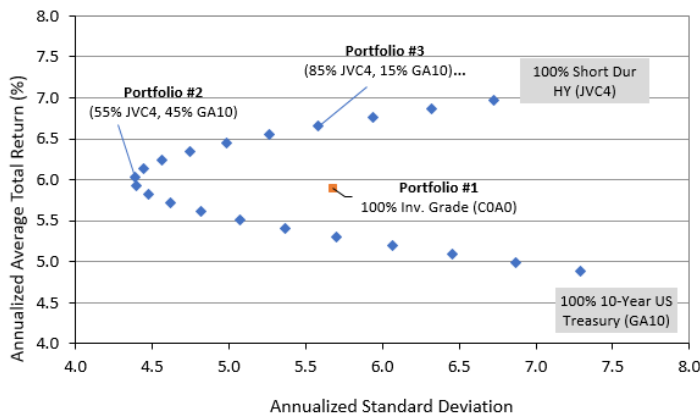
To identify viable alternatives to investment grade, we created efficient frontiers using two asset portfolios. First, we compared the historical risk-return profile of a portfolio consisting of short duration high yield bonds (JVC4) and 10-Year Treasuries (we use the ICE BofA Current 10-Year US Treasury Index, ticker GA10, as our proxy), flexing the asset allocation in 5% increments. As demonstrated in the left chart below, Portfolio #2 (55% JVC4, 45% GA10) has

historically provided similar annualized average returns as Portfolio #1 (100% investment grade, or COA0) with less annualized volatility. Alternatively, Portfolio #3 (85% JVC4, 15% GA10) has generated stronger annualized average returns than Portfolio #1 (100% COA0) with similar volatility. In both alternative portfolios (#2 and #3), average duration was substantially lower than the investment grade index, which has contributed to superior year-to-date total returns (and, in our view, better positioning on a forward-looking basis given expectations for continued upward pressure on rates).

Second, we created an efficient frontier using shorter-duration subsets of each asset class. As demonstrated in the chart below (right side), rotation out of a short duration investment grade portfolio (we use the ICE BofA US Corp 1-3Yr Index, ticker C1A0, as our proxy) and into a mix of short duration high yield (JVC4) and short duration Treasuries (we use the ICE BofA 1-3Yr US Treasury Index, ticker G1O2, as our proxy) can improve portfolio efficiency. In addition to sub-optimal risk and return metrics over the long run, Portfolio #4 (short duration investment grade) has underperformed Portfolios #5 and #6 (mix of short duration Treasuries and short duration high yield) on a year-to-date basis.

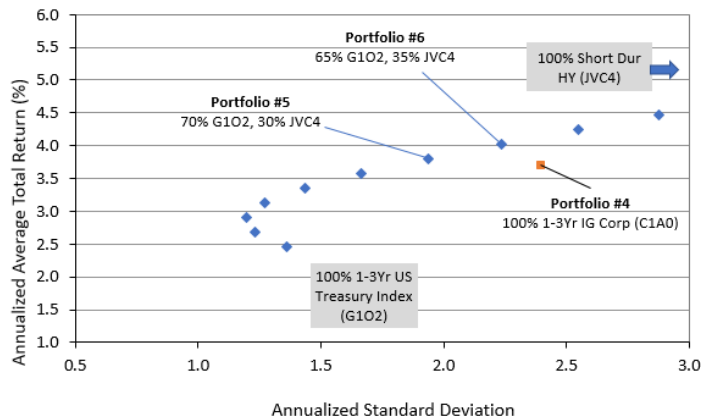
Short Dur. HY (JVC4) & 10 Yr Treasury (GA10) vs. Investment Grade (COA0)

monthly data, trailing 20 years



Short Dur. HY (JVC4) & 1-3Yr Treasury (G1O2) vs. 1-3Yr IG Corp (C1A0)

monthly data, trailing 20 years



Portfolio	Avg. Duration	Ann. St. Dev. Of Returns	Ann. Avg. Total Return	YTD Return (Rising Rate Environment)
#1	7.9	5.7	5.9	(3.6)
#2	5.2	4.4	6.0	1.3
#3	3.0	5.6	6.7	2.0

vs. 100% IG (COA0): same return, lower vol
vs. 100% IG (COA0): same vol, higher return

Portfolio	Avg. Duration	Ann. St. Dev. Of Returns	Ann. Avg. Total Return	YTD Return (Rising Rate Environment)
#5	1.8	2.4	3.7	0.3
#6	1.9	1.9	3.8	0.7
#7	1.9	2.2	4.0	0.8

vs. 100% 1-3Yr IG Corp Index (C1A0): same return, lower vol
vs. 100% 1-3Yr IG Corp Index (C1A0) lower vol, higher return

Source: SKY Harbor, ICE Data Indices, Bloomberg

Investment grade credit returns have suffered on a year-to-date basis, as weak starting spread levels have proven insufficient cushion against the negative impact rising rates has had on a longer-duration asset class. And, with Treasury yields expected to rise further into year-end, investment grade credit remains under pressure. Historically, a portfolio allocation split between Treasury securities and short duration high yield has offered investors better risk-adjusted returns relative to investment grade, while at the same time reducing overall duration. Performance of these alternative portfolios have outpaced investment grade on a year-to-date basis, and we view them as offering better total return potential over the intermediate term should rates continue to rise.

Definitions of Indexes and Terms

Duration is a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates.

ICE BofA US Corp 1-3Yr Index (ticker C1A0) tracks the performance of US dollar denominated investment grade rated corporate debt publicly issued in the US domestic market with a remaining term to maturity of less than 3 years.

ICE BofA 1-5 Year BB-B US Cash Pay High Yield Constrained Index (ticker JVC4) contains all securities in The ICE BofA US Cash Pay High Yield Index that are rated BB1 through B3, based on an average of Moody's, S&P and Fitch, with a maturity less than five years, but caps issuer exposure at 2%.

ICE BofA 10+ Year Treasury Index measures the total return performance of U.S. Treasury bonds with an outstanding par that is greater than or equal to \$25 million. The maturity range of these securities is greater than ten years.

ICE BofA US Corporate Index: An index that tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the US domestic market.

ICE BofA US High Yield Index: An index (ticker H0A0) that tracks the performance of US dollar denominated below investment grade rated corporate debt publicly issued in the US domestic market. The index is further defined by sub-indexes associated with credit ratings (e.g., the CCC sub-index).

Inflation Breakeven Rate is a market-based measure of expected inflation that is the difference between the yield of a nominal bond and an inflation-linked bond of the same maturity.

Important Disclosures and Disclaimers

Past performance does not guarantee future results. The referenced indices are shown for informational purposes only and are not meant to represent the AXS Investments Funds. Investors cannot directly invest in an index.

The views above are those of SKY Harbor Capital Management, LLC. This information is educational in nature and does not constitute investment advice. These views are subject to change at any time based on market and other conditions and no forecasts can be guaranteed. These views may not be relied upon as investment advice or as an indication of any investment or trading intent. This content should not be construed as an offer to sell, a solicitation of an offer to buy, or a recommendation for any security by AXS Investments or any third-party. You are solely responsible for determining whether any investment, investment strategy, security or related transaction is appropriate for you based on your personal investment objectives, financial circumstances and risk tolerance. AXS Investments does not provide tax or legal advice and the information herein should not be considered as such. AXS Investments disclaims any liability arising out of your use of the information contained herein. You should consult your legal or tax professional regarding your specific situation. All investing is subject to risk, including the possible loss of the money you invest. Alternative investments may not be suitable for all investors.