AQUILA®
Three Peaks
High Income Fund

AQUILA®
GROUP OF FUNDS

AQUILA®
Three Peaks
Opportunity Growth Fund

Investment Commentary

April 30, 2016

- The positive price action that the high yield market exhibited in March, due to a perceived improving backdrop for commodities and increasingly accommodative global central bank commentary, continued through April. Positive mutual fund flows into the high yield asset class, along with manageable new issuance, drove the risk-on trade within the asset class. As such, the Energy and Metals/ Mining industries along with lower-quality/lower-rated issuance were notable outperforming segments of the high yield market during the month of April. We continue to have reservations about these segments of the high yield market due to concerns about economic growth and what that ultimately means for commodity prices and companies with significant debt balances. Following fairly strong performance across many equity indices during the month of March, performance of the equity market moderated for April, with many equity indices posting slightly positive gains for the month. In general, first quarter corporate results continue to exhibit a prolonged trend of weaker-than-expected sales growth with better-than-expected earnings growth. In real terms (meaning not compared to expectations), first quarter earnings are expected to decline for the fourth consecutive quarter - a data point that we believe should not be overlooked by investors. The start of 2016 has been very volatile, with fairly violent downward and upward moves across both the high yield market and the equity market. We continue to believe this is an indication of significant investor uncertainty with regard to corporate earnings, market valuations, and economic growth (both domestically and globally). We believe we are in the midst of a period of heightened volatility and expect this may continue throughout much of the year. Continued unease with central bank policy actions around the world (in particular with the Fed), the potential for corporate earnings growth to continue to slow throughout the year, and the elevated uncertainty created by a U.S. Presidential election, justify a more cautious positioning within both our high yield and equity strategies, in our opinion. As such, and by design, we remain relatively defensively positioned from a credit quality and industry perspective in both of our strategies.
- Treasury yields increased slightly throughout April, though they generally remain stubbornly low. We view the recent movement (or lack thereof) of Treasury yields a bit unusual, as it has been somewhat contradictory to the positive movements of the high yield and equity markets over the last few months. The 10-year Treasury yield ended April at 1.83% compared to 2.27% to begin the year, while the 5-year Treasury yield ended April at 1.30% compared to 1.76% to begin the year. We continue to believe Federal Reserve commentary and any future action or inaction with regard to the Fed Funds rate will likely influence directional movements of Treasury yields over the foreseeable future.
- The average spread of the JPM High Yield Index decreased to 681bps at the end of April from 753bps at the end of March. The average yield-to-worst of the Index decreased to 8.05% at the end of April from 8.80% at the end of March. Through April, the average spread and average yield-to-worst of the JPM Index were down 76bps and 123bps, respectively, for the year, with both 239bps lower since the mid-February highs. Activity in the high yield primary market continues to build and has increased sequentially in all four months this year. A total of 35 bonds for $32.3 billion of new issuance priced during the month. Year-to-date, 103 bonds for $83.5 billion of new issuance has priced. Refinancing proceeds account for 48% of the YTD volume compared to 43% for all of 2015. Acquisition proceeds account for 28% of the YTD volume compared to 38% for all of 2015. Refinance activity has comprised nearly 60% of issuance the past two months, as companies took advantage of an improving high yield primary market to extend maturities and in many cases even reduce interest costs. While we believe there will continue to be opportunities for certain companies to refinance debt maturities throughout the year, the trend of more aggressive uses for proceeds (i.e. M&A, dividends, stock repurchases) in recent years seems likely to remain elevated, which may continue to adversely impact corporate credit ratings.
- We continue to focus our research efforts on finding companies that operate in stable industries and with management teams that are exceptionally communicative and focused on strengthening the balance sheet while growing operations. We remain committed to finding companies and securities that we believe will exhibit less price fluctuation should volatility increase within the high yield market or should Treasury yields rise. We believe our higher-quality and lower-duration strategy continues to be prudent at this time. We also believe our approach to selecting companies who are using leverage prudently will benefit the performance of our equity strategy. However, in our opinion, we remain more defensively positioned by historical standards, as we attempt to reduce potential volatility in the strategies in the current environment.

- Thank you for your continued support and investment.

Before investing in a Fund, carefully read about and consider the investment objectives, risks, charges, expenses, and other information found in the Fund prospectus. The prospectus is available from your financial advisor, and when you call 800-437-1020 or visit www.aquilafunds.com.

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