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Three Peaks
High Income Fund

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Three Peaks
Opportunity Growth Fund

Investment Commentary

August 31, 2016

- The high yield market performed reasonably well during August amid easing global macro concerns, an improving backdrop for commodities, and continued accommodative central bank actions. Federal Reserve commentary throughout the month continued to reiterate the case for gradual monetary policy tightening over the coming months. Steadily improving economic data in the U.S. and second quarter corporate earnings that were generally better than expected have helped push many equity indices back into record price level territory. Following strong performance during July, the equity market traded in a reasonably tight range around all-time high price levels throughout August. Oil declined to $39.50 per barrel in early August before rallying back to high $40's per barrel by the end of the month on positive supply/demand data points and the potential for OPEC to come to a supply agreement at its September meeting. Directional movements of the price of oil continue to directly influence the high yield market, and in our opinion, are beginning to be used as a barometer for economic growth as the correlation with equity market movements has seemed to increase lately. We continue to believe performance of the capital markets over the balance of 2016 is likely to be influenced by 1) the U.S. presidential election, 2) Fed policy, and 3) directional movements in the price of oil.
- Consumer and business confidence will be important to monitor as we head towards the U.S. Presidential election in November, as any potential weakness could impact GDP growth, employment measures, and corporate earnings. Current market expectations are for a continued gradual monetary policy tightening over the balance of 2016 and into 2017. In general, the market is expecting at least one rate hike before the end of 2016; however there is a great deal of uncertainty as to the timing of such action. Commentary out of the Federal Reserve will continue to be heavily scrutinized for any indication of a quicker pace of rate increases or more significant magnitude of rate increases. Of note, we have begun to hear more commentary from companies that operate across various industries regarding tighter labor market conditions and increased wage pressure. Should this begin to lead to more significant increases in inflation measures, the Fed may be forced to act more quickly than many market participants expect. With equity market valuations at elevated levels and many corporate bonds yields nearing historically low levels, any economic weakness or increased monetary policy tightening due to inflation could cause volatility to increase across the capital markets. In addition, should oil decline over the coming months, it may reignite corporate solvency concerns across the high yield market and bring into question global economic growth. Conversely, should the price of oil continue its upward trajectory, the industry may reignite capital spending, which could benefit employment, industrial manufacturing activity, and economic growth.
- Treasury yields increased slightly throughout August. We continue to view the recent movement of Treasury yields as 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 August at 1.58% compared to 2.27% to begin the year, while the 5-year Treasury yield ended August at 1.20% 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, which could cause volatility to increase across the high yield and equity market.
- The average spread of the JPM High Yield Index decreased to 564bps at the end of August, compared to 617bps at the end of July. The average yield-to-worst of the Index decreased to 6.75% at the end of August from 7.17% at the end of July. Through August, the average spread and average yield-to-worst of the JPM Index were down 193bps and 253bps, respectively, for the year. Activity in the high yield primary market remained stable during month, which we believe is a good indication of investor demand and access to capital for corporations as August is historically a fairly slow month for new issuance. A total of 38 bonds for $20.6 billion of new issuance priced during the month. Year-to-date, 283 bonds for $197.8 billion of new issuance has priced. Refinancing proceeds account for 55% of the YTD volume compared to 43% for all of 2015. Acquisition proceeds account for 17% of the YTD volume compared to 38% for all of 2015. Companies continue to take advantage of an improving high yield primary market to extend maturities and, in many cases, even reduce interest costs. We believe this will continue to occur over the balance of the year as some companies continue to strengthen their balance sheet. We also believe we may begin to see more aggressive uses for proceeds (i.e. M&A, dividends, stock repurchases), which will need to be monitored as these actions may adversely impact credit metrics and corporate credit ratings. We will continue to monitor the openness of the high yield new issue market as any tightening or weakness may impact the cost of capital and/or access to capital for corporations which may have negative ramifications for equity valuations.
- Despite many U.S. equity indices at or near all-time high price levels as August came to a close, the capital markets have been fairly

volatile over the last year, with 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 may be in the midst of a period of heightened volatility and expect this may continue throughout the balance 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 remain sluggish, 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.

- 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 strategy 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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