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Three Peaks
High Income Fund

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Opportunity Growth Fund

# Investment Commentary

*July 31, 2016*

- Performance in July was positive across many U.S.-based asset classes, as investor expectations for additional accommodative measures from global central banks increased following Britain's referendum to exit from the European Union. Federal Reserve commentary remained relatively muted throughout the month, with many market participants continuing to believe the Fed will be slower with the pace of monetary tightening over the balance of the year. Steadily improving economic data in the U.S. and corporate earnings that, through July, can generally be characterized as better than expected have helped push many equity indices back into record price level territory. Oil's upward trajectory stalled during July, as the price of a barrel of oil declined 14% during the month and is back near $40 per barrel after being above $50 per barrel several times in June. We believe the 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 weaknesses 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. 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 operating 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 bond 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 further as the year progresses, it may reignite corporate solvency concerns across the high yield market and bring into question global economic growth. Conversely, should the price of oil stabilize and/or resume its upward trajectory, the industry may reignite capital spending, which could benefit hiring, industrial manufacturing activity, and economic growth.
- Treasury yields were little changed for the month of July and generally remain stubbornly low. We continue to view the recent movement (or lack thereof) 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 July at 1.45% compared to 2.27% to begin the year, while the 5-year Treasury yield ended July at 1.03% 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 capital markets.
- The average spread of the JPM High Yield Index decreased to 617bps at the end of July, compared to 669bps at the end of June. The average yield-to-worst of the Index decreased to 7.17% at the end of July from 7.68% at the end of June. Through July, the average spread and average yield-to-worst of the JPM Index were down 140bps and 211bps, respectively, for the year. Activity in the high yield primary market remained steady in July, although the pace did slow from the prior three months. A total of 38 bonds for $22.0 billion of new issuance priced during the month. Year-to-date, 245 bonds for $177.2 billion of new issuance has priced. Refinancing proceeds account for 53% of the YTD volume compared to 43% for all of 2015. Acquisition proceeds account for 18% 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 corporate credit ratings.
- Despite many U.S. equity indices at or near all-time high price levels as July 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 that 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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