AQUILA®
Three Peaks
High Income Fund

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Three Peaks
Opportunity Growth Fund

Investment Commentary

May 31, 2016

- Investor activity throughout May seemed to continue with a risk-on based trade, as equities, lower-quality high yield bonds, and the energy and metals/mining industries within the high yield market were stronger performing areas. Fed commentary was somewhat muted throughout the month with many market participants beginning to believe the Fed will be slower with the pace of monetary tightening over the balance of the year. Concerns regarding "Brexit" receded somewhat throughout the month as polls began to show opposition to Britain's exit from the European Union. The referendum is scheduled to occur in late June and many market participants believe the capital markets may experience volatility around the vote. Oil continued on its upward trajectory as it neared $50 a barrel at month-end. As such, the energy and metals/mining segments of the high yield market were once again notable outperformers for the month. 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. Away from these segments, the balance of the high yield market experienced a bit more volatility as the technical picture began to deteriorate in the latter half of the month. High yield mutual funds experienced $2.4 billion of outflows during May after experiencing over $16 billion of cumulative inflows during the previous three months.
- Treasury yields increased slightly for the second consecutive month, though they generally remain stubbornly low. We continue to view the recent movement (or lack thereof) of Treasury yields as being 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 May at 1.85% compared to 2.27% to begin the year, while the 5-year Treasury yield ended May at 1.37% 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 for the foreseeable future, which could cause volatility to increase across the capital markets.
- The average spread of the JPM High Yield Index decreased to 654 bps at the end of May from 681 bps at the end of April. The average yield-to-worst of the Index decreased to 7.84% at the end of May from 8.05% at the end of April. Through May, the average spread and average yield-to-worst of the JPM High Yield Index were down 103 bps and 144 bps, respectively, for the year. Activity in the high yield primary market continues to build and has increased sequentially in all five months this year. A total of 63 bonds for $42.3 billion of new issuance priced during the month. Year-to-date, 166 bonds for $125.8 billion of new issuance has priced. Refinancing proceeds account for 52% of the YTD volume compared to 43% for all of 2015. Acquisition proceeds account for 20% of the YTD volume compared to 38% for all of 2015. Refinance activity has comprised nearly 60% of issuance the past three 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.
- The capital markets have been fairly volatile thus far in 2016, with violent downward and upward moves across both the high yield market and the equity market. We 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.
- 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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