Aquila High Income Fund

PORTFOLIO MANAGER COMMENTARY

Q2 2022

AQUILA® GROUP OF FUNDS

AQUILA® High Income Fund

A SHARE: **ATPAX**	C SHARE: **ATPCX**	I SHARE: **ATIPX**	Y SHARE: **ATPYX**

U.S. Fixed Income Markets: Quarterly Review

Similar to the prior quarter, the second quarter of 2022 saw every major fixed income asset class produce negative total returns for the period. Persistently strong inflation data during the quarter, most notably driven by high food and energy prices, forced the hand of the Federal Reserve ("the Fed"), which aggressively raised the federal funds rate by 50 basis points ("bps") at its May meeting, and another 75 bps in June, while signaling another assertive move at its upcoming Federal Open Market Committee meeting July 26-27. These rate increases are in addition to the 25 bps hike the Fed implemented in March.

The Bloomberg U.S. Corporate High Yield Index experienced one of the steepest declines among fixed income indices (on a relative basis) at -9.83%, compared to -4.69% for the Bloomberg U.S. Aggregate Bond Index, and -3.77% for the Bloomberg U.S. Treasury Index. With inflation, as measured by the Consumer Price Index ("CPI"), running at extremely elevated levels, credit investors have become fearful that the ultimate result of numerous Fed rate hikes may eventually lead to an imminent recession. Hence, high-yield credit spreads widened almost 250 bps during Q2. As of quarter-end, Fed Funds Futures contracts were pricing at a rate of about 3.50% for those dated December 31, 2022. Yet, some forecasters have become concerned that the Fed may need to pause if financial conditions become too constrained.

High-Yield Bond Market and Economic Overview

High-yield corporate bond spreads widened dramatically over the quarter, reaching a year-to-date high of 569 bps on June 30th, compared to about 325 bps at the end of Q1 2022. The headwinds in the high-yield market experienced late in the first quarter continued in April, with below-investment grade bonds producing -3.56% in total return for the month. That was driven by CCC-rated companies, which were down -4.18%, compared to single-B at -3.33%, and BB at -3.70%. The month of June was even more challenging, with the Bloomberg U.S. Corporate High Yield Index down -6.73% for the month. Higher-quality bonds had relatively better performance, with BB bonds (-6.46%) outperforming single-B bonds by 31 bps (-7.04%), and CCC bonds by 76 bps (-7.22%). Remarkably, on an historical basis, June was considered the second-worst monthly total return for high-yield bonds since 2008.

The up-in-quality trade continued throughout the quarter, as credit spreads on CCC-rated bonds gapped out to 1047 bps at quarter-end, compared to 593 bps on March 31st, producing a second quarter return of -13.64%, while single-B's ended the quarter down -10.57%, and BB-rated bonds at -8.50%. No doubt, the upside surprise in June's Core CPI data, combined with weak Consumer Confidence and manufacturing data, put investors in a "risk-off" position, leading to another quarter of disappointing results in the high-yield market.

During the quarter, the Energy sector was one of the best performers on a relative basis (-8.02%), as West Texas Intermediate ("WTI") crude moved from approximately $95 per barrel to nearly $106 by quarter-end. With 5-year U.S. Treasury yields rising 60 bps, and 10-year U.S. Treasury yields rising 68 bps, sectors, such as Finance Companies (-11.38%) and Brokers & Asset Managers (-12.64%) were the laggards during the quarter, as the increase in rates took a toll on these interest-rate sensitive sectors.

Surprisingly, the lack of new issuance did not give much support to the high-yield market. Lackluster supply of only $24.6 billion in Q2, likely driven by unattractive funding levels and low investor demand, produced the lowest quarterly issuance since the fourth quarter of 2018. This compares to $46.5 billion in Q1, and a quarterly average of $117 billion over the prior two years, according to JPMorgan.

Summary of key economic data points:

- Gross Domestic Product ("GDP") quarter-over-quarter: -1.6% (Q1 2022)
- Consumer Price Index ("CPI") year-over-year: 9.1% (June 2022)
- Producer Price Index ("PPI") year-over-year: 11.3% (June 2022)
- Personal Consumption Expenditures Price Index (also known as "PCE Deflator") year-over-year: 6.3% (May 2022)
- Unemployment rate: 3.6% (June 2022)
- Oil prices (West Texas Intermediate, "WTI Crude") increased over 11% to $105.76 during the quarter

Fund Strategy and Outlook

Aquila's Investment Management team has become concerned that the rampant inflation and late monetary response by the Federal Reserve, has now raised the possibility of a potential recession in coming quarters, as rate hikes may likely be aggressive. Credit fundamentals currently remain in a solid position, although default rates have ticked higher. According to JPMorgan, 2022 could see high-yield defaults rise to 1.25% by year-end (from 1.08% in June), and expand to 1.75% in 2023. As the rotation to higher-quality assets continues, we believe CCC-rated issuers could underperform over the next 3-6 months, making it difficult for those lower-rated companies to tap the capital markets to fund M&A activity or refinance upcoming maturities. With the conflict in Ukraine no closer to ending, food and energy prices elevated, and recessionary fears looming, the probability of the Federal Reserve executing a so-called "soft landing" is becoming increasingly remote.

As volatility remains heightened, and extreme uncertainty related to numerous macroeconomic and geopolitical issues persist, our investment team continues to focus on a proactive approach. To help mitigate risk while providing a stable and consistent level of income, we continue to emphasize in-depth credit research, and comprehensive portfolio analysis and construction. As we anticipate yields moving mostly higher throughout the remainder of 2022, we anticipate maintaining a lower duration while opportunistically moving up in credit quality to mitigate any widening in credit spreads due to a potential economic downturn.

We believe opportunities are available to active asset managers, and our team monitors the entire high-yield universe to identify positions with attractive risk-adjusted characteristics. We seek to accomplish this by avoiding credit downgrades and defaults, while identifying companies and sectors with above-average total return potential. In an ever-changing environment, the latter part of 2022 and early 2023 will likely present new challenges for the high-yield market. However, in our view, the absolute level of yields in the asset class compared to previous quarters, along with its inherently lower duration than other fixed income sectors, present attractive opportunities for suitable investors seeking high current income.

For specific information about fund characteristics, holdings and performance please see the Fund Fact Sheet on our website at www.aquilafunds.com.

Fund Facts as of 6/30/2022

Lead Portfolio Manager	Inception Date	Total Investments	Number of Holdings
DAVID SCHIFFMAN	6/1/2006	$109.2M	74

The Bloomberg U.S. Corporate High Yield Index is an unmanaged index considered representative of the universe of fixed-rate, non-investment grade debt. The Bloomberg U.S. Aggregate Bond Index is an unmanaged index considered representative of the universe of fixed-rate, investment grade taxable debt. The Bloomberg U.S. Treasury Index is an unmanaged index considered representative of the U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. Performance of an index does not reflect management fees and expenses which are reflected in Fund performance. An investment cannot be made directly in an index.

Independent rating services (such as Standard & Poor's, Moody's and Fitch) assign bond ratings, which generally range from AAA (highest) to D (lowest), to indicate the credit worthiness of the underlying bonds in the portfolio. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. Where the independent rating services differ in the rating they assign to an issue, or do not provide a rating for an issue, the highest available rating is used in calculating allocations by rating. Non-rated bonds are holdings that have not been rated by a nationally recognized statistical rating organization.

Information contained herein has been obtained from sources we consider reliable, but its accuracy is not guaranteed. This report is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of a security.

Please refer to the Fund's prospectus for a complete description of risks associated with an investment in the Fund. These include, but are not limited to, potential loss of value, market risk, financial risk, interest rate and credit risk, and investments in highly-leveraged companies, lower-quality debt securities, foreign markets and foreign currencies.

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.