HIGH YIELD MARKET

INVESTMENT COMMENTARY & REVIEW

by Michael Yean

Second Quarter 2021

The rally in the high yield bond market continued through the second quarter of 2021, with the Bloomberg Barclays U.S. High Yield Corporate Index (Index) gaining 2.74% during the quarter and bringing total returns for the first half of the year to 3.62%. The CCC-rated cohort outperformed once again, returning 3.49% compared to 2.16% and 2.86% for the B-rated and BB-rated cohorts, respectively.

With the grind higher, the Index option-adjusted spread (OAS) ended the quarter at +268 bps, the tightest level since the 2007-08 global financial crisis, while the yield-to-worst (YTW) reached a record low of 3.75%. By rating categroy, BB-rated credits now trade at an OAS of +200 bps and offer a YTW of 3.04%, B-rated credits at an OAS of +294 bps and 4.06% YTW, and CCC-rated credits at an OAS of +462 bps and 5.65% YTW. The average dollar price of the Index rose to $105.35 at quarter end.

With elevated bond prices, call constraints, and local and record tights for spreads and yield, total returns will be limited. Based on historical data (source: Jefferies), twelve-month forward returns for the high yield market are only modestly positive when beginning spreads are less than +350 bps or YTW is below 4.5%.

However, in a market environment where we envision rate risk to be greater than credit risk, we believe investment in the high yield market is still warranted, particular when alternative asset classes are nearly all at similarly tight/high valuations and more exposed to rising interest rates. The high yield market is well-supported by current macro-economic and credit fundamentals, most notably very low default rates and estimated losses. Asset prices and bond valuations are theoretically anchored by estimates of default losses and expected default-adjusted returns, and with default rates trending to less than 1% for 2021 and expectations of similar levels for 2022, the high yield market is appropriately pricing in minimal credit risk.

Michael Yean
High Yield Portfolio Manager

Pacific Income Advisers, Inc. (PIA) is an autonomous investment management firm registered under the Investment Advisers Act of 1940. PIA manages a variety of fixed income, equity, and balanced assets for primarily United States clients. The information contained herein is based on internal research derived from various sources and does not purport to be statements of all material facts relating to the securities mentioned. Fund holdings and/or sector allocations are subject to change at any time and are not recommendations to buy or sell any security.

The fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectus contains this and other important information about the investment company, and it may be obtained by calling 800-251-1970 or visiting www.PIAMutualFunds.com. Read it carefully before investing.

Mutual fund investing involves risk. Principal loss is possible. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. The Fund may invest in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods. These risks may increase for emerging markets. Investment by the Fund in lower-rated and non-rated securities presents a greater risk of loss to principal and interest than higher-rated securities. The Fund may invest in derivatives, which may involve risks greater than the risks presented by more traditional investments. The risk of owning an exchange-traded fund ("ETF") or mutual fund generally reflects the risks of owning the underlying securities that the ETF or mutual fund holds. It will also bear additional expenses, including operating expenses, brokerage costs and the potential duplication of management fees. These risks are fully disclosed in the Prospectus.

Index performance is not indicative of Fund performance. It is not possible to invest directly in an index. For current standardized performance of the Fund, please visit www.piamutualfunds.com or call 310-393-1424.

Bloomberg Barclays U.S. Corporate High Yield Index covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets (e.g., Argentina, Brazil, Venezuela, etc.) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included. The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility, and Finance, which include both U.S. and non-U.S. corporations. The Yankee sector has been discontinued as of 7/1/00. The bonds in the former Yankee sector have not been removed from the index, but have been reclassified into other sectors. You cannot invest directly in an index.

The Barclays' Quality sectors discussed above use the following rating methodology. Securities that are rated by three rating agencies, will receive the middle of the three ratings. Securities that are rated by only two agencies will receive the lower of the two ratings. Securities rated by only one agency will receive that rating while securities not covered by any of the three agencies will receive a non-rated (NR) rating. Bond ratings start at Aaa (denoting the highest investment quality) and usually end at D (meaning payment is in default). In limited situations when the rating agency has not issued a formal rating, the rating agency will classify the security as non-rated (NR).

Option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst uses the Treasury securities yield for the risk-free rate.

Basis point (bp)- A unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument.

Yield to worst - the lowest potential yield that can be received on a bond without the issuer actually defaulting.

Macroeconomics is the branch of economics that deals with the structure, performance, behavior, and decision-making of the whole, or aggregate, economy.

Yield - the income return on an investment, such as the interest or dividends received from holding a particular security.

Spread - The difference in yields between two fixed-income securities with the same maturity, but originating from different investment sectors.

Opinions expressed are subject to change, are not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

Past performance does not guarantee future results.

The PIA Funds are distributed by Quasar Distributors, LLC

P I A

Pacific
Income
Advisers

1299 Ocean Ave. Second Floor Santa Monica California 90401

telephone 310.255.4488 fax 310.434.0100

www.pacificincome.com