HYLD ETF

High Yield in your Portfolio

Investing involves risk including the possible loss of principal. For more about the risks of the HYLD ETF, see page 8.

The Why's and How's of High Yield Debt in Your Portfolio

High yield debt may fill an attractive role in the fixed income portion of your portfolio. Why should you consider high yield bonds in your portfolio? How should you go about investing in high yield debt?

In this report, we will highlight the reasons why you should consider adding high yield debt to the fixed income portion of your portfolio. Additionally, we will make the case for considering an actively managed high yield portfolio instead of investing in a passive or indexed portfolio. We will highlight how the High Yield ETF managed by Phase Capital (HYLD) can be used to gain exposure to high yield debt.

Why Invest in High-Yield Debt Securities?

First, let's define what high yield means. High yield, or non-investment grade as it is also known by, is based on the ratings grids provided by the two major credit rating agencies, Moody's and Standard & Poor's. All bonds rated below Baa by Moody's and BBB by Standard & Poor's are considered high yield.

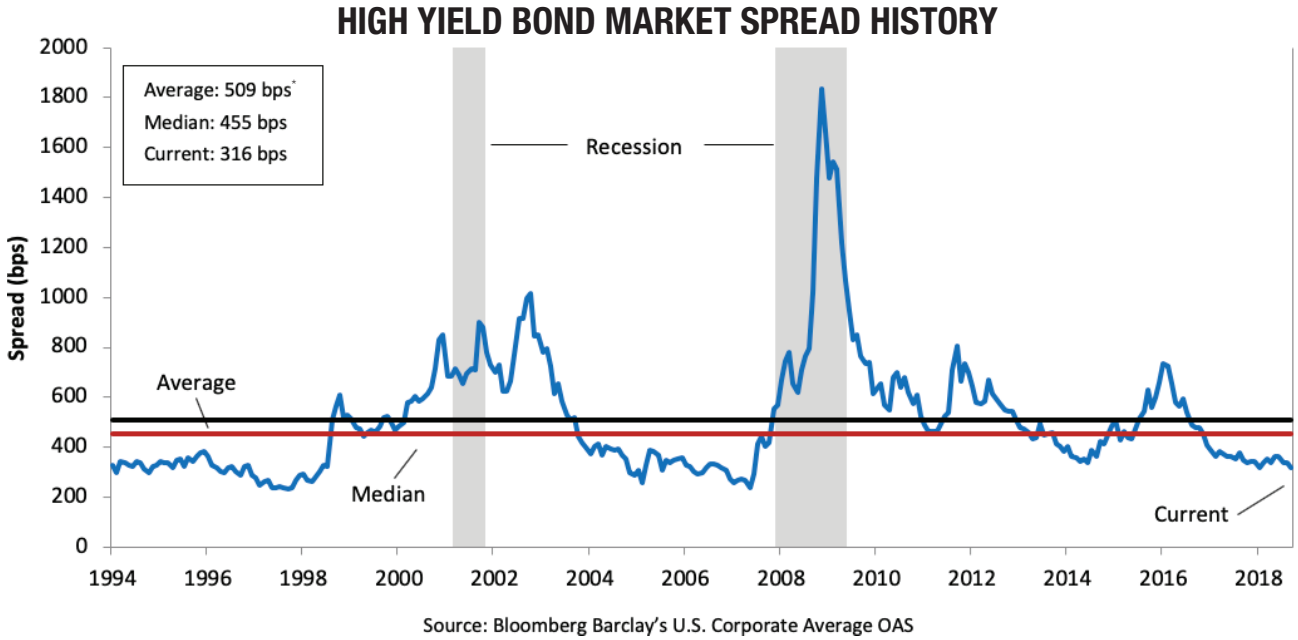
Opportunity for Enhanced Yield

High yield debt, as its name implies, usually offers investors the opportunity to realize higher yields relative to government and investment grade corporate bonds. In evaluating high yield debt, attention is focused on the spread, or yield advantage, over a risk-free rate, comparable maturity U.S. Treasury bond. For example, if the spread is 5.00%, that means that the bond is priced at a yield that is five percentage points higher than the comparable maturity U.S. Treasury bond. The spread varies over time and is often dependent on the economic environment. It tends to widen during periods of economic stress and to narrow when the economy is strong.

As the chart below shows, the average spread for the high yield bond market over the comparable maturity Treasury is approximately 509 basis points or 5.09%. Due to the spike in spreads seen during the 2008 financial crisis, the median spread of 455 basis points may be a more useful way to view the long-term central tendency for spreads.

	Moody's	Standard & Poor's	Fitch
INVESTMENT GRADE	Aaa	AAA	AAA
	Aa1	AA+	AA+
	Aa2	AA	AA
	Aa3	AA–	AA–
	A1	A+	A+
	A2	A	A
	A3	A–	A–
	Baa1	BBB+	BBB+
	Baa2	BBB	BBB
	Baa3	BBB–	BBB–
	Ba1	BB+	BB+
	Ba2	BB	BB
	Ba3	BB–	BB–
	B1	B+	B+
	B2	B	B
	B3	B–	B–
	Caa	CCC	CCC
	Ca	CC	CC
		C	C
	C	D	D

Source: S&P, Moody's



Basis Points (bps): unit of measure used in quoting yields, changes in yields or differences between yields. One basis point is equal to 0.01%, or one one-hundredth of a percent of yield and 100 basis points equals 1%.

Potential Diversification Benefits

The historical correlation between high yield debt and other segments of the fixed income market, as well as the equity market has been low, as shown in the chart below. Thus, high yield debt may offer the opportunity for portfolio diversification.

CORRELATION OF HIGH YIELD TO OTHER FIXED INCOME SECTORS AND STOCKS HAS HISTORICALLY BEEN LOW

High Yield Bonds[1]	**1.00**
Large-Cap Stocks[2]	**0.58**
Small-Cap Stocks[3]	**0.60**
Investment Grade Corporate Bonds[4]	**0.53**
Aggregate Bonds[5]	**0.29**
Municipal Bonds[6]	**0.34**
Treasury Bonds[7]	**0.06**
Gold[8]	**0.04**

Calculated with monthly returns from September 1983 to September 2018. All data from Bloomberg. 1 Bloomberg Barclay's US Corporate High Yield Index, 2 S&P 500, 3 Russell 2000, 4 Bloomberg Barclay's US Corporate Investment Grade Bond Index, 5 Bloomberg Barclay's US Aggregate Bond Index, 6 Bloomberg Barclay's Municipal Bond Index, 7 Bloomberg Barclay's US Treasury Bond Index, 8 Spot Gold $/oz.

Correlation - a statistical measure of how two securities move in relation to each other.

For a complete definition of indices, please see page 8.

Attractive Historical Risk/Return Profile

The historical average return on high yield bonds has exceeded returns in other areas of the debt market. Additionally, although the segment has realized returns lower than equities, its risk-adjusted return has historically been very attractive as evidenced by the accompanying chart.

	Annualized Return	Annualized Volatility[9]	Return/ Risk	Highest 12-Month Return	Lowest 12-Month Return	Frequency of Positive Returns	Frequency of Negative Returns
High Yield Corporate Bonds[1]	8.93%	8.21%	1.09	64.95%	-31.22%	83.17%	16.83%
Large-Cap Stocks[2]	11.20%	14.61%	0.77	53.62%	-43.32%	82.93%	17.07%
Small-Cap Stocks[3]	9.64%	18.78%	0.51	64.41%	-42.38%	75.61%	24.39%
Investment Grade Corporate Bonds[4]	7.83%	5.51%	1.42	35.52%	-13.82%	90.24%	9.76%
Aggregate Bonds[5]	7.06%	4.17%	1.69	30.23%	-3.67%	92.20%	7.80%
Municipal Bonds[6]	6.64%	4.93%	1.35	28.12%	-5.25%	91.71%	8.29%
Treasury Bonds[7]	6.68%	4.72%	1.42	29.24%	-4.46%	87.56%	12.44%
Gold[8]	3.06%	15.21%	0.20	54.63%	-28.04%	56.34%	43.66%

Calculated with monthly returns from September 1983 to September 2018. All data from Bloomberg. 1 Bloomberg Barclay's US Corporate High Yield Index, 2 S&P 500, 3 Russell 2000, 4 Bloomberg Barclay's US Corporate Investment Grade Bond Index, 5 Bloomberg Barclay's US Aggregate Bond Index, 6 Bloomberg Barclay's Municipal Bond Index, 7 Bloomberg Barclay's US Treasury Bond Index, 8 Spot Gold $/oz, 9 Volatility - a statistical measure of risk. Volatility can either be measured by using the standard deviation or variance between returns from that same security or market index. Commonly, the higher the volatility, the riskier the security. Past performance does not guarantee future results. The referenced indices are shown for general market comparisons and are not meant to represent the Fund. Investors cannot directly invest in an index and unmanaged index returns do not reflect any fees, expenses or sales charges

Capital Appreciation

Part of the potential attractive returns of high yield debt is derived from capital appreciation. Risk aversion may result in high yield securities being priced below their intrinsic value. Additionally, many institutional investors may have to sell bonds once they fall below investment grade, artificially depressing their price. As a result, this may create a buying opportunity for investors willing to hold non-investment grade securities.

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What About Defaults?

Given that high yield bonds are rated below investment grade, the perception is that the risk of default, or the issuing company being unable to make interest or principal payments, is high. However, as the chart below shows, the historical default rate over the past 25 years has averaged 2.9%. As expected, the default rate is higher during periods of financial distress, such as the financial crisis in 2008 and 2009. However, not all money invested in high yield bonds is lost during a default. The average recovery rate on defaults has historically been near 41%. More simply, investors have historically lost 59% of their principal, on average, during a default. A high rate, to be sure, but not 100%.

	Default Rate (a)	Principal Recovery Rate (b)	Principal Loss (c) (100% - (b)	Loss Given Default (a)*(c)
1992	4.40%	45.90%	54.10%	2.40%
1993	2.30%	43.10%	56.90%	1.30%
1994	1.40%	45.60%	54.40%	0.80%
1995	2.80%	43.30%	56.70%	1.60%
1996	1.60%	41.50%	58.50%	0.90%
1997	1.50%	48.80%	51.20%	0.70%
1998	1.70%	38.30%	61.70%	1.10%
1999	4.10%	33.80%	66.20%	2.70%
2000	5.00%	25.30%	74.70%	3.80%
2001	9.10%	21.80%	78.20%	7.10%
2002	8.00%	29.70%	70.30%	5.60%
2003	3.30%	40.40%	59.60%	2.00%
2004	1.10%	58.50%	41.50%	0.50%
2005	2.80%	56.00%	44.00%	1.20%
2006	0.90%	55.00%	45.00%	0.40%
2007	0.40%	54.70%	45.30%	0.20%
2008	2.30%	26.90%	73.20%	1.60%
2009	10.30%	22.40%	77.60%	8.00%
2010	0.80%	40.90%	59.10%	0.50%
2011	1.70%	48.60%	51.40%	0.90%
2012	1.30%	53.20%	46.80%	0.60%
2013	0.70%	52.70%	47.30%	0.30%
2014	2.90%	48.00%	52.00%	1.50%
2015	1.80%	25.20%	74.80%	1.30%
2016	3.60%	31.10%	68.90%	2.50%
2017	1.30%	52.60%	47.40%	0.60%
25-yr Annual Avg.	**2.90%**	**41.50%**	**58.50%**	**1.70%**

For informational purposes only. Does not represent the Fund.

Lower Historical Sensitivity to Interest Rate Increases

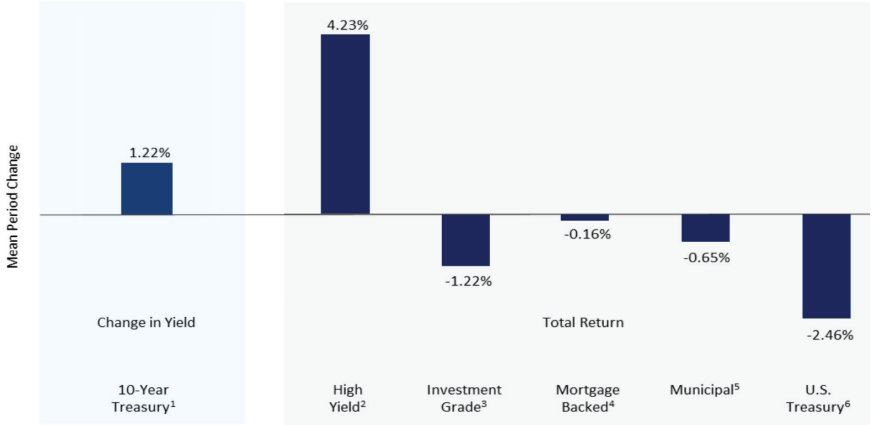
The chart below examines the historical performance of fixed income instruments during periods of rising interest rates. For the purpose of this chart, periods of rising interest rates are defined as an increase in the yield of the 10-Year Treasury of 0.50% or more. As expected, most fixed income securities decline during periods of rising interest rates. However, what is surprising is that historically, during periods of rising interest rates, high yield bonds have produced positive returns.

There are two primary reasons for this outcome. The first is that the spread above less risky instruments serves as a buffer against the effect of rising interest rates. The spread may narrow without necessarily causing prices to erode, but even if it doesn't narrow the additional yield offered by high yield debt offers a cushion against lower prices due to higher interest rates. The second reason is that interest rates generally rise during periods of economic strength. This type of economic environment is favorable to high yield instruments as it may reduce default risk, resulting in narrower spreads as an offset to rising interest rates.

In summary, high yield bonds offer the potential for enhanced yield, attractive risk-adjusted returns, portfolio diversification, lower sensitivity to rising interest rates, and lower than perceived default risk.

HIGH YIELD BONDS' LOWER SENSITIVITY TO RISING INTEREST RATES

Mean performance during periods of rising interest rates: September 1983 – September 2018



Calculated with monthly returns from September 1983 to September 2018. All data from Bloomberg. [1] Generic 10-year Treasury yield, [2] Bloomberg Barclay's US Corporate High Yield Index, [3] Bloomberg Barclay's US Corporate Investment Grade Bond Index [4] Bloomberg Barclay's US Mortgage-Backed Securities Index, [5] Bloomberg Barclay's Municipal Bond Index, [6] Bloomberg Barclay's US Treasury Bond Index.

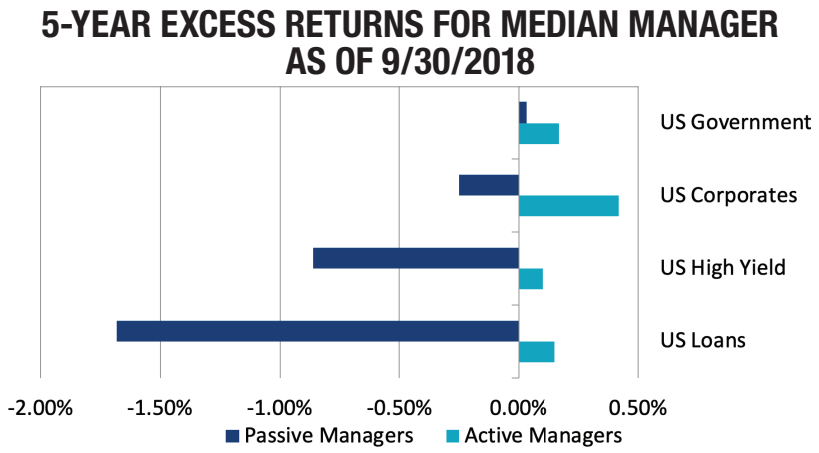
Past performance does not guarantee future results. The referenced indices are shown for general market comparisons and are not meant to represent the Fund. Investors cannot directly invest in an index and unmanaged index returns do not reflect any fees, expenses or sales charges. For a complete definition of indices, please see page 8.

Why Active Management Makes Sense in the Fixed Income Market?

Once you have made the decision to invest in high yield debt, it makes sense to consider an actively managed high yield portfolio. Why?

Historically, actively managed fixed income portfolios have been able to outperform their passive peers. In fact, a recent study by PIMCO showed that more than half of active fixed income managers outperformed their passive peers, and in the case of active high yield managers, the figure is closer to 80%. These results were far better than experienced by active managers in the equity space.

Similarly, a look at active managers in the eVestment database yields similar results:



Source: eVestment Alliance
Past performance does not guarantee future results.

While a case can be made that active and passive managers perform similarly in the more liquid government bond market, as we look into the less liquid, more research-intensive corporate bond and loan markets, the picture skews decidedly in favor of active managers.

Additionally, an academic paper looked at active fixed income portfolios constructed using trading rules which incorporated anticipated rate and spread change criteria. The paper found that using these straightforward rules would have led to superior risk-adjusted performance relative to standard fixed-income benchmarks.[10]

[10] Boyd, Naomi E., and Mercer, Jeffrey M., Gains from Active Bond Portfolio Management Strategies, Journal of Fixed Income, 9/14/10

What May Cause This Performance?

There are several potential reasons why active bond managers have outperformed passive indices. One of these involves the trading and rebalancing of indices. Bond indices are often rebalanced monthly to accommodate the maturation and issuance of debt. Much of the trading activity in bond indices is non-informational in that it merely responds to these changes or to index inclusion rules. On the other hand, the trading activity of active managers is often based on information. Fixed income portfolio managers perform in-depth analysis to pick securities that represent potentially attractive investment opportunities. To the extent that the trading activity of active managers is based on information, there is the potential for outperformance.

An active manager's information may also be evidenced in the holdings and construction of a portfolio. *Active managers can choose to hold the securities that he or she finds most attractive, irrespective of whether it is held in the index.* Additionally, active managers can choose to make structural tilts in the portfolio such as sector or industry tilts, duration tilts, or tilts towards factors such as credit quality, etc. An active fixed manager's portfolio can differ substantially from an index, which can potentially lead to outperformance.

In summary, active management can be a potentially attractive source of additional return in a fixed income portfolio. Non-informational trading in indices, coupled with in-depth analysis performed by fixed income portfolio managers and analysts, and the ability to take non-benchmark positions and tilts, can help active managers to potentially outperform in the fixed income space.

Since high yield is an attractive asset class and active management is a potentially profitable way of accessing the high yield market, how can investors gain exposure to active management in the high yield market?

The High Yield ETF (HYLD), managed by Phase Capital

The High Yield ETF (HYLD), managed by Phase Capital is an actively-managed fund which invests primarily in U.S. corporate high yield debt securities with the goal of achieving high current income and a secondary goal of capital appreciation.

On top of this, Phase Capital believes risk management is central to long-term investment success, and defines risk as permanent loss of capital. Therefore, Phase Capital layers market-leading risk management technology with fundamental insight from its team of industry veterans to deliver a strategy that is proactive in its effort to control volatility and minimize exposure to large losses.

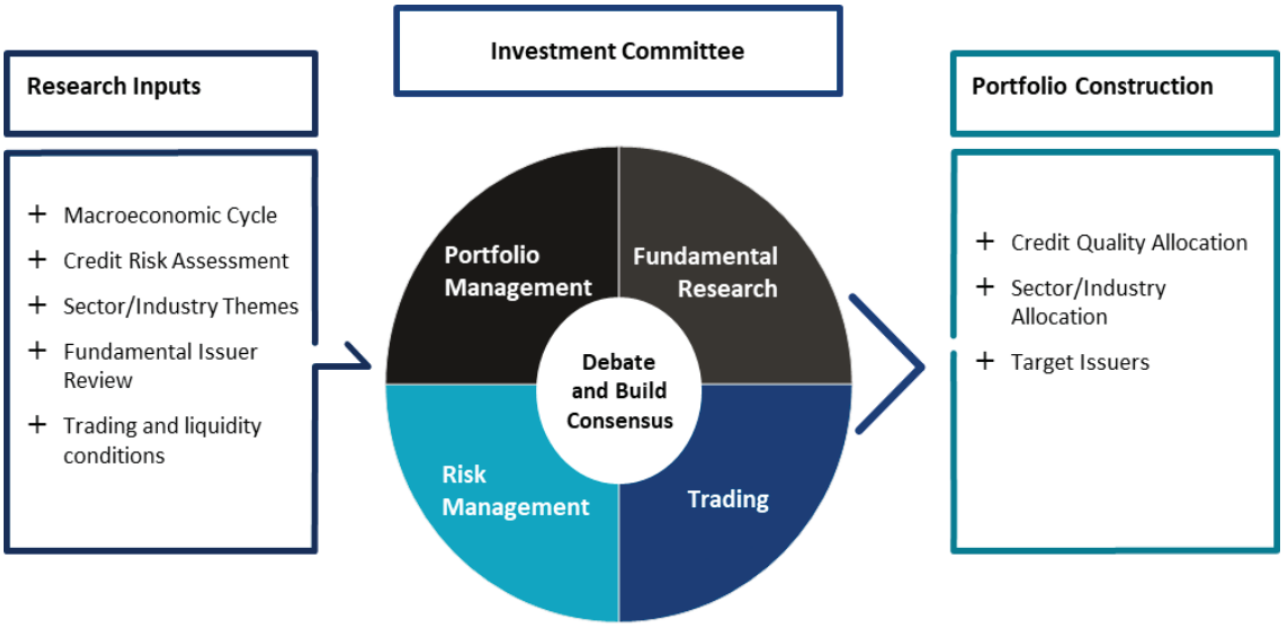
There are three key risks in a high yield corporate debt portfolio. The most commonly known are interest rate and default risk. As discussed earlier, interest rate risk is typically not material in a high yield portfolios because (1) the higher yield provides a cushion when interest rates rise, and (2) interest rates typically increase when the economy is strong, which is when default risk is much less of a concern, therefore spreads typically narrow during rising rate environments providing an offset to higher interest rates.

There is no assurance that the Fund will achieve its investment objective.

A far bigger risk in a high yield portfolio is credit or default risk. We aim to manage default risk through fundamental credit research at the issuer level and we actively monitor issuer level fundamentals for signs of stress. In addition, we run a very diversified portfolio so that no individual security can severely impair the portfolio. We target 1% position sizes, 1.5% for high conviction names, and limit industry weights to no more than 20%.

Equally as important, but often overlooked, is macroeconomic or business cycle risk. While the need for income may not change over time, the relative attractiveness of investing in high yield debt, or any risky asset for that matter, may vary with the macroeconomic cycle. During economic expansions, corporate profitability is typically robust and default risk very low. Therefore investing in single-B or triple-C rated issuers is usually a less risky proposition. During economic slowdowns or outright recessions, portfolios should be repositioned to hold higher credit quality and more senior debt since there is a greater probability of default risk.

Once a macroeconomic and credit risk assessment has been completed, the next step of our process involves selecting bonds and loans for the portfolio. The fund seeks to take advantage of the fact that many fixed income investors rely exclusively on debt ratings as a primary investment tool. HYLD believes that the focus should be on the fundamentals of the businesses in which the fund invests rather than the firm's rating. HYLD focuses primarily on cash flow and leverage, while also considering the company's balance sheet, history of producing cash flow and the firm's capital structure.



The goal of this process is to identify fixed income securities that are underpriced, and therefore offer generous yield and spread, relative to the risks involved. HYLD seeks to hold the debt of solid companies with cash flows that can support both its business and payment of interest and principal which it can buy at an attractive price.

Where HYLD Fits In a Portfolio

- **Fixed Income Sleeve –** HYLD can serve as all or a portion of a portfolio's fixed income allocation.
- **Income –** HYLD may provide investors with higher potential yield.
- **Potential Enhanced Return –** HYLD may offer potential enhanced return versus investment grade or U.S. Treasury debt securities.
- **Diversification –** high yield debt has historically exhibited low correlations to both equity and higher quality fixed income, such as investment grade and U.S. Treasury debt.

Summary

High yield debt securities offer many attractive features for investors including the potential for higher yield, capital appreciation, and portfolio diversification. Active investing within the fixed income space offers the potential for outperformance relative to passive fixed income indices.

HYLD combines these attractive features into one product. An ETF that actively invests in high yield securities. HYLD offers the potential for clients to realize the benefits of active management in the high yield debt market.

HYLD ETF

Disclosure

Carefully consider the Fund's investment objectives, risk factors, charges and expenses before investing. This and additional information can be found in the Fund's prospectus and Summary Prospectus, which may be obtained by visiting https://hyldetf.com/documents. Read the prospectus and Summary Prospectus carefully before investing.

Foreside Fund Services, LLC, distributor.

An investment in the Fund is subject to risk, including the possible loss of principal amount invested. High Yield Securities Risk. The risk that high yield securities or unrated securities of similar credit quality (commonly known as "junk bonds") are more likely to default than higher rated securities. High yield, lower rated bonds involve a greater degree of risk than investment grade bonds in return for higher yield potential. As such, securities rated below investment grade generally entail greater credit, market, issuer and liquidity risk than investment grade securities. Interest rate risk occurs when interest rates rise as bond prices usually fall. This Fund may not be suitable for all investors.

High Yield Bonds - Bloomberg Barclay's US Corporate High Yield Index - measures the USD-denominated, high yield, fixed-rate corporate bond market; **Large Cap Stocks** – S&P 500 – tracks the performance of large-cap U.S. equities. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization; **Small Cap Stocks** – Russell 2000 – tracks the performance of small-cap U.S. equities; **Investment Grade Corporate Bonds** - Bloomberg Barclay's US Corporate Investment Grade Bond Index - measures the investment grade, fixed-rate, taxable corporate bond market; **Aggregate Bonds** - Bloomberg Barclay's US Aggregate Bond Index - measures the investment grade, US dollar-denominated, fixed-rate taxable bond market; **Municipal Bonds** - Bloomberg Barclay's Municipal Bond Index - covers the USD-denominated long-term tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prefunded bonds; **Treasury Bonds** - Bloomberg Barclay's US Treasury Bond Index - measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury; **Mortgage Backed** – Bloomberg Barclay's US Mortgage-Backed Securities Index - tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC); **Gold** – Spot Gold $/oz.

Shares are bought and sold at market price (closing price) not net asset value (NAV) and are not individually redeemed from the Fund. Market price returns are based on the midpoint of the bid/ask spread at 4:00pm Eastern Time (when NAV is normally determined) and do not represent the return you would receive if you traded at other times.