Osterweis Strategic Income Annual Report

April 24, 2017

Fund Information	
Ticker	OSTIX
Asset Class Category	Absolute-Return-Oriented Bond
Share Class	Retail
Min. Initial Investment	$5,000
Availability*	Schwab, TD Ameritrade, Fidelity
Expense Ratio	0.83%
Opinion	*Recommended*
Firm	Osterweis Capital Management
Managers	Carl Kaufman, Simon Lee, Bradley Kane, and Craig Manchuck
Phone	866-236-0050
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**Certain restrictions apply. Please check with your broker/dealer for details.*

Discussion of Recent Performance

We recently met with three members of the Osterweis Strategic Income team in their San Francisco offices to get their view on the high-yield market and portfolio positioning. We also wanted to meet the newest member of the team, Craig Manchuck. He replaces Simon Lee, who is retiring in mid-May. More on these team changes in the opinion section below.

Market Opportunity

The team views high-yield valuations, in aggregate, as mildly expensive. However, they mention the high-yield market is not priced at extremes based on yield or spread levels. Yet, high-yield still appears attractive relative to the paltry yields offered by investment-grade fixed-income alternatives, both domestically and abroad.

One indication of a frothier high-yield market is new-issue deal terms. According to the team, some higher-rated companies in the high-yield universe have recently been able to issue longer-maturity bonds with sub-5% coupons, a level well below the 8.5% long-term average coupon for the high-yield market. Generally speaking, when demand for high-yield is strong, issuer-friendly deals occasionally squeak through. Subsequently, the market typically reacts by requiring issuers to provide more investor-friendly terms. In the current market environment, portfolio manager Carl Kaufman says issuer-friendly deals continue to get done. The team is avoiding these deals. In Kaufman's eyes, the yield is often not adequate for the level of risk. He says should there be a normalization of interest rates, yields on high-yield bonds will increase, even if credit fundamentals do not deteriorate. "It won't take much of a rate move to wipe out a 5% coupon for an eight- to 10-year maturity [high-yield] bond in this type of market." For example, if the 10-year Treasury increases to 3.5%, he asserts, "There is no way someone is going to buy a [sub-5% yielding] B-rated issuer. It's just not going to happen." He estimates the price of such a bond could decline meaningfully, as yields could increase by 300 basis points or more.

With the new-issue market generally unattractive, the team's recent portfolio additions have, for the most part, been opportunistic purchases in the secondary market. Kaufman explains that in a strong new-issue market, it's common for the longer-dated, benchmark-oriented high-yield funds to sell holdings that are closer to maturity in exchange for longer-dated bonds that typically have higher yields. This creates an opportunity for the team to purchase bonds that are closer to maturity with a decent amount of yield, and

Osterweis Strategic Income Top 10 Holdings (3/31/17)	
Rite Aid	3.7%
Regis	2.0%
Transfield Services	1.6%
CHS/Community Health	1.5%
ADS Tactical	1.5%
Shearers Foods/Chip	1.5%
AK Steel	1.5%
Herc Rentals	1.4%
Oppenheimer Holdings	1.4%
Navistar International	1.4%
Total	**17.4%**

Osterweis Strategic Income Credit Quality (3/31/17)	
BBB	0.2%
BB	13.6%
B	41.6%
Below B	9.9%
Not Rated	14.0%
Cash	20.7%
Total	**100.0%**

Osterweis Strategic Income Characteristics (3/31/17)	
Coupon	6.10%
Effective Duration	1.45
Years to Maturity	2.61
Yield to Maturity	6.51%

an attractive risk/reward tradeoff. For example, the team recently added a bond with six months remaining to maturity, yielding 3.25%. Kaufman says in this environment, "We're happy to hit singles … and [the return] is better than cash."

Going forward, the team believes a large portion of the high-yield market will be more correlated to the Treasury market than it historically has. As Treasury yields eventually move higher, today's tight yield spreads relative to Treasurys will force bond yields higher. But this could take time to play out. The combination of a domestic economy that is grinding ahead and generally healthy high-yield fundamentals suggests that high-yield defaults (and spreads) could remain at below-average levels. Also, companies have been prudently refinancing debt in order to reduce their interest expense and extend debt maturities. Kaufman adds that financial leverage is stable to improving.

The team remains patient in waiting for attractive opportunities. At the time of our interview, cash was approximately 20% of the portfolio. The team is putting some cash to work, but the combination of portfolio holdings being called and investor inflows is keeping cash high. Kaufman says he'll put more cash to work when buying opportunities present themselves during market pullbacks.

The team's asset base of approximately $5.5 billion changes the profile of deals they get to see. The fund's larger asset base gives the team the ability to negotiate directly with companies, as opposed to dealers. In some cases, Kaufman is among the largest holders of a particular bond issue. When a portfolio-holding company wants to refinance early, it can talk directly with large holders, such as Osterweis, instead of with the big banks. This can be beneficial for both parties. The team provided us with a few examples of deals that went largely ignored by other investors because they were initially non-index issues and from smaller (around $400 million) first-time issuers during a busy issuance season. A recent addition to the portfolio is **Conduent**, a spinoff from **Xerox**. The company is the world's largest diversified business process services company with capabilities in transaction processing, automation, and analytics. Kaufman says the company is deeply embedded with its customers and hard to displace. The company was a first-time issuer. The team was able to initiate a meaningful portfolio weight (1.1%) at a discount to par, with a 10.5% coupon for a seven-year maturity.

The team has been opportunistically adding convertible bonds and recently had a roughly 6% exposure. These are typically busted convertibles, which have more bond-like characteristics (because a decline in the corresponding equity price has rendered the conversion option less valuable), as opposed to equity-sensitive convertibles. Kaufman and Manchuck highlighted a recent increase in convertible bond issuance, which means there could be more opportunities down the road.

Notable Developments

At the team level, there are noteworthy changes. Simon Lee, assistant portfolio manager, is retiring effective May 15, 2017. Lee joined Osterweis Capital in 2008. Stepping in is Craig Manchuck, who joined the Strategic Income team in February of this year. Manchuck comes from the sell-side. He was formerly a managing director of fixed-income sales at Stifel Nicolaus, where he was responsible for sales and origination of high-yield bonds, leveraged loans, and post-reorganization equities. Before Stifel, he held a similar role at Knight Capital. Prior to that, Manchuck was the executive director for convertible securities and then high yield/distressed securities at UBS. He has previous experience in convertible securities sales at Donaldson, Lufkin & Jenrette, SBC Warburg, and Merrill Lynch.

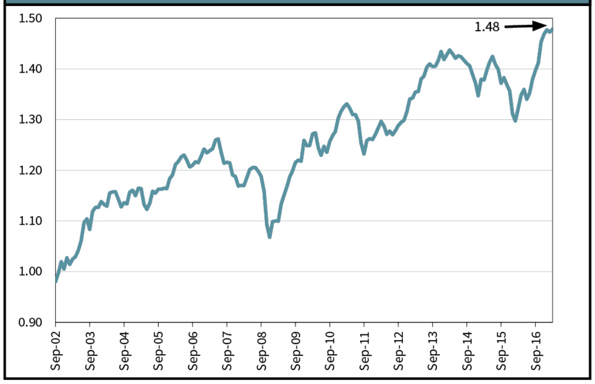
Our initial impression of Manchuck is that he is a good fit, both professionally and culturally. Kaufman and Lee have known Manchuck for approximately 20 years. We're confident that Kaufman would not risk changes to the team's positive dynamic, investment philosophy, or approach. Manchuck has also been an investor in the fund for over 10 years, so he is very familiar with the strategy. We plan to spend more time with Manchuck in the future, walking through portfolio holdings to ensure that he is applying the same investment philosophy and process as the team has done to date.

Litman Gregory Opinion

When evaluating this fund's performance, up until now, we have considered two benchmarks. In this report we are adding a third. Our primary benchmark is the Vanguard Total Bond Market Index Fund, an investable version of the Bloomberg Barclays U.S. Aggregate Bond Index. Our view is that Kaufman's flexible strategy was designed such that it could serve as an investor's entire fixed-income allocation. It therefore should beat the bond market over the long term. Over shorter time periods, we compare performance against the Citigroup 3-Month U.S. Treasury Bill Index given Kaufman's goal of preserving capital. The third benchmark we are adding is the iShares 0-5 Year High-Yield Corporate ETF. iShares introduced this short-dated high-yield ETF in mid-October 2013. We think it's a relevant performance benchmark given its similar duration and maturity profile.

Year to date through March, Osterweis Strategic Income is up 1.6%. The Vanguard benchmark gained 0.9% in the first quarter, whereas the Citigroup 3-Month Treasury Bill Index returned 0.1%, and the iShares ETF is up 1.9%.

Relative Strength:
Osterweis Strategic Income Fund vs.
Vanguard Total Bond Market Index Fund
(3/31/17)



Looking longer term, since the start of our track record for the fund in September 2002 through March 2017, Kaufman generated a 6.9% annualized return, compared to 4.2% for the Vanguard Total Bond Market Index Fund and 1.2% for three-month T-bills. The fund has also outpaced both benchmarks over the trailing one-, three-, five-, and 10-year periods. Since the beginning of November 2013, which approximates the ETF's inception, Osterweis Strategic Income had an annualized returned of 4.1% versus 3.6% for the ETF.

Looking at rolling one-year periods, Kaufman has outperformed the Vanguard fund in 65% of rolling 12-month periods. We expect the fund to periodically underperform both benchmarks. For example, Kaufman has underperformed the Vanguard Total Bond Market Index Fund by 600 bps in a single month, and has also underperformed T-bills by as much as 500 bps in a single month. The 600 bps of underperformance occurred during the credit collapse in the fourth quarter of 2008. In downturns prior to and since then, the fund's worst one-month underperformance has been in the 200- to 300-basis-point range. Over rolling three-year time frames, which approximates the average holding period, the fund has out-

Performance Table
(3/31/17)

		Calendar Year Returns					Trailing Returns*				
	YTD	2016	2015	2014	2013	2012	One-Year	Three-Year	Five-Year	10-Year	Since Start of Record
Osterweis Strategic Income Fund	1.58%	10.95%	-0.93%	1.26%	6.58%	8.55%	12.18%	3.46%	4.88%	5.98%	6.99%
Vanguard Total Bond Market Index Fund	0.88%	2.50%	0.30%	5.76%	-2.26%	4.05%	0.33%	2.49%	2.16%	4.12%	4.16%

**Start of record Sep-2002.*

performed the Vanguard benchmark in 84% of rolling periods and bettered the three-month T-bill index 96% of the time.

At the portfolio holdings level, we compared Osterweis Strategic Income with the short-term high-yield ETF. We found that of the 69 high-yield bond issuers (as of 3/31/17) Kaufman held in the fund, 28 were in the ETF. This overlap is a tad higher than it has been in the past. In some cases where Kaufman does own the same issuer as the ETF, he often owns a different issue (i.e., one with a different maturity, coupon, and/or structure). This is worth mentioning because an ETF will generally hone in on one bond from a certain issuer, and that bond can trade at slightly richer levels than the other bonds. The overlap the fund does have with the ETF, we think, is based on opportunities, not an attempt to mimic the ETF. We continue to view Kaufman as benchmark agnostic. Our observations supporting this view include the fact that Kaufman does identify one-off type names as well as deals that fall below the minimum deal size required for the ETF. Recently, roughly 60% of Osterweis Strategic Income's assets were in cash, convertibles, and bonds with issuance below $350 million, all assets that ETFs typically do not own. This speaks to the fund's differentiation relative to the ETF.

We don't currently have any material concerns and believe the team remains disciplined in the execution of their risk-averse strategy. In this extended credit cycle, we believe the team's emphasis on being selective and waiting for attractive risk/rewards remains central to the investment process. Kaufman will not own a longer-maturity issue just for the sake of picking up incremental yield). He is willing to accept lower absolute returns if he feels it is appropriate given the risk/reward environment. To that end, we like that the success of the fund is credit specific and not dependent upon making macro calls.

—Jack Chee and Kiko Vallarta, CFA

OSTERWEIS STRATEGIC INCOME FUND

Litman Gregory Advisor Intelligence

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The Fund's average annual total return for the one year, three year, five year, ten year and since-inception periods ending 9/30/2017 were as follows:

	1 Year	3 Year	5 Year	10 Year	Since Inception (8/30/2002)
Osterweis Strategic Income Fund	***6.74%***	***4.50%***	***4.93%***	***6.28%***	***6.97%***
Bloomberg Barclays U.S. Aggregate Bond Index	***0.07%***	***2.71%***	***2.06%***	***4.27%***	***4.31%***
Vanguard Total Bond Market Index Fund	***-0.23%***	***2.52%***	***1.86%***	***4.11%***	***n/a***
Citigroup 3-Month U.S. Treasury Bill Index	***0.64%***	***0.29%***	***0.19%***	***0.42%***	***n/a***
iShares 0-5 Year High-Yield Corporate ETF*	***7.01%***	***4.18%***	***n/a***	***n/a***	***n/a***

Expense Ratio as of 3/31/2017: 0.88%
Performance data quoted represents past performance and does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted above. Performance data current to the most recent month end may be obtained by calling toll-free (866) 236-0050 for the Osterweis Strategic Income Fund and www.iShares.com or www.blackrock.com for SHYG and www.vanguard.com/performance or by calling Vanguard toll-free at 800-662-7447 for the Vanguard Total bond Market Index Fund.

* iShares returns are Market Price returns. Shares of ETFs are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Brokerage commissions will reduce returns. Market returns are based upon the midpoint of the bid/ask spread at 4:00 p.m. Eastern time (when NAV is normally determined for most ETFs), and do not represent the returns you would receive if you traded shares at other times. The fund's inception date is October 15, 2013.

Investing involves risk, principal loss is possible.

The Osterweis Strategic Income Fund (the Fund) may invest in debt securities that are un-rated or rated below investment grade. Lower-rated securities may present an increased possibility of default, price volatility or illiquidity compared to higher-rated securities. The Fund may invest in foreign and emerging market securities, which involve greater volatility and political, economic and currency risks and differences in accounting methods. These risks may increase for emerging markets. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Small- and mid-capitalization companies tend to have limited liquidity and greater price volatility than large-capitalization companies. Higher turnover rates may result in increased transaction costs, which could impact performance. From time to time, the Fund may have concentrated positions in one or more sectors subjecting the Fund to sector emphasis risk. The Fund may invest in municipal securities which are subject to the risk of default.

References to other mutual funds should not be interpreted as an offer of these securities.

While the fund is no-load, management fees and other expenses still apply. Please refer to the prospectus for more information.

Opinions expressed in the article are those of the author and portfolio manager and the information has not been verified by Osterweis Capital Management. These opinions are subject to change at any time, are not guaranteed and should not be considered investment advice.

Click here to read the Osterweis Funds prospectus.

As of 9/30/2017, the Fund's top ten holdings as a percentage of total assets were:

Holding	% of Total Portfolio
Rite Aid Corp. 9.25%	3.5
Regis Corp. 144A 5.50%	1.9
CHS/Community Health 8.00%	1.4
Herc Rentals Inc. 144A 7.50%	1.3
Shearers Foods / Chip 144A 9.00%	1.3
Navistar Intl. Corp. 8.25%	1.3
Ruby Tuesday Inc. 7.625%	1.2
Ally Financial Inc. 8.00%	1.2
GFL Environmental Inc. 144A 9.875%	1.2
Alliance Data Systems Co. 144A 6.375%	1.2

Fund holdings are subject to change and are not recommendations to buy or sell any security. *Current and future holdings are subject to risk.* Further information about the Fund's portfolio allocation as of the last day of the most recent calendar quarter is available by visiting www.osterweis.com.

Credit Quality weights by rating were derived from the most recent data available as determined by Standard and Poor's. Grades are assigned to bonds by private independent rating services such as Standard & Poor's and these grades represent their credit quality. The issues are evaluated based on the bond issuer's financial strength, or its ability to pay a bond's principal and interest in a timely fashion. Ratings are expressed as letters ranging from 'AAA', which is the highest grade, to 'D', which is the lowest grade.

Short dated high yield ETFs are generally passively managed and track an index while short-dated high yield funds maybe be actively managed and have various investment objectives. ETFs may have lower fees than mutual funds. ETFs may be traded by investors throughout the day while mutual funds are only traded once per day. ETFs maybe be more tax efficient that mutual funds.

The Bloomberg Barclays U.S. Aggregate Bond Index is an unmanaged index that is widely regarded as the standard for measuring U.S. investment grade bond market performance.

The Citigroup 3-Month T-Bill Index is an unmanaged index of three-month Treasury bills.

The Vanguard Total Bond Market Index Fund (VBMFX) pays a management fee of 0.12% and has a total annual expense ratio of 0.15%. Total market value as of 8/31/2017 was $188.8 billion. The fund seeks to track the performance of a broad, market-weighted bond index. The fund invests in investment-grade corporate, U.S. Treasury, mortgage-backed, and asset-backed securities with short, intermediate, and long maturities in excess of one year, resulting in a portfolio of intermediate duration. The fund's passive investment style uses a sampling technique to closely match key benchmark characteristics: sector weight, coupon, maturity, effective duration, convexity and credit quality. The fund subject to interest rate risk (The chance that bond prices overall will decline because of rising interest rates.). Additionally the fund is subject to other risks including income risk (the fund's income will decline because of falling interest rates), credit risk (bond issuers could fail to pay interest in a timely manner causing the price of the bonds to decline), and reinvestment risk (in times of falling interest rates, issuers may call higher coupon bonds causing the fund to reinvest proceeds at lower interest rates). The Osterweis Strategic Income Fund (OSTIX) pays a management fee of 0.71% and has a total annual expense ratio of 0.88%. Total market value as of 8/31/2017 was $5.8 billion. The fund seeks to preserve capital and attain long-term total returns through a combination of current income and moderate capital appreciation.

The Osterweis Strategic Income Fund seeks to preserve capital and attain long-term total returns through a combination of current income and moderate capital appreciation.

The iShares 0-5 Year High Yield Corporate Bond ETF seeks to track the investment results of an index composed of U.S. dollar-denominated, high yield corporate bonds with remaining maturities of less than five years. The ETF's expense ratio as of 3/1/2017 was 0.30%Fixed income risks include interest-rate and credit risk. Typically, when interest rates rise, there is a corresponding decline in bond values. Credit risk refers to the possibility that the bond issuer will not be able to make principal and interest payments. Non-investment-grade debt securities (high-yield/junk bonds) may be subject to greater market fluctuations, risk of default or loss of income and principal than higher-rated securities. Performance shown reflects fee waivers and/or expense reimbursements by the investment advisor to the fund for some or all of the periods shown. Performance would have been lower without such waivers.

Click here to read the iShares 0-5 Year High Yield Corporate ETF's prospectus.

Click here to read the Vanguard Total bond Market Index Fund's prospectus. The Fund's inception date is December 11, 1986.

ETFs may have lower fees than mutual funds. ETFs may be traded by investors throughout the day while mutual funds are only traded once per day. ETFs maybe be more tax efficient that mutual funds.

A basis point is a unit that is equal to 1/100th of 1%.

Availability: S, A, F refers to brokerage platform availability; the fund is available at Schwab, TD Ameritrade and Fidelity.

A convertible bond is a type of debt security that can be converted into a predetermined amount of the underlying company's equity at certain times during the bond's life, usually at the discretion of the bondholder.

Coupon is the interest rate stated on a bond when it's issued. The coupon is typically paid semiannually.

Duration measures the sensitivity of a bond's price (or the aggregate market value of a portfolio of bonds) to changes in interest rates. Bonds with longer durations generally have more volatile prices than bonds of comparable quality with shorter durations. Effective Duration is a duration calculation for bonds with embedded options and takes into account that expected cash flows will fluctuate as interest rates change. Effective duration is calculated only on the Fund's fixed income holdings and cash.

EBITDA is an acronym for Earnings Before Interest, Taxes, Depreciation and Amortization.

Free cash flow represents the cash that a company is able to generate after laying out the money required to maintain and expand the company's asset base. Free cash flow is important because it allows a company to pursue opportunities that enhance shareholder value.

Relative strength creates points of comparison regarding the performance of a particular security or fund against the performance of a selected benchmark, such as a market index, as well as to other similar securities or funds.

Yield to maturity is the rate of return anticipated on a bond if it is held until the maturity date.

Criteria for Recommended Funds: Recommended funds are evaluated by Litman Gregory based on a combination of qualitative and quantitative measures, including absolute and relative long-term performance metrics when compared to an appropriate benchmark and peer group, manager skill, investment process and the discipline by which the process is applied, quality and tenure of research team, shareholder orientation, assets under management, and fund expenses. Recommended reflects Litman Gregory's confidence in a fund's potential to outperform a relevant benchmark over the long term.

Osterweis Capital Management is the adviser to the Osterweis Funds, which are distributed by Quasar Distributors, LLC. [26563]