Osterweis Strategic Income Annual Update

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Fund Information	
Ticker	OSTIX
Asset Class	Absolute-Return-Oriented Bond
Share Class	Institutional
Investment Minimum	$5,000
Availability	Schwab, TD Ameritrade, Fidelity
Expense Ratio	0.88%
Opinion	Recommended
Firm	Osterweis Capital Management
Managers	Carl P. Kaufman, Bradley M. Kane, Craig L. Manchuck
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Investment Environment & Opportunity Set

Prior to the Ukraine-Russia crisis, we met with the three portfolio managers of Osterweis Strategic Income Fund. At the macroeconomic level, portfolio manager Carl Kaufman expects the Fed will stick to its word and begin raising rates at a slow and measured pace, but he believes "they are late, as always." He notes that the Fed will be raising rates into a weakening, but still-growing economy with inflation. Kaufman points to the yield curve, which is currently flatter than usual at this point in a Fed hiking cycle, implying the economy may slow or the Fed will make a policy error. (The shape of the yield curve typically discounts 12 months out.)

If the consensus number of rate hikes plays out, by the end of 2023, Kaufman says rates will be near pre-Covid levels. At that level, rates would still be historically low against a relatively healthy economic backdrop. He does not believe this level of rates will be a hindrance to businesses or the economy given his expectation for slow and steady economic growth. With rates still historically low, Kaufman believes the global search for yield will continue.

When it comes to inflation, Kaufman says that while the supply chain snarls are certainly inflationary, it's important to realize that the absolute amount of goods being sold and delivered is at record levels. Companies simply cannot keep up with the excess demand. Over time, goods inflation should subside, but he cautions that the inflationary baton could be handed off to the services segment of the economy. Meanwhile, it's unlikely that companies will let go of their newly found pricing power too easily. Ultimately, Kaufman thinks we are in for a period of higher inflation and rates, and eventually that will impact demand but for now he does not see severe economic headwinds.

Kaufman notes that the broad high-yield market is in better shape than it has been in a long time. Amid prevailing low interest rates, management teams have appropriately lowered their cost of debt, extended maturities, and improved interest coverage ratios. Meanwhile, access to capital is abundant (N.B. pre-war) as issuers have access to the various markets including high-yield, floating-rate loans, private debt, and alternatives. Co-portfolio manager, Brad Kane highlights the speed at which companies can raise money today. He says, "In the snap of their fingers, larger, well-known companies can raise a couple hundred million dollars." All of this is healthy for the overall high-yield market. Of course, some companies are taking advantage of the issuer-friendly environment and taking on too much leverage. "We avoid those, and we stay patient," says Kaufman.

Despite the recent volatility in the equity market, high-yield bonds have not seen a meaningful correction. "Until we get money pulled out of the system, we're not going to see the weakness we need to go in with both hands," says Kaufman. For now, the team remains opportunistic and buying individual bonds on dislocations.

In terms of the team's opportunity set, they continue to avoid emerging-markets bonds. "We don't trust their numbers," says Kaufman. "A lot of the emerging market is China, and we avoid markets run by edict. I am not saying opportunities do not exist at times, but I will leave that to other investors." Co-portfolio manager Craig Manchuck adds that when investing in emerging-markets debt, the rules can suddenly change, and outcomes can be painful. For example, it is common for emerging-markets bond investors to assume zero recoveries in the event of a default. "That's the downside in those markets," says Manchuck. Furthermore, in some bankruptcies, equity holders get paid ahead of bondholders, which is the opposite of the U.S. He also gives the example of a large-cap Canadian mining company that had a large mine in Zambia. Out of nowhere, the government instituted a tax on all extracted minerals and bond prices plummeted. "We could see exogenous effects on the portfolio from government edicts and that's way beyond the scope of what we look for," says Manchuck. Recently, the team passed on a mining deal that was tied to a Brazilian copper mine for similar reasons. "Headline surprise is not what we're looking for," says Kaufman, who reiterated the team's emphasis on understanding the risks they take. "We look at the world as a market of individual bonds, as opposed to broad market, meaning every single company and bond is different."

Portfolio Update

In terms of portfolio positioning, Kaufman says high-yield bonds are attractive relative to most other parts of the fixed-income market. As the team surveys the landscape, they continue to feel that below-investment-grade corporate debt offers attractive forward-looking risk-reward characteristics, i.e., relatively attractive yields, less interest-rate sensitivity, and low expected defaults. He notes that the overall credit quality profile for the high-yield universe has improved over the past several years and the interest-rate risk has declined. The opposite is true for investment-grade corporate bonds. Other unattractive markets are mortgages and Treasuries given their low yields and long duration.

While the team is generally constructive on the economy, they believe inflation and rising rates are both headwinds that will likely persist throughout 2022. Given these crosscurrents, they have constructed a barbell strategy that includes a mix of short-term and longer-term debt. This approach allows them to take advantage of attractive returns for a portion of the portfolio, while shorter maturities mature, creating liquidity. Cash and equivalents were 15.06% of assets at the end of January. This cash allocation is not a top-down call, but rather a function of less attractive market fundamentals and valuations. With a slow and deliberate Fed tightening cycle looming, the team will have dry powder to opportunistically take advantage of volatility.

A purchase in the third quarter of last year was **American Airlines**, currently a top position. The bond has an 11.75% coupon and matures in July 2025. The team bought bonds with yields in the 4.5% to 5% range (depending on the price they paid), for what is now just over a three-year maturity. Kane points out that it's a first-lien bond for the company which is generating meaningful cash flow again and is planning to pay down $5 billion of debt over the course of 2022. Therefore, it's likely the company will call the bonds, which have a high interest cost, at a slight premium this year, which will result in slight upside price appreciation for the bonds.

One area the team has been finding attractive opportunities is in convertible bonds, a segment where the team has expertise and has periodically invested over the years. Convertible bond exposure is approximately 8.0% of the portfolio, of which just over half (4.5%) is in equity-sensitive converts and the remainder is in busted convertibles. Convertible bonds are categorized based on their sensitivity to movements in the underlying stock. Busted convertibles have the least sensitivity and behave more like bonds, whereas equity-sensitive or "in the money" convertibles trade more like equities and most of their value is derived from the underlying stock price. The position size of convertible bond holdings tends to be smaller, especially equity-sensitive holdings. Liquidity is also another factor as convertible bonds tend to be as liquid as the underlying equity. If the underlying common stock does not trade much, an equity-sensitive position will be kept smaller. Liquidity for busted convertibles is less important as the team looks at it as buying a bond.

An example of a convertible holding is Fluor, a 6.5% convertible Preferred. After struggling operationally for a few years, then being forced to go through a formal investigation by the SEC, Fluor's stock price got clobbered from over $60 per share down to $3 in 2020. The company cleaned house and then brought in a new management team to turn the business around. As the business showed signs of bottoming in mid-2021, the company issued a 6.5% convertible preferred issue to shore up its capital base. Seeing signs of a turnaround in the business and recognizing that the Biden administration was focused on passing a large infrastructure bill that would also likely provide a tailwind to the company, the Osterweis team bought some of the Fluor convertible preferred shares when they were issued, given the brightening prospects for the company and the depressed stock price. The business has been slowly improving, it has shed some non-core assets and is refocusing on core energy and chemical construction projects globally.

As for return expectations, Kaufman believes high-yield bonds could return 4% to 5% this calendar year (N.B. prewar estimate) which is roughly in line with the asset class's coupon. If interest rates are increasing because of inflation and a strong economy, he expects credit spreads to be relatively stable or tighten a bit at first. But eventually they'll widen.

The portfolio has approximately 175 issues, held across fewer issuers. (They frequently own multiple tranches from the same issuer.) At the time of our conversation, the high-yield portion of the portfolio's yield-to-maturity was 5.70%, compared to 5.25% for the high-yield market, and has lower duration.

Sector Distribution	
Government	0.00%
Investment Grade Corporate	0.95%
High Yield	73.08%
Bank Loans	0.00%
Structured	0.00%
Other*	10.91%
Cash & Equivalents	15.06%
	100.00%

*Converts/Preferreds/Private Mortgages/Corporate Action Equities

Source: Osterweis Capital Management. As of 1/31/22.

Credit Quality	
AAA	9.14%
AA	3.29%
A	1.90%
BBB	1.03%
BB	28.81%
B	39.55%
< B	4.92%
Not Rated	11.36%
Total	100.00%

Source: Osterweis Capital Management. As of 2/28/22

Investment Philosophy & Process

The team seeks to preserve capital and attain long-term total returns through a combination of current income and a moderate level of capital appreciation. The investment philosophy is predicated on the belief that strong long-term investment results are best achieved through a compounding of reasonable gains and the avoidance of major losses. Co-managers Kaufman, Kane, and Manchuck are absolute-return oriented rather than relative-return oriented, seeking out the most opportunity for the least amount of risk. To accomplish this goal, they build a portfolio of credits through bottom-up credit analysis, while opportunistically emphasizing different segments of the fixed-income universe based on their view of relative attractiveness. They employ this risk-averse approach during all stages of a credit cycle and will not stretch for yield in a low-yielding environment to boost returns.

The investment approach is based on Kaufman's analysis that the bond market consists of sectors that behave differently under different economic conditions. For instance, during periods of economic growth, high-yield and convertible bonds tend to perform well as rising corporate profits lead to improved credit profiles. Conversely, these bonds tend to perform very poorly during periods of economic contraction as credit profiles deteriorate. During these recessionary periods, higher-quality bonds (for example, Treasuries) generally prove to be the best performers because of their responsiveness to declining interest rates. Kaufman believes that limiting a portfolio to just one broad fixed-income sector, such as high-yield bonds, investment-grade bonds, or convertible bonds, would force the team to be invested in that sector not only when it is performing well but also when it is overvalued or performing poorly. So, he avoids the "style-box" trap and has the flexibility to invest in multiple asset classes and credit ratings of bonds. As such, the portfolio is managed in such a way as to emphasize the most attractive opportunities at any given time.

Typical portfolio holdings are corporate bonds, including short-dated, and to a lesser extent, longer-dated high-yield bonds, convertibles, investment-grade bonds (though exposure tends to be limited), floating-rate bonds, and Treasuries. Convertibles can account for a meaningful percentage of the portfolio, as the team has many years of experience investing in convertibles. Typically, they purchase busted convertibles, which have more bond-like characteristics (because a decline in the corresponding equity has rendered the conversion option valueless) as opposed to equity-sensitive convertibles, though they will selectively own these when they deem the risk/reward tradeoff to be appropriate. Kaufman typically avoids mortgages, municipals, and TIPS, as well as distressed issuers and industries. The fund's average duration will be in the two-and-a-half to three range, though we expect there will be periods where portfolio duration could be less or more. Kaufman believes that one- to three-year high-yield paper has unique defensive characteristics over multiple time periods, while producing consistently positive performance. Furthermore, company managements are typically focused on ensuring repayment of shorter-term maturities; therefore, price volatility is usually lower than for longer-term debt. Plus, many companies have only a few pieces of debt outstanding; this improves the ability to analyze risk in shorter-term paper.

Kaufman, Kane, and Manchuck select individual securities based on bottom-up, fundamental credit analysis. They look to understand the company's balance sheet by determining the company's ability to generate recurring free cash flow from operations. As a result, they strive to understand a company's business prospects, which influences the company's ability to generate cash flow. They believe they find their best investments in companies that have great products, a competitive advantage that permits pricing power, a consistent operating history, and management that operates the company as if they own it. Lastly, they determine what they believe to be the appreciation potential versus the downside risk to gauge the attractiveness of the security versus existing holdings and other investment opportunities.

Performance Analysis & Opinion

Performance as of 2/28/22	MTD	Three-Month	YTD	One-Year	Three-Year	Five-Year	10-Year	Since Start of Record
Osterweis Strategic Income	-0.53%	-0.65%	-1.83%	2.92%	4.83%	4.35%	4.62%	6.32%
Bloomberg U.S. Aggregate Bond Index	-1.12%	-3.49%	-3.25%	-2.64%	3.30%	2.71%	2.47%	3.92%

Relative Strength: Osterweis Strategic Income vs. Bloomberg U.S. Aggregate Bond Index

We have been investing with Kaufman for approximately 14 years and have observed the strategy through several cycles. We continue to think highly of him and his co-managers, and we remain impressed with the quality of the team's analysis and the discipline in which they execute the investment process. In our opinion, they continue to place a lot of emphasis on stacking the deck in their favor by focusing on favorable outcomes, i.e., they do not speculate or stretch for incremental yield. We like that the team has a willingness to accept lower absolute returns if they believe it is appropriate given an unattractive risk/reward environment. Conversely, we have observed the team aggressively put money to work when the market sells off and valuations become more attractive. To that end, we like that the success of the fund is credit-specific and not dependent upon making macro calls.

The team is very selective about the types of companies they own and how much they will pay for a bond given the company-specific characteristics and risks. For over a decade we have seen a consistent theme of identifying stable businesses with consistent operating histories and competitive advantages that can lead to recurring revenues as well as pricing power. There is a clear focus on understanding a company's balance sheet, a company's ability to generate recurring free cash flow from operations, and the risks to those cash flows, which could impair a company's ability to meet debt obligations. Sticking to their competency is key to the approach, and the discussion above on the team's decision to avoid emerging-markets debt shines some light on this.

When evaluating this fund's performance, we consider two primary benchmarks, but we also monitor additional benchmarks. Our primary benchmark is the Bloomberg U.S. Aggregate Bond index. Our view is that the strategy was designed such that it could serve as someone's entire fixed-income allocation, and therefore it should beat the broader bond market over the long term. Over shorter time periods, we compare performance against the FTSE 3-Month U.S. Treasury Bill Index given the team's goal of preserving capital. Since the fund's August 2002 inception (through February 28, 2022), Osterweis Strategic Income has generated a 6.32% annualized return, compared to 3.92% for the Agg and 1.26% for three-month T-bills. We also look at the high-yield index, but this is not a perfect fit, as the fund has a shorter duration than this benchmark and will at times hold meaningful off-benchmark exposures in cash (and equivalents), short-term investment-grade bonds, and convertibles. But we think the fund's volatility and return is worth monitoring. Lastly, we look at the iShares 0-5 Year High-Yield Corporate Bond ETF. This shorter-dated high-yield benchmark is closer to the fund's strategy. Since this benchmark's inception in October 2013, Osterweis Strategic Income has an annualized return of 4.19% compared to 3.70%.

We do not have any material concerns and believe Kaufman, Kane, and Manchuck remain disciplined in the execution of their strategy. We rate the fund *Recommended* in our Absolute-Return-Oriented bond fund category and own it across many of our model portfolios.

OSTERWEIS STRATEGIC INCOME FUND

AdvisorIntelligence

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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 12/31/23 were as follows:

	1 Yr.	3 Yr.	5 Yr.	10 Yr.	Since Inception (8/30/2002)
Osterweis Strategic Income Fund	*12.30%*	*3.67%*	*5.06%*	*4.14%*	*6.12%*
Bloomberg U.S. Aggregate Bond Index	*5.53%*	*-3.31%*	*1.10%*	*1.81%*	*3.32%*

Expense Ratio as of 3/31/2023: 0.86% / 30-Day SEC Yield as of 12/31/23 is 6.64%.
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.

The Osterweis Funds are available by prospectus only. The Funds' investment objectives, risks, charges and expenses must be considered carefully before investing. The summary and statutory prospectuses contain this and other important information about the Funds. You may obtain a summary or statutory prospectus by calling toll free at (866) 236-0050, or by visiting www.osterweis.com/statpro. Please read the prospectus carefully before investing to ensure the Fund is appropriate for your goals and risk tolerance.

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.

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.

OSTIX's top ten holdings as of 12/31/23:

Holding	% of Total Portfolio
Southeastern Grocers Inc	2.3
Las Vegas Sands Corp 3.200% 8/8/24	1.8
Goodyear Tire & Rubber Co 9.500% 5/31/25	1.6
Xerox Holdings Corp 144A 5.000% 8/15/25	1.5
Tutor Perini Corp 144A 6.875% 5/1/25	1.4
Enova International Inc 144A 8.500% 9/15/25	1.4
Conduent Business Services LLC / Conduent State & Local Solutions Inc 144A 6.000% 11/1/29	1.3
KeHE Distributors LLC / KeHE Finance Corp 144A 8.625% 10/15/26	1.3
Hecla Mining Co 7.250% 2/15/28	1.3
Empire Communities Corp 144A 7.000% 12/15/25	1.3

Click here to view OSTIX's complete holdings as of the most recent quarter end.

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.

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

A yield curve is a graph that plots bond yields vs. maturities, at a set point in time, assuming the bonds have equal credit quality. In the U.S., the yield curve generally refers to that of Treasuries.

Spread is the difference in yield between a risk-free asset such as a Treasury bond and another security with the same maturity but of lesser quality.

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

Treasury Inflation-Protected Security (TIPS) are a type of Treasury security issued by the U.S. government that is indexed to inflation in order to protect investors from a decline in the purchasing power of their money. As inflation rises, TIPS adjust in price to maintain its real value.

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

The FTSE 3 Month U.S. T Bill Index Series is intended to track the daily performance of 3 month U.S. Treasury bills. The indices are designed to operate as a reference rate for a series of funds.

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.

Investment grade bonds are those with high and medium credit quality as determined by ratings agencies.

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

Duration measures the sensitivity of a fixed income security's price (or the aggregate market value of a portfolio of fixed income securities) to changes in interest rates. Fixed income securities with longer durations generally have more volatile prices than those of comparable quality with shorter durations.

Treasuries (including bonds, notes, and bills) are securities sold by the federal government to consumers and investors to fund its operations. They are all backed by "the full faith and credit of the United States government“ and thus are considered free of default risk.

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.

Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income.

Criteria for Recommended Funds: Recommended funds are evaluated by AdvisorIntelligence 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 AdvisorIntelligence's confidence in a fund's potential to outperform a relevant benchmark over the long term.