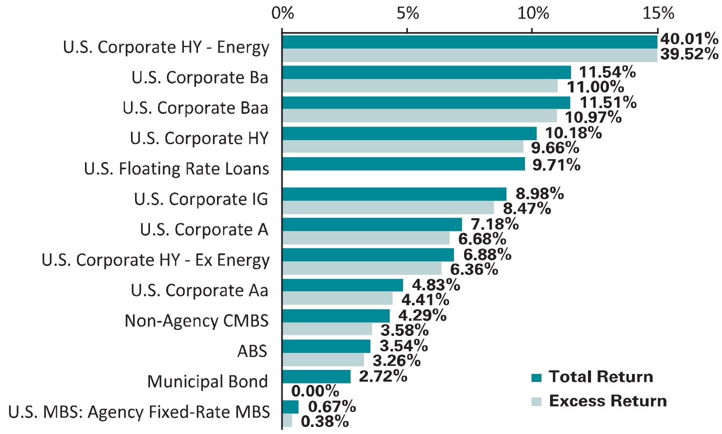
# BBH Income Fund

*Quarterly Fund Update / 2Q 2020*

The second quarter of 2020 was extraordinary. Not only did credit solidly outperform, but we saw record issuance of new credit across the rating spectrum despite the unfolding recession that no doubt began in Q2, followed by rebounding Coronavirus incidence and civil unrest in cities across the country. The S&P 500 is only down 5% from the beginning of the year, recovering from more than a 30% decline in late March, and many stocks from unaffected sectors, such as technology, are making new highs. We all understand that markets look at the future more than the present, but what to make of all this?

**2Q 2020 Credit Market Returns**




**Past performance is no guarantee of future results**
Data reported quarterly as of June 30, 2020
HY = High Yield, MBS = Mortgage-Backed Securities, CMBS = Commercial Mortgage-Backed Securities, ABS = Asset-Backed Securities, IG = Investment Grade
Sources: Credit Suisse, Bloomberg, and BBH Analysis

**Performance**
**As of June 30, 2020**

| | Total Returns | | Average Annual Total Returns | | | | |
|---|---|---|---|---|---|---|---|
| | 3 Mo.* | YTD | 1 Yr. | 3 Yr. | 5 Yr. | 10 Yr. | Since Inception |
| **Class I** | 6.61% | 5.42% | 7.85% | N/A | N/A | N/A | 8.00% |
| **Benchmark** | 2.90% | 6.14% | 8.74% | N/A | N/A | N/A | 8.24% |

Class I Inception: 6/27/2018

**Class I: Net/Gross Expense Ratio (%) 0.50 / 0.52**

* Returns are not annualized.

***Past performance does not guarantee future results, and current performance may be lower or higher than the past performance data quoted. The investment return and principal value will fluctuate, and shares, when sold, may be worth more or less than the original cost.***

Fund shares redeemed within 30 days of purchase are subject to a redemption fee of 1.00%.

The investment adviser has contractually agreed to limit the Total Annual Fund Operating Expenses for Class I Shares to 0.50%, through March 1, 2021. The Expense Limitation Agreement may only be terminated during its term with approval of the Fund's Board of Trustees (the "Board").

The Bloomberg Barclays U.S. Aggregate Bond Index: covers the USD-denominated, investment-grade (rated Baa3 or above by Moody's), fixed-rate, and taxable areas of the bond market. This is the broadest measure of the taxable U.S. bond market, including most Treasury, agency, corporate, mortgage-backed, asset-backed, and international dollar-denominated issues, all with maturities of 1 year or more. The index is not available for direct investment.

Sources: BBH & Co. and Bloomberg

We will leave the stock market to others, as credit is our daily concern, and we have a fairly clear view of what happened in fixed income, and why. We would rank the important credit factors as follows:

1. The forced selling and illiquidity we saw in credit in March was almost entirely in short maturities. Demand for longer maturities remained robust even in the worst days of March. Furthermore, the ferocity of the drawdown was due, in part, if not in whole, to the withdrawal of algorithmic trading of Treasuries and demand for Treasury liquidity that the private banking system, under current regulations, simply could not meet. Dealer illiquidity in the Treasury market, and the adjustment to traders working at home removed dealer balance sheets temporarily from corporate liquidity[1]. In sum, March's drawdown was at least as much technical as it was fundamental, driven by margin calls and liquidity needs, and, therefore, open to a rapid rebound once the Federal Reserve (Fed) addressed these technical factors and put banks and dealers back in the market.
2. The Fed put an enormous, unprecedented bid under the corporate bond market, while also purchasing a record amount of Treasuries. The result has been the largest increase in money supply (M2) ever. The exposures that rallied fastest were those directly named in the Fed's purchase intentions.
3. Rapid issuance of longer bonds, as well as drawing down credit lines, enlarged issuer's liquidity and reduced refinancing needs while the pandemic raged. Bonds from these newly liquid issuers also rallied in response.
4. Even as producers raised liquidity and cut capital expenditures, oil prices rallied in the second quarter, taking some pressure off energy and energy-related sectors. Energy was the best performing fixed income sector in the second quarter.

[1] For more on this we recommend "Scary Stories to Tell in the Dark – how COVID-19 took down some of the safest trades, and global markets with it", Younger, St. John, and Aggarwal, JPMorgan (North America), 06/29/2020.

5. Severe effects from the pandemic have been concentrated in a few sectors of the credit market – indoor malls, entertainment, consumer cyclical, travel and lodging, airlines and aviation, and consumer and business lending. Even in some of these sectors, reported results have frequently exceeded March/April expectations.
6. As in prior cycles, structured securities (asset-backed securities [ABS] and commercial mortgage-backed securities [CMBS]) pricing reacted on a delay, recovering more slowly than corporates in April, and tightening more rapidly than corporates in May and June as new issue and secondary trading volumes clarified current market levels. Both new issuance and Fed buying (the Term Asset-Backed Securities Loan Facility [TALF] program) have also started later than corporate securities, but are underway.

To summarize, the best-performing obligors in the second quarter recovery have been those that were a) targets of Fed buying, b) able to issue and stockpile liquidity, and c) outside of directly impacted sectors.

A look at the top and bottom performing subsectors (across our entire coverage universe) in March, in the table below, illustrates the wide dispersion of returns. For instance, Aircraft ABS, Midstream Energy, and Finance Companies and Financials were among the worst performing subsectors in 1Q, subsequently recovering sharply in the second quarter to be the best performing subsectors.

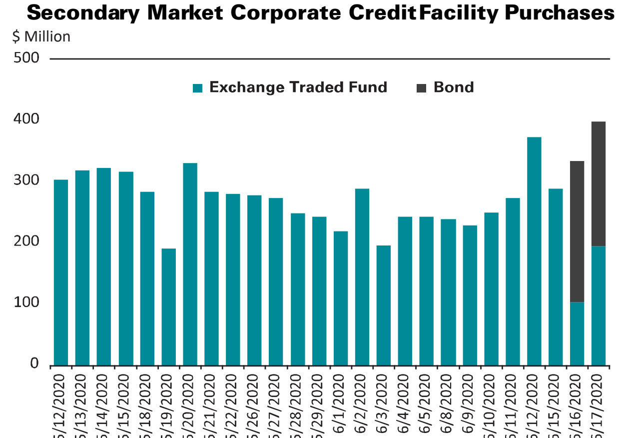
| | Return | | | | Percentile Rank | | | |
|---|---|---|---|---|---|---|---|---|
| **Subsector** | **March** | **April** | **May** | **June** | **March** | **April** | **May** | **June** |
| **Aircraft Equipment ABS** | -30.8% | -7.7% | -4.9% | 9.8% | 0% | 1% | 1% | 99% |
| **Midstream Loans** | -28.5% | 14.9% | 6.2% | 0.0% | 1% | 100% | 100% | 15% |
| **Conduit Fixed CMBS** | -23.8% | -16.2% | -0.9% | 7.2% | 3% | 0% | 8% | 96% |
| **Cell Tower ABS** | -23.7% | 9.7% | 2.3% | 2.9% | 4% | 97% | 84% | 86% |
| **Midstream** | -23.5% | 13.7% | 4.6% | 2.2% | 5% | 99% | 94% | 81% |
| **CRE CLO** | -17.3% | 3.6% | 0.4% | 7.6% | 6% | 78% | 33% | 98% |
| **Media - Entertainment Loans** | -16.6% | 8.0% | 4.6% | 0.4% | 8% | 96% | 92% | 44% |
| **Finance - Companies** | -15.7% | 1.3% | 3.2% | 2.8% | 9% | 55% | 89% | 85% |
| **Financial - Other** | -15.4% | 0.4% | 1.6% | 4.1% | 10% | 38% | 76% | 93% |
| **Triple Net Lease ABS** | -15.3% | 8.0% | 0.9% | 0.1% | 11% | 95% | 67% | 31% |
| **Trade Receivables ABS** | -1.0% | -0.2% | 0.0% | 0.0% | 90% | 26% | 18% | 16% |
| **Building - Materials** | -1.0% | -0.4% | 0.4% | 0.1% | 91% | 19% | 35% | 26% |
| **Prime Auto ABS** | -0.8% | 0.2% | 0.5% | 0.1% | 93% | 30% | 46% | 25% |
| **FFELP Student Loan ABS** | -0.7% | -1.7% | -0.2% | 0.9% | 94% | 9% | 13% | 64% |
| **Private Equity ABS** | -0.7% | 0.3% | 0.1% | 0.0% | 95% | 32% | 22% | 18% |
| **Agency** | -0.6% | 0.4% | 0.1% | 0.1% | 96% | 36% | 25% | 21% |
| **Australian RMBS** | -0.5% | -0.8% | 0.0% | 0.1% | 98% | 16% | 20% | 23% |
| **Wirelines** | -0.3% | 0.6% | 0.2% | 0.9% | 99% | 44% | 28% | 69% |
| **CFO** | -0.2% | 0.4% | 0.1% | 0.0% | 100% | 38% | 23% | 20% |
| **Chemicals Loans** | N/A | 3.5% | 0.5% | -2.0% | N/A | 77% | 42% | 1% |

**Past performance is no guarantee of future results**
Data reported monthly from March 31 to June 30, 2020
ABS = Asset-Backed Securities, CMBS = Commercial Mortgage-Backed Securities, CRE CLO = Commercial Real Estate Collateralized Loan Obligation, FFELP = Federal Family Education Loan Program, RMBS = Residental Mortgage-Backed Securitiies, CFO = Collateralized Fund Obligation
Source: BBH Analysis

It was a banner quarter for issuance, with record volumes in both high yield (HY) and investment grade (IG) corporates, while ABS lagged last year's torrid pace until June. Overseas buying was very strong, particularly in longer maturities (as shown in the charts on the top of the next page). According to the Treasury, foreign buyers had been net sellers of corporates in January and February but became net buyers in late March and April.

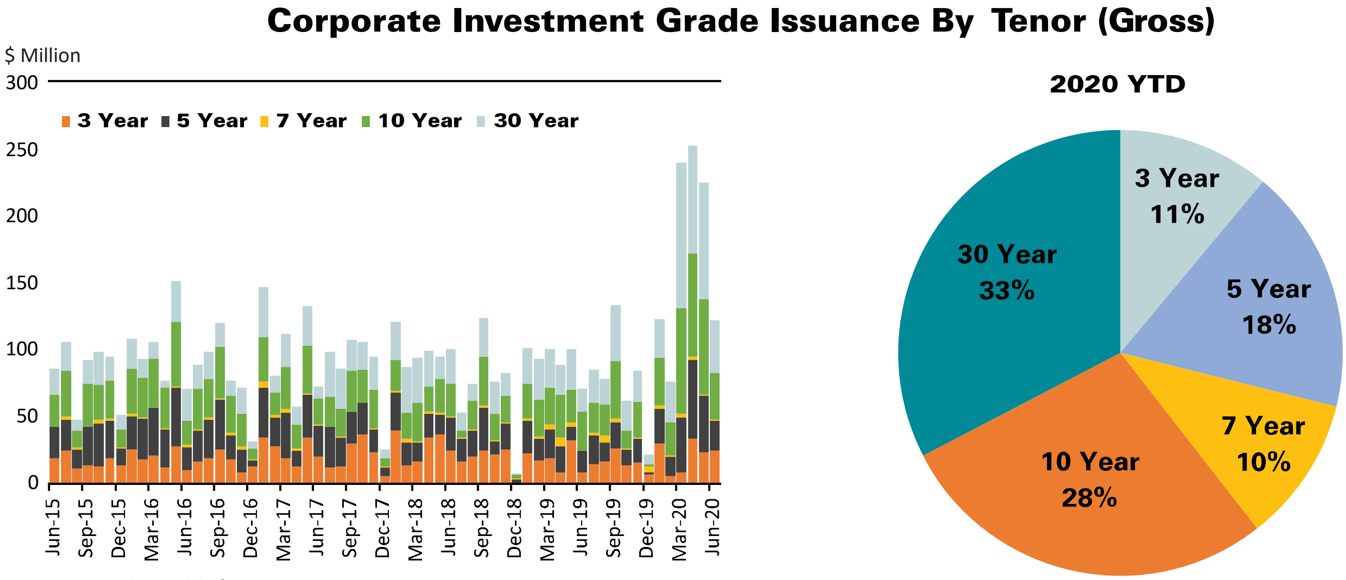
Thus far, Fed purchases have been fairly small, with about $8.5 billion of total holdings as of the last week in the quarter, mostly in broad/index exchange traded funds (ETFs). ETF purchases began in mid-May and have been averaging about $300 million per day, while corporate purchases began on June 16 at a similar pace (illustrated in the chart on the right). The volume of purchases has only been enough to show a credible commitment to the program, though the Fed has a staggering $2 trillion of buying power to use in the secondary market if needed. In late June, the Fed published a custom index of bonds totaling $646

**Secondary Market Corporate Credit Facility Purchases**




Data reported daily from May 12 to June 17, 2020
Sources: JP Morgan, Federal Reserve, and BBH Analysis

billion that could be purchased, about 10% of the corporate index value. Certainly, this puts anyone bearish on U.S. IG credit in the position of "fighting the Fed".




Data reported monthly from June 30, 2015 to June 30, 2020
Sources: JP Morgan and BBH Analysis

We are convinced that the severity of both the crisis in March, and the rebound in the second quarter, were exacerbated by technical factors, as discussed above. The extent of *fundamental* stress is emerging more slowly, and we are only just one quarter into the recession. This is not to say that the financial stress will not be severe, but simply that it takes more time for financial damage to be realized. Rating agencies have anticipated this: S&P downgraded 161 IG issuers and 1,050 HY issuers in the first half of 2020, more than in all of 2015 or 2016.

Weaker companies are already folding, as 130 companies filed for bankruptcy in the first half. For example, in April and May, five highly leveraged borrowers with over $5 billion of debt filed for reorganization (e.g. Frontier, Chesapeake Energy, Latam, Intelsat, and Hertz). Only Frontier and Intelsat are not in pandemic-affected sectors. In the CMBS sector, over 5% of CMBS loans were in "special servicing" including about 25% of hotel and retail loans, collecting only a portion of their rent and facing a high degree of uncertainty over the coming year.

While we purchased credit at a much faster pace than usual in March through May, we kept to issuers we felt were well-positioned in the pandemic. It is our view that because of the gradual effects of lower sales volume, and the possible delay or elimination of income support going into the end of the year, credit is likely to deteriorate and credit markets are vulnerable to a slower, but more fundamentally-driven, pullback. We have added to positions in a few pandemic-affected sectors, such as aviation, midstream energy, and consumer lending, where we were able to purchase with significant protection at very attractive yields.

Below we offer you some comments on pandemic-affected sectors that we hold. We are monitoring these positions closely, but do not expect impairments in any of these holdings.

1. **Retail and retail real estate**

   Our retailer exposure is limited to Nordstrom, which should have all its stores open shortly, and is the best positioned credit in the troubled department store sector. Retail properties in CMBS, particularly enclosed malls, are dealing with rent collections below 50% and multiple requests for deferral, but properties are open again and sales traffic is rising. Cash reserves and servicer advances in CMBS can help service the debt for a year or more, but some properties will have to change hands. We believe our high-quality properties, with equity cushions above 50%, will preserve our principal within our exposures here.

2. **Travel and hotel real estate**

   Luxury hotels are still anticipating a slow recovery from occupancy in the 20% range. CMBS in which these are held have substantial cash reserves to make payments for the next year. Most importantly, we rely on the fact that our limited CMBS debt holdings typically represent less than one quarter of the appraised value of the marquis hotel properties – i.e., the value of the land alone usually covers our debt. Discount and long-term stay hotels, like Wyndham Hotels, are doing much better, with well over 50% occupancy. Wyndham can withstand far lower levels of occupancy and still service its debt.

**3. Midstream energy and electric generation**

While we were initially worried about pipeline volume decreases and counterparty bankruptcies, our credits have performed far better than we expected so far, with only small decreases in volume. In generation, the continuing need for gas capacity in the Northeast keeps our electricity generation companies cash flow positive. All our credits have marshalled substantial liquidity to cover needs in the coming year.

**4. Aircraft leasing**

We view the major aircraft lessors (Air Lease, Aercap) as well-equipped to handle this period of severe stress Performance is better in fuel-efficient narrow-bodies, where we tend to focus our investing. Lessors are benefiting from the multiple airline bailouts underway and have suffered only low levels of lease cancellations. Meanwhile, they are retiring old planes and canceling orders to cut the excess plane inventory rapidly.

**5. Rental fleet ABS**

Hertz ABS have been paying down in an orderly fashion as used car prices have rebounded, and the company is liquidating its fleet at a rapid clip. The thick cushion between the resale value of their autos and the remaining Hertz ABS debt protects us against impairment.

**6. Consumer and subprime auto lending**

ABS in these sectors are extraordinarily well-protected, launching with up to 50% credit enhancement. Default levels have risen only moderately and remain lower than in the Great Financial Crisis, nowhere near the levels required to impair tranches we own. We also own HY unsecured bonds issued by the best of the subprime auto issuers, that have strong unique underwriting models which should protect them from significant credit losses. For example, losses at Credit Acceptance continue to run below 1%, and the company is deleveraging as principal repayments exceed new loans.

**7. Business lending**

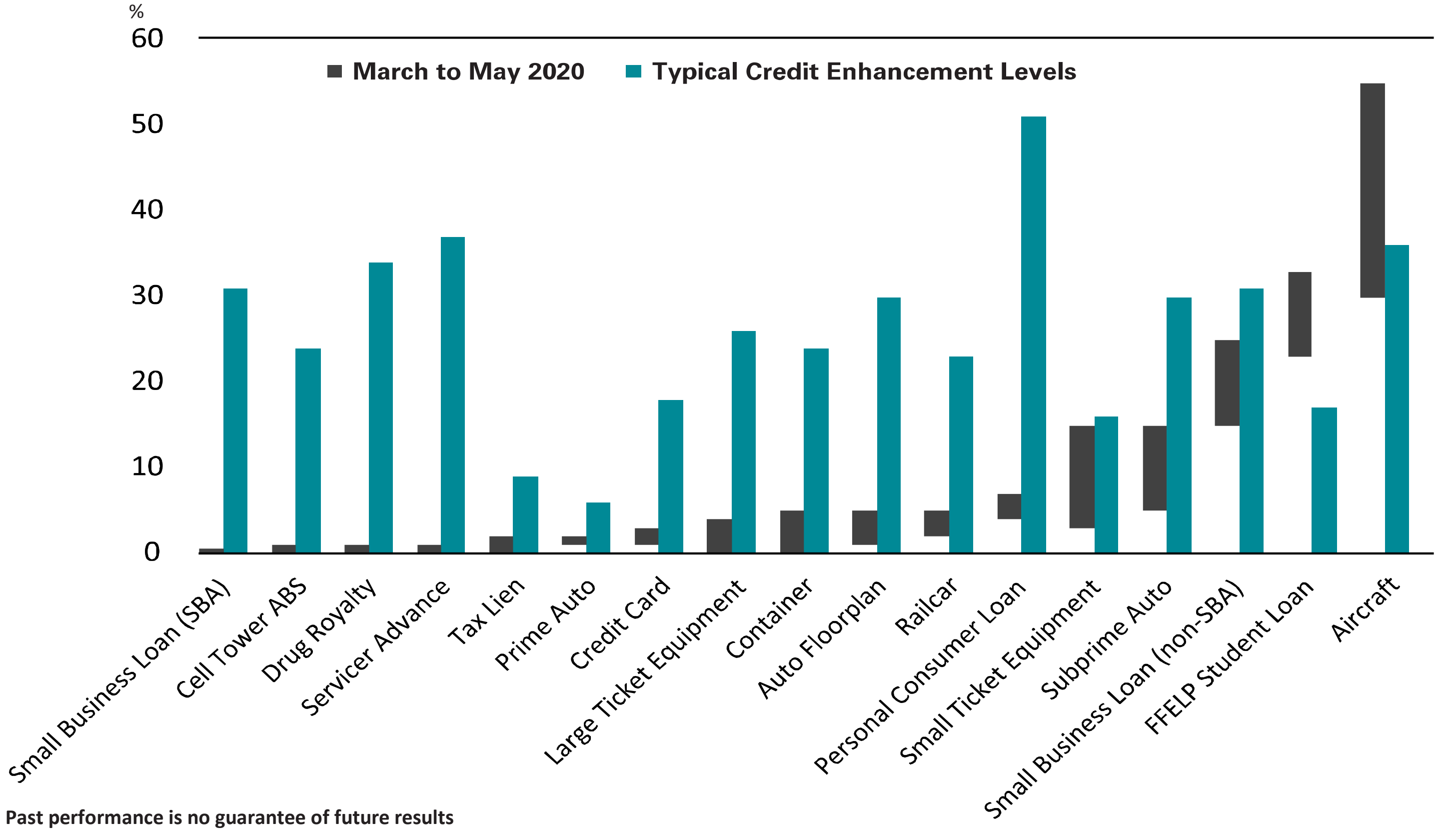
We own corporate debt issued by Business Development Companies. Loan non-accrual rates for these large lenders have risen modestly and we are amply protected by the low debt leverage of these companies, with equity of 40% or more beneath our notes.

Our structured team put together the chart on the following page, showing the peak non-payment rates in various sectors of ABS in March through May of this year, and comparing that to the credit enhancement for senior issuance in that sector. Note that only aircraft non-payment rates are above the enhancement level, due primarily to negotiated temporary deferrals. It is important to remember that non-payment rates will be significantly larger than the eventual loss rate due to borrower rehabilitation and collateral recovery. Our quarterly Structured Fixed Income Update has much more.

We currently hold no agency mortgage-backed securities (MBS), given the meager compensation and risk of rapid refinancing eroding bond premiums in a declining rate environment. Furthermore, with U.S. mortgage rates now at historic lows, a refinancing wave in recently issued MBS is likely to persist for months and will rapidly deprive investors of what little coupon they are earning.

As our clients know, we claim to own no crystal ball to predict interest rates. However, we do think about inflation as a potential driver of rates in the future. After the post-COVID recovery begins in earnest, which we do not expect until at least next year, there are a variety of inflationary pressures that may, at last, begin to pressure rates higher. For instance, supply chains around the world are being brought closer to home and are becoming more resilient, and businesses reopening will have to invest to protect their clients and employees, both of which should lead to more expensive goods.

**Peak Non-Payment Rates on Scheduled Principal and Interest for ABS Subsectors**

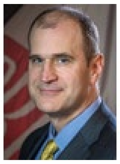



**Past performance is no guarantee of future results**
Data reported from March 1 to May 31, 2020
ABS = Asset-Backed Securities, FFELP = Federal Family Education Loan Program
Sources: Wells Fargo and BBH Analysis

The second quarter brought a very large technical rally in fixed income, spurred by Fed buying, overseas buying, and the rapid resolution of a liquidity crisis in the bank/dealer market. Meanwhile, in an economy already carrying enormous corporate leverage, the damage done by the Coronavirus will continue to claim victims in corporate earnings and, ultimately, credit quality. As valuations get less compelling, our purchasing has slowed, and we are likely to be sellers rather than buyers if the trend continues. While investors now have hindsight on the first half's volatility, views ahead may be far from 20-20.

Sincerely,

*Andrew P. Hofer*
*Fund Co-Manager*



*Neil Hohmann, PhD*
*Fund Co-Manager*

*Paul Kunz, CFA*
*Fund Co-Manager*

## Share Class Overview
As of June 30, 2020

| | Ticker | CUSIP | Inception Date | Total Net Assets (mil) | NAV | 30-Day SEC Yield* (Subsidized) | 30-Day SEC Yield* (Unsubsidized) |
|---|---|---|---|---|---|---|---|
| **Class I** | BBNIX | 05528C766 | 06/27/2018 | $446.1 | $10.63 | 2.31% | 2.31% |

**SEC yield is a calculation based on a 30-day period and is computed by dividing the net investment income per share earned during the period by the maximum offering price per share on the last day of the reported period.

## Credit Quality
As of June 30, 2020

| | |
|---|---|
| Cash and Cash Equivalents | 1.6% |
| U.S. Treasuries | 5.8% |
| AAA | 11.6% |
| AA | 10.2% |
| A | 20.3% |
| BBB | 35.3% |
| BB | 8.4% |
| B or Lower | 5.5% |
| Not Rated | 1.2% |
| **Total** | **100.0%** |

## Top 10 Credits
As of June 30, 2020

| | |
|---|---|
| Freedom Financial | 1.7% |
| Owl Rock Capital Corp | 1.6% |
| MEDNAX Inc | 1.5% |
| Air Lease Corp | 1.5% |
| AerCap Holdings NV | 1.5% |
| FS KKR Capital Corp | 1.4% |
| Athene Global Funding | 1.2% |
| Oportun Funding LLC | 1.1% |
| Oxford Finance Funding Trust | 1.1% |
| Dell Inc | 1.1% |
| **Total** | **13.6%** |

Reported as a percentage of total portfolio.

## Sector Distribution
As of June 30, 2020

| | |
|---|---|
| Corporate Securities | 49.0% |
| Asset-Backed Securities | 22.7% |
| Commercial Mortgage-Backed Securities | 4.5% |
| Municipal Securities | 0.0% |
| Agency Mortgage-Backed Securities | 0.0% |
| Trust Preferred | 0.0% |
| Loans | 15.6% |
| U.S. Treasuries | 3.6% |
| U.S. Inflation-Indexed Securities | 2.2% |
| Residential Mortgage-Backed Securities | 0.9% |
| Cash and Cash Equivalents | 1.6% |
| **Total** | **100.0%** |

## Duration Distribution
As of June 30, 2020

| | BBH Income Fund | Bloomberg Barclays US Aggregate Index |
|---|---|---|
| 0 - 1 Yr. | 27.0% | 5.5% |
| 1 - 2 Yrs. | 10.9% | 15.6% |
| 2 - 4 Yrs. | 20.9% | 32.3% |
| 4 - 6 Yrs. | 18.1% | 15.0% |
| 6 - 8 Yrs. | 8.9% | 9.1% |
| 8 - 12 Yrs. | 7.1% | 5.8% |
| 12+ Yrs. | 7.0% | 16.6% |
| **Total** | **100.0%** | **100.0%** |

## Fund Facts
As of June 30, 2020

| | |
|---|---|
| Number of Holdings | 245 |
| Effective Duration (years) | 6.12 |
| Weighted Average Life (years) | 5.90 |
| Yield to Maturity | 3.70% |

Holdings are subject to change.

Totals may not sum due to rounding.

Credit Quality letter ratings are provided by Standard and Poor's, Moody's and Fitch and are presented as the higher of the three ratings. When a security is not rated by Standard & Poor's, Moody's or Fitch, the highest credit ratings from DBRS and Kroll may be used. Credit ratings reflect the credit quality of the underlying issues in the portfolio and not of the portfolio itself. Issuers with credit ratings of AA or better are considered to be of high credit quality, with little risk of issuer failure. Issues with credit ratings of BBB or better are considered to be investment grade, with adequate capacity to meet financial commitments. Issues with credit ratings below BBB are considered speculative in nature and are vulnerable to the possibility of issuer failure or business interruption.

Effective duration is a measure of the portfolio's return sensitivity to changes in interest rates.

Weighted Average Life of securities excludes US Treasury futures positions.

Yield to Maturity is the rate of return the portfolio would achieve if all purchased bonds and derivatives were held to maturity, assuming all coupon and principal payments are received as scheduled and reinvested at the same yield to maturity. This figure is subject to change and is not meant to represent the yield earned by any particular security. Yield to Maturity is before fee and expenses.

**This material is not authorized for distribution unless accompanied or preceded by a current Fund prospectus.**

**RISKS**

Investing in the bond market is subject to certain risks including market, interest-rate, issuer, credit, maturity, call and inflation risk; investments may be worth more or less than the original cost when redeemed.

The value of some asset- backed securities and mortgage-backed securities may be particularly sensitive to changes in prevailing interest rates and are subject to prepayment and extension risks, as well as risk that the underlying borrower will be unable to meet its obligations.

Below investment grade bonds, commonly known as junk bonds, are subject to a high level of credit and market risks.

The Fund also invests in derivative instruments, investments whose values depend on the performance of the underlying security, assets, interest rate, index or currency and entail potentially higher volatility and risk of loss compared to traditional bond investments.

Foreign investing involves special risks including currency risk, increased volatility, political risks, and differences in auditing and other financial standards. Prices of emerging market securities can be significantly more volatile than the prices of securities in developed countries, and currency risk and political risks are accentuated in emerging markets.

The Fund may engage in certain investment activities that involve the use of leverage, which may magnify losses.

A significant investment of Fund assets within one or more sectors, industries, securities and/or durations may increase its vulnerability to any single economic, political, or regulatory developments, which will have a greater impact on the Fund's return.

Illiquid investments subject the Fund to the risk that it may not be able to sell the investments when desired or at favorable prices.

To the extent that the Fund experiences a large purchase or redemption on any business day, the Fund's performance may be adversely affected.

**For more complete information, visit www.bbhfunds.com for a current Fund prospectus. You should consider the fund's investment objectives, risks, charges and expenses carefully before you invest. Information about these and other important subjects is in the fund's prospectus, which you should read carefully before investing.**