Mesirow

High Yield | Commentary

Market overview

With the S&P 500 closing at an all-time high as the first quarter drew to a close, markets have proven to be relentless thus far in 2024, brushing off the Fed's more tempered statements regarding rate cuts later in the year.

The Bloomberg US Corporate High Yield Index finished the quarter up 1.47%. The Credit Suisse Leveraged Loan Index, likewise, returned 2.52%. Neither index posted a negative month during the first quarter.

Treasury rates rose during the quarter, with the 5-Year rate up 53bps and the 10-Year rate up 48bps. The Federal Funds target rate was left unchanged.

The Bloomberg US Corporate High Yield Index option-adjusted spread continued to tighten, falling another 13bps in March and ending the quarter at 299bps. The Credit Suisse Leveraged Loan Index's 3-Year discount margin decreased 10bps ending at 509bps.

Default activity decreased in March. Two companies defaulted on their loans ($1.8B total) and two companies completed distressed exchanges ($778M in bonds and $2.1B in loans). Despite the light default activity, the par-weighted US high yield bond default rate (including distressed exchanges) increased 6bps to 2.59%, and the par-weighted loan default rate increased 14bps to 3.52%. This increase was the result of the extremely light defaults/distressed exchange volume from March 2023 ($0 bonds/$2.5B loans) rolling off. (JP Morgan.)

High yield market overview

The Bloomberg Barclays High Yield Corporate Index increased +1.47% for the quarter.

- **Lower quality led returns in the first quarter:** CCC-rated bonds returned +2.14%, B-rated bonds returned +1.36% and BB-rated bonds returned 1.13%.
- **Most industry returns were positive:** Retailers topped industry performance in 1Q (+4.99% return) on the heels of a very strong performance in March (+2.18% return). By comparison, the Wireless sector was the most significant laggard for the quarter (-7.11%) driven almost entirely by one issuer (Altice France).
- **Small bonds outperformed in the first quarter:** Small bond issues ($200M–$500M) returned +2.25% in 1Q, while mid-size issues ($500–$1B) returned +1.74%and large issues ($1B+) returned +0.87%.

Loan market overview

The Credit Suisse Leveraged Loan Index returned +2.52% for the quarter.

- **Lower rated loans led:** For the quarter the CCC-rated cohort returned +6.14%, the B cohort returned +2.48% and the BB-rated cohort returned +1.92%.
- **All industries were positive:** Retail was one of the strongest sectors for the quarter (+3.51%) while Media/Telecommunications was among the weakest (+1.57%).
- **Small loans outperformed:** Small loans (less than $500M) returned 3.17% during the quarter, mid-size bonds returned +2.37% ($500-$1B) and large bonds returned +2.47% ($1B+).

Source: Bloomberg, JPMorgan. | Mesirow High Yield ("MHY") is a division of Mesirow Financial Investment Management, Inc., ("MFIM") an SEC-registered investment advisor. | Past performance is not indicative of future results. | Please see the disclosures at the end for additional, important information. Any performance mentioned above is supplemental; please see the GIPS Report that is included for complete performance and benchmark descriptions.

Performance review

The Mesirow High Yield strategy has outperformed its benchmark Bloomberg US Corporate High Yield Index every month so far in 2024. In March, the portfolio returned +1.53% (+1.50% net) versus the benchmark's +1.18% return. For the quarter, the strategy returned +3.29% (+3.18% net) versus the +1.47% return of the benchmark.

March's excess return wasn't propelled by our rating, industry or issue size allocations. Rather, strong selection continued to drive the strategy's outperformance, concentrated in B-rated and CCC-rated holdings and small issuers. Even a handful of larger names (Organon, for example) added to the relative return.

Similarly, acute selection was also responsible for the majority of the outperformance for the quarter. While the strategy did receive tailwinds from the relative outperformance of smaller and lower-rated issues in the market, as well as our shorter duration, the contribution was less than 20% of the strategy's total excess return. The remaining outperformance was due to strong credit selection.

Within industries, our credit selection among Basic Industry and Consumer Cyclical issues was the most additive. By rating, virtually all the outperformance for the quarter was due to credit selection in B-rated and CCC-rated issues.

Outlook and positioning

Our strategy's focus on small cap issuers is grounded in the belief that the market overestimates the relative risk of small cap companies versus large cap companies. Rating agencies, for example, chronically rate smaller companies lower than their large cap peers, even when the fundamentals of both companies are nearly identical. We believe these views are unfounded.

For one, an often-cited justification for the lower ratings (and thus higher yields) in the small cap universe is the belief that small cap companies have inferior access to capital, due to their size and the fact that they are often privately held. However, we believe this view is deeply misguided, especially when considering the various avenues for capital raises during a liquidity event.

For example, while it's technically possible for larger listed companies to expedite an issuance of highly dilutive equity into the public markets at low prices in times of distress, in practice it is very difficult. Privately held firms, by comparison, tend to have concentrated ownership (often by private equity firms) that can and do rationally infuse equity or new debt during a cash crunch. Privately held companies can do this because the negotiations often involve just one owner and a handful of large bondholders who can speak for the class. Therefore, in the event a company needs to be "rescued" via access to the debt markets, as bondholders, we would rather have a powerful and savvy private equity firm negotiating a difficult refinancing behind closed doors than the CFO of a publicly traded firm trying to right the ship.

Furthermore, there have been other cases in recent years, some notorious, in which a debt security's face value (and thus its par claim in any future reorganization) was reduced. Ironically, those have most often occurred in the context of a complex exchange offer (such as a recent corporate action at a firm called GoTo, whose bonds we own) in which a par claim was compromised not to induce an equity infusion, but rather to allow one class of debt to be promoted in seniority ahead of another class of debt in the capital structure (commonly referred to as "priming"). Equity sponsors sometimes infuse equity to correct course if they still believe in the business (which is good for us as creditors) but some also aggressively engage in so-called "creditor-on-creditor warfare," which can sometimes benefit us as holders and at other times can hurt us. Exchange offers can be very complex. For example, as noted, it is possible for a sponsor to offer no new equity, but merely offer one class of debt as a "promotion" to a more senior status in exchange for a reduction in the face value of the claim. What is important to note is that those aggressive actions are actually more prevalent in large companies, because only large companies tend to have complex capital structures in which multiple classes of layered creditors can be played off against each other. Small companies tend to have simple capital structures – ideally, a small working capital facility and one class of bonds. This also makes restructurings, if they do occur, much simpler and less prone to leakage of value.

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About Mesirow

Mesirow is an independent, employee-owned financial services firm founded in 1937. Headquartered in Chicago, with locations around the world, we serve clients through a personal, custom approach to reaching financial goals and acting as a force for social good. With capabilities spanning Global Investment Management, Capital Markets & Investment Banking, and Advisory Services, we invest in what matters: our clients, our communities and our culture. To learn more, visit mesirow.com and follow us on LinkedIn.

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GIPS REPORT – HIGH YIELD COMPOSITE

Gross and Net of Fees Total Returns from January 1, 2014 – March 31, 2024

	Year end						Annual performance results				3-year annualized dispersion(2)	
Year	No. of portfolios	Composite Asset at end of period ($MM)	MHY Assets at end of period ($MM)	Total Firm Assets ($MM)	Non paying fee (%)	Carve out (%)	MFIM (gross) Composite (%)	MFIM (net) Composite (%)	Bloomberg US Corp. High Yield Index (%)	Composite Dispersion (1) (%)	MFIM (gross) Composite (%)	Bloomberg US Corp. High Yield Index (%)
2014	8	593	797	–	1	0	3.14	2.68	2.45	0.7	4.01	4.50
2015	8	617	757	–	1	0	-1.02	-1.45	-4.47	0.7	4.26	5.26
2016	7	742	841	–	0	0	15.18	14.67	17.13	n/a	4.57	6.00
2017	5 or fewer	512	526	4,772	0	0	8.90	8.45	7.50	n/a	4.24	5.65
2018	5 or fewer	859	873	4,137	0	0	-1.02	-1.37	-2.08	n/a	3.76	4.59
2019	5 or fewer	1,124	1,199	3,895	0	0	13.02	12.58	14.32	n/a	3.74	4.02
2020	5 or fewer	1,338	1,407	6,706	0	0	9.00	8.55	7.11	n/a	12.23	9.24
2021	5 or fewer	1,301	1,421	6,168	0	0	12.12	11.67	5.28	n/a	12.08	9.00
2022	5 or fewer	717	898	3,616	0	0	-10.38	-10.76	-11.19	n/a	12.70	10.97
2023	5 or fewer	1,089	1,457	3,963	0	0	15.58	15.08	13.44	n/a	5.85	8.24
Current Performance Results												
2024	5 or fewer	1,189	1,883	4,371	0	0	3.29	3.18	1.47	n/a	5.79	8.26

Past performance is not necessarily indicative of future results.

Mesirow Financial Investment Management Institutional – Fixed Income claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Mesirow Financial Investment Management Institutional – Fixed Income has been independently verified for the periods 01.01.1996 through 12.31.2022. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The High Yield Composite has had a performance examination for the periods from 03.01.1999 to 12.31.2022. The verification and performance examination reports are available upon request.

*Creation date is 03.01.1999. * Performance and Composite inception are 03.01.1999.*

Mesirow Financial Investment Management, Inc. ("MFIM") is an investment advisor registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940. The "Entity" is defined as Mesirow Financial Investment Management Equities and Fixed Income, which is comprised of the GIPS-compliant units of MFIM which specialize in managing portfolios for institutional clients adhering to an investment process geared towards institutional investors. The historical performance presented prior to the creation of the division was managed by MFIM or its predecessor firms prior to 01.01.2005. For purposes of claiming GIPS compliance, as of 01.01.2010, the "Firm" is further defined as the Fixed Income business unit, Mesirow Financial Investment Management Institutional – Fixed Income, which manages portfolios primarily for institutional investors adhering to an investment process, incorporating fundamental analysis of security valuation factors and drivers.

Effective 10.23.2017, the Firm completed the lift out of the High Yield Team, now Mesirow High Yield ("MHY"), from a former and unaffiliated registered Investment Advisor, Pacific Income Advisers. The High Yield Team, along with the High Yield Composite, became an integral part of the Firm. The current Portfolio Management Team consists of the original members, less one, and they are the only individuals responsible for selecting the securities to buy and sell.

The list of composite descriptions, the Firm's list of pooled fund descriptions for limited distribution pooled funds and the Firm's list of broad distribution pooled funds is available upon request. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. Benchmark returns are not covered by the report of independent verifiers.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. The Performance presented from 03.01.1999 to 4.30.2010 was generated while the Portfolio Managers were affiliated with a prior firm. Prior to 05.01.2010, the track record was reviewed for conformance with the portability requirements of GIPS standards. The predecessor firm was also verified, and the composite underwent a performance examination from inception in 03.01.1999 to 12.31.2009 by Ashland Partners & Company LLP. The High Yield Composite had been examined for the period of 05.01.2010 – 06.30.2016 while at Pacific Income Advisers (PIA). PIA had been verified for the period of 01.01.1994 – 06.30.2016.

The High Yield Composite consists of portfolios whose major concentration is in high yield bonds, both public and private. Equity-linked securities purchased in conjunction with debt securities, and equity securities obtained in exchange offers or insolvency proceedings, as well as leveraged corporate loans, and ETFs (in certain circumstances when onboarding a new account) may also be included. The portfolios are considered to be substantially fully invested, with minor cash holdings, at such time as the portfolio consists of at least 85% high yield bonds. This High Yield Composite definition was amended as of October 2019 to more fully reflect the intended strategy. On 01.01.2009, a substantially large equity position (comprising several securities) became non-discretionary and was transferred from the High Yield Composite portfolio when the client restricted the portfolio manager from selling the positions due to tax consequences.

Prior to 11.01.2010, the High Yield Composite was named the U.S. High Yield Composite. It is not for use with the general public and may not be redistributed. Please reference the last page of this presentation for important additional information.

Beginning 05.01.2010, composite policy requires the temporary removal of any portfolio incurring a client initiated significant cash inflow or outflow of 20% of portfolio assets or greater. Additional information regarding the treatment of significant cash flows is available upon request. The U.S. Dollar is the currency used to express performance.

Prior to 01.01.2010, carve-outs reflect the capping of cash to 8% of Net Asset Value on an account which represents the personal holdings of one of the portfolio managers in order to align such cash amount to the level typical of an institutional account.

Calculation of Risk Measures: Annual / 3 Years Dispersion

(1). N/A = Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year. Composite dispersion presented is the equal-weighted standard deviation of the gross annual returns of portfolios in the composite for the entire year.

(2). N/A = The 3-year Ex-post standard deviation isn't presented since there aren't 36 monthly returns available prior to this period. 1999 is a partial period from March 1 through December 31. The three- year annualized Ex-post standard deviation measures the variability of the composite gross returns, and the benchmark returns over the preceding 36-month period. It is not required to be presented for annual periods prior to 2011, or when a full three years of composite performance is not yet available.

Performance / Net of Fee Disclosure

Returns are presented gross and net of management fees and include the reinvestment of all income. Returns do not reflect the deduction of investment advisory fees. Client returns will be reduced by such fees and other expenses that may be incurred in the management of the account. Advisory fees are described in Part 2 of Form ADV of MHY. As of 10.01.2013, net of fee performance was calculated using actual management fees. Prior to 10.01.2013, net of fee performance was calculated using the highest annual management fee applied to the gross results on a monthly basis. For the period 04.01.2011 through 09.30.2013, the highest management fee was 0.65%. Prior to 03.31.2011, the highest management fee was 0.50%. Actual investment advisory fees incurred by clients may vary. When applicable the standard deviation will be calculated as an equal-weighted standard deviation calculated for the accounts in the composite the entire year. The management fee schedule is as follows:

High Yield Strategy (*described in MHY's Form ADV, Part 2*)

0.60% on the first $25 million
0.55% on the next $25 million
0.50% on the next $50 million
0.45% on the balance.

High Yield CIT

0.40% on all assets – Founder Class (First $100 million) [Closed]*
0.55% on all assets – Class A (under $25 million)**
0.48% on all assets – Class L ($25 million and above)**

*The Founders share class was closed to new investors 01.21.2022 after reaching $100 million in assets under management.

**Class A Units are available to Participating Plans investing less than $25 million and Class L Units are available to Participating Plans investing $25 million or more.

An actual fee charged to an individual portfolio may vary by size and type of portfolio. Fees are collected quarterly, which produces a compounding effect on the total rate of return net of management fees. As an example, the effect of investment management fees on the total value of a client's portfolio assuming (a) $1,000,000 investment, (b) portfolio return of 8% a year, and (c) 0.60% annual investment advisory fee would reduce the portfolio's value by $6,292 in the first year, by $36,614 over five years and $89,411 over 10 years. Actual investment advisory fees incurred by clients will vary.

Benchmark Definition

The primary benchmark was formerly the Credit Suisse High Yield Index. The benchmark was changed to the Barclays U.S. Corporate High Yield Index on 05.01.2010, since the Portfolio Management Team believes it is more commonly recognized as the industry standard index for the high yield asset class. The index was renamed the Bloomberg Barclays U.S. Corporate High Yield Index, following Bloomberg's acquisition of Barclays Risk Analytics and Index Solutions (BRAIS) in August of 2016. The Bloomberg Barclays fixed income benchmark indices have since been rebranded as the "Bloomberg Indices" as of 08.24.2021, further updating the benchmark name to the Bloomberg U.S Corporate High Yield Index. The Bloomberg U.S. Corporate High Yield Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Bloomberg EM country definition, are excluded.

Mesirow Financial Investment Management, Inc. and its affiliated companies and/or individuals may, from time to time, own, have long or short positions in, or options on, or be a market maker in, any securities discussed herein and may also perform financial advisory or investment banking services for those companies.