High Yield | Commentary

Market overview

The high yield and leveraged loan markets surged in May, the high yield market bouncing back after a significant sell off in April. Gains were driven by strong earnings reports, supportive macroeconomic data and healthy inflows into leveraged finance markets.

The Bloomberg US Corporate High Yield Index rose +1.10% and the Credit Suisse Leveraged Loan Index increased +0.91% in May.

Treasury rates fell, with the 5-Year and 10-Year Treasuries down 21bps and 18bps respectively. The Federal Funds target rate was left unchanged.

The Bloomberg US Corporate High Yield Index option-adjusted spread rose slightly, up 7bps to 308bps. Conversely, the Credit Suisse Leveraged Loan Index's 3-year discount margin fell, down 12bps to 492bps.

There were no outright defaults in May, however there was a flurry of distressed exchange activity. A total of seven companies completed distressed exchanges during the month, between $1.1B in bonds and $7.7B loans (a record high according to JPM).

The arrival of the exchange offer as the preferred mode of corporate reorganization is the culmination of a long-standing trend. Decades ago, corporate bankruptcies were unplanned, somewhat chaotic and very expensive both in terms of legal fees and loss of value to the estate due to the protracted and highly contested resolution of financial distress. The advent of "pre-packaged" bankruptcies, in which the equity and debt stakeholders agreed to the key economic and structural terms of the reorganization in advance of the bankruptcy, was a partial solution to this problem.

Today, exchange offers implement those economic and structural terms in a consensual way, without the need for a legal insolvency process at all. Formal bankruptcies retain some advantages, such as the ability to reject onerous contracts. But we are not surprised that the market has embraced a mechanism which, for many debtors, is the least costly way to bring a capital structure into alignment with the realities of the issuer's cash flow.

We do agree that an exchange offer in which par value is diminished should be treated as a default for purposes of tracking the very important default rate calculations, and we count such exchanges as defaults within our portfolios. It is also true that in some cases it is to be debated whether such exchanges are truly consensual. As the proposing party, the companies' owners (frequently very sophisticated private equity groups) can structure exchange offers in a coercive way, playing different creditor groups against each other for the benefit of the equity holders. We ourselves have been victims of such clever "liability management exercises." Nonetheless, we do believe exchange offers are, in the main, an efficient corporate finance tool, and debtholders can protect themselves against abusive exchange offers if they are mindful of, and engaged in, the negotiation of covenants in the bonds they buy.

Including distressed debt exchanges, the last twelve months par-weighted default rate fell for US high yield bonds but increased for loans month over month. The US high yield bond LTM default rate decreased by 34bps to 2.02%, while the loan default rate increased 36bps to 2.94%. The 25-year average high yield and leveraged loan default rates are 3.4% and 3.0%, respectively (JPM).

High yield market overview

The Bloomberg Barclays High Yield Corporate Index increased +1.10%.

- **Higher quality outperformed:** BB-rated bonds added +1.21% B-rated bonds increased +0.97% and CCC-rated bonds returned +0.44%.
- **Industry performances were mostly positive:** Pharmaceuticals (+5.67%) was the best performing sector for the second month in a row while Media Entertainment was the worst performing sector (-1.22%) in May.
- **Performance by bond size was consistent:** Small issue bonds ($200–$500M) were up +1.11%, mid-size issues ($500M–$1B) were up +1.04% and large issue sizes ($1B+) were up +1.17%.

Loan market overview

The Credit Suisse Leveraged Loan Index returned +0.91%.

- **CCC loans outperformed:** CCC-rated loans returned +1.57%, B-rated loans returned +0.91% and BB-rated loans returned +0.74%.
- **All industries were positive:** Chemicals was the best performing sector at +1.50%, while Media/Telecom was the worst performing sector for the second consecutive month, returning +0.21%.
- **Performance by loan size was consistent:** Small issue size loans (less than $500M) rose +0.96%, mid-size issues ($500M–$1B) rose +1.01 % and large issue sizes ($1B+) returned +0.85%.

Performance review

The Mesirow High Yield strategy outperformed the Bloomberg US Corporate HY Index benchmark in May, with strong credit selection overcoming the headwinds posed by our shorter duration in a month where rates fell.

By rating, the majority of outperformance was driven by selection decisions in the B- and CCC-rated cohorts. By industry, the individual credits within the Consumer Cyclical and Technology sectors outperformed in May. And finally, by issue size, it was our selection within both small and large issues that underpinned our outperformance for the month.

Outlook and positioning

As we have stated in previous commentaries, we believe inflationary pressures will continue to be significant, with two significant data trends supporting this belief: the escalating interest expense on federal debt and the substantial increase in regulatory burden.

First, the interest expense on federal debt has surged substantially, doubling over the past three years and surpassing the trillion-dollar mark. To put this increase in perspective, this jump in interest payments is equivalent to the entire deficit before the COVID-19 pandemic-related fiscal stimulus measures. Meanwhile, the current annual deficit stands at an alarming $2 trillion every year, the majority of which is likely to be financed through additional monetary expansion, thereby exacerbating current inflationary pressures.

Concurrently, the volume of regulations has experienced a sixfold increase over the past 25 years. This proliferation of regulatory requirements has significantly amplified the cost of operations across various sectors, as businesses must allocate substantial resources to ensure compliance and navigate an increasingly complex regulatory landscape. Additionally, the increased regulatory burden has contributed to inefficiencies and constraints in the production and distribution of goods and services, further worsening supply-side constraints.

The confluence of these two factors has created an environment conducive to persistent inflationary pressures. With more money chasing a relatively limited supply of goods and services, upward pressure on prices becomes an inevitable consequence.

Source: Bloomberg, JP Morgan. | 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.

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.

Contact us

UNITED STATES INVESTORS

portfoliospecialist@mesirow.com | 312.595.7300

UNITED KINGDOM AND EUROPEAN INVESTORS

Katie Renouf

katie.renouf@mesirow.com | 011.44.207.851.1702

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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.