Mesirow

High Yield | Commentary

Market overview

High yield bonds and leveraged loans edged higher in the fourth quarter, overcoming pressure from rising rates and widening spreads. Leveraged loans fared better during the quarter, thanks to the asset class's floating rate structure and near-zero duration. The Bloomberg US Corporate High Yield Index rose 0.17% for the quarter, while the Credit Suisse Leveraged Loan Index increased +2.29%. For the year, the indices finished up +8.19% and +9.05%, respectively.

Treasury rates rose significantly during the quarter, with 5-year and 10-year Treasuries both up approximately 80bps. This provides further evidence that the Fed can control short rates (and long rates temporarily) if it actively buys or sells bonds on a massive scale. Long rates, however, must ultimately reflect the willingness of the marginal investor to lend money to a borrower who has demonstrated that massive deficits are now permanent.

When including distressed exchanges, the par-weighted default rates for the trailing twelve months rose in both high yield bond and leveraged loan markets: in December the US high yield bond default rate increased by 32bps to 1.47%, while loan default rates grew by 45bps to 4.49%. These rates compare to 25-year averages of 3.4% for high yield bonds and 3.0% for leveraged loans. (JP Morgan).

High yield market overview

The Bloomberg US Corporate High Yield Index returned +0.17%.

- **CCCs bonds outperformed:** BB-rated bonds returned -0.48%, B-rated bonds returned +0.33% and CCC-rated bonds returned +2.19%.
- **Industries were mixed:** Transportation was the best performing sector (+1.79%) while Capital Goods was the worst (-0.68%)
- **Small bonds outperformed:** Large issue sizes ($1B+) were up +0.09%, mid-size issues ($500M–$1B) were up 0.08% and small issue bonds ($200–$500M) were up +0.61%.

Loan market overview

The Credit Suisse Leveraged Loan Index returned +2.29%.

- **High quality outperformed:** BB-rated loans returned +2.21%, B-rated loans returned +2.53% and CCC-rated loans returned +0.25%.
- **Industries were positive:** Metals/Minerals was the best performing sector for the quarter, returning +3.69%, Transportation was the weakest at +0.99%.
- **Loan size performance was consistent:** Small issue size loans (less than $500M) increased +2.21%, mid-size issues ($500M–$1B) increased +2.25% and large issue sizes ($1B+) increased +2.30%.

Source: Bloomberg, JP Morgan. | Mesirow High Yield Management ("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

For the quarter and for 2024, the strategy exceeded its benchmark on a net basis by more than 110bps, driven by several factors.

As noted earlier, Treasury rates rose significantly during the fourth quarter, which was a tailwind given the strategy's shorter duration. The strategy was also aided by its traditional emphasis on lower-rated issues and smaller issues, as both were the best performing cohorts in the index. And finally, superior credit selection among these issues by our investment team also contributed to the strategy's benchmark-beating performance for the quarter.

Outlook and positioning

2024 proved to be a robust year for high yield markets, with the high yield bond and leveraged loan indexes delivering total returns of 8.19% and 9.05% respectively. These strong returns came despite investor hesitation early in the year due to tight spreads, which stood at 350bps at the beginning of January. The performance of both asset classes exceeded the Bloomberg US Aggregate Index (1.3%) and Emerging Market Aggregate Index (6.6%). As we enter 2025 with even tighter spreads at 287bps, this outperformance serves as a reminder of the difficulty in market timing.

Liability Management Exercises (LMEs) emerged as a dominant theme in 2024, particularly in the loan market. These have arisen due to the extremely weak covenants in many loan documents. Recall that most of these transactions involve an offer to certain favored existing investors to invest more money into a struggling borrower. As part of that transaction, their much larger existing investments are elevated to a senior position in the capital structure, thus subordinating those investors who are not included in the exchange offer. December marked a particularly active month, recording the second-highest monthly LME volume in history at $13.4B across bonds and loans. While these transactions can be a disadvantage for smaller investors, recent developments suggest both markets and courts are evolving in response to increasingly creative tactics by large, distressed managers.

For example, a significant milestone came just this month as a federal appeals court overturned a controversial 2020 debt restructuring deal involving Serta Simmons. This ruling reversed a decision that had granted preferential repayment terms for certain lenders in exchange for new capital while subordinating others. The market had already begun adapting to these developments; since the original Serta transaction in 2020, new loan agreements have incorporated more explicit provisions prohibiting such exchanges. However, legacy agreements still contain other similar provisions that could be positively affected by this new ruling.

The court's decision is particularly significant given how rarely the judiciary provides guidance on such complex financial transactions. As lenders and financial sponsors continue seeking more aggressive debt management arrangements, this ruling establishes clearer parameters for future deal structures. Moreover, it validates our long-held view that the recent pace of LME activity is unsustainable. In well-functioning markets, investors will demand more protections from unfair treatment, and market demand and litigation serve as checks to these partial transactions.

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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 – December 31, 2024

	Year end						Annual performance results				3-year annualized dispersion	
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(2) (%)	Bloomberg US Corp. High Yield Index(2) (%)
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	15.65	15.15	13.44	n/a	5.86	8.24
Current Performance Results												
2024	5 or fewer	2,283	2,811	5,473	0	0	9.74	9.26	8.19	n/a	5.72	8.36

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 12.31.2023. 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 12.31.2023. The verification and performance examination reports are available upon request.

*Creation date is 03.01.1999. * Performance and Composite inception are 03.01.1999.*
Benchmark returns are not covered by the report of independent verifiers.
All returns are calculated and presented in US dollars.

Mesirow Financial Investment Management, Inc. ("MFIM") is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940.ßor purposes of claiming GIPS compliance, as of 01.01.2010, the firm is defined as Mesirow Financial Investment Management - Fixed Income divisions. The Mesirow Financial Investment Management - Fixed Income groups 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 Mesirow Financial Investment Management - Fixed Income groups was managed by MFIM or its predecessor firms prior to 01.01.2005. MFIM provides investment management services to separately managed accounts, limited partnerships, public mutual funds/Registered Investment Companies (RICs) and Collective Investment Trusts (CITs).

The Mesirow Financial Investment Management - Fixed Income business unit includes the Mesirow Financial Investment Management - Strategic Fixed Income (formerly Core Fixed Income) group and the Mesirow Financial Investment Management - High Yield Fixed Income group and manages portfolios primarily for institutional investors adhering to an investment process incorporating fundamental analysis of security valuation factors and drivers. The composites within this business unit vary primarily by duration and the type of originator of the security.

Effective 10.23.2017, MFIM Fixed Income completed the lift-out of the High Yield team from a former and unaffiliated registered Investment Advisor.

Effective 05.29.2020, MFIM Fixed Income completed the lift out of the Analytic Fixed Income Team from a former and unaffiliated registered Investment Advisor, Chicago Equity Partners (CEP) which its team, became an integral part of MFIM Fixed Institutional Fixed Income. On 05.29.2020, MFIM acquired the asset management rights for a portion of the managed portfolios from an independent investment advisory firm and retained all the principals and employees related to such portfolios. Effective 11.30.2022, the MFIM Fixed Income - Analytic Fixed Income business discontinued operations. Accounts either transferred to the Strategic Fixed Income business unit or terminated its relationship with Mesirow.

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.

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.

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

Performance information that is provided gross of fees does not reflect the deduction of 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 Form ADV Part 2 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. 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.