Core Total Return quarterly commentary

Market commentary

US Treasury market volatility remained elevated during the 4th quarter as the market continued to struggle with interpreting the Fed's policy and the ultimate level of the Fed Funds rate, as well as some changes in global monetary policy outside the US. The final month of the year saw increased volatility, with Treasury yields at the low end of the recent range heading into December. This was a reflection of US data in November, which showed signs that the economy was weakening and that inflation was finally trending downward, stoking more "pivot" rhetoric.

This storyline carried for a few weeks with Treasury yields matching quarterly lows by mid-December. This all changed as The Bank of Japan caught markets off guard by tweaking its yield curve control policy to allow the yield on the 10-year JGB to move 50 basis points either side of its 0% target. As a result, global yields rose, equities fell and the Yen strengthened significantly. While the overall range may not seem much compared to the rate hikes executed by central banks elsewhere, this was a significant change in policy. Higher rates in Japan would create incentive to bring money home versus investing in US and European debt.

Additionally, US data, which had appeared to create some relief several weeks earlier, again showed some strength to close the year. This was reflected in continued solid labor data, better than expected personal income figures and a Core PCE number that — while still declining — came in better than expected at 4.7%. The improved data dampened any pivot talk as the year ended and pushed yields up 30-35 basis points across the curve in the last few weeks of December.

Looking forward, we believe rates will remain relatively range bound in the near term, with 10-year Treasuries likely trading in roughly a 50 basis point range (3.50%-4.00%). The wider range in yields will likely persist as the market struggles to reconcile the opposing forces of elevated recession risks, a strong labor market that might prompt the Fed to continue their tightening path and a futures market that is still pricing in rate cuts in 4Q23.

We believe Chairman Powell has been very transparent in his approach and will remain steadfast in his fight against inflation. We expect the FOMC to maintain their hiking path with core inflation still running over 2X their desired target.

We do not believe we will see a pivot with the Fed cutting rates at any time in 2023. In fact, the recent economic data points to more of a soft landing. With some very material drags on real disposable income set to lessen during the year, and continued strength in the labor market, GDP growth may come in higher than what is currently expected by the market. We have remained consistent with our forecast and feel Powell will deliver at least another 50 basis points of rate hikes at the coming meetings in February and March, with potential for that to surprise to the upside depending on the data.

Broader risk assets rebounded modestly during the fourth quarter. The US stock market (as measured by the S&P 500 Stock Index) hit its low for the year on October 12 at 3577 before rebounding to close the year at 3839, earning a 4Q total return of +7.55%. For 2022, the S&P 500 produced a total return of -18.13%, its worst year since 2008. Bond market performance was similar in reaching lows in October before rebounding to produce a 4Q total return of +1.87%. The US bond market (as measured by the Bloomberg Aggregate Bond Index) in 2022 produced a total return of -13.01%, its worst year on record.

The 10-year UST yield started the year at 1.51% and peaked on October 24 at 4.24% before closing the year at 3.88%. The 2-year UST yield started the year at 0.73% and peaked on November 7, at 4.72% before closing the year at 4.43%.

The yield curve inversion (2s vs 10s) was 55 basis points at the end of the year (the high was 88 basis points on December 7). This is the most inverted the yield curve has been since 1981. As notable as the yield itself, the volatility exhibited by the bond markets reached levels last seen in 2008-09 during the Global Financial Crisis.

Consistent with the broad market rebound, risk assets in the US bond market rebounded as well in the fourth quarter. Mortgage-backed securities' (MBS) OAS tightened 18 basis points, from +69 to +51 during the quarter after widening to +88 in October. Corporate bonds' OAS started the fourth quarter at +159 and widened to +165 in October before tightening in November and closing the year at +130.

Strategy commentary

Within Mesirow Strategic Fixed Income's Core Total Return Composite, our portfolios outperformed by 34 basis points as our overweight position in Corporates drove performance. Core Total Return earned a 4Q total return of 2.21% versus 1.87% for the Bloomberg Aggregate Bond Index. The strength was partially offset by our defensive duration posture as we maintained a below-market duration for most of the quarter. In addition, security selection was slightly negative as our emphasis towards shorter-maturity, higher-quality Single-A non-financial bonds detracted from performance. Widely held credits with short maturities, like BP Capital, Merck and Apple, didn't enjoy the same magnitude of spread compression as longer maturity, lower quality bonds.

Our strategy since mid-year 2022 has been to reduce overall market risk and add liquidity, emphasizing common holdings across portfolios in more on-the-run (more recently issued) bonds. We maintained a below-market duration posture for most of the quarter. Additionally, credit selection favored less cyclical names while reducing exposure to less liquid off-the-run bonds. This strategy proved beneficial for most of the year. However, it proved detrimental in the month of November and early December when yields declined and spreads compressed meaningfully, with BBB-rated bonds outperforming Single-A and AA-rated bonds.

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.

If you have questions or would like to receive additional materials, please contact contact portfoliospecialist@mesirow.com or 312.595.7300.

The S&P 500 Index is a stock market index tracking the stock performance of 500 large companies listed on stock exchanges in the United States.

The Bloomberg U.S. Aggregate Bond Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and assetbacked securities. These major sectors are subdivided into more specific indexes that are calculated and reported on a regular basis.

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GIPS REPORT – CORE TOTAL RETURN COMPOSITE

Gross and Net of Fees Total Returns from January 1, 2000 – December 31, 2022

	Year end			Annual performance results				3-year annualized dispersion(2)	
Year	No. of portfolios	Composite Asset at end of period ($MM)	Total Firm Assets ($MM)	MFIM (gross) Composite (%)	MFIM (net) Composite (%)	Bloomberg US Aggregate Index (%)	Composite Dispersion(1) (%)	MFIM (gross) Composite (%)	Bloomberg US Aggregate Index (%)
2000	5 or fewer	290	n/a	12.51	12.37	11.63	n/a	–	–
2001	5 or fewer	562	n/a	8.59	8.46	8.44	n/a	–	–
2002	5 or fewer	575	n/a	10.69	10.55	10.25	n/a	–	–
2003	5 or fewer	643	n/a	4.49	4.36	4.10	n/a	–	–
2004	5 or fewer	830	n/a	4.83	4.70	4.34	n/a	–	–
2005	5 or fewer	665	1,911	2.53	2.43	2.34	n/a	–	–
2006	9	997	2,258	4.64	4.47	4.33	0.15	–	–
2007	9	1,198	2,684	6.20	6.05	6.96	0.14	–	–
2008	10	1,313	2,971	3.39	3.25	5.24	0.41	–	–
2009	12	1,378	3,251	11.97	11.81	5.93	0.93	–	–
2010	16	1,386	3,241	7.34	7.19	6.54	0.28	–	–
2011	14	1,387	3,516	7.37	7.21	7.84	0.40	2.92	2.78
2012	12	658	4,106	6.00	5.78	4.22	0.33	2.32	2.38
2013	14	805	4,871	-1.90	-2.10	-2.02	0.09	2.73	2.71
2014	15	987	4,972	6.47	6.24	5.97	0.18	2.70	2.63
2015	14	858	4,532	0.04	-0.17	0.55	0.17	2.93	2.88
2016	14	863	4,410	3.27	3.05	2.65	0.26	2.97	2.98
2017	14	941	4,772	3.53	3.32	3.54	0.12	2.74	2.78
2018	13	719	4,161	-0.04	-0.21	0.01	0.15	2.72	2.84
2019	9	612	3,895	9.16	8.94	8.72	0.14	2.80	2.87
2020	10	789	6,706	8.84	8.62	7.51	0.16	3.57	3.36
2021	11	1,099	6,168	-1.65	-1.84	-1.54	0.10	3.67	3.35
Current Performance Results – PRELIMINARY									
2022	7	711	3,616	-12.27	-12.43	-13.01	0.16	5.90	5.77

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 Institutional Fixed Income has been independently verified for the periods 01.01.1996 - 12.31.2021. A firm that claims compliance with the GIPS standard 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 GIPS standards and have been implemented on a firm-wide basis. The Core Total Return Composite has had a performance examination for the periods 01.01.2006 -12.31.2021. The verification and performance examination reports are available upon request.

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" as shown represents 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, which 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. Please note that the 2018 percentage of firm assets have been restated to properly include the addition of assets obtained through the acquisition of the High Yield Team from a former and unaffiliated registered Investment Advisor, effective 10.23.2017. On 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 of the principals and employees related to such portfolios.

The above composite was created on 01.01.2000, the inception date is 01.01.2000.

Core Total Return Fixed Income Composite is defined as U.S. dollar dominated fixed income investment grade securities primarily rated BBB- or better and with a maturity range of one to thirty years at the time of purchase. The Core Total Return composite consists of fixed income fee-paying discretionary portfolios with a minimum of $7,500,000 under management. The benchmark is the Bloomberg Aggregate Index. In March of 2005, the Core Total Return fixed income portfolio management team of an independent investment advisor joined the MFIM Fixed Income portfolio management team. The performance results shown prior to 03.15.2005 reflect the team's performance prior to joining MFIM-Fixed Income. Such returns have been incorporated into the MFIM Core Total Return Fixed Income composite. Upon receipt of client consent, MFIM-Fixed Income obtained the required custody and holdings information from the independent custody firms, or other similar sources, for all clients that have been managed on a continuous basis and that information has been incorporated into the MFIM Core Total Return Fixed Income composite. The list of composite descriptions, the list of pooled fund descriptions for limited distribution pooled funds, and the firm's list of broad distribution pooled funds is available upon request. For the period, portfolios below $7,500,000 are considered nondiscretionary, as MFIM-Fixed Income may be unable to fully and efficiently implement the intended investment strategy of the composite. Effective 01.01.2019, accounts will be temporarily removed from the composite due to significant cash flows of 15% or more of market value. Prior to 01.01.2019, accounts had been temporarily removed from the composite due to significant cash flows of 10% or more of market value. Additional information regarding the significant cash flow policy is available upon request.

Calculation of Risk Measures: Annual / 3 Years Dispersion

(1) Composite dispersion presented is the equal-weighted standard deviation of the gross annual returns of portfolios in the composite for the entire year. Because it is not statistically meaningful, MFIM Fixed Income does not calculate the dispersion of annual returns for the years the composite held five or fewer accounts.

(2) 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

MFIM-Fixed Income's investment management fees vary based upon account size, with breakpoint deductions for larger accounts and a minimum annual fee of $20,000. The standard fee schedule for Core Total Return Portfolios is listed below:

0.350% on the first $10 million

0.250% on the next $40 million

0.200% on the next $100 million

0.150% on the next $150 million

0.125% on the next $200 million

0.100% over $500 million

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 Mesirow Financial Investment Management, Inc. Net of fee performance is presented utilizing actual client net of fee performance for all accounts included in the composite. We do, however, have clients that pay lower fees than the maximum. Any stated results include the reinvestment of dividend and other earnings. 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.

Benchmark Definition

The Bloomberg U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indexes that are calculated and reported on a regular basis.