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High Yield commentary

Market commentary

The high yield market fell 1.15% in March, as measured by the Bloomberg benchmark, bringing its year-to-date return to -4.84%. The primary engine for this decline was a large increase in Treasury rates: the key 10-year rate is up nearly a full percent so far during 2022. Since August 2020, the 10-year rate has quintupled.

As described in our recent report, "Wrong Way Bonds," we speculated that the next meaningful upward move in Treasuries would not be driven by a strong economy like the last 13, but rather be driven by inflation. As investors required a higher interest rate to compensate, they would demand a higher yield from high yield bonds as well.

That is what is occurring now. Also fueling negative performance is what was a remote possibility before inflation exploded a year ago: the fear of a recession. The Fed is now fully cognizant of being behind the curve, and many economists now believe that its belated tightening will cause a near term recession.

All industries except energy had negative returns for the quarter, with several cyclical industries (automotive, housing, chemicals, and transportation) being the worst performers as the quarter ended. High yield funds experienced outflows of $4.9 billion in March, and the outflow for the quarter was a large $25 billion. Loan funds meanwhile experienced their 16th straight monthly inflow, and loans as a whole have managed near-zero returns in both March and year-to-date.

As is typical in down months where there are large fund outflows, large bonds ($+1B) underperformed over the quarter. Default rates remain low: the trailing 12-month rates (including distressed exchanges) are well under historical averages. But they appear to have bottomed out; we expect them to gradually rise from here but remain well under their long-term averages during both 2022 and 2023.

The war, inflation, rapidly rising long rates, a major change in the posture of the Fed, and surging prices for energy in all forms have dramatically decreased new issuance. March is historically the busiest issuance month of the year, but this March just $7 billion in new bonds were sold (ex-refinancings.) This is 75% below the long-term average.

New issue volume in the first quarter was $25 billion, down 43% from 2021. Loan issuance (again ex-refinancings) was down 60%.

Strategy commentary

Year-to-date, the strategy once again outperformed versus the benchmark. Security selection remained the predominant source of value added in Q1, though the bank loan portion of the strategy also served as a notable tailwind in recent months.

The strategy outperformed in all rating cohorts over the quarter with selection providing roughly half of value added. The other half of outperformance was due to allocation, which is unusual for us. Our large underweight of the poorly performing, longer duration Ba sector (and our correspondingly large overweight of B bonds) was a significant contributor to performance this quarter.

In terms of issue size, we returned to the normal pattern: the vast majority of the outperformance during the first quarter came from selection (not allocation) and it was produced almost entirely in the small and mid-cap cohorts. From an industry viewpoint, a significant amount of value added came from individual security selection, especially in basic industry, transportation, and technology. (For the strategy, "basic industry" consists largely of mining and metals companies. Although we do not invest in these companies to speculate on commodities, rising prices certainly are contributing a strong tailwind at present.)

Source: Bloomberg, JPMorgan. Past performance is not necessarily indicative of future results. Performance shown above is gross and does not reflect the deduction of management fees. Please see disclosure at end for additional, important information. Please see the GIPS Reports attached for complete performance, including net, and benchmark descriptions. Any targeted performance results mentioned herein may not be achieved and materially different performance results may occur.

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.

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GIPS REPORT – MFIM FIXED INCOME HIGH YIELD COMPOSITE

Gross and Net of Fees Total Returns from March 1, 1999 – December 31, 2021

			Year end				Annual Performance results					
Year	Firm assets (millions)	MHY assets (millions)	High Yield USD (millions)	Number of accounts	Non-paying fees (%)	Carve out (%)	Composite gross (%)	Composite net (%)	Barclays high yield (%)	Composite dispersion (%)	Composite 3-yr ex-post STD (%)	Index 3-yr ex-post STD (%)
1999	–	507	507	2	1	1	4.81	4.38	1.49	n/a	n/a	n/a
2000	–	465	465	2	1	1	-8.42	-8.88	-5.86	n/a	n/a	n/a
2001	–	648	648	2	1	1	7.14	6.60	5.28	n/a	n/a[2]	n/a[2]
2002	–	888	888	2	1	1	11.63	11.08	-1.41	n/a	8.01	10.34
2003	–	1,265	1,265	2	1	1	23.64	23.03	28.97	n/a	7.03	10.65
2004	–	1,522	1,522	3	1	1	16.00	15.43	11.13	n/a	4.14	8.38
2005	–	1,536	1,536	2	1	1	6.81	6.28	2.74	n/a	4.48	5.55
2006	–	14	14	1	100	100	18.61	18.03	11.85	n/a	4.63	3.95
2007	–	297	11	1	100	100	7.59	7.06	1.87	n/a	4.70	4.74
2008	–	207	8	1	100	100	-17.70	-18.12	-26.16	n/a	10.14	13.41
2009	–	270	10	1	100	100	44.33	43.63	58.21	n/a	11.57	16.93
2010	–	295	11	1	100	0	16.94	16.36	15.12	n/a	11.72	17.03
2011	–	310	27	2	0	0	4.44	4.06	4.98	n/a	7.23	11.09
2012	–	334	40	1	0	0	14.63	14.00	15.81	n/a	5.40	7.08
2013	–	817	520	7	1	0	9.41	8.90	7.44	n/a[1]	5.33	6.41
2014	–	797	593	8	1	0	3.14	2.68	2.45	0.7	4.01	4.50
2015	–	757	617	8	1	0	-1.02	-1.45	-4.47	0.7	4.26	5.26
2016	–	841	742	7	–	–	15.18	14.67	17.13	–	4.57	6.00
2017	4,772	526	512	1	–	–	8.90	8.45	7.50	–	4.24	5.65
2018	4,137	873	859	2	–	–	-1.02	-1.37	-2.08	–	3.81	4.66
2019	3,895	1,199	1,124	3	–	–	13.02	12.58	14.32	–	3.79	4.07
2020	6,706	1,407	1,338	4	–	–	9.00	8.55	7.11	–	12.39	9.37
Current YTD Performance Results — PRELIMINARY												
12.31.2021	6,168	1,421	1,301	4	–	–	12.12	11.67	5.28	–	12.25	9.13

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 from inception through 12.31.2020. 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 3.1.1999 - 12.31.2020. The verification and performance examination reports are available upon request. The firm's list of pooled fund descriptions for limited distribution pooled funds is available upon request. The firm's list of broad distribution pooled funds is 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" 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 1.1.2005. For purposes of claiming GIPS compliance, as of 1.1.2010, 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.

Effective October 23, 2017 MFIM Fixed Income completed the lift out of the High Yield Team from a former and unaffiliated registered Investment Advisor, Pacific Income Advisers which its team, along with the High Yield Composite became an integral part of MFIM Fixed Income. Pacific Income Advisers had been verified for the period of 1.1.1994 - 6.30.2016. The High Yield Composite had been examined for the period of 5.1.2010 - 6.30.2016 while at PIA.

The Performance presented from March 1, 1999 through April 30, 2010 was generated while the Portfolio Managers were affiliated with a prior 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.

Prior to May 1, 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 3.1.1999 to 12.31.2009 by Ashland Partners & Company LLP. The High Yield Composite was created in March 1999.

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 in certain circumstances when onboarding a new account, ETFs 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 definition was amended as of October 2019 to more fully reflect the intended strategy. On 1.1.2009 a substantially large equity position (which included several securities) became non-discretionary and was transferred from the portfolio when the client restricted the portfolio manager from selling the positions due to tax consequences. Prior to November 1, 2010, the 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.

GIPS REPORT – MFIM FIXED INCOME HIGH YIELD COMPOSITE (CONTINUED)

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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 May 1, 2010 since we believe it is more commonly recognized as the industry standard index for the high yield asset class. The Bloomberg Barclays US Corporate High Yield Bond 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 Barclays EM country definition, are excluded. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Beginning May 1, 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. Past performance is not indicative of future results. The U.S. Dollar is the currency used to express performance.

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 MFIM. As of 10.1.2013, net of fee performance was calculated using actual management fees. Prior to 10.1.2013, net of fee performance was calculated using the highest annual management fee applied to the gross results on a monthly basis. For the period 4.1.2011 through 9.30.2013, the highest management fee was 0.65%. Prior to 3.31.2011, 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: 0.60% on the first $25 million, 0.55% on the next $25 million, 0.50% on the next $50 million and 0.45% thereafter.

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.

Prior to January 1, 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. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. A complete list of composites can be made available upon request.

1. N/A = Information is not statistically meaningful due to an insufficient number 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.