Mesirow

High Yield | Commentary

Market commentary

The high yield market gained 0.46% in the third quarter, as measured by the Bloomberg US Corporate High Yield Index (Index), but that temperate performance masks a period of shifting expectations and vacillating performance. July was a strong month for the leveraged finance markets, as encouraging inflation and GDP data prompted investors to bet increasingly on a "Goldilocks" economic scenario. Credit markets remained steadfast in August, as economic data indicated a moderating job market and, therefore, a lower likelihood of the Federal Reserve raising rates again in 2023. However, market sentiment shifted in September as investors began accepting the reality that interest rates will likely be higher for much longer than expected and dealt with the specter of a government shutdown.

One constant during the quarter in the high yield bond market was the strong performance of lower quality bonds versus their more highly rated counterparts, largely on the back of rising interest rates. As measured by the Index, Caa-rated bonds gained 2.51% for the quarter. B-rated bonds gained 78bps while Ba-rated bonds were down 36bps.

From an issue size standpoint, smaller bonds lagged in August but outperformed for the quarter. By cohort, $200–500M issues were up 55bps, $500–1B were up 48bps and $1B+ gained 40bps.

Sector performance largely tracked investor sentiment in the third quarter. All sectors were positive in July, were mixed in August and then largely turned negative in September. For the quarter, the best performing sectors in the Index were finance related: Banking (3.16%), Brokerages (2.54%) and Finance Companies (1.67%). Energy also had a relatively good quarter, up 1.66% due to oil price increases. The worst performing sectors for the quarter were Natural Gas (-2.99%) and Capital Goods (-0.38%).

According to JP Morgan, default/distressed exchange volume totaled $11.5B in the third quarter, the lowest quarterly total year-to-date, following elevated totals of $30.8B in 2Q and $20.8B in 1Q.

In the bank loan market, the story was much the same. Lower quality loans tended to outperform higher quality loans and performance by loan size was mixed for the quarter. The differentiator was that all loan industries turned in positive performance for each month in the quarter.

Portfolio commentary

The Mesirow High Yield strategy had a strong third quarter, posting a total net return of 2.6% versus the Index return of 0.46%. Despite shifting conditions and outlooks in the third quarter, the strategy beat the Index each month. Year to date, the strategy has significantly outperformed its benchmark with a 9.9% total net return, versus 5.86% for the Index.

The favorable market environment for lower-rated issues was a tailwind, but credit selection remained the foundation for the strong performance.

Given that our strategy is to consistently overweight lower-rated bonds, rating allocation was responsible for approximately a third of the quarter's excess return. The remaining outperformance for the quarter was driven by the strength of individual credits. The performance of B-rated names in the portfolio was particularly additive in the third quarter, and responsible for more than 100bps of additional return versus the Index.

Regarding sectors, Capital Goods, Basic Industry and Energy were the top performing sectors in the portfolio, all outperforming their benchmark cohorts by 100-400bps. There were no significant industry laggards in the portfolio this quarter.

Source: Bloomberg, JPMorgan. 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.

Finally, our value-add in small and midcap names was on target this quarter, with more than 80% of outperformance attributed to credit selection within these issue size cohorts.

Outlook and positioning

Looking forward, the high yield market has remained relatively resilient from a credit standpoint despite the backdrop of sharply rising rates. Although credit stats (net leverage and interest coverage) likely peaked in 4Q2022, we have seen only a slight drop off throughout 2023 with still very healthy levels by historical standards. Leveraged loans, however, experienced a notable deterioration in credit fundamentals that will continue to be stressed if the economy softens.

Year-to-date credit spreads have tightened despite outflows in both markets (particularly loans). And with expected limited new issue supply on the horizon, it is possible credit spreads may grind tighter in the near term, especially if Treasuries increase.

As a result, we are seeing less opportunity in the loan market. The rally in loan prices year-to-date has made this segment less attractive versus high yield bonds. Since the Fed began raising rates, almost all loan-only exposure companies have seen their interest bill double because they did not hedge their exposure. That, combined with limited price upside and deteriorating credit conditions, has reduced the attractiveness of the loan market.

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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.

Contact us

UNITED STATES INVESTORS

portfoliospecialist@mesirow.com | 312.595.7300

UNITED KINGDOM AND EUROPEAN INVESTORS

Katherine Wentrup-Estupinan

kwe@mesirow.com | 011.44.207.851.1715

Katie Renouf

katie.renouf@mesirow.com | 011.44.207.851.1702

GIPS REPORT – HIGH YIELD COMPOSITE

Gross and Net of Fees Total Returns from March 1, 1999 – September 30, 2023

Year	Year end						Annual performance results				3-year annualized dispersion(2)	
	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 (%)
1999	5 or fewer	507	507	–	1	1	4.81	4.38	1.49	n/a	n/a	n/a
2000	5 or fewer	465	465	–	1	1	-8.42	-8.88	-5.86	n/a	n/a	n/a
2001	5 or fewer	648	648	–	1	1	7.14	6.60	5.28	n/a	n/a	n/a
2002	5 or fewer	888	888	–	1	1	11.63	11.08	-1.41	n/a	8.01	10.34
2003	5 or fewer	1,265	1,265	–	1	1	23.64	23.03	28.97	n/a	7.03	10.65
2004	5 or fewer	1,522	1,522	–	1	1	16.00	15.43	11.13	n/a	4.14	8.38
2005	5 or fewer	1,536	1,536	–	1	1	6.81	6.28	2.74	n/a	4.48	5.55
2006	5 or fewer	14	14	–	100	100	18.61	18.03	11.85	n/a	4.63	3.95
2007	5 or fewer	11	297	–	100	100	7.59	7.06	1.87	n/a	4.70	4.74
2008	5 or fewer	8	207	–	100	100	-17.70	-18.12	-26.16	n/a	10.14	13.41
2009	5 or fewer	10	270	–	100	100	44.33	43.63	58.21	n/a	11.57	16.93
2010	5 or fewer	11	295	–	100	0	16.94	16.36	15.12	n/a	11.72	17.03
2011	5 or fewer	27	310	–	0	0	4.44	4.06	4.98	n/a	7.23	11.09
2012	5 or fewer	40	334	–	0	0	14.63	14.00	15.81	n/a	5.40	7.08
2013	7	520	817	–	1	0	9.41	8.90	7.44	n/a	5.33	6.41
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	–	–	–	15.18	14.67	17.13	n/a	4.57	6.00
2017	5 or fewer	512	526	4,772	–	–	8.90	8.45	7.50	n/a	4.24	5.65
2018	5 or fewer	859	873	4,137	–	–	-1.02	-1.37	-2.08	n/a	3.76	4.59
2019	5 or fewer	1,124	1,199	3,895	–	–	13.02	12.58	14.32	n/a	3.74	4.02
2020	5 or fewer	1,338	1,407	6,706	–	–	9.00	8.55	7.11	n/a	12.23	9.24
2021	5 or fewer	1,301	1,421	6,168	–	–	12.12	11.67	5.28	n/a	12.08	9.00
2022	5 or fewer	717	898	3,616	–	–	-10.38	-10.76	-11.19	n/a	12.70	10.97
Current Performance Results												
2023 YTD	5 or fewer	961	1,389	3,737	–	–	10.21	9.85	5.86	n/a	6.25	7.91

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 12.31.2021. 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 12.31.2021. 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 or asset-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 Composite 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 Strategy

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.

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