Mesirow

# High Yield | Commentary

## Market commentary

New risks emerged in October, dampening investor sentiment in both bond and equity markets. Investors grappled with an increasing likelihood of "higher for longer" interest rates, a weaker outlook on US government finances and an emerging war between Israel and Hamas in the Middle East. In response, the Bloomberg US Corporate High Yield Index fell -1.16% in October, while the Credit Suisse Leveraged Loan Index remained flat at 0.03%. (However, year-to-date returns remain strong at 4.63% and 9.94%, respectively.)

In the wake of headlines, Treasury rates continued to increase in October. The 5-Year Treasury rate increased 19bps and the 10-Year rate increased 30bps. The Federal Funds target rate was left unchanged.

High yield credit spreads also widened in response to October's volatility, increasing 43 bps during the month and finishing at 437bps. The Credit Suisse 5-Year discount margin likewise widened by 18bps to 517bps.

After a slowdown in September, the increase in default activity in October was notable. There were nine defaults (including distressed exchanges) totaling $8.4B ($5.7B bond and $2.7B loan). Through October, the par-weighted US high-yield bond and loan default rates increased 49bps and 14bps month-over-month to 2.60% and 3.08%.

## High Yield market commentary

**The Bloomberg Barclays High Yield Corporate Index fell -1.16%.**

- **Lower quality bonds lagged:** Caa-rated bonds fell the most in October losing -3.41%, while B-rated bonds were down -1.14% and Ba-rated bonds were down -0.59%.
- **Most industry returns were negative:** Pharmaceuticals was the worst performing sector for the second month in a row (-3.47%) followed by Airlines (-3.38%). Independent (Exploration & Production) was the only positive sector (+0.05%) followed by Supermarkets which was flat (+0.0%).
- **Small bonds outperformed:** Small issue sizes ($200–500M) lost -1.03%, compared to mid-size issues ($500M–$1B) which were down -1.12%, and large issues ($1B+) which were down -1.28%.

## Loan market commentary

**The Credit Suisse Leveraged Loan Index produced a +0.03% return.**

- **BBs led in September:** The BB cohort gained +0.35%, while the B-rated and CCC-rated cohorts fell -0.05% and -0.16% respectively.
- **Loan industry performance was mixed:** Utility and Food and Drug led with +0.70% and +0.67% returns, while Chemicals lagged returning -0.64%.
- **Smaller loans outperformed:** Small issue size loans (less than $500M) returned +0.53%, mid-size issues ($500–$1B) returned +0.13% and large issue size loans ($1B+) returned -0.11%.

## Portfolio commentary

The strategy outperformed in October, as strong credit selection was able to overcome substantial market headwinds.

Ba-rated bonds were the best performing rating cohort in October, outperforming B-rated bonds by more than 50bps and Caa-rated bonds by almost 300bps.

Given our evergreen underweight of Bas, the strategy would have underperformed if the month's return were based on rating allocation alone. However, the performance of individual credits was strong in October, and more than made up for the portfolio's out-of-favor rating allocations. Caa names had a particularly strong showing in the portfolio in October. While the index's Caa-rated cohort was down -3.41%, the portfolio's Caa holdings was only down -0.62%, virtually the same return as the higher rated Ba-rated bonds in the index.

Reviewing sectors, Energy was the most significant value add to the portfolio in October, while transportation was the most significant detractor. Allocation and selection factors played a role in the performances of both industries.

Finally, issue size performance was notable only in the fact that the strategy's positive credit selection was largely concentrated in small issue sizes.

## Outlook and positioning

Looking ahead, it is hard to ignore many of the recent economic headlines impacting the market. We continue to agree with the prevailing sentiment that inflation and interest rates are likely to remain high for the foreseeable future with the growing US deficit now providing additional support for our analysis.

In a recent update to Congressional Budget Office (CBO) projections, the CBO forecasts deficits to average about $2 trillion per year for the next decade. However, it is our belief that the deficits in coming years will actually be much larger given that the assumptions from the CBO do not incorporate increased interest rates the government will need to pay on Treasury bonds.

The current forecast assumes that the average coupon of federal debt will stabilize at 3.2%, which seems unrealistic given today's yield curve. (By comparison, if one were to freeze today's yield curve, and refinance all outstanding federal debt, the average coupon rate would be just over 5%.)

Therefore, the CBO's analysis is discounting the more realistic scenario where Treasury bonds mature and are replaced at today's interest rates, which would add hundreds of billions of dollars to US deficits and the national debt. For years, and especially during COVID, the largest "buyer" of Treasury debt has been the Fed, which is essentially money printing and no longer feasible in today's inflationary environment. Therefore, the market (not the Fed) will need to step in as buyers for new Treasury bonds, which would keep rates at elevated levels not seen since the Great Recession.

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.

## 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 March 1, 1999 – September 30, 2023

| | 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 (%) |
| 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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