Mesirow

High Yield commentary

Market commentary

Credit markets remained steadfast in August, as economic data indicated a moderating job market and, therefore, a lower likelihood of the Federal Reserve (Fed) raising rates again in 2023. The Bloomberg US Corporate High Yield Index increased 0.28% in the last month, while the Credit Suisse Leveraged Loan Index rose 1.15%. Year-to-date, both indices are up 7.13% and 8.95%, respectively.

Treasury rates increased slightly over the period (the 5-year and 10-year up 7bps and 15bps) while the Federal Funds rate remained unchanged.

High yield credit spreads, as measured by the Bloomberg US Corporate HY Bond Index option-adjusted spread, were largely unchanged, increasing only 5bps and ending the month at 372bps. The Credit Suisse 3-year yield-to-maturity similarly decreased only 7bps, now 9.65% versus 9.72% in July.

Given there were only slight changes in rates and spreads last month, the returns of both the high yield and loans markets were predominately driven by the coupon income of each asset class and not market value changes.

There was slight increase in default activity as five companies defaulted and six completed distressed exchanges in August, totaling $6.1B par. The last twelve months (LTM) par-weighted US high-yield bond default rate, per JPMorgan, is now at 2.4% and the US LTM par-weighted loan default rate is now at 2.92%. (Both include distressed exchanges.) This equates to an 18bp increase month-over-month for the high yield default rate, and a 4bp decrease to the loan rate. Loan-only borrowers continued to show their relative weakness in August as six of the 11 defaults during the month were loan-only borrowers. (Of the 60 defaults YTD, 50% have been loan-only borrowers compared with 20 bond-only defaults and 10 from bond-and-loan issuers, per JPMorgan.).

High Yield market overview

The Bloomberg US Corporate HY Bond Index returned +0.28%.

Caa bonds posted another strong month:

August 2023 returns	
Ba rated	-0.06%
B rated	+0.43%
Caa rated	+1.20%

Industry performance was mixed | Metals and Mining fell -0.55%, Automotive was down -0.52% and Restaurants was down -0.46%. Meanwhile, Wireless was the strongest sector in August, posting a +2.34% return, with Cable satellite (+1.08%) Brokerage/asset managers/exchanges (+1.02%) and Independent (E&P) (+1.02%) also top performers.

Small bonds lagged:

August 2023 returns	
Small issues ($200-$500M)	+0.04%
Mid-sized issues ($500-$1B)	+0.31%
Large issues ($1B+)	+0.38%

Loan market overview

The Credit Suisse Leveraged Loan Index produced a 1.15% return.

Lower quality loans led in August:

August 2023 returns	
BB rated	+0.81%
B rated	+1.31%
CCC/Split CCC	+1.88%

All loan industries had a positive month | Healthcare led with a +1.55% return in while Forest Products/Containers posted the worst return at +0.57%.

Issue size performance was mixed | Small issue size loans (less than $500M) returned +1.06%, mid-size issues($500-$1B) returned +0.94% and large issue size loans ($1B+) returned 1.26%.

Source: Bloomberg, JPMorgan. Past performance is not indicative of future results. Performance mentioned above is supplemental; please see GIPS Reports included at the end for complete performance and benchmark descriptions. Please refer to the disclosure at the end for additional, important information.

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Mesirow High Yield performance review

August was another strong month for the strategy, which outperformed the benchmark by more than 40bps. The Mesirow High Yield Composite produced a return of +0.74% (net) versus the benchmark's return of +0.28%.

Performance in August was driven both by supportive market conditions and the outperformance of individual credits in the strategy. Credit markets being relatively unchanged over the month (both in terms of rates and spreads) meant that high yielding investments (generally lower-rated names) had the highest returns due to their higher carry. Given that our strategy is consistently overweight lower rated bonds, our strategy's rating allocation was responsible for more than half of the month's outperformance. The remaining outperformance was due to individual names outperforming. Ba and B names within the strategy outperformed their benchmark cohorts, generating excess return. (Conversely, the Caa names in the strategy underperformed the benchmark Caa return, but not enough to outweigh the benefit added by the strategy's Ba and Bs.)

In terms of sectors, three notable outperformers were Energy, Capital Goods, and Basic Industry names, all due to the performance of individual credits. As discussed in earlier commentaries, these are the sectors we tend to be overweight, as they have historically best exhibited the characteristics we favor most: strong free cash flows, fairly mature business models and long histories where past cyclicality can be measured. For that reason, it is not a surprise that the month's outperformance was more concentrated in these industries.

Performance by issue size was similarly as expected – individual security performances within small cap names were the main source of the added performance in August; however, mid cap and large cap holdings were still additive.

Outlook and positioning

Each month we publish commentary discussing our views on the market including an assessment of sectors or comparing relative value among rating categories and asset classes. While we may share our outlook of the economy, these assessments rarely influence the ultimate positioning of our strategy. Instead, we prefer to leave the role of playing an accurate economist to other more inclined, such as macro hedge fund managers. Also, while rarely acted on, we do assess macroeconomic variables during our portfolio management process and, at times, share our analysis with clients. In that regard, at the beginning of this year we expressed our belief that the US economy would likely experience stagflation in 2023, but ultimately avoid a recession. And nine months later, we believe that call rings true for today's economy.

The Core Inflation Rate has been consistently running between 4.7% and 6% over the last year, which supports the inflation component of stagflation. And while GDP prints remain resilient, we question whether the most recent prints may be overstating true increases in productivity. For example, spending in green energy was a massive $141B in 2022. But that investment does not really create equivalent value within the US economy, as in the case of an investment in a factory or a new drug. Instead, it is funding a transition from low cost, established, predictable energy sources to new, unpredictable and higher priced energy, using materials that are largely sourced outside the US. The associated loss in value/productivity is perceived as acceptable because the point is not to fuel the economy but rather to fight climate change. If that loss in productivity were accurately reflected in the GDP, we believe stagflation would correctly describe the state of today's US economy.

Looking ahead, the impact of the Fed's Quantitative Tightening (QT) program is also worth highlighting. The Federal Reserve's pivot from Quantitative Easing (QE) to QT last year means the Federal Reserve is no longer a dominant and price insensitive buyer of Treasuries and Mortgage-Backed Securities. This marks a significant departure from the past 15 years and is now a contributing factor to the high current levels of intermediate-term Treasury rates, now at a 30-year peak. Historically (before QE), long-term and intermediate-term Treasury rates were typically 1-2% higher than inflation. This is roughly where they are now, which is a return to a more conventional market equilibrium. For that reason, we anticipate bond rates (5- 7- 10-year rates) will continue to stay elevated and potentially continue to rise.

Source: Bloomberg, JPMorgan. Past performance is not indicative of future results. Performance mentioned above is supplemental; please see GIPS Reports included at the end for complete performance and benchmark descriptions. Please refer to the disclosure at the end for additional, important information.

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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 March 1, 1999 – June 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	838	1,203	3,585	–	–	7.35	7.11	5.38	n/a	6.51	8.29

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.

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