Mesirow

# High Yield | Commentary

## Market overview

Leveraged finance markets posted strong returns in August after a month of volatility. The Bloomberg US Corporate High Yield Index rose +1.63%, outperforming the Credit Suisse Leveraged Loan Index, which increased +0.60%. Year to date, the indices are up 6.29% and 5.84%, respectively.

Treasury rates fell with 5-Year and 10-Year Treasuries down 21bps and 13bps, respectively. The Federal Funds target rate was left unchanged.

The Bloomberg US Corporate High Yield Index option-adjusted spread was down slightly, falling 9bps to 305bps. The Credit Suisse Leveraged Loan Index's 3-Year discount margin similarly fell to 495bps, down 5bps.

There was a significant uptick in distressed exchanges in August, with the loan market experiencing more default activity than the bond market. (This trend has now resulted in the widest gap between loan and bond default rates since June 2014.) There was one loan default in August of $143 million and five distressed transactions totaling $10.8 billion across both bonds and loans. Notably, half of these six companies are repeat defaulters. Through August, the par-weighted US high yield bond default rate slightly decreased to 1.73%, while the loan default rate rose to 3.60%, both including distressed exchanges (JP Morgan). The bond default rate is about half of its long-term average, while the loan default rate is well over its long-term average, reflecting the increased risk, both relative and absolute, in the loan market.

## High yield market overview

**The Bloomberg US Corporate High Yield Index increased +1.63%.**

- **CCCs outperformed:** BB-rated bonds gained +1.58% B-rated bonds gained +1.52% and CCC-rated bonds gained +1.95%.
- **Industry performances were all positive:** Wirelines (+4.77%) was once again the best performing sector while Oil Field Services (+0.55%) was the worst.
- **Issue size performance was consistent:** LLarge issue sizes ($1B+) were up +1.69%, mid-size issues ($500M–$1B) were up +1.60% and small issue bonds ($200–$500M) were up +1.63%.

## Loan market overview

**The Credit Suisse Leveraged Loan Index returned +0.60%.**

- **CCC loans lagged:** BB-rated loans returned +0.57%, B-rated loans returned +0.71% and CCC-rated loans returned -0.20%.
- **Industries were mostly positive:** Media/Telecommunications was the best performing sector for the second month in a row, returning +1.13% and Transportation was the worst performing sector at -0.30%.
- **Size performance was mixed:** Small issue size loans (less than $500M) rose +0.64%, mid-size issues ($500M–$1B) rose +0.44% and large issue sizes ($1B+) returned +0.65%.

Source: Bloomberg, JP Morgan. | Mesirow High Yield Management ("MHY") is a division of Mesirow Financial Investment Management, Inc., ("MFIM") an SEC-registered investment advisor. | 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.

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## Performance review

The Mesirow High Yield strategy underperformed its benchmark in August.

Treasury rates fell again, contributing to the strategy's underperformance for the second consecutive month. Our strategy's shorter duration (one year shorter than the benchmark) was responsible for about a quarter of the month's underperformance.

Apart from a less favorable rate environment, a handful of names within the Technology, Communications and Capital Goods sectors also contributed to the month's lag. These underperformers were among B-rated and CCC-rated holdings and mid-to-large issue sizes. We believe the sell-off in most of these names will be short lived and expect a turnaround in subsequent quarters.

## Outlook and positioning

As we look at the current market landscape, sector allocation continues to be a main focus of our strategy.

We continue to be overweight Energy amid its recent tightening. Contrary to the historical volatility in the sector, the US shale industry has become more efficient and focused on cash generation. This shift has made the sector less vulnerable to price fluctuations, which supports our current overweight.

By comparison, we continue to generally avoid the Telecom, Healthcare and Retail sectors, all of which pose unique risks that have resulted in above-market defaults in recent years. Telecom companies require significant ongoing investments in infrastructure. Healthcare tends to be reliant on government programs like Medicare and Medicaid, which exposes these companies to crippling reductions in reimbursement rates from those two payors. And retailers grapple with significant cyclical pressures, most prominently the risk posed by the evolving ecommerce landscape.

Building products is another area we have more recently avoided, though we do not chronically zero weight the sector. The sector today is generally trading tight due to its consolidation into large, well-known names; however, we are also largely avoiding the sector's smaller, higher yielding LBO deals. Given the current housing market, weaker consumer spending and increased costs of new construction, we feel these credits may face significant challenges going forward.

In terms of the broad economy, as we have stated, while we don't see immediate recession risks, we're cognizant of several potential triggers for economic deterioration in 2025 and beyond. And the current tight spread environment in credit markets suggests to us that many investors may be underpricing these risks. However, that is not meant to discount potential opportunities for the high yield and loan markets on the horizon. If the Fed begins to cut short-term rates aggressively, we anticipate this could stimulate more deal activity and potentially create more investment opportunities. However, we are mindful that such cuts could be driven by economic weakness. As such, we are readying ourselves for possible economic (and political) shifts in the coming months, and ensuring we're prepared to navigate whatever challenges or opportunities the market presents.

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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 January 1, 2014 – June 30, 2024

| | Year end | | | | | | Annual performance results | | | | 3-year annualized dispersion | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 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(2) (%) | Bloomberg US Corp. High Yield Index(2) (%) |
| 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 | – | 0 | 0 | 15.18 | 14.67 | 17.13 | n/a | 4.57 | 6.00 |
| 2017 | 5 or fewer | 512 | 526 | 4,772 | 0 | 0 | 8.90 | 8.45 | 7.50 | n/a | 4.24 | 5.65 |
| 2018 | 5 or fewer | 859 | 873 | 4,137 | 0 | 0 | -1.02 | -1.37 | -2.08 | n/a | 3.76 | 4.59 |
| 2019 | 5 or fewer | 1,124 | 1,199 | 3,895 | 0 | 0 | 13.02 | 12.58 | 14.32 | n/a | 3.74 | 4.02 |
| 2020 | 5 or fewer | 1,338 | 1,407 | 6,706 | 0 | 0 | 9.00 | 8.55 | 7.11 | n/a | 12.23 | 9.24 |
| 2021 | 5 or fewer | 1,301 | 1,421 | 6,168 | 0 | 0 | 12.12 | 11.67 | 5.28 | n/a | 12.08 | 9.00 |
| 2022 | 5 or fewer | 717 | 898 | 3,616 | 0 | 0 | -10.38 | -10.76 | -11.19 | n/a | 12.70 | 10.97 |
| 2023 | 5 or fewer | 1,089 | 1,457 | 3,963 | 0 | 0 | 15.65 | 15.15 | 13.44 | n/a | 5.86 | 8.24 |
| **Current Performance Results** | | | | | | | | | | | | |
| 2024 YTD | 5 or fewer | 829 | 2,331 | 4.841 | 0 | 0 | 5.07 | 4.85 | 2.58 | n/a | 5.74 | 8.27 |

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 12.31.2023. 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 12.31.2023. The verification and performance examination reports are available upon request.

*Creation date is 03.01.1999. * Performance and Composite inception are 03.01.1999.*
Benchmark returns are not covered by the report of independent verifiers.
All returns are calculated and presented in US dollars.

Mesirow Financial Investment Management, Inc. ("MFIM") is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940.ßor purposes of claiming GIPS compliance, as of 01.01.2010, the firm is defined as Mesirow Financial Investment Management - Fixed Income divisions. The Mesirow Financial Investment Management - Fixed Income groups 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 Mesirow Financial Investment Management - Fixed Income groups was managed by MFIM or its predecessor firms prior to 01.01.2005. MFIM provides investment management services to separately managed accounts, limited partnerships, public mutual funds/Registered Investment Companies (RICs) and Collective Investment Trusts (CITs).

The Mesirow Financial Investment Management - Fixed Income business unit includes the Mesirow Financial Investment Management - Strategic Fixed Income (formerly Core Fixed Income) group and the Mesirow Financial Investment Management - High Yield Fixed Income group and 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.

Effective 10.23.2017, MFIM Fixed Income completed the lift-out of the High Yield team from a former and unaffiliated registered Investment Advisor.

Effective 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 the principals and employees related to such portfolios. Effective 11.30.2022, the MFIM Fixed Income - Analytic Fixed Income business discontinued operations. Accounts either transferred to the Strategic Fixed Income business unit or terminated its relationship with Mesirow.

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.

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..

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 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**
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 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. The management fee schedule is as follows:

High Yield 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
- 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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