

Hidden gems: The compelling case for small cap high yield

The small cap high yield market is not as well known or closely followed as the “traditional” market of bigger high yield issues – that’s exactly why small issues may offer high yield investors much more of what they are looking for: overcompensated credit risk, diversification and lower default rates.



Robert Sydow

Chief Investment Officer
High Yield Management

Below, we make the case as to why every high yield investor should focus on small cap over traditional or large cap high yield. We will also share our research findings, some of which surprised us.¹

What does small cap high yield offer investors? Quite a lot.

- **More income** | Small cap bonds trade on average 128bp wide vs large cap bonds²
- **Lower default rate** | Small cap bonds have experienced a 16% lower average annual default rate than large bonds over the last two decades (3.8% vs 4.5%)³
- **Lower volatility** | Large cap bonds are much more volatile on a week-to-week basis vs small cap bonds (the respective standard deviations of returns are 1.17% and 0.70%)⁴
- **Lower correlations** | Lower correlation to the S&P 500 and Bloomberg Aggregate⁵

Small cap high yield investors have benefitted from all these factors for many years. So why is no one paying attention? We have our theories. But first, let’s see if the data backs up our assertions.

More income

As shown in Chart 1 below, small cap bonds trade on average 128bp wide vs large cap bonds (Credit Suisse, HY Index Weekly Data 2011-2022), which is not all that surprising.

Large household names are generally associated with more data transparency via equity research, news coverage and research from industry consultants. Such transparency applies to large issuers’ high yield bonds, too – analysts have access to a wealth of standardized data that makes pricing them much easier.



Servia Rindfleish, CFA

Managing Director,
Client Portfolio Specialist

CHART 1: LARGE BOND ISSUES VS SMALL BOND ISSUES SPREAD*



*Spread-to-worst. | Source: Credit Suisse, HY Index Weekly Data 2011-2022. Past performance is not necessarily indicative of future results.

Conversely, a small issuer from a small industry will be much less known, and reliable data will be harder to come by. An analyst must do a lot more work to form an estimate of value and may lack confidence in that estimate once it has been made. When investors are not confident of their valuations, they rationally build in an extra margin of safety or an extra margin of yield.

Lower default rate

Many investors have an intuitive belief that large firms have lower default rates. They share a view articulated by the rating agencies that large firms have better access to the capital markets, better management teams and generally more levers to pull if their financial situation turns precarious. Until last year, we believed that small cap bonds defaulted at about the same rate as large cap bonds, but we had never seen a carefully done default study that validated our own belief, until the summer of 2022 when we launched a research project aiming to prove just that. To our surprise, the data showed a different story as illustrated in Chart 2. Small caps are not like large caps in terms of default rates. Instead, their long-term default rate is actually much lower!¹⁶

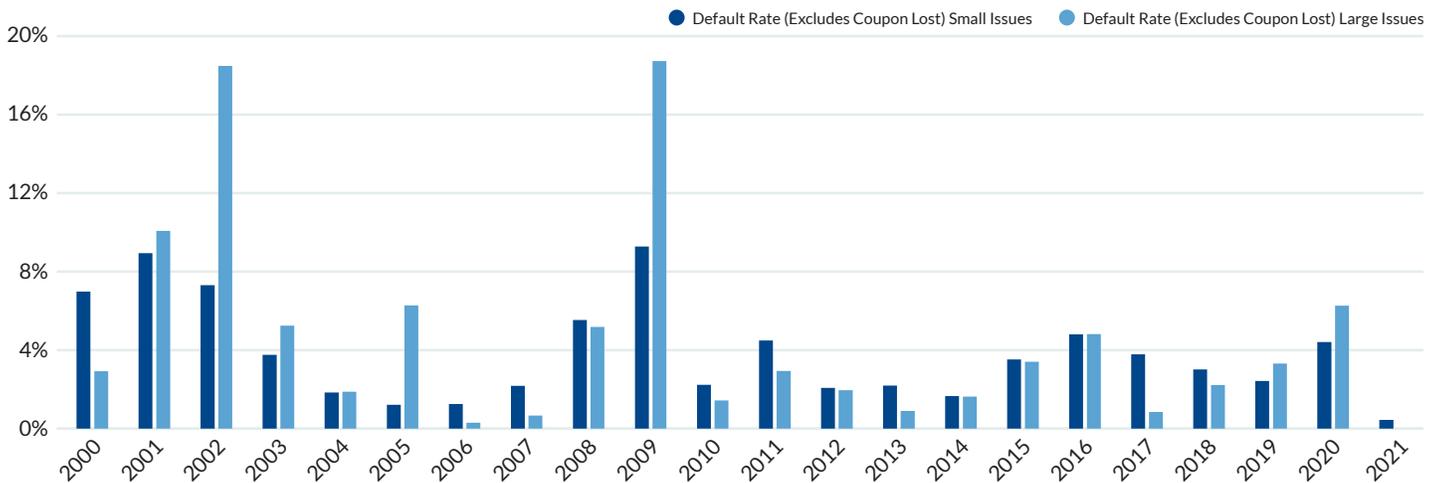
The data revealed that from 1999 to 2022:

- Small cap high yield bonds experienced a 16% lower default rate than large bonds, with an annual average of 3.8% of par defaulting in small bonds over the period vs 4.5% of par defaulting in large bonds. Notably, during the two particularly stressful years of 2002 and 2009, the large cap default rate was more than double the rate for small cap bonds. This means that if we calculated the overall default rates on a dollar-weighted basis instead of weighing each year equally, the dominance of small cap bonds would be even greater.
- Divergence in annual default rates was particularly notable in years of distress, such as 2002 and 2009 when large bonds took an outsized hit.

Science is really in the business of disproving current models or changing them to conform to new information. In essence, we are constantly proving our latest ideas wrong.

David Suzuki | Geneticist, Author and Professor Emeritus, University of British Columbia

CHART 2: SMALL BOND ISSUES VS LARGE BOND ISSUES DEFAULT RATES, PAR VALUE BASIS



Sources: JPM, Bloomberg 1999-2021. Past performance is not indicative of future results.

Lower volatility

Followers of Modern Portfolio Theory will be delighted to learn that return volatility is also a significant differentiator between large cap and small cap high yields. Though often seen as the safer area of the high yield market, large cap bonds are much more volatile on a week-to-week basis vs small cap bonds, with respective return standard deviations of 1.17% vs 0.70%, as shown in Chart 3 using Credit Suisse HY Index Weekly Data from 2011-2022.

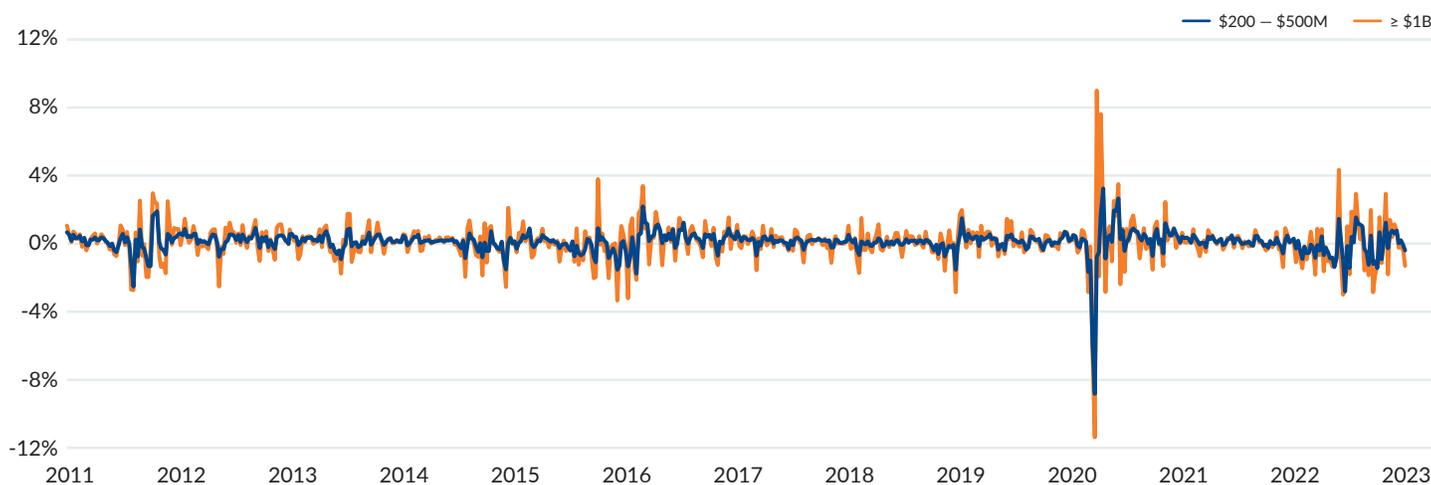
The explanation for this finding is relatively straightforward once investors think about flows in the market. Time-sensitive investors who demand fast execution — mutual fund investors redeeming shares, for example — impose much larger demands for near-instant liquidity and thus

tend to favor large bonds. Their preference for large bonds ultimately creates higher than average liquidity costs for them, which are borne by whichever side of the trade is acting under a greater sense of urgency. Importantly, the rapid-fire trading caused by “hot money” entering or redeeming from the large bond space creates volatility borne even by large cap holders who merely buy and hold. Small cap bonds, meanwhile, have prices that are governed more by economic value, not by immediate money flows, which results in more market value stability.

Better diversification

Finally, we looked at correlations within the high yield market vs other asset classes as shown in Table 1. The ICE BofA US Small Cap HY index once again makes the case for the added

CHART 3: LARGE BOND ISSUES VS SMALL BOND ISSUES WEEKLY RETURNS



Sources: Credit Suisse, HY Index Weekly Data 2011-2022. | Past performance is not indicative of future results.

TABLE 1: LONG TERM CORRELATION | 12.31.1994 — 12.31.2022

| | ICE BofAML US Large Cap HY | ICE BofAML US Small Cap HY | ICE BofAML US HY | Bloomberg US Aggregate | Russell 2000 | S&P 500 |
|----------------------------|----------------------------|----------------------------|------------------|------------------------|--------------|---------|
| ICE BofAML US Large Cap HY | 1.00 | 0.86 | 0.99 | 0.31 | 0.65 | 0.67 |
| ICE BofAML US Small Cap HY | 0.86 | 1.00 | 0.92 | 0.20 | 0.61 | 0.59 |
| ICE BofAML US HY | 0.99 | 0.92 | 1.00 | 0.29 | 0.66 | 0.66 |
| Bloomberg US Aggregate | 0.31 | 0.20 | 0.29 | 1.00 | 0.00 | 0.10 |
| Russell 2000 | 0.65 | 0.61 | 0.66 | 0.00 | 1.00 | 0.83 |
| S&P 500 | 0.67 | 0.59 | 0.66 | 0.10 | 0.83 | 1.00 |

Source: BAML, Bloomberg, eVestment 2018-2022. | The ICE BofAML US Large Cap High Yield Index and ICE BofAML US Small Cap High Yield Index track securities by market cap of the ICE BofAML US Cash Pay High Yield Index which represents below investment grade US dollar denominated bonds making coupon payments in cash and that have at least \$100 million in outstanding issuance. The ICE BofAML US High Yield Index tracks the performance of below investment grade, but not in default, US dollar denominated corporate bonds publicly issued in the US domestic market, and includes issues with a credit rating of BBB or below, as rated by Moody’s and S&P. The Bloomberg US Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the US investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indexes that are calculated and reported on a regular basis. The Russell 2000 Index offers investors access to the small cap segment of the US equity universe. The Russell 2000 is constructed to provide a comprehensive and unbiased small cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small cap opportunity set. The Russell 2000 includes the smallest 2000 securities in the Russell 3000. The S&P 500 Index, or Standard & Poor’s 500 Index, is a market-capitalization-weighted index of 500 leading publicly traded companies in the US | Past performance is not indicative of future results.

Past performance is not indicative of future results. Please see the disclosures at the end for important information and the GIPS Report that is also included.

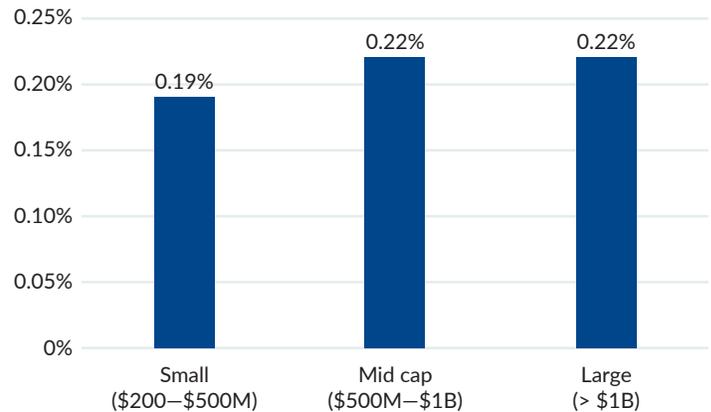
diversification benefit of small cap high yield for those also investing in the S&P 500, Russell 2000 or Bloomberg US Aggregate. High yield debt, as a whole, is a good diversifier vis-a-vis the investment grade and equity markets, but small cap high yield is better than large cap.⁷

So why is no one paying attention?

Given all the potential advantages offered by the small cap high yield market, where are the investors? Why the inefficiency? We have a few theories.

- 1. Default rate data by issue size is, to our knowledge, not readily available.** We are not aware of any rating agency or larger bank study which correctly stratifies defaults by issue size even though such pundits assert that small size is a contributor to risk. For that reason, there continues to be a bias against small bonds based on incorrect perceptions regarding default rates. We would add that issuers take advantage of this bias in the minds of investors – large issuers, on average, are more highly levered than small issuers.
- 2. Investors often penalize small cap issues for liquidity concerns that are exaggerated.** Liquidity is arguably best measured by the balance of supply and demand. When judging which bonds can be bought or sold with a minimum effect on market prices, an imbalance in the flow of bids and asks significantly impacts the cost of a trade. Average daily trading volume as a percentage of the bond's total size outstanding is the correct metric to gauge "liquidity." By that measure, as Chart 4 shows, small cap bonds trade only 14% less often than large bonds; however, the perception is that the difference is much greater, discounting small cap bonds further, ultimately to the benefit of the small cap investor.⁸
- 3. Less interest by larger investors due to scale and scant company information.** For the largest high yield investors, a bond issue less than \$500M is not feasible given the size of their fund, especially if the fund is greater than \$10-\$15B. For larger firms managing massive amounts of AUM, and therefore desiring to hold individual position sizes of \$100M or more to limit their own workloads, the higher return potential of small cap bonds isn't worth the manpower required to effectively research, price and monitor them.

CHART 4: AVERAGE DAILY TURNOVER AS A PERCENT OF ISSUE SIZE



Source: TRACE. Past performance is not indicative of future results.

Make the market's inefficiency work for you

For all these reasons, we believe investors who ignore the potential of small cap high yield bonds may be overlooking an outstanding opportunity. **Investors price small issues as if they have greater default and liquidity risk, when the reverse is actually true.** This has created a large, enduring and exploitable market inefficiency. Such deeply discounted lunches are not common in public security markets. Further, Mesirow has proven to be an effective partner with clients seeking to consistently exploit the return potential of what we believe is a grossly undervalued and underfollowed segment of the market.

TABLE 2: MESIROW ADDS POSITIVE SELECTION WITHIN STRONG MARKET SEGMENT

| Returns (%) | 1 Year | 3 Years | 5 Years | 7 Years | 10 Years | 15 Years | 20 Years | Common 24 Years 1999 - 2022 |
|---|--------|---------|---------|---------|----------|----------|----------|--------------------------------|
| Mesirow High Yield (net) | -10.76 | 2.65 | 3.73 | 5.90 | 5.09 | 6.74 | 8.46 | 7.53 |
| ICE BofAML US Small Cap HY Index | -9.94 | 0.51 | 2.07 | 5.88 | 4.29 | 6.91 | 7.83 | 6.82 |
| ICE BofAML US Large Cap HY Index | -11.62 | -0.50 | 2.14 | 4.62 | 3.81 | 5.59 | 6.80 | 5.65 |
| ICE BofAML US HY | -11.11 | -0.20 | 2.14 | 4.94 | 3.94 | 5.89 | 7.04 | 5.95 |

Source: BAML, Bloomberg. | The ICE BofAML US Large Cap High Yield Index and ICE BofAML US Small Cap High Yield Index track securities by market cap of the ICE BofAML US Cash Pay High Yield Index which represents below investment grade US dollar denominated bonds making coupon payments in cash and that have at least \$100 million in outstanding issuance. The ICE BofAML US High Yield Index tracks the performance of below investment grade, but not in default, US dollar denominated corporate bonds publicly issued in the US domestic market and includes issues with a credit rating of BBB or below, as rated by Moody's and S&P. | Past performance is not indicative of future results. Performance referenced above is supplemental. Please see the GIPS Reports at the end for complete performance information.

Appendix – Technical discussion of default rates

Readers familiar with existing default studies will note that we have calculated all rates as the par amount of debt defaulting divided by the amount outstanding at the beginning of each calendar year. An alternative method calculates the rate as the number of issuers defaulting in a given cohort divided by the number of companies in the cohort. We believe that the par value concept is the correct one, and we accordingly do not look at default rates on an issuer count basis.

An issuer count basis statistic implicitly treats all defaults as equal in importance. The par value concept weights defaults by their size. And it is only the latter measurement which reflects actual weighted average investor experience. Intuitively, massive defaults like the bankruptcies of Lehman Brothers, Enron, and Worldcom are simply more important events than a bankruptcy of a small company with \$300M in debt. (In fact, we believe that many investors tend to forget just how consequential those huge bankruptcies are. Enron defaulted on \$31B, and Worldcom defaulted on \$41B; each of these alone inflicted more losses on investors than dozens of less well-known small cap high yield issuers added together). More to the point, when we look at returns on indexes like the S&P 500 or the Bloomberg High Yield Index, those indexes are all market capitalization weighted, and properly so. Those reflect the weighted average of actual returns by investors. Every dollar, not every investor, should be treated the same. In order to compare the default records of managers, we also want a statistic which has the desirable characteristic that the weighted, not the unweighted,

average of the managers' default rates will be equal to the market-wide average. The par weighted default rate does have this important mathematical feature, and the issuer weighted default rate does not.

So why are default rates calculated on an issuer count basis at all? Most investment banks which publish default studies do present both par value and issuer count default data. The issuer count basis rate might be relevant to a manager whose fund required him to invest the same amount in each company, regardless of the company's size. There are some vehicles where this may be approximately true (the complex rules governing Collateralized Loan Obligations, or "CLOs," are one example). But by and large, high yield managers are under no such restriction. A manager who holds bonds at a rate different from their weighting in the relevant universe is making an active management decision, and he should be chargeable with the impact of that decision. Only the par value method does this correctly.

Our paper represents an innovation in the way we stratify the universe. All other default studies we have seen set static cutoff points, in dollars, between what are small cap, mid cap, and large cap bonds. For example, in the Credit Suisse Index, a small bond is under \$500M in size, a mid cap bond is between \$500M and \$1B in size, and a large cap bond is over \$1B in size. The problem is that the size of the market and the average size of bond issues has been growing, and growing a lot, over the years. In our work, for example, we looked at default rates back as far as 2000. But in 2000, a \$500M bond was actually a large cap bond in relation to the then existing universe. Today, a \$500M bond is well

below the average issue size. This introduces a large error into any study which is anchored to static cutoff points. A \$500M bankruptcy in 2023 would go into the “small firm” column, whereas a default of the same size in 2000 would have gone into the “large firm” column. We solve this by calculating not arbitrary and static cutoff points, but rather a dynamic concept in which bonds are re-sorted into quartiles, ranked by size from first to fourth, at the beginning of each year. Thus, an issuer which sold a \$500M bond in 2003 might have been a comparatively large (first quartile) issuer at that time, but by the time it defaulted in 2010 it might have been midsize (second or third quartile) company amongst its peers during the default year. So, what we are calling “large issues” are more accurately thought of as “first quartile” size issues, and the small cap bonds are “fourth quartile” bonds.

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](#).

1. Throughout this paper, we use the size of the bond issue as a generally accurate proxy for the size of the issuing firm. This is commonly done because firm size, measured by sales, profits, or market capitalization, is dynamic what is a small firm one year may become a mid-size firm in the near future. And the market capitalization of private companies cannot be observed. Issue sizes, on the other hand, remain constant, so averages across long periods have meaning.

2. Credit Suisse HY Index Weekly Data 2011-2022.

3. JPM, Bloomberg 1999-2021.

4. Credit Suisse HY Index Weekly Data 2011-2022.

5. BAML, Bloomberg, eVestment 1994-2022.

6. Our default study covered the period commencing in 2000 because we have a particular interest in the interval representing our own track record.

7. We use different indexes to make different comparisons because not all the indexes capture the same data. In each case, we use the most data-appropriate index, and we present data all the way back to that the origin of that index's time series.

8. For a more extended and quantitative discussion of the complex subject of liquidity, see the co-author's paper “Thoughts about the liquidity of small issue high yield bonds.”

The S&P 500 Index, or Standard & Poor's 500 Index, is a market-capitalization-weighted index of 500 leading publicly traded companies in the US | **Past performance is not indicative of future results.**

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GIPS REPORT - HIGH YIELD COMPOSITE

Gross and Net of Fees Total Returns from March 1, 1999 – June 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 | 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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