CrossingBridge Funds Q4 2022 Commentary

Qué Será, Será – The Future's Not Ours to See[1]

It's the season when companies, investors and financial gurus look into their crystal balls to predict the economic and market path for the new year. During our morning coffee ritual, we were excited to read TheDailyMail.com headline: "A time for transformation, freedom... and PROSPERITY! Astrologers reveal why 2023 could be your BEST year yet for money and romance."[A] We agree whole-heartedly! However, this runs in stark contrast to the CNBC CFO Council Q4 2022 Survey[2] in which over 80% of respondents predict a recession in 2023.

Household Net Worth as a Percentage of Disposable Personal Income[B]

[1] *Qué Será, Será (Whatever Will Be, Will Be)*, is a song written by Jay Livingston and Ray Evans, first published in 1955 and popularized after Doris Day sang it in the 1956 Alfred Hitchcock film, *The Man Who Knew Too Much*. Although the Spanish-like spelling and Italian-like form suggest a non-English origin, the saying is a mis-translation of a 16th century English heraldic motto which has no origin in either Spanish or Italian.
[2] *Dow headed back below 30,000, slim chance for soft landing for economy in 2023: CNBC CFO survey*, www.CNBC.com, December 28, 2022

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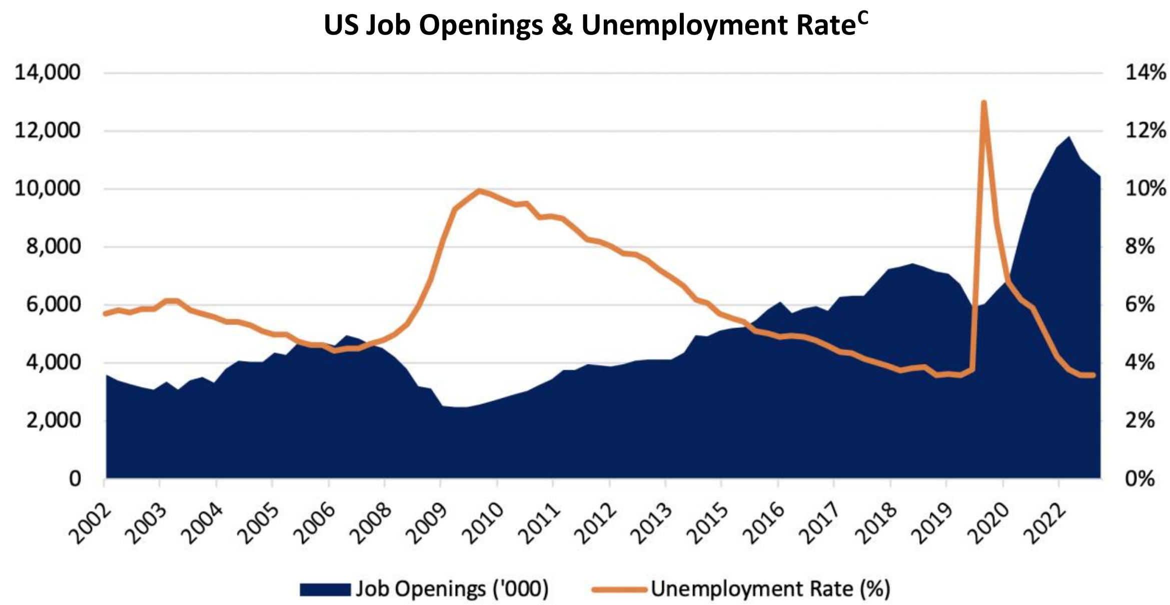
Shamelessly borrowed from the economist David Rosenberg, the graph above illustrates the relationship between household disposable income and household wealth. Basically, when your household wealth grows at a robust pace, you feel "richer" and when net worth declines, you feel "poorer". This changes behavior which ultimately ripples through the economy.[3]

As bottom-up investors, we subscribe to the adage: "Return of principal is more important than return on principal." In 2022, all four CrossingBridge Funds produced positive returns for the year. While returns were exceptional on a relative basis, ultimately investors will judge us on long-term performance.

Although the market is not necessarily cheap, it is also not expensive. Opportunities will arise from uncertainty, volatility, flow of funds and a "day of reckoning" among borrowers. We continue to subscribe to many of the themes we have communicated over the past year. We are optimistic with respect to future absolute performance. That said, we have our work cut out for us in 2023.

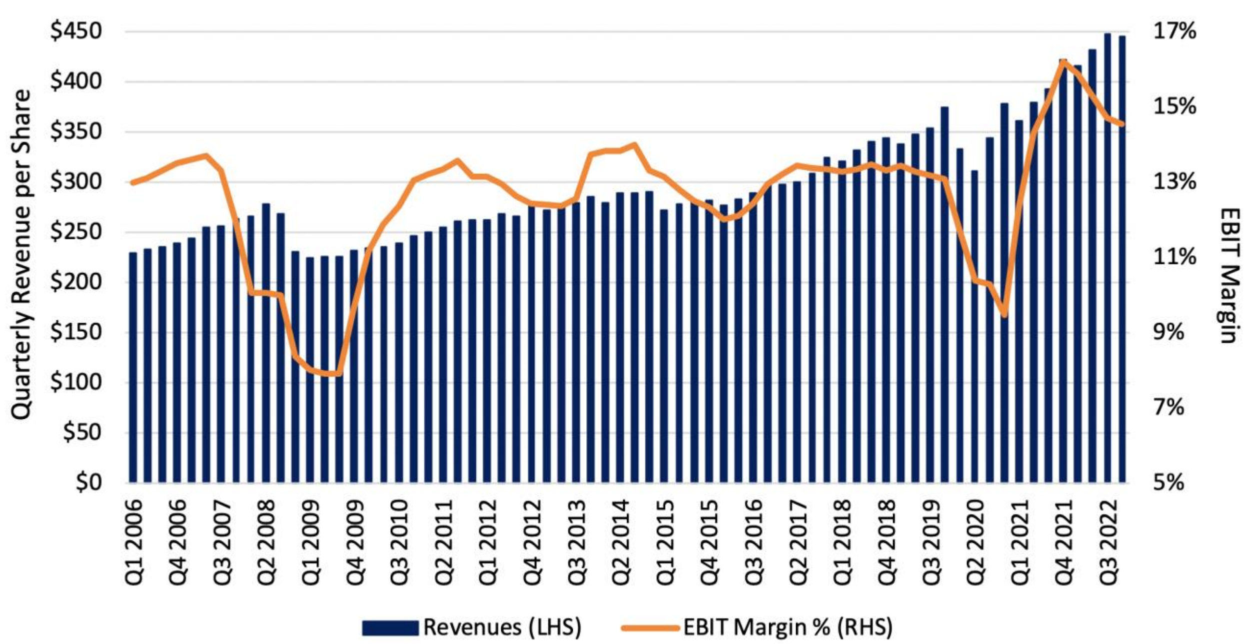
Themes for 2023



[3] It may seem obvious that whether one feels rich or poor is dependent on one's net worth relative to disposable income and that, after a year in which both bonds and equities experienced significant declines, we might be feeling poorer. However, as shown in the graph above, even after such draw-downs, aggregate wealth relative to disposable income is just below the peak and above every other period over the last 30+ years.

Inflation is expected to decline but will remain. The Federal Reserve will continue rate increases. Although it may ultimately pause, the Fed won't pivot unless systematic risk emerges. Unemployment remains low and employers continue to have difficulty filling job openings; recent layoffs are not sufficient to close the gap.[4] This problem may be being exacerbated by the fact that there is a significant disparity between the labor demanded and the skills of the labor supply. Moreover, as noted above, household wealth remains near peak. COVID-related stimulus drove up household wealth as a percentage of disposable income to exceed the giddy days prior to the Great Recession of 2008. Although the market declines of 2022 have caused the ratio to retreat, levels are still elevated, significantly above prior peaks of 2007 and 2019. Consequently, the Fed has determined there is plenty of room to raise rates in an effort to quell inflation even if it risks a recession.

S&P EBIT Margins & Revenues[D]

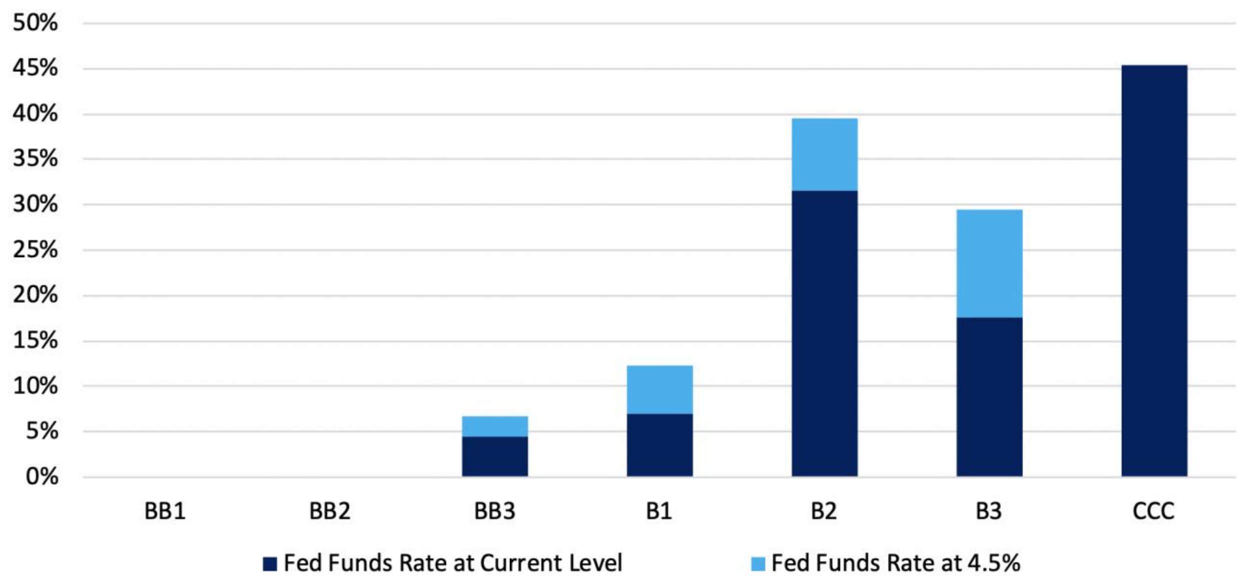


Corporations are in pretty good shape, but the differences between the "haves" and the "have nots" are likely to widen. Maturity profiles for high yield issuers have been pushed out with 85% of bonds maturing three years out and beyond.

[4] For those who want to better understand the relationship between unemployment and job openings, known as the Beveridge Curve, this can be examined in more detail on the website for the Bureau of Labor Statistics at https://www.bls.gov/charts/job-openings-and-labor-turnover/job-openings-unemployment-beveridge-curve.htm .

Corporations are de-risking their balance sheets by using cash balances to repay obligations at or before maturity.[E] Regardless, *profit margins will narrow.* Inflation in the cost of raw materials and labor, as well as the Fed's efforts to reduce demand, will pressure profit margins. The possibility exists that margins may decline to the trough levels seen in the recessions of 2008-9 and 2020 as shown above.

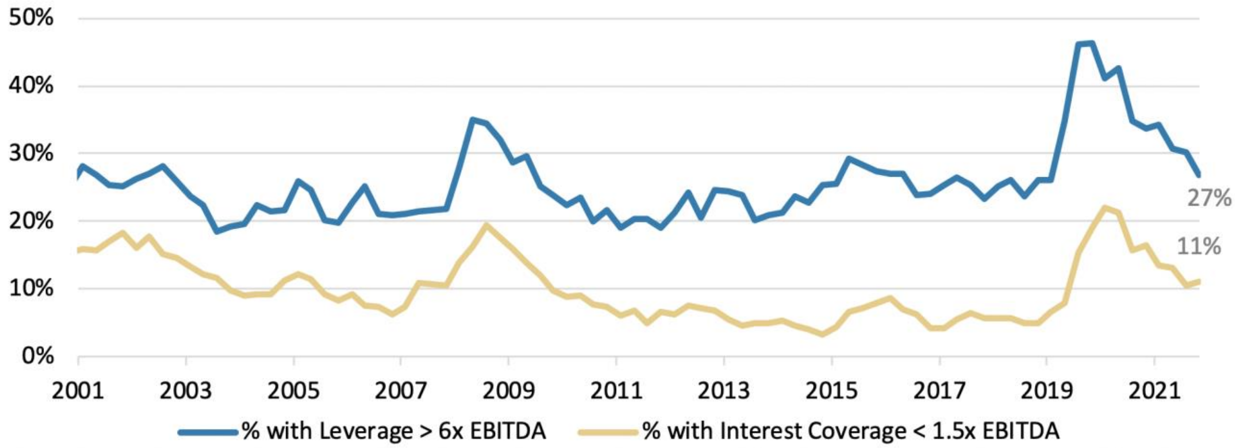
Percentage of Companies with Fixed Charge Coverage Less than 1.5x[F]



Higher interest rates have increased the cost of debt and reduced asset valuations. Corporations with lower leverage will feel less impact from rising interest rates and will be better able to withstand a decline in profitability caused by a reduction in revenues or narrowing margins. That said, higher interest rates will increase the incidence of distress among over-levered companies, those with bad business models and corporate "zombies"[5], all of which have benefitted from cheap money. Moreover, the slowdown in the residential real estate market and the decline in the stock market are directly tied to the increased cost of capital and the lower present value of future cash flows that result from higher interest rates.

[5] We discussed "zombie" credits in our 2Q19 investor letter, *Rise of the Living Dead*. Zombie companies are defined as non-financial companies that are over 10 years old and unable to cover their interest expense from current operating income for three consecutive years. Typically, they survive on expanding borrowings facilitated by low interest rate environments.

Loan Issuers with High Leverage and Low Interest Coverage[G]



<u>Leveraged loan market will present opportunistic investments.</u> As shown in the graph above, credit quality has improved significantly since mid-2020. This should provide us with the opportunity to invest in leveraged loans that provide both better credit quality and higher yields, given the rise in rates. Moreover, in contrast to the past two years, during which collateralized loan obligations (CLOs)[6] have accounted for more than 50%[H] of new loan purchases, CLOs are likely to have a reduced presence in the market as over 40% of them, by assets under management, will have reached the end of their investment period.[I] Thus, with less competition for these investments, borrowers will have less power, likely leading to higher yields, lower leverage and better terms. "Cov-lite"[7] deals, which afford lenders much less protection in the case of credit deterioration, comprised over 91% of the leveraged loan issuance over the past two years;[J] this should begin to reverse as non-CLO lenders are likely to demand better covenant packages to fund new loans.

[6] Collateralized Loan Obligations are securitized pools of syndicated loans that are sold in tiered tranches of debt and equity so that CLO investors may choose to invest in specific tranches that meet their desired level of risk and associated rate of return.
[7] "Cov-lite" loans are loans that are issued with fewer restrictions on the borrower and less protection for the lender due to their lack of covenants. Some leveraged loan investors have made the point that cov-lite loans protect the borrower and lenders in times of stress since lenders have limited ability to force a "day of reckoning", allowing the company breathing room to work through their issues. Generally, we prefer loans that are not cov-lite and have made the analogy that cov-lite loans are similar to an uber-wealthy person getting married without a pre-nup.

Hight Yield Spread per Turn of Leverage[K]

Bond spreads are "middle of the road" – not cheap, not expensive – but *provide improved return versus risk*. At 481 basis points, the average credit spread for high yield bonds[L] is nearly at the long-term median of 489 basis points. However, the credit spread per turn of leverage, a reflection of compensation for taking on additional credit risk, has increased since the beginning of 2022. At 107 basis points, it is above the long-term median, 89.5 basis points, a level not seen, but for brief periods in 2019 and 2020, since prior to 2017. It has been a common complaint among high yield bond professionals that, in the environment of low rates experienced in recent years, investors have bid down credit spreads to capture yield seemingly with little regard for credit risk. With the rise in high yield spread per turn of leverage, high yield investors are being paid better for taking on risk.

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Investment Approach and Portfolio Positioning

	CrossingBridge Low Duration Fund 4Q22	CrossingBridge Responsible Credit Fund 4Q22	CrossingBridge Ultra Short Duration Fund 4Q22	CrossingBridge Pre-Meger SPAC ETF 4Q22
Cash	6.2%	15.9%	2.6%	8.3%
Investment Grade & SPACs	18.5%	18.5%	73.2%	91.6%
High Yield & Other	75.3%	65.6%	24.2%	0.1%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**
YTW	8.92%	8.42%	6.40%	4.95%
YTW Duration	1.12	1.19	0.55	0.31
Dry Powder	26.4%	28.9%	55.5%	100.0%
SEC Yield Subsidized	8.24%	9.70%	4.84%	-0.47%
SEC Yield Unsubsidized	8.24%	8.81%	4.68%	-0.47%

Note: The Yield to Worst (YTW) for the Pre-Merger SPAC ETF is represented by its expected Yield to Liquidation.

At year-end, the portfolios remain defensively positioned, maintaining attractive yields while keeping duration relatively low and holding significant "dry powder"[8] to take advantage of opportunities as they arise.

In the song, *Qué Será, Será,* Doris Day asks the question, "Will we have rainbows day after day?" We answer – definitely not, but the attractiveness of the high yield and leverage loan market have improved. Over the past year, many fixed income investors were hurt by the sharp increase in rates. In contrast, we protected our investors by keeping duration low to reduce interest rate risk, focusing on near term events when selecting specific credits. Now, with the end of the rate rise cycle in sight sometime over the next year, risk in the fixed income market has largely shifted from interest rates to credit.

[8] "Dry powder", in the context of our portfolios, is defined as cash and investments that are expected to be repaid within 90 days as well as pre-merger SPACs that can be sold at or close to liquidation value. The liquidation value is the amount of cash and short-term securities held in a SPAC's trust that is to be invested in a target company, distributed to shareholders who elect to redeem their shares for cash rather than invest in a proposed transaction or returned to shareholders at the liquidation date if the SPAC fails to find a merger partner. The "dry powder" category includes securities such as called bonds and debt maturing in less than 30 days. Called or maturing bonds with an ultra-short period to redemption may provide a misleading representation of portfolio metrics due to the potential large impact on yields from minor pricing variances versus the upcoming redemption price. Investments represent a snapshot of a specific point in time and may not reflect future positioning.

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In the current environment, we feel well-equipped as bottom-up investors to choose investments that will pay off as expected while capturing the higher yields that prevail in the market.

“Whatever will be will be”,

DKS

David K. Sherman and the CrossingBridge Team

Endnotes

[A] *A time for transformation, freedom... and PROSPERITY! Astrologers reveal why 2023 could be your BEST year yet for money and romance*, DailyMail.com, December 26, 2022, https://www.dailymail.co.uk/femail/article-11533617/Astrologers-reveal-whats-store-star-sign-2023.html

[B] *Special Report - The 2023 Outlook: The Year of the Rabbit Means Hopping Back to the Bond-Bullion Barbell*, Rosenberg Research, January 5, 2023, Haver Analytics, FRED Economic Data, Federal Reserve Bank of St. Louis

[C] FRED Economic Data, Federal Reserve Bank of St. Louis (chart end-date: 9/30/22)

[D] Bloomberg (chart end-date: 12/30/22)

[E] *Capital Allocation: Thinking Like a CFO*, BofA Securities, November 15, 2022

[F] *State of the Credit Markets and Best Ideas*, BofA Securities, January 6, 2023

[G] *Fundamentals – Bracing for Earnings Damage*, Morgan Stanley, January 6, 2023 (chart end-date: 9/30/22)

[H] BofA Securities

[I] *CLO Outlook: JekyLL vs Hyde*, BofA Securities, November 22, 2022

[J] *High Yield Bond and Leveraged Loan Market Monitor*, J.P. Morgan, January 3, 2023

[K] *HY Credit Chartbook*, BofA Securities, January 4, 2023

[L] ICE BofA US High Yield Index

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Disclosures

Must be preceded or accompanied by a prospectus. The prospectus for the CrossingBridge Ultra-Short Duration Fund, CrossingBridge Low Duration High Yield Fund, and CrossingBridge Responsible Credit Fund can be found by clicking here. To obtain a hardcopy of the prospectus, call 855-552-5863. Please read and consider the prospectus carefully before investing. Per rule 30e-3, the fiscal Q1 holdings and Q3 holdings can be found by clicking on the respective links.

The prospectus for the CrossingBridge Pre-Merger SPAC ETF can be found by clicking here. The Statement of Additional Information (SAI) can be found by clicking here. To obtain a hardcopy of the prospectus, call 855-552-5863. Please read and consider the prospectus carefully before investing.

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CrossingBridge mutual funds' disclosure: mutual fund investing involves risk. Principal loss is possible. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investment in lower-rated and non-rated securities presents a greater risk of loss to principal and interest than higher-rated securities. Because the fund may invest in ETFs and ETNs, they are subject to additional risks that do not apply to conventional mutual fund, including the risks that the market price of an ETF's and ETN's shares may trade at a discount to its Net Asset Value ("NAV"), an active secondary trading market may not develop or be maintained, or trading may be halted by the exchange in which they trade, which may impact a fund's ability to sell its shares. The value of ETN's may be influenced by the level of supply and demand for the ETN, volatility and lack of liquidity. The fund may invest in derivative securities, which derive their performance from the performance of an underlying asset, index, interest rate or currency exchange rate. Derivatives can be volatile and involve

various types and degrees of risks, and, depending upon the characteristics of a particular derivative, suddenly can become illiquid. Investments in asset backed, mortgage backed, and collateralized mortgage backed securities include additional risks that investors should be aware of such as credit risk, prepayment risk, possible illiquidity and default, as well as increased susceptibility to adverse economic developments. Investing in commodities may subject the fund to greater risks and volatility as commodity prices may be influenced by a variety of factors including unfavorable weather, environmental factors, and changes in government regulations. Shares of closed-end fund frequently trade at a price per share that is less than the nav per share. There can be no assurance that the market discount on shares of any closed-end fund purchased by the fund will ever decrease or that when the fund seeks to sell shares of a closed-end fund it can receive the nav of those shares. There are greater risks involved in investing in securities with limited market liquidity.

CrossingBridge Pre-Merger SPAC ETF disclosure: investing involves risk; principal loss is possible. The fund invests in equity securities and warrants of SPACs. Pre-combination SPACs have no operating history or ongoing business other than seeking combinations, and the value of their securities is particularly dependent on the ability of the entity's management to identify and complete a profitable combination. There is no guarantee that the SPACs in which the fund invests will complete a combination or that any combination that is completed will be profitable. Unless and until a combination is completed, a SPAC generally invests its assets in U.S. Government securities, money market securities, and cash. Public stockholders of SPACs may not be afforded a meaningful opportunity to vote on a proposed initial combination because certain stockholders, including stockholders affiliated with the management of the SPAC, may have sufficient voting power, and a financial incentive, to approve such a transaction without support from public stockholders. As a result, a SPAC may complete a combination even though a majority of its public stockholders do not support such a combination. Some SPACs may pursue combinations only within certain industries or regions, which may increase the volatility of their prices. The fund may invest in SPACs domiciled or listed outside of the U.S., including, but not limited to, Canada, the Cayman Islands, Bermuda and the Virgin Islands. Investments in SPACs domiciled or listed outside of the U.S. May involve risks not generally associated with investments in the securities of U.S. SPACs, such as risks relating to political, social, and economic developments abroad and

differences between U.S. And foreign regulatory requirements and market practices. Further, tax treatment may differ from U.S. SPACs and securities may be subject to foreign withholding taxes. Smaller capitalization SPACs will have a more limited pool of companies with which they can pursue a business combination relative to larger capitalization companies. That may make it more difficult for a small capitalization SPAC to consummate a business combination. Because the fund is non-diversified it may invest a greater percentage of its assets in the securities of a single issuer or a smaller number of issuers than if it were a diversified fund. As a result, a decline in the value of an investment in a single issuer could cause the fund's overall value to decline to a greater degree than if the fund held a more diversified portfolio.

Definitions: The S&P 500, or simply the S&P, is a stock market index that measures the stock performance of 500 large companies listed on stock exchanges in the united states. The **ICE BOFA Investment Grade Index** tracks the performance of us dollar denominated investment grade rated corporate debt publicly issued in the us domestic market. The **ICE BOFA High Yield Index** tracks the performance of us dollar denominated below investment grade rated corporate debt publicly issued in the us domestic market. **EBITDA** is a company's earnings before interest, taxes, depreciation, and amortization is an accounting measure calculated using a company's earnings, before interest expenses, taxes, depreciation, and amortization are subtracted, as a proxy for a company's current operating profitability. **A Basis Point (BP)** is 1/100 of one percent. **Pari-Passu** is a Latin term that means 'on equal footing' or 'ranking equally'. It is an important clause for creditors of a company in financial difficulty which might become insolvent. If the company's **debts** are **Pari-Passu**, they are all ranked equally, so the company pays each creditor the same amount in insolvency. **LIBOR** is the average interbank interest rate at which a selection of banks on the London money market are prepared to lend to one another. **Yield to Maturity (YTM)** is the total return anticipated on a bond (on an annualized basis) if the bond is held until it matures. **Free Cash Flow (FCF)** is the cash a company produces through its operations, less the cost of expenditures on assets. In other words, Free Cash Flow is the cash left over after a company pays for its operating expenses and capital expenditures. **Duration** is a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates. **Debtor-in-Possession (DIP)** financing is a special kind of financing meant for companies that are in bankruptcy. Only companies that have filed for bankruptcy protection under chapter 11 are allowed to access dip financing, which usually happens at the start of a filing. Dip financing is used to facilitate the reorganization of a Debtor-in-Possession (the status of a company that has filed for bankruptcy) by allowing it to raise capital to fund its operations as its bankruptcy case runs its course. **Yield to Call (YTC)** refers to the return a bondholder receives if the bond is held until the call date, which occurs sometime before it reaches maturity. The SEC Yield is a standard yield calculation developed by the U.S. Securities and Exchange Commission (SEC) that allows for fairer comparisons of bond funds. It is based on the most recent 30-day period covered by the fund's filings with the SEC. The yield figure reflects the dividends and interest earned during the period after the deduction of the fund's expenses. It is also referred to as the "standardized yield." **Yield to Worst** is the yield on the portfolio if all bonds are held to the worst date; Yield to Worst date is the date of lowest possible yield outcome for each security without a default.

ETF definitions: the ICE BOFA 0-3 Year U.S. Treasury Index tracks the performance of U.S. dollar denominated sovereign debt publicly issued by the U.S. government in its domestic market with maturities less than three years. **Gross Spread** is the amount by which a SPAC is trading at a discount or premium to its pro rata share of the collateral trust value. For example, if a SPAC is trading at $9.70 and shareholders' pro rata share of the trust account is $10.00/share, the SPAC has a gross spread of 3% (trading at a 3% discount). **Yield to Liquidation:** similar to a bond's yield to maturity, SPACs have a yield to liquidation/redemption, which can be calculated using the gross spread and time to liquidation. **Maturity:** similar to a bond's maturity date, SPAC also have a maturity, which is the defined time period in which they have to complete a business combination. This is referred to as the **Liquidation or Redemption Date.** Price refers to the price at which the ETF is currently trading. The sec yield is a standard yield calculation developed by the U.S. Securities and Exchange Commission (SEC) that allows for fairer comparisons of bond funds. It is based on the most recent 30-day period covered by the fund's filings with the SEC. The yield figure reflects the dividends and interest earned during the period after the deduction of the fund's expenses. It is also referred to as the "standardized yield." **Weighted Average Life** refers to the weighted average time until a portfolio of SPACs' Liquidation or Redemption Dates.

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All performance data greater than 1 year is annualized.

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