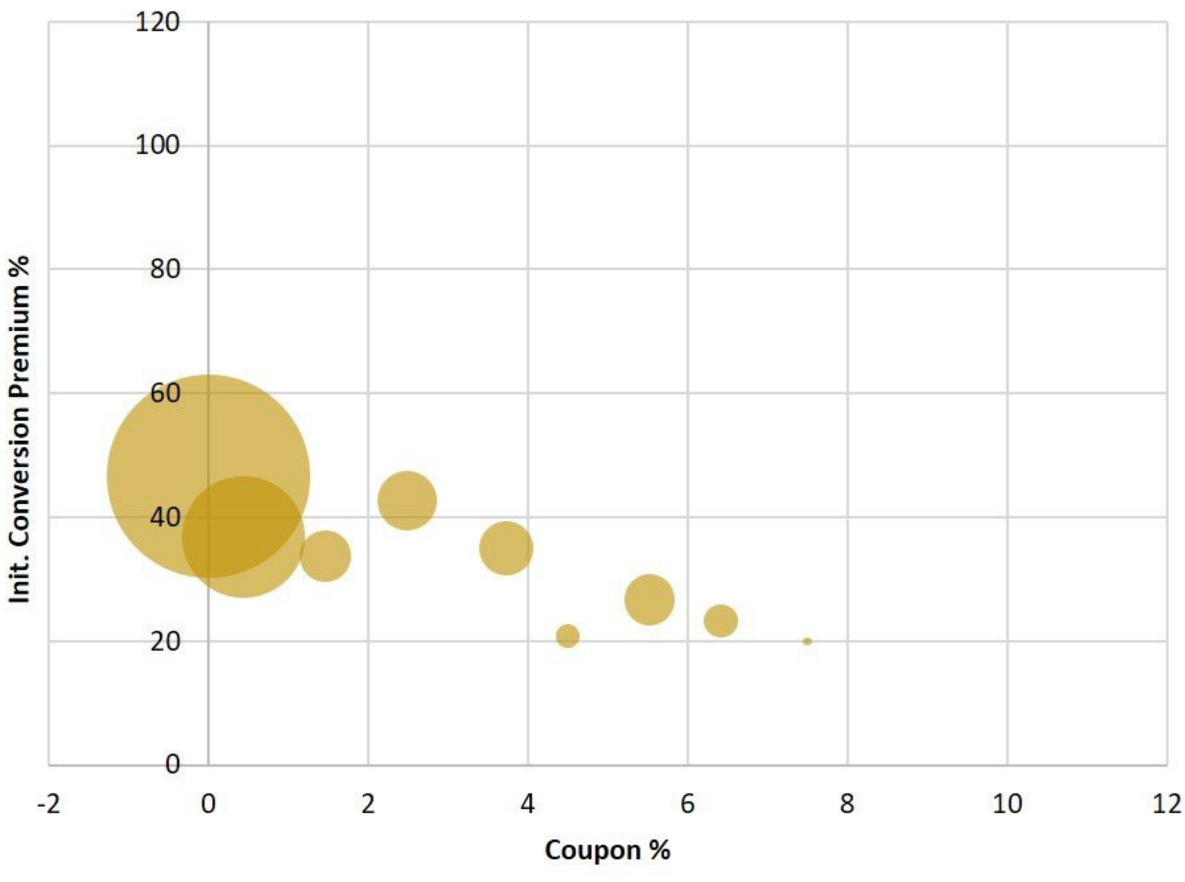
Rubber Ducky: Ode to Sesame Street

The U.S. government's aggressive stimulus in response to the COVID-19 crisis, while necessary, has been like drawing a bubble bath for the financial markets. The $1.9 trillion American Rescue Plan and an anticipated $2.0 trillion infrastructure program will keep the water warm, the suds fluffy and "…make bath time lots of fun".[1] Awash in investible cash and abundant confidence in a post-COVID economy, investors have driven financial markets to new heights and new issuance to record levels.

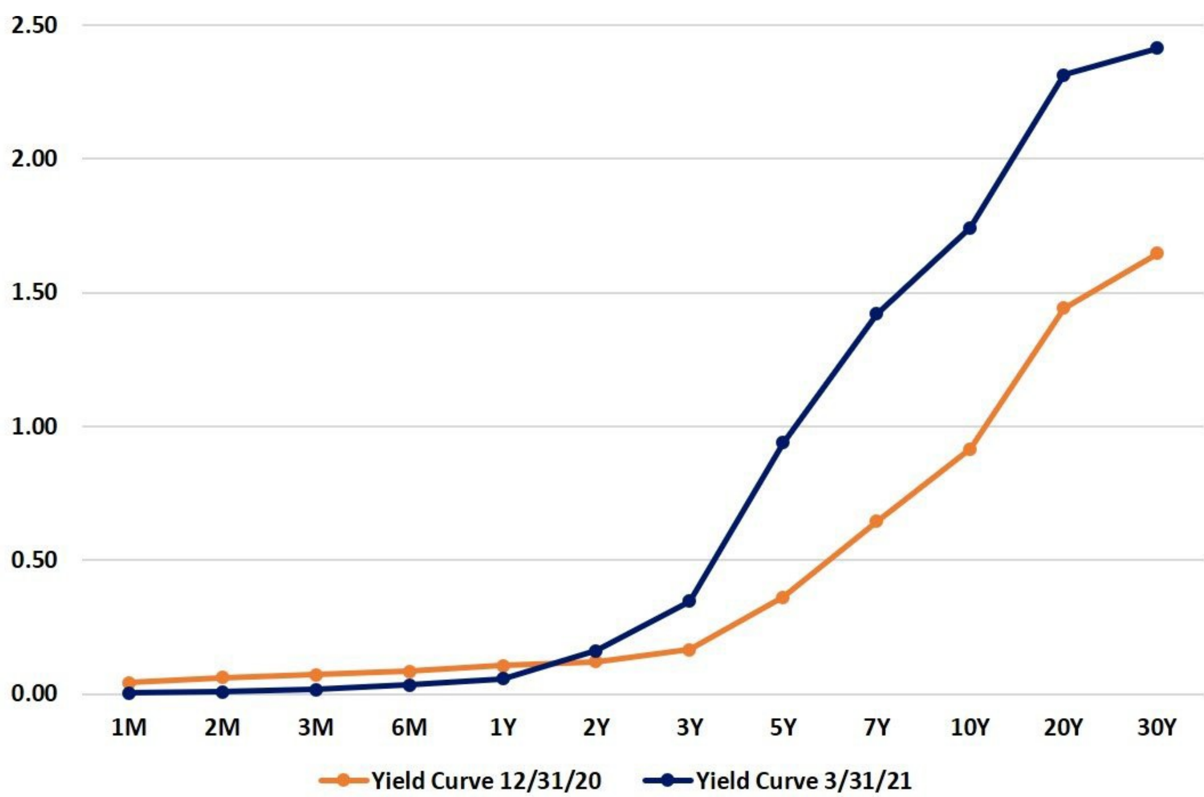
Conversion Premium and Coupon of 2021 Convertible Bond Issuance[2]



The convertible bond market provides an example of this liquidity. In 2020, convertible bond issuance was approximately $110 billion, nearly double the prior historical high.[3,4] In the first quarter of 2021, issuance continued to accelerate. More startling, investor appetite has driven pricing to new lows, a boom for corporate issuers, but not so much for investors. The two major pricing components of a convertible bond are coupon and the imbedded call option.[5] In 1Q21, 55% of convertible bonds were issued with a 0% interest rate and an imbedded call option at a 50% premium above the issuers' stock price.[6] We scratch our heads when thinking about this pricing.

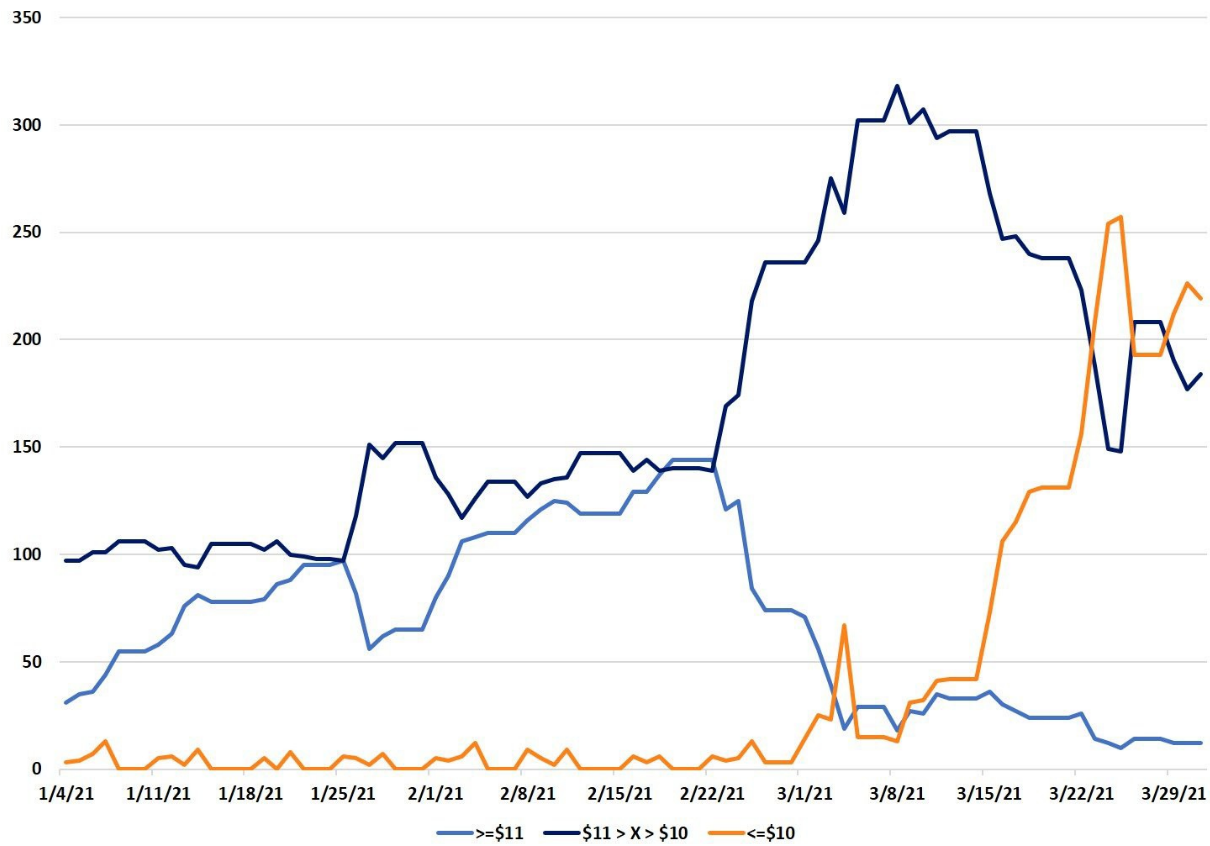
As a lender, the bondholder is senior to the equity but is not receiving a return on capital unless the stock price rises significantly. At that point, we would just rather own the common stock.

U.S. Treasury Yield Curve[7]



Beginning in mid-February, the market appeared to recognize the risk of ongoing stimulus funded by Government debt and the specter of inflation with yields for the 3- to 10-year U.S. Treasury bonds nearly doubling during the quarter. The Investment Grade Corporate Bond Index[8] had a negative total return for each month during the quarter, culminating in a -4.95% quarterly total return. This was the worst quarterly performance since 3Q08 and the second worst quarter over the last 40 years. We do not have a crystal ball as to future interest rate movement, but a government policy that favors unnaturally low interest rates is not sustainable. We have been and continue to be defensive in our portfolio duration and see market normalization as an opportunity.

1Q21 SPAC Market Price Distribution[9]



Activity in the SPAC market reflects the decline in investor speculation as rising rates began to throw cold water on the market. Similar to the convertible bond market, SPAC issuance has been robust with over $97 billion in "blank check" capital raised in 1Q21; this amount exceeds all of the SPAC capital raised in 2020. As highlighted in previous letters, in 2H20 and early in 1Q21, a large portion of SPACs traded at a premium to their collateral trust value, an anomaly for the asset class. In late February, the rise in interest rates caused investors' speculative fervor to fade and a renewal of rationality with respect to pre-merger SPAC pricing.[11] As a result, with the majority of SPACs trading much closer to their $10.00 per share trust value and some SPACS with announced deals trading below trust value, we are seeing many more opportunities to invest in SPACS in keeping with our fixed-income oriented discipline.

1Q21 Fixed Income Market Performance[12]

Asset Class	ETF Symbol	Total Return 12/31/20 to 3/31/21	March 31, 2021 Total Assets ($billion)	Duration	Yield to Worst	OAS*
US IG Aggregate Bonds	AGG[13]	-3.37%	$84.4	6.32	1.54%	29.8
US IG Corp Bonds	LQD[14]	-5.47%	$41.7	9.40	2.53%	95.9
US Short Term HY Bonds	SHYG[15]	1.68%	$ 4.6	1.77	3.49%	286.1
US HY Corporate Bonds	HYG[16]	0.58%	$21.5	3.32	3.92%	277.6
US Leveraged Loans	BKLN[17]	0.17%	$ 5.9	0.84	3.18%	297.6

* Option-Adjusted Spread over Treasury

When interest rates go up, fixed income prices go down. This is exactly what happened in 1Q21. The table above provides several observations:

- The longest duration assets, IG Aggregate Bonds (AGG) and IG Corporate Bonds (LQD), performed the worst as, by definition, these are the most sensitive to a rise in interest rates. Conversely, shorter duration high yield bonds (SHYG) outperformed the broad high yield market (HYG).
- Price changes for less credit-worthy debt, such as high yield bonds and leveraged loans, were cushioned by wider credit spreads.
- The Option-Adjusted Spread for all corporate segments narrowed with the credit spreads for high yield bond declining the most. This likely reflects an increase in investor confidence in the economic outlook and expected improvement in corporate profitability.
- Floating rate securities benefit when short-term rates increase. However, the fixed nature of the credit spread causes a negative offset.
- Corporate spreads, in both investment grade and high yield, are now back to the levels seen just before the pandemic. Given investor appetite for yield and the positive economic outlook, we are unlikely to see a significant widening in credit spreads until market liquidity begins to decline, interest rates continue to rise, or economic expectations disappoint.

In our 4Q20 investor letter,[18] we outlined several macroeconomic factors that we expected to impact the financial markets in 2021. Thus far, these views have been correct: negative real interest rates, a steeper yield curve and significant additional fiscal stimulus. We also expressed the view that investment opportunities would continue to arise from refinancings, corporate events and bankruptcies. Several examples of 1Q21 investments bear out these expectations:

<u>Brazos Electric Power Cooperative (BRELPO)</u> – Brazos is a Texas electrical power cooperative that provides generation and transmission services by wholesaling power to its members who then pass along the costs to retail customers. The cooperative has maintained an A credit rating for 80

years. As a direct result of the catastrophic generation and transmission failures caused by the winter storm that blanketed Texas in mid-February 2021, power prices sky-rocketed causing Brazos to build up an estimated $2.1 billion in charges[19] over the seven-day freeze. Far exceeding its ability to make this payment, Brazos filed for Chapter 11 on March 1, 2021. Shortly after the bankruptcy filing, we were presented with the opportunity to purchase 503(b)(9) claims against Brazos, the debtor, which we purchased for the CrossingBridge Low Duration High Yield Fund at a price of 90. Although unsecured claims, they have administrative status as they are obligations that stem from the sale of goods (in this case, natural gas) to the debtor within 20 days of the bankruptcy filing. Unless the debtor is administratively insolvent, a rare occurrence, administrative claims must be "paid in full" as a requirement for confirmation of the Plan of Reorganization. Thus, we expect these claims to be paid at 100[20] when Brazos exits bankruptcy. The timing of the company's exit from bankruptcy is uncertain, which will impact the return of this investment. If the case takes one year from the time of our investment, the simple rate of return will be approximately 11.1%, which will decline to 5.4% if it takes two years (and so on).

UpHealth (GIX) – In November 2020, GigCapital2, a SPAC sponsored by GigCapital Global, announced that it had entered into agreements to combine with UpHealth Holdings and Cloudbreak Health, two leaders in digital/tele-medicine, to form a publicly-traded global digital healthcare company. The GigCapital2 investment values the combined company at approximately $1.55 billion, about 7.0x 2021 estimated revenue. At the time the transaction is completed, expected in 2Q21, the new company will issue $225 million of 6.25% Convertible Senior Notes due 2026 which will convert to common shares at a price of $11.50 per share, a 15% conversion premium to the price being paid by SPAC investors. Upon consummation of the de-SPAC-ing transaction, cash on the balance sheet is expected to exceed total debt, including the convertible notes. The CrossingBridge Low Duration High Yield Fund committed to participate in this issue that we believe to be creditworthy with equity upside.

SPAC-related Short-Term High Yield Opportunities – Some SPAC sponsors have sought mergers with private equity companies that may provide attractive short-term high yield opportunities in the target's debt. In such cases, the company may be required to repay the debt, at the lenders' option, due to a change of control provision in its legal documents. Further, should the merger be consummated, the cash provided by the SPAC is likely to result in a deleveraging event and an improvement in credit quality. During 1Q21, the CrossingBridge Low Duration High Yield Fund made several investments, following announcement of an issuer's merger agreement with a SPAC, in anticipation that these obligations will be repaid upon consummation:

- Tempo Acquisition (TEACLL) (a.k.a Alight Solutions) - On January 25th, 2021 the Foley Transimene Acquisition Corp SPAC (Ticker: WPF) announced an agreement to acquire Alight Solutions for a pro-forma enterprise value of approximately $7.3 billion, in a deal that is expected to close in 2Q21. A slide presentation distributed at the time of the merger announcement indicates that the 6.75% Senior Notes due 2025 are expected to be repaid, while the Secured Notes will remain outstanding. We began purchasing the Senior Notes in March at a 2.88% weighted-average yield to the call price step-down date of 6/1/21, the likely take-out date. While leverage through the Senior Notes is over 6x, we are happy owning the securities regardless of the deal outcome due, in part, to their leading position in the health benefits management space, as well as the pre-deal trading levels of the Notes that were similar to where we acquired them.

- Hillman Group (HILCOS) – January 25, 2021, the Landcadia Holdings III SPAC (Ticker: LCY) announced an agreement to acquire the Hillman Group for an implied enterprise value of approximately $2.64 billion. Expected to close in 2Q21, the transaction is expected to include repayment of all Hillman debt, including the 1st Lien Term Loan due 2025 and the 6.375% Senior Notes due 2022. We purchased the Term Loan in late January at a 3.70% approximate yield to the estimated 4/30/21 close date and began to purchase the Senior Notes in February at a weighted average yield of 4.12% to the same date. The company, a leading distributor of specialty hardware, has been performing well, with 2020 estimated sales up 12% and estimated EBITDA up 24%.

- Ardagh Packaging (ARGID/ARD) – On February 23, 2021, the Gores Holdings V SPAC (Ticker: GRSV) announced an agreement to acquire the metal packaging business of Ardagh Group at an enterprise value of approximately $8.5 billion in a deal that is expected to close in 2Q21. Ardagh has indicated that it will use the sale proceeds to reduce net leverage, and we believe the 6% Senior Notes due 2025 are a likely target for repayment as they are the nearest bond maturity and the highest coupon in Ardagh's capital structure. We began purchasing the Notes in late February at a weighted average yield of 2.53% to the 4/30/21 estimated close date.

We end the quarter wondering how long the "warm bath syndrome"[21] will go on: Will investors be content to stay in while the water begins to cool or step out into the cold air of reality once the Fed dials back its support, the fiscal stimulus has been spent and growth begins to slow? In the meantime, we are enjoying "tubby-time" with our favorite little pal, Rubber Ducky. "And I've got a big fluffy towel to dry myself when I'm done."[22]

Reflective with optimism,

DKS

David K. Sherman and the CrossingBridge team

[1] From *Rubber Ducky,* a song sung by Muppet character Ernie on Sesame Street, first heard on February 25, 1970. https://www.youtube.com/watch?v=jBy03hCclJY

[2] Bloomberg

[3] Total convertible bond issuance in 2019 was $56.8 billion.

[4] Bloomberg

[5] The imbedded call option gives the investor the ability to exchange the bond for a predetermined number of common shares of the issuer with the ratio of the bond's par value to the number of shares implying a conversion or "strike" price.

[6] Bloomberg

[7] Bloomberg

[8] BofA U.S. Corporate Index

[9] A special purpose acquisition company, or "SPAC", is a publicly traded "blank check" company formed with the intent to purchase an unidentified business in the future. Investors purchase freely tradeable shares collateralized by the cash proceeds, which are escrowed and invested in U.S. Treasury bills. The corporate by-laws require that the accumulated cash be returned to investors at a pre-determined liquidation date (usually two years from issuance) or following a "de-SPAC-ing" event. Such an event occurs when shareholders vote in favor of a merger or acquisition. However, each individual investor can vote to receive its pro rata portion of cash rather than shares in the new entity. Effectively, this mirrors a bond with a stated maturity that is callable sooner upon a de-SPAC-ing event. Yield-oriented investors are attracted to these vehicles because they offer yields similar to T-bills, a "maturity" based on the investor's ability to redeem at trust value and an embedded call option on a future business combination. Reflecting the amount of capital raised in the SPAC's initial public offering, the initial offering price, typically $10.00 per share approximates the trust collateral value and demarcates whether the SPAC is trading at a premium or discount to trust value.

[10] Citigroup and Bloomberg

[11] SPAC shares that trade significantly above trust value prior to announcement of a merger transaction reflect investor speculation that the SPAC sponsor will complete an attractive investment and cause the shares to appreciate.

[12] Bloomberg

[13] iShares Core U.S. Aggregate Bond

[14] iShares iBoxx US Investment Grade Corporate Bond ETF

[15] iShares 0-5 Year High Yield Corporate Bond ETF

[16] Invesco Senior Loan ETF

[17] iShares iBoxx High Yield Corporate Bond ETF

[18] https://blog.crossingbridgefunds.com/blog/q4-2020-commentary-perception-is-reality

[19] This compares to $774 million in power costs for all of 2020.

[20] Holders of 503(b)(9) claims may also receive post-petition interest, usually at the Federal Judgement Rate (FJR), if other unsecured claims are awarded interest as part of the Plan of Reorganization. In this case, the FJR is 0.07% per annum, so any accrued interest is likely to be minor.

[21] The "warm bath syndrome" is the concept that people cease to take action when they become comfortable. https://marketersclub.com.au/warm-bath-syndrome/

[22] From *Rubber Ducky,* a song sung by Muppet character Ernie on Sesame Street, first heard on February 25, 1970. https://www.youtube.com/watch?v=jBy03hCclJY

Disclosures

The prospectus for the CrossingBridge Low Duration High Yield 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.

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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 publically issued in the US domestic market. The **The ICE BOFA High Yield Index** tracks the performance of US dollar denominated below investment grade rated corporate debt publically 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.

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 funds, 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 funds 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. *Duration* is a measure of the sensitivity of the price of a bond or other debt instrument to a

change in interest rates.

Fund holdings and sector allocations are subject to change and should not be considered recommendations to buy or sell any security. Any direct or indirect reference to specific securities, sectors, or strategies are provided for illustrative purposes only. When pertaining to commentaries posted by CrossingBridge, it represents the portfolio manager's opinion and is an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding the fund or any security in particular. Specific performance of any security mentioned is available upon request. Please click here for a full holdings report as of the most recent month-end.

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling 914-741-9600. Please click here for current standardized performance as of the most recent quarter-end.

Diversification does not assure a profit nor protect against loss in a declining market.

A stock is a type of security that signifies ownership in a corporation and represents a claim on part of the corporation's assets and earnings. A bond is a debt investment in which an investor loans money to an entity that borrows the funds for a defined period of time at a fixed interest rate. A hedge fund is a private investment vehicle that may execute a wide variety of investment strategies using various financial instruments.

A stock may trade with more or less liquidity than a bond depending on the number of shares and bonds outstanding, the size of the company, and the demand for the securities. The Securities and Exchange Commission (SEC) does not approve, endorse, nor indemnify any security.

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