Monthly Fund Commentary

Muzinich & Co

Supra Institutional: MZCSX Institutional: MZCIX Class A: MZCRX

March 2022

Fund

Muzinich Credit Opportunities Fund

Portfolio Commentary

Global credit markets[1] delivered mixed returns in March. It was another challenging month for US fixed income as rates moved higher, impacting duration[2] sensitive credit like US investment grade[3] (IG) bonds and Treasuries most directly. March economic data was strong and inflation prints were higher. The Federal Reserve (Fed) announced their hawkish rate plan which consists of several rate hikes and a wind down of quantitative easing. During the month, the belly of the curve flattened (3 year to 7 years flatter) and the 7 to 10 year segment inverted, with 10 year rates lower than 7 year rates. European fixed income returns were mixed in March with European high yield[4] (HY) flat to barely positive as duration sensitive credit declined more substantially. Early in the month, spreads[5] were wider on the back of the Russian invasion of the Ukraine, however, as the month progressed, inflation concerns, rates, and central bank action dominated investor thoughts. The European Central Bank (ECB) announced an end to its pandemic asset purchase program by the end of Q2 and intention to raise interest rates in the second half of 2022. This communication was viewed as very hawkish and led to higher short term interest rates, which led to a substantial decline in the amount of negative yielding European debt. Emerging Markets[6] (EM) continued to be challenged this month by negative performance from China (particularly the property sector) and Russian assets, as well as rising US rates. While the war in Ukraine continues to exact a horrific human toll, the markets seem to be looking through the current geopolitical situation. EM saw inflows each week of the second half of the month.

Strategy and Outlook

In this environment, the fund declined but outperformed the global credit market[1]. The fund underperformed its benchmark target LIBOR[7] + 300 this month. During the month, we increased fund duration by increasing our longer dated US IG holdings given opportunities in discounted bonds with what we believe to be relatively attractive yields[8]. We also increased our high yield[9] holdings in US and EM slightly, while decreasing exposure to banking and more cyclical sectors[10]. The portfolio's yield-to-worst[11] has increased considerably during Q1 2022. While overall valuations have improved year-to-date and fundamentals generally remain solid in most markets, we are maintaining flexibility in the portfolio via cash and shorter dated investments to continue to deploy on additional rate and/or geopolitical driven volatility. We continue to avoid deploying capital into the primary hotspots of Eastern Europe and China given high uncertainty in those regions.

Global central banks (with the exception of the Bank of Japan) are generally tackling the same issue of inflation that has remained higher for longer than expected. In March, both the US Fed and the ECB announced plans to end stimulus programs and raise interest rates. Historically, tightening cycles have led to recessions. In anticipation of a recession, interest rate curves show that investors are forecasting lower longer term (10 year and beyond) rates given a weak growth outlook and potentially, a flight to safety. As central banks attempt to fight inflation, they have much to consider – as do we. We are closely examining the question of who will absorb higher energy and commodity prices. Can companies pass these price increases on to consumers instead of absorbing them? What does this mean for corporate earnings? Much depends on the strength of corporate backlogs. We believe companies that have consistently backlogged orders can more easily pass on price increases to weather the storm. We see wide variation between industries and even within them. For example, within the packaging industry, energy costs factor higher for glass packagers which uses furnaces than for paper packagers which do not. As the market becomes more differentiated, we believe credit underwriting is key.

All references to market performance are sourced from Bloomberg as of March 31, 2022. [1]GI00 – The ICE BofA ML Global Corporate & High Yield Index tracks the performance of investment grade and below investment grade corporate debt publicly issued in the major domestic and eurobond markets. [2]Duration is a measure of the sensitivity of the price -- the value of principal -- of a fixed-income investment to a change in interest rates, expressed as a number of years. [3]C0A0 - The ICE BofA ML US Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. [4]HE00 - The ICE BofA ML Euro High Yield Index tracks the performance of EUR dominated below investment grade corporate debt publicly issued in the euro domestic or eurobond markets. [5]Spread is the difference between yields on differing debt instruments of varying maturities, credit ratings, issuer, or risk level, calculated by deducting the yield of one instrument from the other. [6]EMCL - The ICE BofA ML US Emerging Markets Liquid Corporate Plus Index tracks the performance of the U.S. dollar denominated emerging markets non-sovereign debt publicly issued in the major domestic and eurobond markets. [7]LIBOR (London Interbank Offered Rate) is a benchmark interest rate at which major global banks lend to one another in the international interbank market for short-term loans. [8]Yield refers to the earnings generated and realized on an investment over a particular period of time. [9]High-yield bonds are bonds that pay higher interest rates because they have lower credit ratings than investment-grade bonds. [10]Cyclical sectors refer to a type of industry that is sensitive to the business cycle, such that revenues generally are higher in periods of economic prosperity and expansion and are lower in periods of economic downturn and contraction. [11]Yield-to-worst is a measure of the lowest possible yield that can be received on a bond that fully operates within the terms of its contract without defaulting.

New York Office I 450 Park Avenue, New York, NY 10022, USA I P. 1-855-Muzinich (689-4642)

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