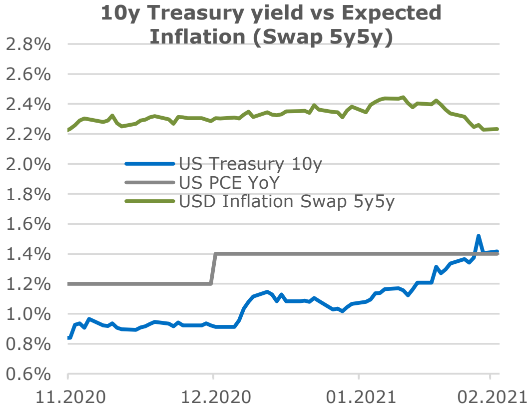
Monthly Spotlight

Real rates increased while expected inflation did not (yet) move

Since December 2020, US long-term nominal yields (US Treasury 10y) rose 60 bps, while expected inflation (US Inflation Swap 5y5y) remained flat at ~2.2%. Markets incorporate a benign outlook, but inflation will pick up significantly over the next quarters based on statistical effects (y-o-y comparison) and cyclical forces (economic recovery, lower unemployment, higher commodity prices). Therefore, we expect bouts of market volatility as rates tend to rise and equity multiples to shrink.

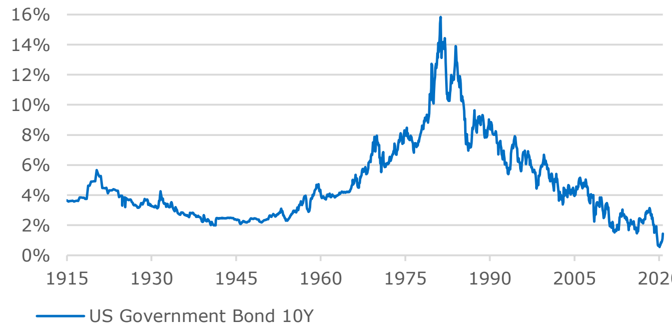
$$\text{nominal yield} = \text{real yield} + \text{expected inflation}$$

The US Fed announced that it will tolerate a temporary inflation overshoot above 2% with its recently implemented "average inflation targeting" framework. Nevertheless, should "expected" inflation move towards 3% or beyond, bond and equity markets will be challenged.

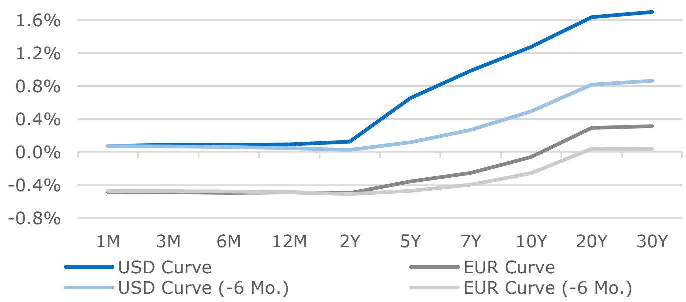


Rates Perspective

1) Historical US Treasury Yield: 10-year US government bond yield reached its 100-year low in 2020.

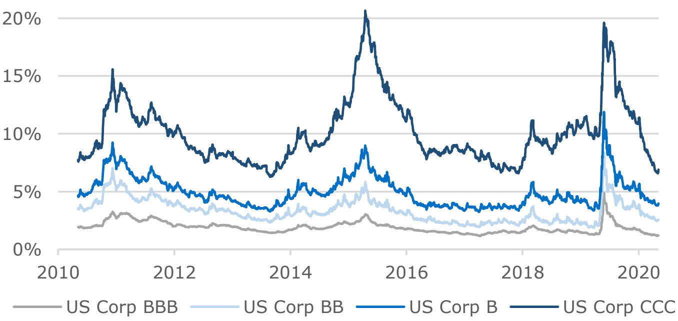


2) Interest Swap Curve: USD swap curve steepened considerably. EUR curve has steepened modestly at the long end with 20y tenor back in the positive.



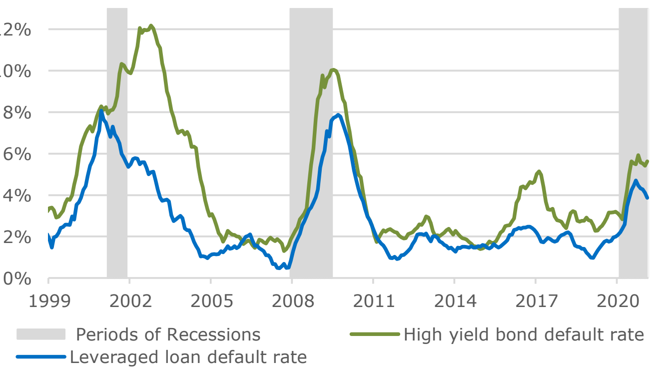
Corporate Perspective

3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds continued to tighten disproportionately.

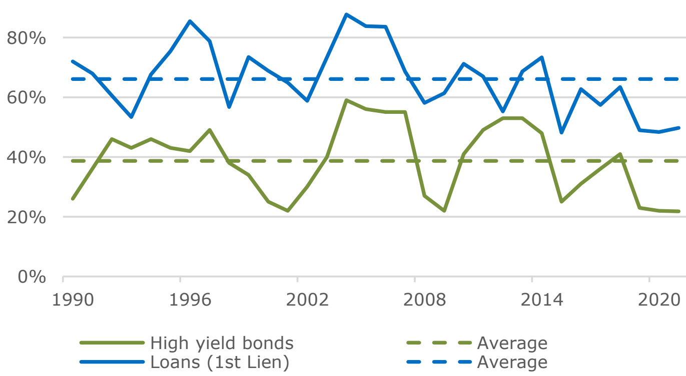


4) EU vs US: Since the March-spike, credit spreads (OAS) between the USA and EU have converged in tandem to lower levels.

5) Default Rates: Default rates of HY bonds & loans are peaking. HY bond default rates are structurally higher (Ø4.4%) vs. loans (Ø2.8%).



6) Recovery Rates: Recovery rates of leveraged loans are higher (Ø66%) vs. high yield bonds (Ø39%) due to lower severity.



OAS spread change overview across major credit asset classes - as of month end

US corporates by rating (bps)

	curr	Δ month
AAA	50	-5
AA	60	-5
A	72	-7
BBB	119	-9
BB	256	-24
B	397	-27
CCC	691	-45

Global high yield (bps)

	curr	Δ month
US HY	357	-27
EU HY	324	-26
Asia HY	745	-3
EM HY	404	-23

CDS spreads (bps)

	curr	Δ month
CDX IG - US	56	-0
iTraxx IG - EU	51	-1
CDX HY - US	310	-8
iTraxx XO - EU	265	-4

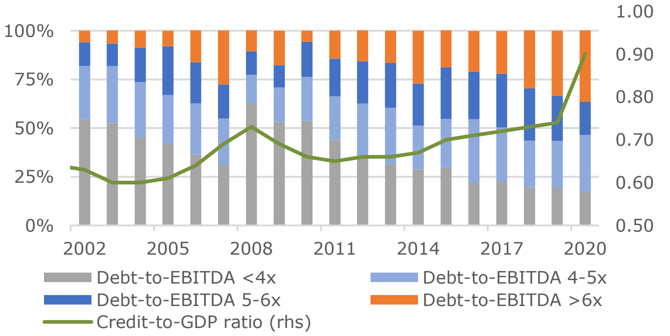
Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	366	-12
CLO AAA	130	-1
CLO BBB	381	-4
CLO BB	774	+25

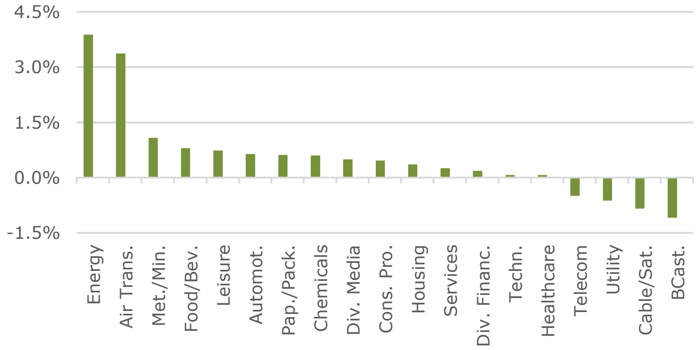
spread tightening (positive price action)

spread widening (negative price action)

7) US Leverage: Debt-to-EBITDA of US companies decreased in Q1 2020, but increased to a record high in Q3 2020.

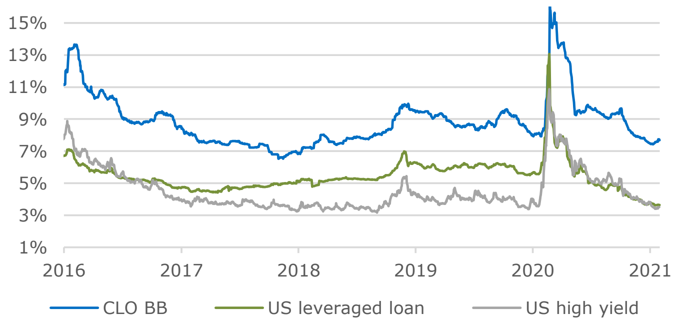


8) YTD Sector High-Yield Returns: Broadcasting, cable, telecom, and utilities faced negative price action YTD, while energy rallied with surging oil prices.



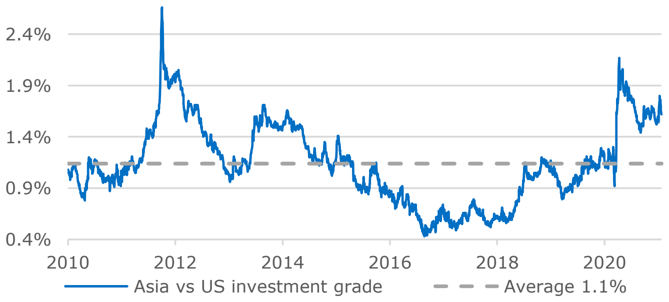
Alternative Perspective

9) Loans vs. CLO vs. HY: CLO BB yields are still wider vs Loans and HY bonds, despite the recent price increase in CLO BB.

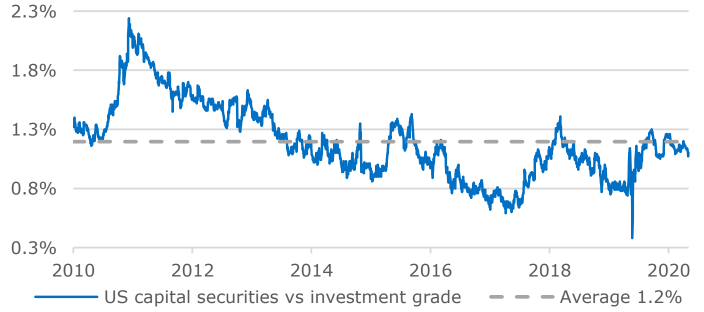


10) CLO Yields: CLO BB yields tightened more than higher rated CLOs. CLOs offer an attractive yield premium over bonds / loans.

11) Asia vs. US: Despite a recent tightening of Asian IG spreads they continue to offer a sizeable premium vs. US IG spreads.



12) Capital vs IG.: Capital Securities structurally earn a premium vs. US IG bonds. Capital Securities are dominated by the financial sector.



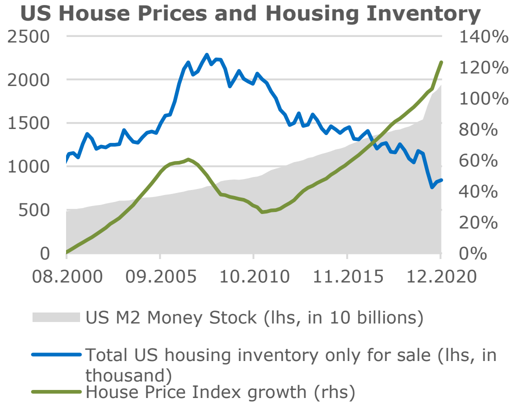
Education Corner

US house prices reach all-time high, inventories collapsed

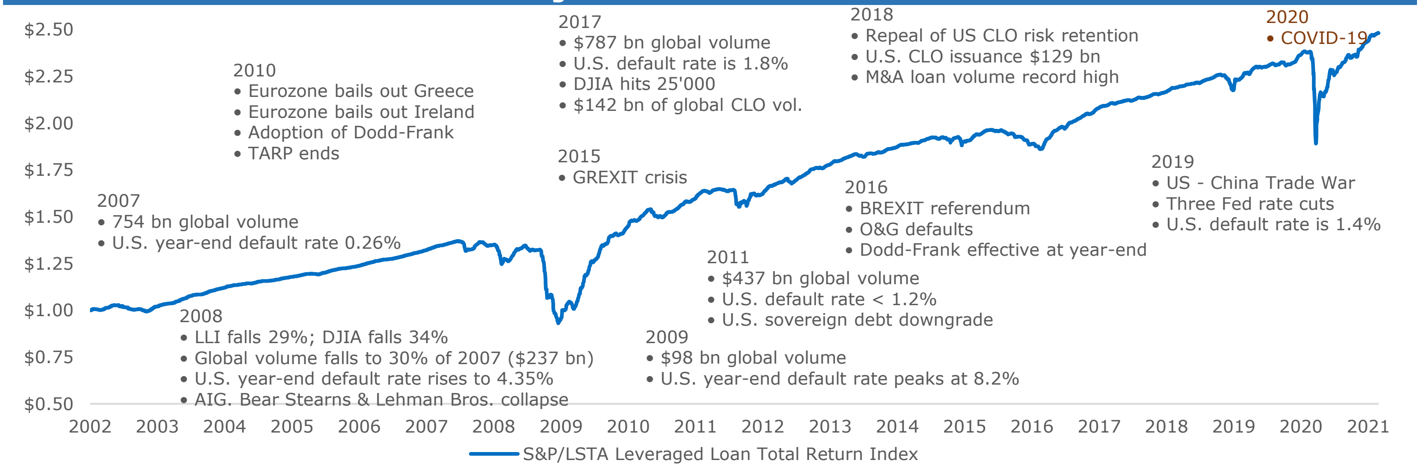
Supply shortage in "homes for sale" combined with ultra-low mortgage rates and "staying at home" measures drove home prices to record levels. The median price of a home sold in December 2020 reached USD 340,000 (Realtor.com) – an all-time high level.

US housing inventories fell to a multi-year low level because of a variety of reasons: 1) the pandemic created job insecurity and hence, employees preferred to stay in their job, what resulted in less "mobility" and lower home sales activity. 2) More than 4 mio. homeowners with government-backed loans were in mortgage forbearance during the pandemic. Many of these homes would otherwise have hit the market. However, government policies such as the COVID hardship mortgage forbearance and a temporary halt of foreclosures prevented "forced sales" so far.

US House Prices and Housing Inventory



US Loan Index Total Return - Attractive Long Term Yield Generation



List of Abbreviations

Capital Securities (Or preferred securities): Are fixed income securities combining features of bonds and preferred stocks.

CDS: Credit default swaps transfer credit event risk to another party in exchange of a perdiodically paid premium. CDX index covers the US IG-, iTraxx the EU IG- and iTraxx crossover (XO) the EU HY market.

CLOs: Collateralized loan obligations are structured finance securities collateralized predominantly by a large pool of different loans.

Default Rate: Number of defaulted corporate issuers of leveraged loans and high yield bonds.

Loans: Are syndicated, public tradable loans. Synonyms are «syndicated loans», «loans», «leveraged loans» and «bank loans».

OAS: Option-adjusted spread is the yield difference of an interest paying security to the risk free rate considering embedded options.

TIPS: Treasury Inflation-Protected Securities are US government linked to the US CPI Urban Non-Seasonally Adjusted.

Up-/ downgrades: Rating actions of Moody's and S&P of up-or downgrades of US high yield bond issuers denominated in USD.

Up-/ downgrade ratio: Number of upgrades of total rating actions.

Recovery Rates: Bond issuer-weighted recovery rates express the principal and accrued interest on defaulted debt that can be recovered in percentage of face value. Example:
Expected loss rate if US HY defaults were 10%: 10% ./. Estimated average recovery rate of ~30% = -7%; Example for Loans:
Expected loss rate if US Loan defaults were 10%: 10% ./. Estimated average recovery rate of ~65% = -3.5%;

Data and Price Sources

Alpinum Investment Management	Federal Reserve Bank of St. Louis	Palmer Square indices
Bank of America Merrill Lynch indices	Markit CDS indices	Preqin
Bloomberg	Moody's Investors Service	S&P
The Federal Reserve	J.P. Morgan	Federal Housing Finance Agency
US Census Bureau		

Disclaimer

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