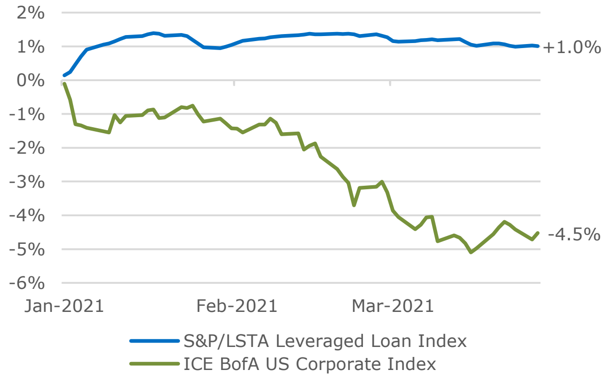
Monthly Spotlight

Duration-heavy IG bonds tanked, loans are up YTD

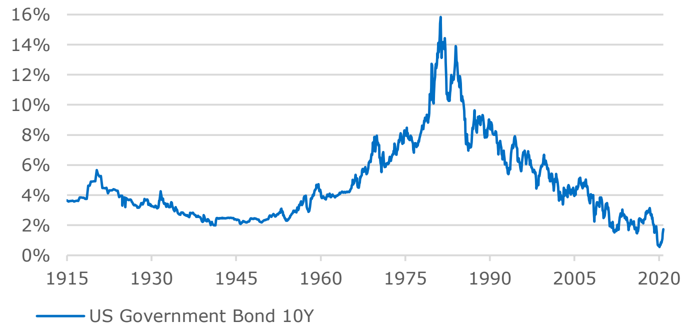
In anticipation of a strong economic recovery ahead of us, long term interest rates have spiked from their historical lowest levels. This has paid its toll. For example, US investment grade bonds suffered a performance of -4.5% on a YTD-basis as these bonds are highly interest rate sensitive with an average duration risk of around 7 years. On the opposite, US loans generated a solid plus of around +1% on a YTD-basis, given the asset class' low interest rate sensitivity. Loans have a floating rate mechanism and are priced based on a fixed credit spread combined with a (floating) money market rate (i.e. libor rate). Depending on the respective credit rating, loans earn currently an average yield of ~4% p.a. in USD.

YTD: US Loans vs Investment Grade Bonds

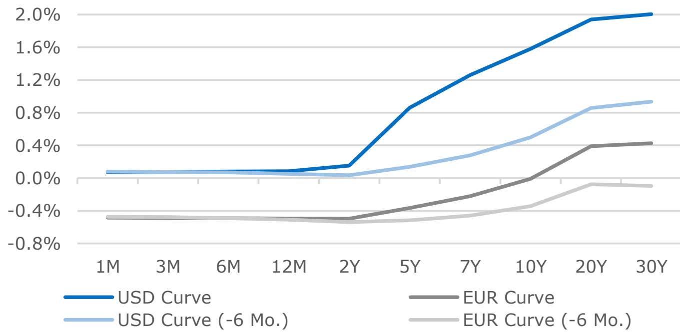


Rates Perspective

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

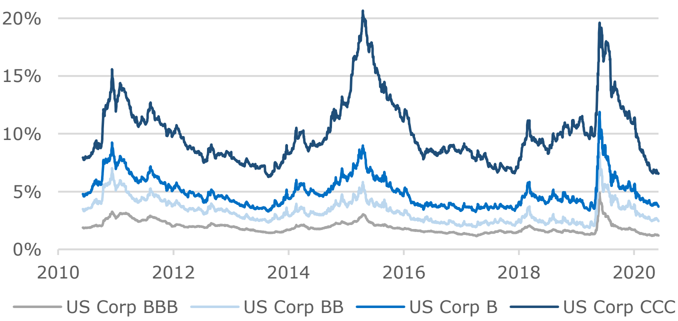


2) Interest Swap Curve: USD swap curve experienced a strong steepening, what is most evident with tenors > 2 years.

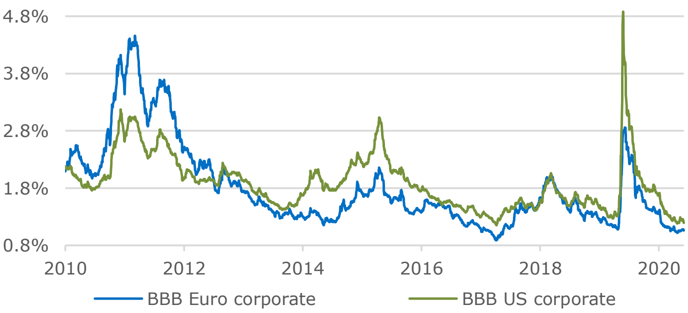


Corporate Perspective

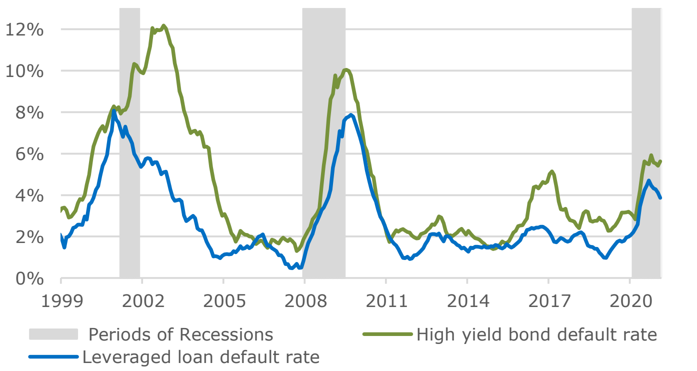
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds continued to tighten disproportionately.



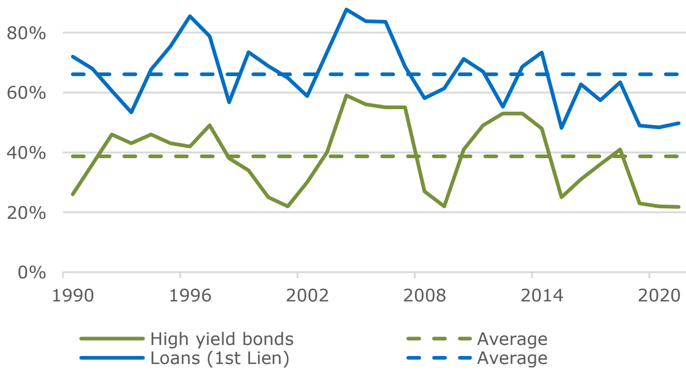
4) EU vs US: Since the March-spike, credit spreads (OAS) between the USA and EU have converged in tandem to lower levels.



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	47	-3
AA	60	+0
A	75	+3
BBB	119	+0
BB	244	-12
B	369	-28
CCC	656	-35

Global high yield (bps)

	curr	Δ month
US HY	336	-21
EU HY	314	-10
Asia HY	748	+3
EM HY	398	-6

CDS spreads (bps)

	curr	Δ month
CDX IG - US	54	-2
iTraxx IG - EU	52	+1
CDX HY - US	308	-2
iTraxx XO - EU	252	-13

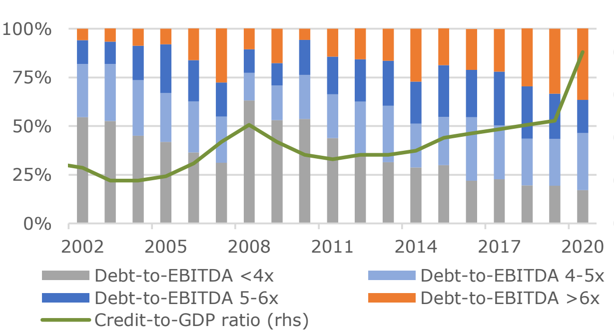
Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	374	+8
CLO AAA	143	+13
CLO BBB	440	+59
CLO BB	819	+45

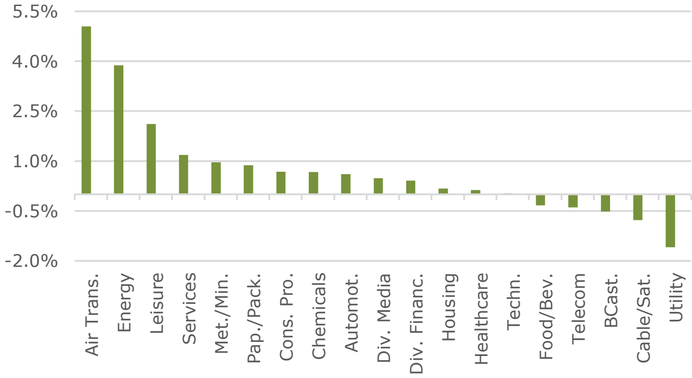
spread tightening (positive price action)

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.

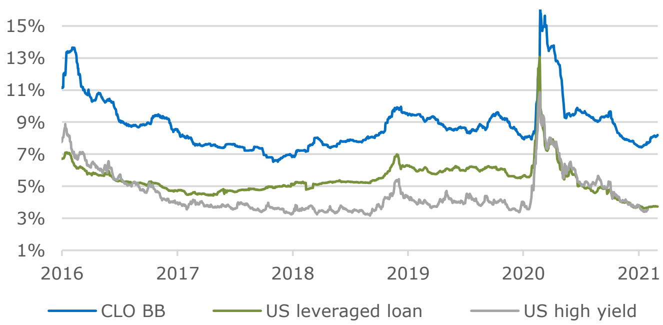


8) YTD Sector High-Yield Returns: Air transport, energy and leisure continued to catch up.



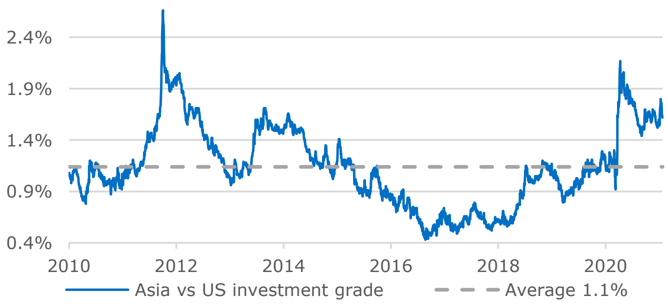
Alternative Perspective

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.

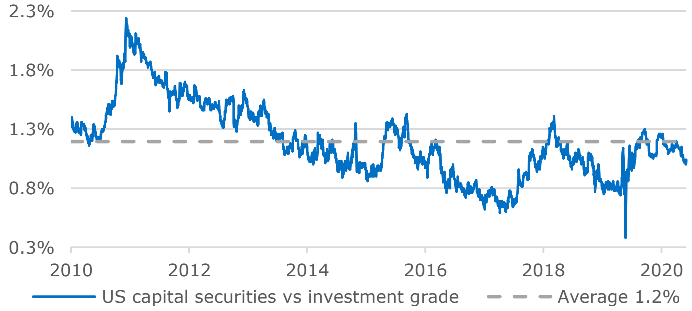


10) CLO Yields: CLO BB yields tightened more than higher rated CLOs. CLOs offer an attractive yield premium over bonds / loans.

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



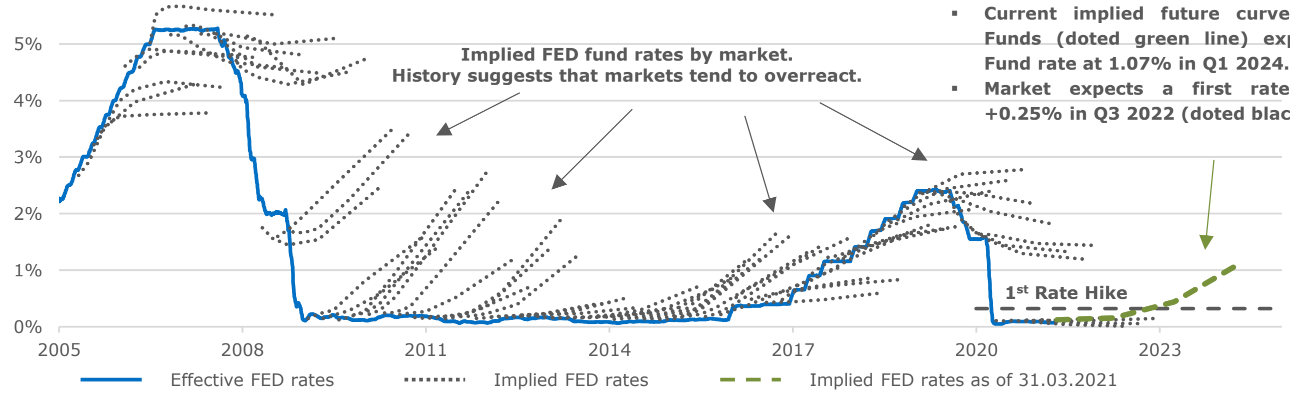
12) Capital vs IG.: Capital Securities structurally earn a premium vs. US IG bonds. Capital Securities are dominated by the financial sector.



Education Corner

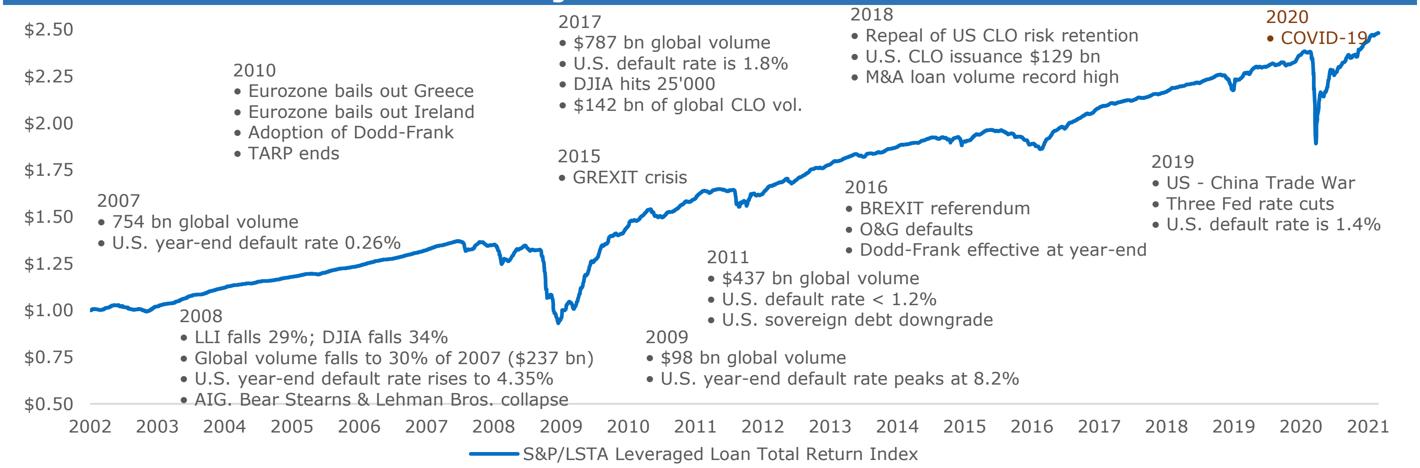
FED Fund Futures at different Points in Time

- **Current implied future curve for FED Funds (doted green line) expects Fed Fund rate at 1.07% in Q1 2024.**
- **Market expects a first rate hike of +0.25% in Q3 2022 (doted black line).**



Alpinum Investment Management

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		

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Contact Information:
Alpinum Investment Management AG
Talstrasse 82
CH-8001 Zurich
Tel: +41 43 888 79 30
Fax: +41 43 888 79 31
alpinumim.com