

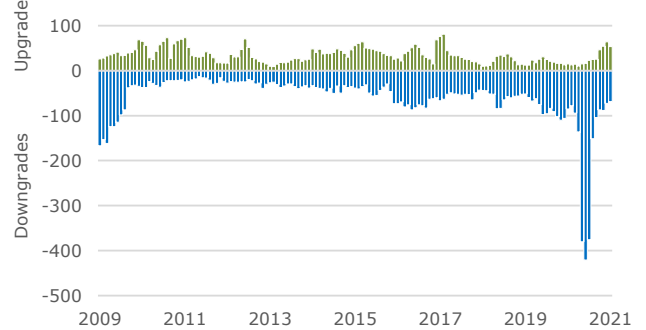
Monthly Spotlight

Rating downgrade cycle has stopped

In 2020, the rating agencies acted as quickly as never before in downgrading the issuer ratings due to the COVID-19 pandemic – very different to 2007/08, when rating agencies were criticized for acting too slowly. During 2020, 45% (USD 521 bn) of the loan market by par amount had received a rating downgrade from a total market size of USD 1.2 tn.

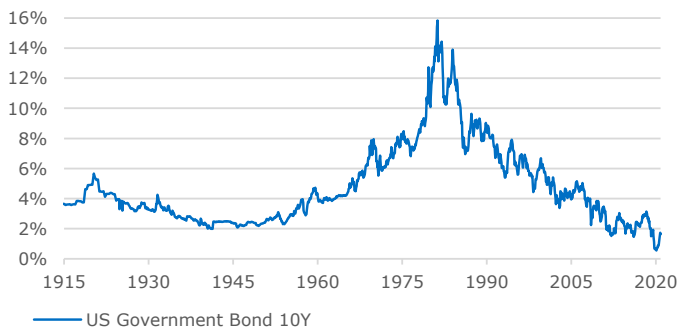
However, the flood of corporate downgrades has ebbed down and has even started to reverse. As of Q1 2021, the number of upgrades in the S&P/LSTA Leveraged Loan Index is now nearly equal to the number of downgrades. Not only are upgrades increasing, but the number of downgraded loans is also declining, providing a strong support for the loan market.

Rolling 3-month count of loan ratings upgrades & downgrades

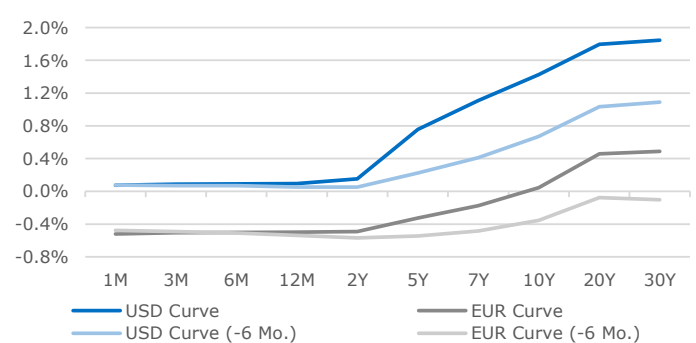


Rates Perspective

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

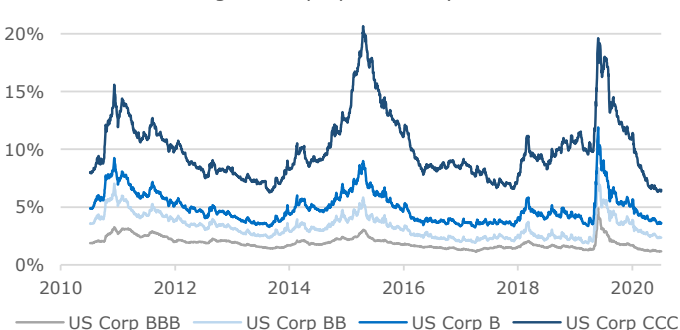


2) Interest Swap Curve: USD swap curve experienced a strong steepening, what is most evident with tenors > 2 years.



Corporate Perspective

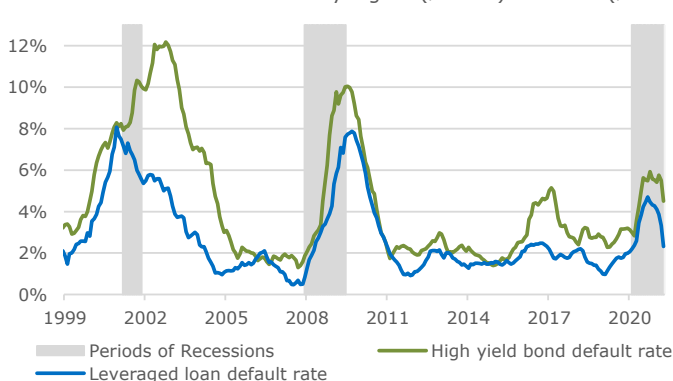
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds continued to tighten disproportionately.



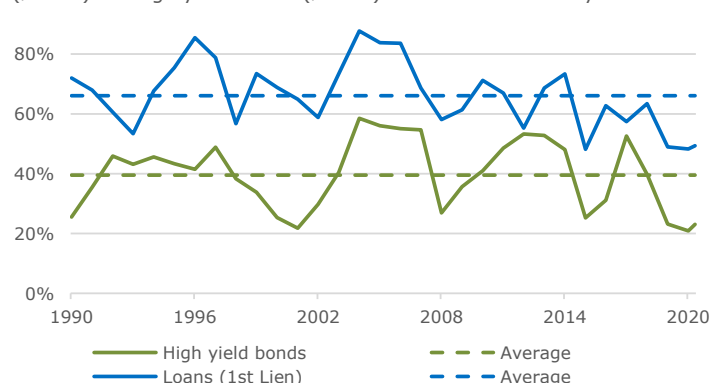
4) EU vs US: Since the Covid-19 spike, credit spreads (OAS) between the USA and EU have converged in tandem to lower levels.



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 (Ø40%) 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	48	+1
AA	57	-2
A	73	-2
BBB	117	-2
BB	237	-7
B	363	-6
CCC	650	-6

Global high yield (bps)

	curr	Δ month
US HY	328	-8
EU HY	304	-10
Asia HY	714	-34
EM HY	382	-16

■ spread tightening (positive price action)
■ spread widening (negative price action)

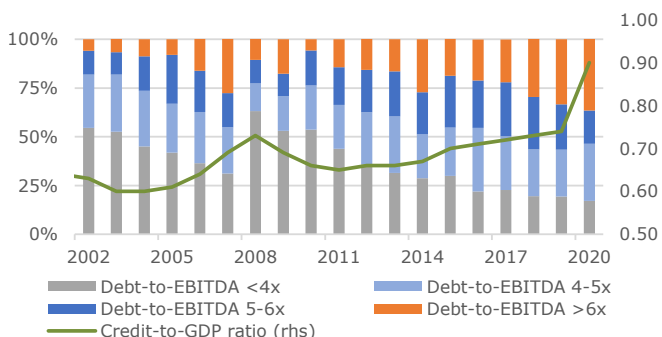
CDS spreads (bps)

	curr	Δ month
CDX IG - US	50	-6
iTraxx IG - EU	50	-4
CDX HY - US	286	-28
iTraxx XO - EU	249	-15

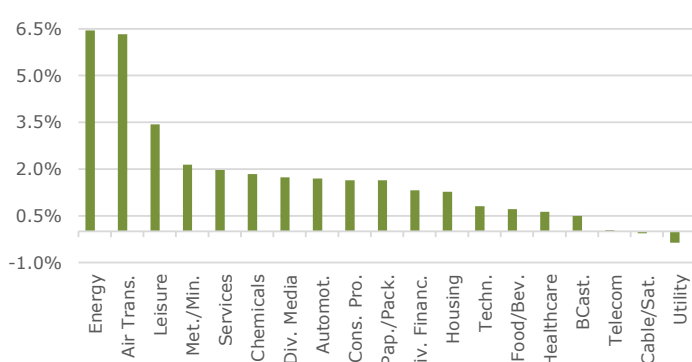
Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	370	-3
CLO AAA	136	-1
CLO BBB	391	-38
CLO BB	760	-54

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

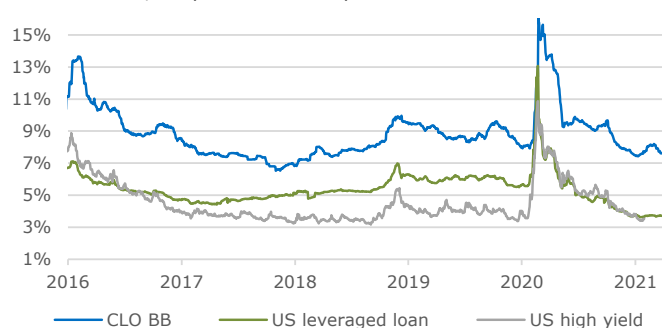


8) YTD Sector High-Yield Returns: Air transport, energy and leisure continued to catch up.



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.



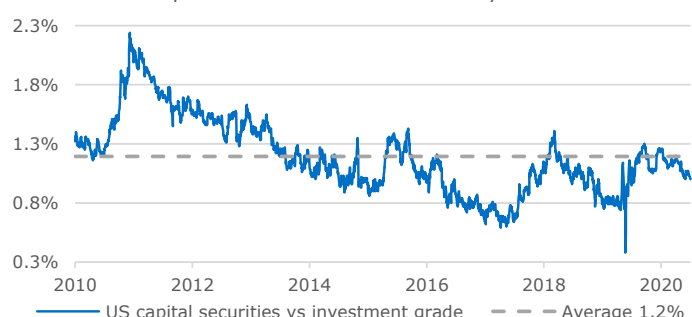
10) CLO Yields: CLO BB yields tightened more than higher rated CLOs. CLOs offer an attractive yield premium over bonds / loans.



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.



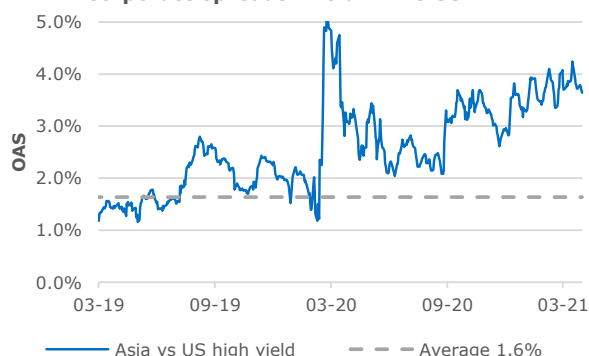
Education Corner

Wide Asian high yield spreads offer an opportunity

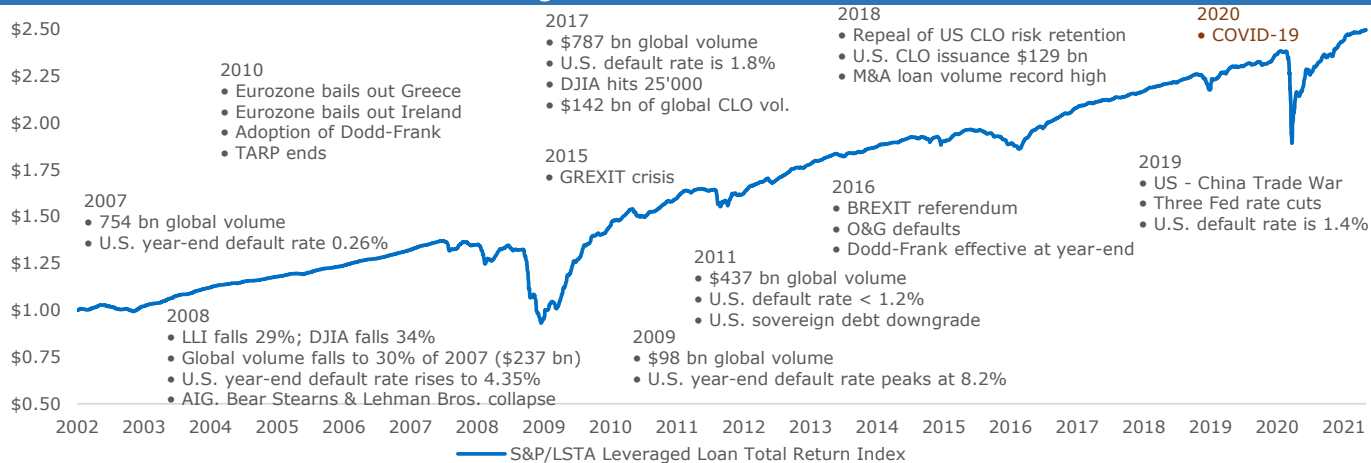
Asian HY spreads have widened so far in 2021. To a lesser degree, the widening reflects the strengthening of the USD as it increases the cost of debt of companies paying interest in USD.

However, more importantly, the market weakness is primarily policy driven as the Chinese government is willing to let weaker companies default - including state-owned enterprises (SOEs). Beijing's restriction on borrowing led to a record wave of defaults, whereas the Chinese property sector was hit the hardest. In Q1 2021, real estate firms made up 27% of the total of USD 15.1 bn of missed payments. These corporate defaults had a contagion effect on the whole Asian HY market, which offers now a premium of almost 4% vs. the U.S. HY market. While an investment is now attractive, local expertise and a careful bond selection are imminent.

Corporate spreads - Asia HY vs US HY



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 periodically 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

Alpimum Investment Management

Bank of America Merrill Lynch indices

Bloomberg

The Federal Reserve

US Census Bureau

Federal Reserve Bank of St. Louis

Markit CDS indices

Moody's Investors Service

J.P. Morgan

Palmer Square indices

Preqin

S&P

Federal Housing Finance Agency

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