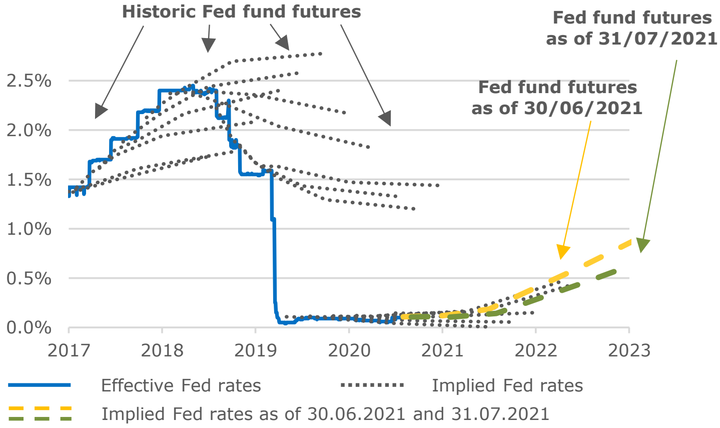
Monthly Spotlight

No Fed Fund Rate increase anytime soon

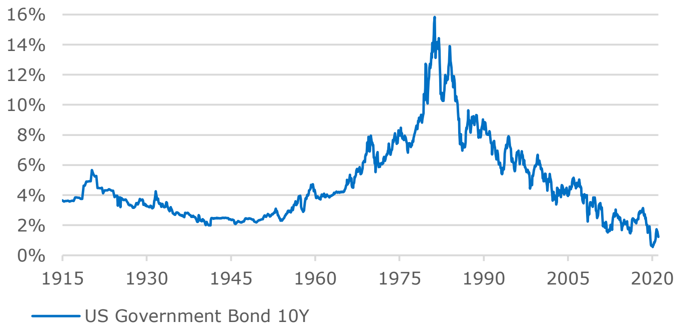
The Treasury yields fell substantially in July, especially at the long end of the curve. Moreover, current Fed fund future prices point to a more moderate pace of rate hikes, as the chart illustrates.

It remains to be seen whether recent price movements represent an overreaction, especially in the event that labor supply constraints will ease later this year, leading to an increase in employment and higher wage costs. In any case, the recent downward movement in yields has resulted in a flatter yield curve, which has now returned to its January 2021 level (see chart 2).

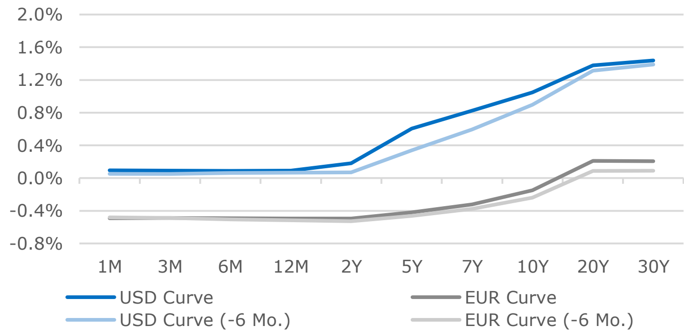


Rates Perspective

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

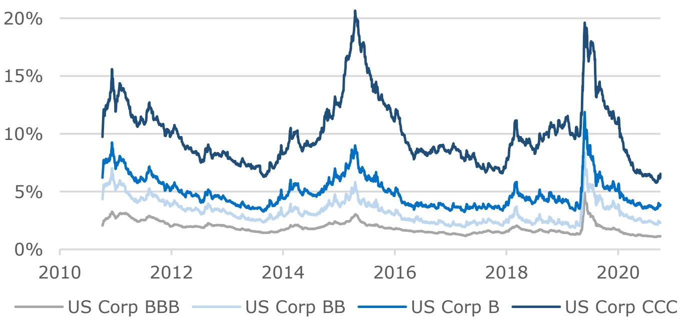


2) Interest Swap Curve: The long tenors of the USD swap curve are almost at the same level as at the beginning of 2021.

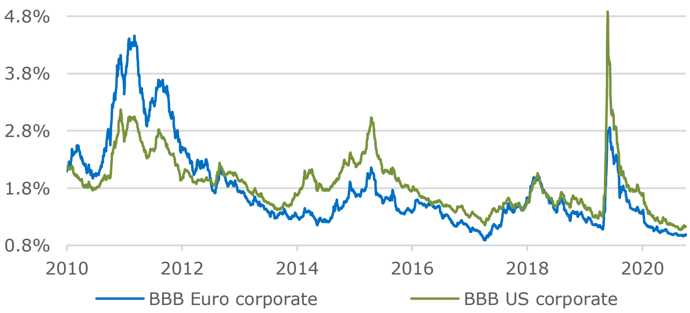


Corporate Perspective

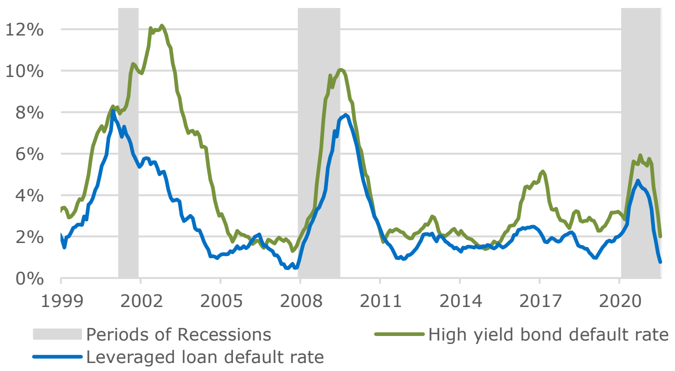
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds tightened disproportionately.



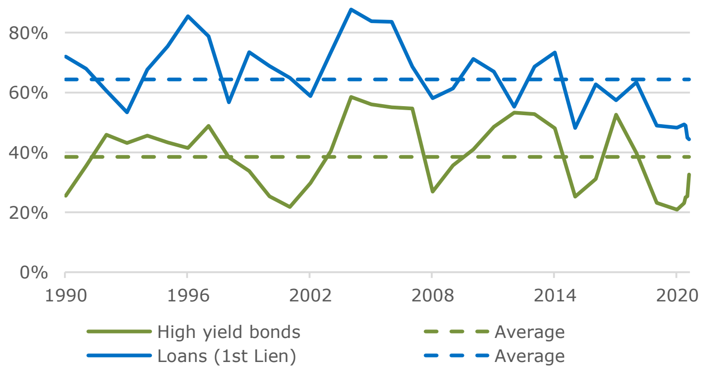
4) EU vs US: Since the Covid-19 spike, credit spreads (OAS) between the USA and EU have converged in tandem to lower levels.



5) Default Rates: Default rates peaked in Q4 2020. HY bond default rates are structurally higher (Ø4.4%) vs. loans (Ø2.8%).



6) Recovery Rates: Recovery rates of leveraged loans are higher (Ø64%) vs. high yield bonds (Ø38%) 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	49	+5
AA	58	+6
A	72	+5
BBB	113	+6
BB	233	+14
B	386	+37
CCC	654	+71

Global high yield (bps)

	curr	Δ month
US HY	332	+28
EU HY	313	+17
Asia HY	1036	+224
EM HY	403	+32

CDS spreads (bps)

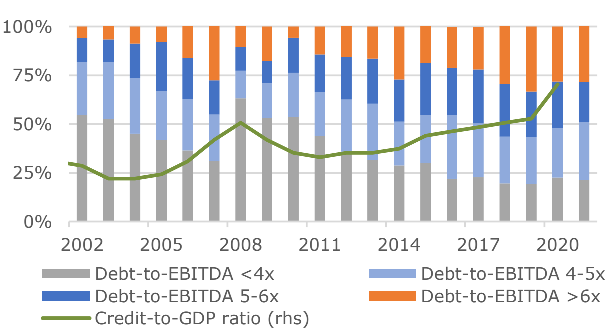
	curr	Δ month
CDX IG - US	50	+2
iTraxx IG - EU	47	-0
CDX HY - US	292	+19
iTraxx XO - EU	236	+4

Loans and CLOs (yld, bps)

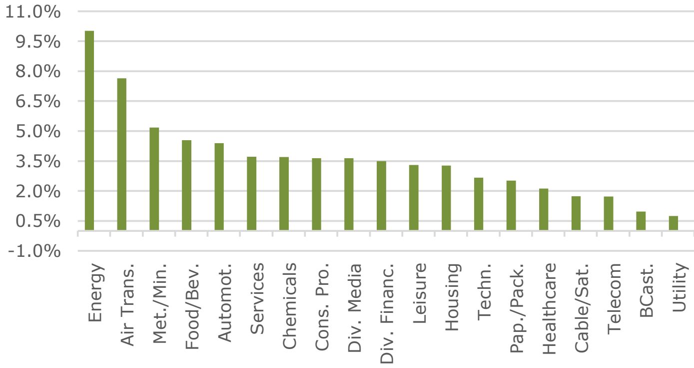
	curr	Δ month
US Loan	390	+20
CLO AAA	135	-6
CLO BBB	375	-6
CLO BB	725	-17

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

7) US Leverage: Debt-to-EBITDA of US companies has remained stable at high level in Q1 2021.

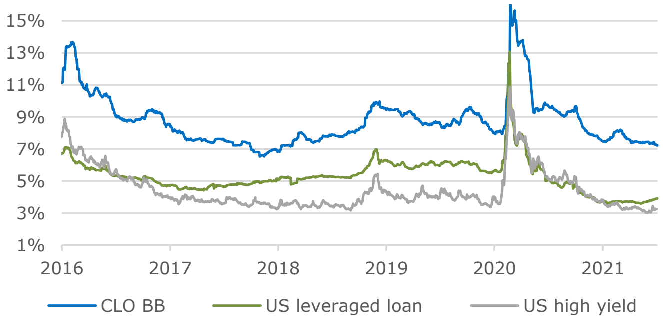


8) YTD Sector High-Yield Returns: Energy and air transport continued to catch up.



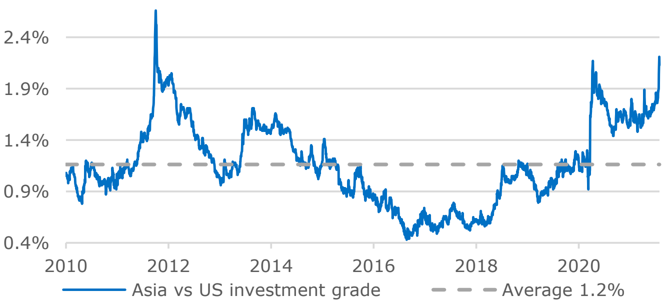
Alternative Perspective

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

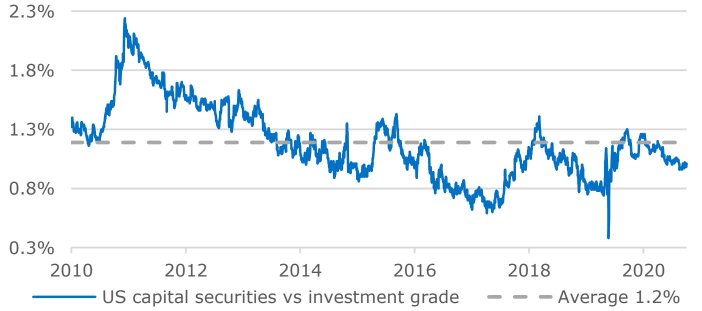


10) CLO Yields: CLO BB yields tightened more than higher rated CLOs. CLOs offer an attractive yield premium over bonds / loans.

11) Asia vs. US: Asian IG spreads 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.



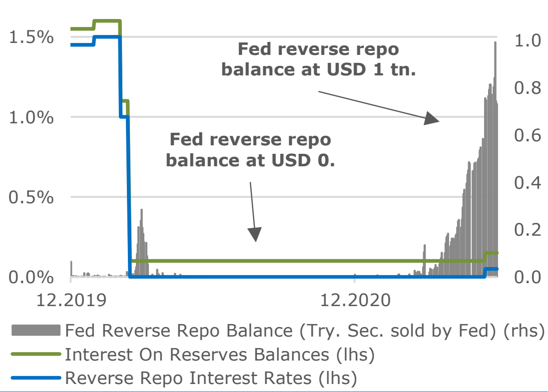
Education Corner

Excess liquidity pushes US reverse repo balance towards USD 1 tn.

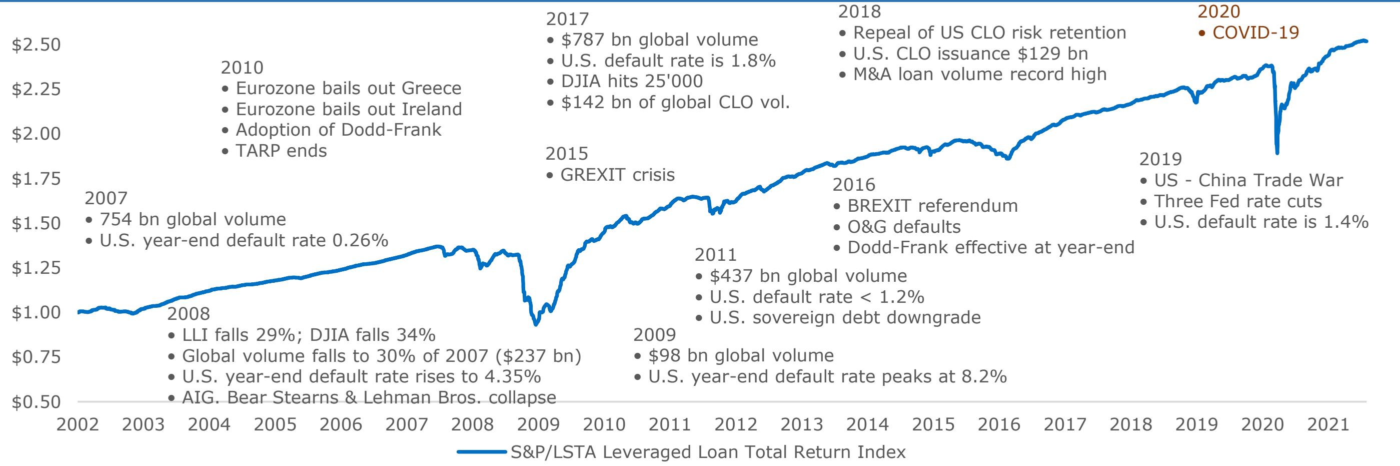
In July, we described that the U.S. market is facing excess cash due to quantitative easing and pandemic support. A similar picture can be seen in reverse repo agreements (RRP) of the Fed, which stood at 1.04 trillion at the end of July 2021. The record volume emerged after the Fed recently raised the interest rate on reverse repos from zero to 0.05%.

Reverse repos are used to provide stability in lending markets through open market operations (OMOs). Reverse repos temporarily reduce the supply of reserve assets in the banking system and are used when there is too much liquidity. In addition, the interest rate paid on reverse repos helps provide a floor by serving as an alternative investment for a broad base of money market investors when interest rates fall below the interest rate on reserve balances (IORB).

Reverse Repo Balance and Rates



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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