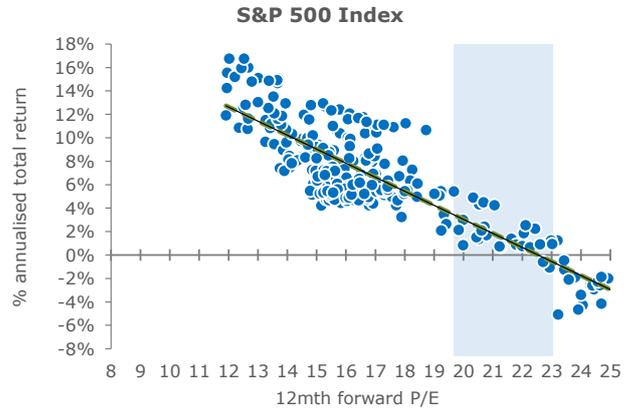


## Monthly Spotlight

### Average down - future equity returns will be lower

While high quality bonds with close to zero yields haven't offered a feasible investment opportunity since a long time, equities rallied over the last 18 months. However, equities trade now at elevated levels in a historical context and annualized return expectations over the next 10 years are only in the low to mid single digits, especially in case interest rates would creep higher. The S&P 500 12-month forward P/E ratio currently trades at ~22x. Looking from a historical perspective at the subsequent 10-year equity returns at a PE ratio of 20-23x (chart blue shaded part), the performance resulted in a range of 0% to 5%.

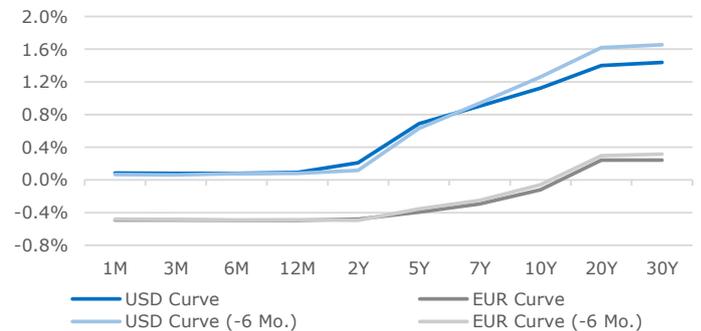


## Rates Perspective

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

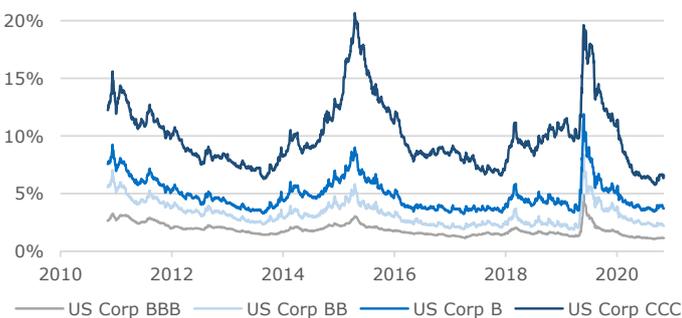


**2) Interest Swap Curve:** The long tenors of the USD swap curve are almost at the same level as at the beginning of 2021.



## Corporate Perspective

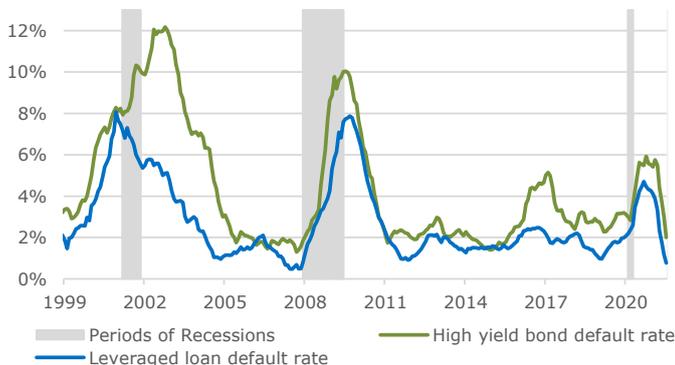
**3) US Corp. Rating:** Credit spreads (OAS) of lower rated high-yield bonds tightened disproportionately.



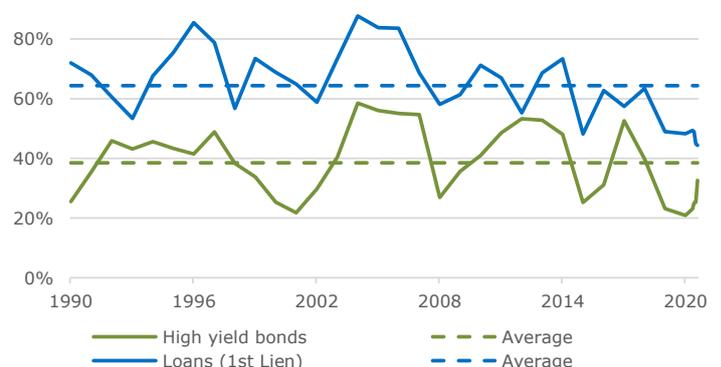
**4) EU vs US:** Since the Covid-19 spike, credit spreads (OAS) between the USA and EU have converged in tandem to lower levels.



**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	+0
AA	59	+1
A	73	+1
BBB	114	+1
BB	221	-12
B	372	-14
CCC	660	+6

### Global high yield (bps)

	curr	Δ month
US HY	321	-11
EU HY	303	-10
Asia HY	948	-88
EM HY	387	-16

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

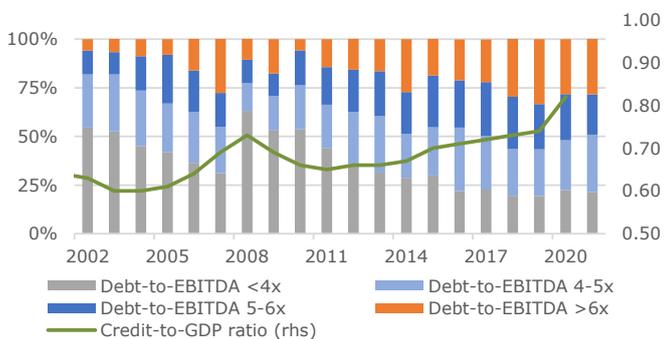
### CDS spreads (bps)

	curr	Δ month
CDX IG - US	46	-4
iTraxx IG - EU	45	-2
CDX HY - US	276	-16
iTraxx XO - EU	228	-8

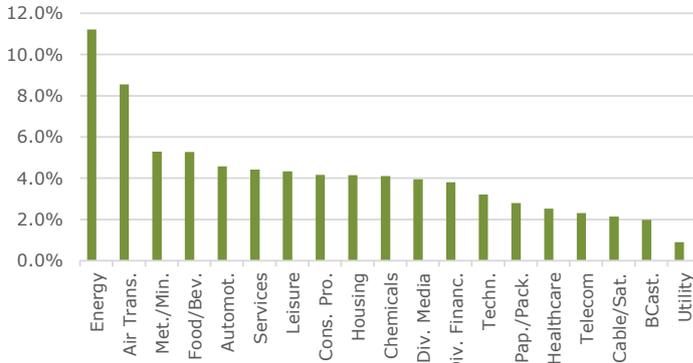
### Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	382	-8
CLO AAA	134	-1
CLO BBB	379	+3
CLO BB	733	+8

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

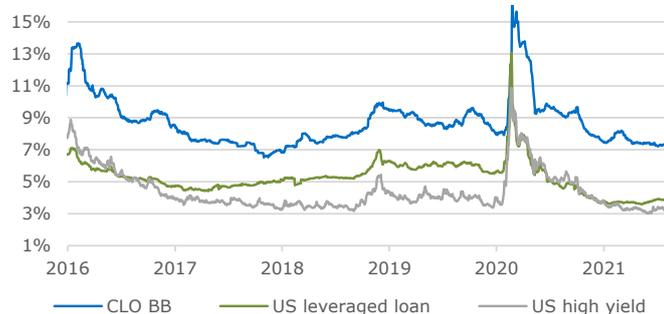


**8) YTD Sector High-Yield Returns:** All sectors recorded a positive month-over-month return.



## Alternative Perspective

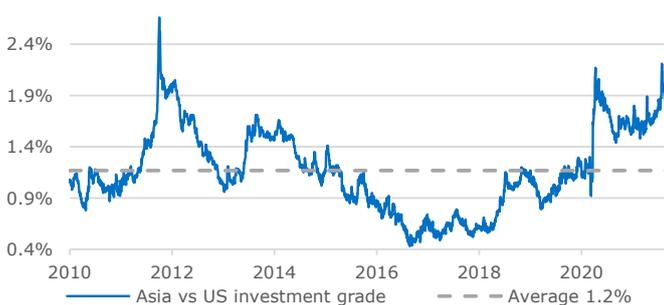
**9) Loans vs. CLO vs. HY:** CLO BB yields are still wider vs Loans and HY bonds, despite the recent price increase in CLO BBs.



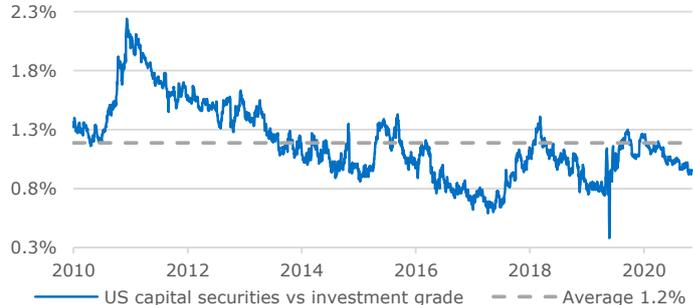
**10) CLO Yields:** CLO BB yields tightened more than higher rated CLOs. CLOs offer an attractive yield premium over bonds / loans.



**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.

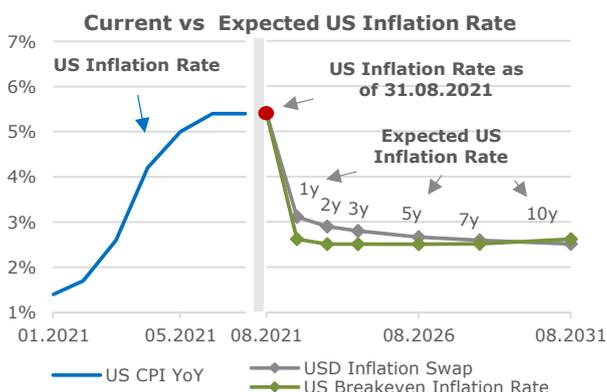


## Education Corner

### Markets price in a benign inflation scenario

The inflation level as of 31.08.2021 is at a long-term high of 5.4%. As described in the Monthly Spotlight of March 2021, the spike in inflation is due to a statistical effect (y-o-y comparison) and cyclical forces (economic recovery).

The chart illustrates that investors expect inflation to fall rapidly from current levels and to remain subdued thereafter. The decline in expected inflation is one of the main reasons why bond yields are depressed at the long end. Currently, the 5 year TIPS breakeven inflation rate stands at 2.51% and the 5-year inflation swap at 2.66%.



## 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

Alpium 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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