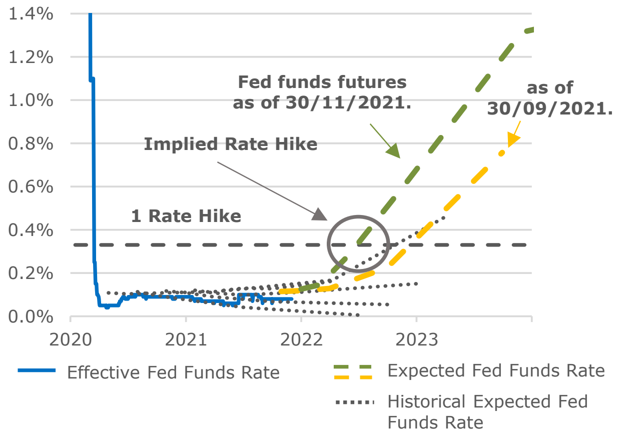
Monthly Spotlight

Change in Fed funds futures imply a sooner rate hike

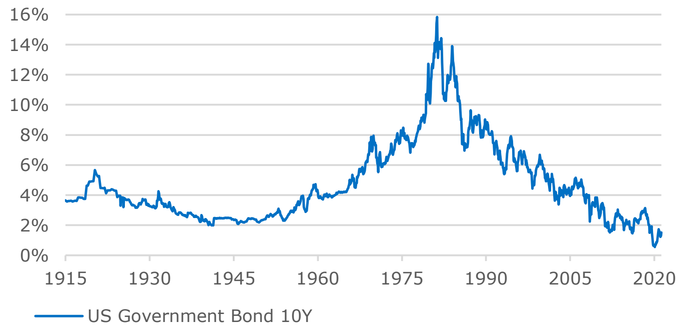
The hawkish tone of Powell's remarks on November 30 surprised the market and the yield curve flattened significantly as a consequence. While long term rates retreated considerably, the Fed funds futures imply a sooner Fed funds rate hike now, as it is illustrated in the chart.

In September, the market did not price in a rate hike until late 2022, but with Powell's shift in toning, a first rate hike is now expected in mid-2022. However, despite the expectation that the Fed may accelerate the pace of taper in its December meeting, it will maintain its dovish bias, as the status of the employment market still receives a high weight.

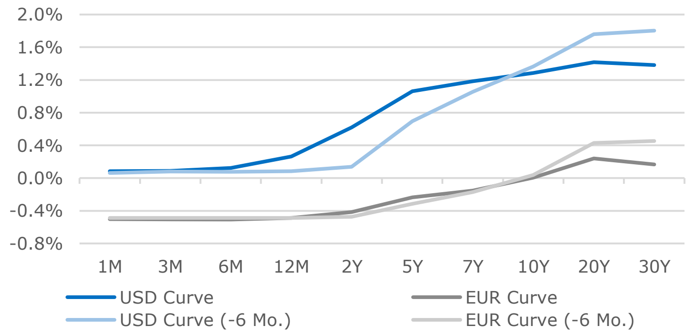


Rates Perspective

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

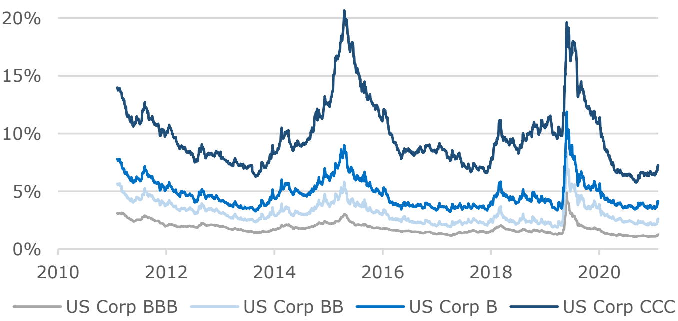


2) Interest Swap Curve: The USD and EUR swap curves steepened at the short end (1-5 yr) and lowered at the long end.



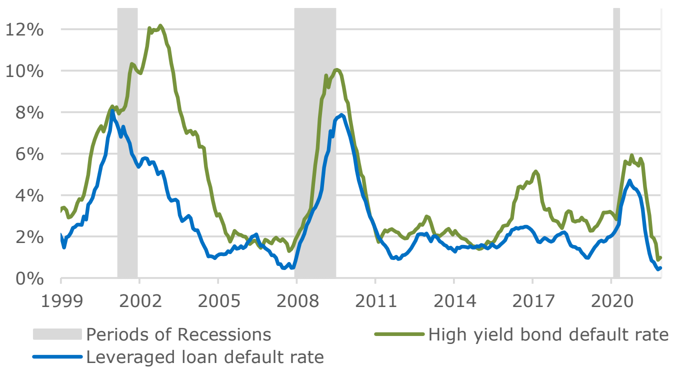
Corporate Perspective

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

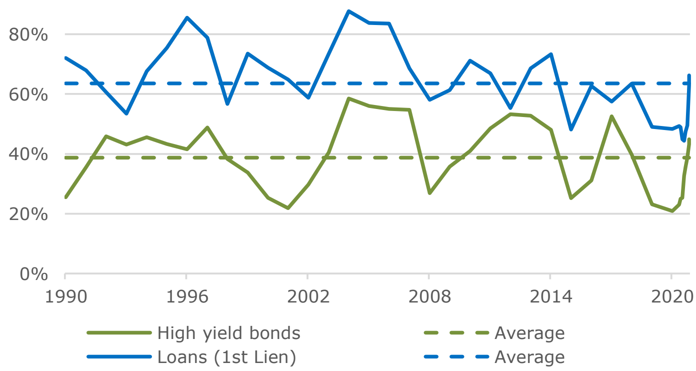


4) EU vs US: Since the Covid-19 spike, credit spreads (OAS) between the USA and EU have converged in tandem to lower levels.

5) Default Rates: Default rates peaked in Q4 2020. HY bond default rates are structurally higher (Ø4.4%) vs. loans (Ø2.7%).



6) Recovery Rates: Recovery rates of leveraged loans are higher (Ø64%) 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	59	+11
AA	67	+11
A	83	+12
BBB	126	+15
BB	263	+45
B	415	+50
CCC	727	+79

Global high yield (bps)

	curr	Δ month
US HY	367	+52
EU HY	371	+49
Asia HY	1377	+39
EM HY	465	+54

CDS spreads (bps)

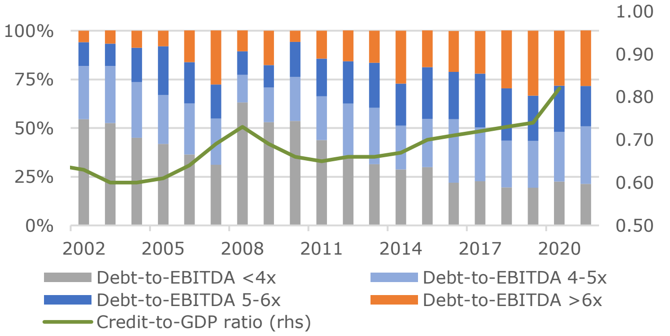
	curr	Δ month
CDX IG - US	58	+5
iTraxx IG - EU	58	+7
CDX HY - US	327	+23
iTraxx XO - EU	288	+27

Loans and CLOs (yld, bps)

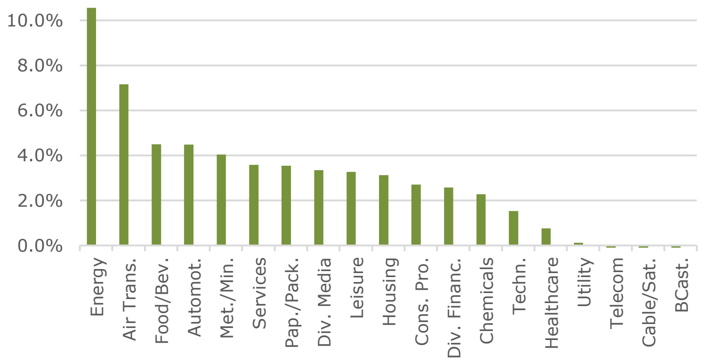
	curr	Δ month
US Loan	406	+27
CLO AAA	175	+23
CLO BBB	427	+22
CLO BB	796	+37

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.

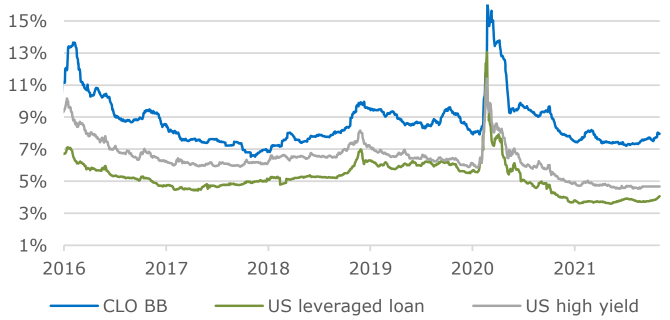


8) YTD Sector High-Yield Returns: The energy sector and Air Transportation lost since last month 2%.



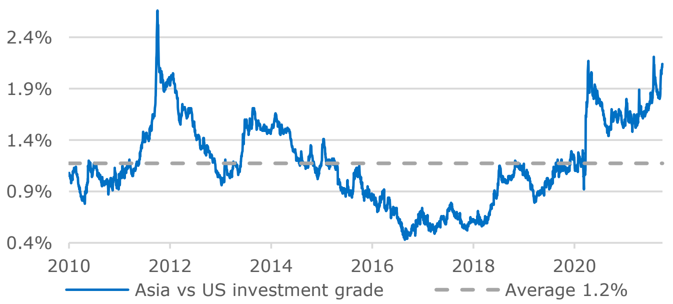
Alternative Perspective

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.

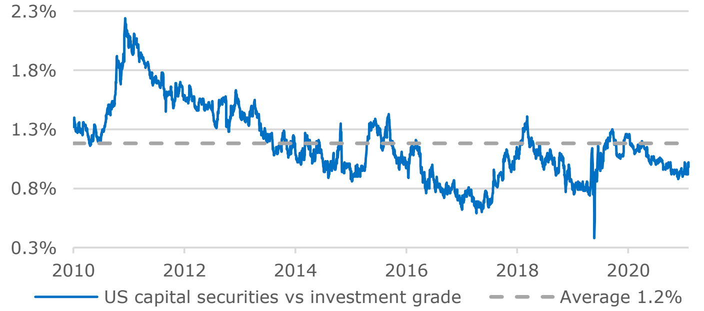


10) CLO Yields: CLOs offer an attractive yield premium over bonds and loans.

11) Asia vs. US: Asian IG spreads spiked in recent months due to the stress in the Chinese real estate development sector.



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

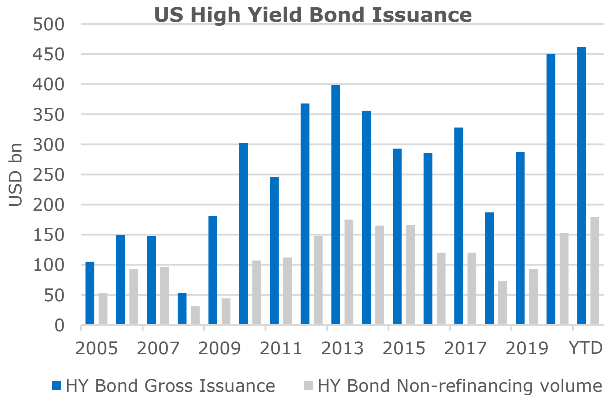


Education Corner

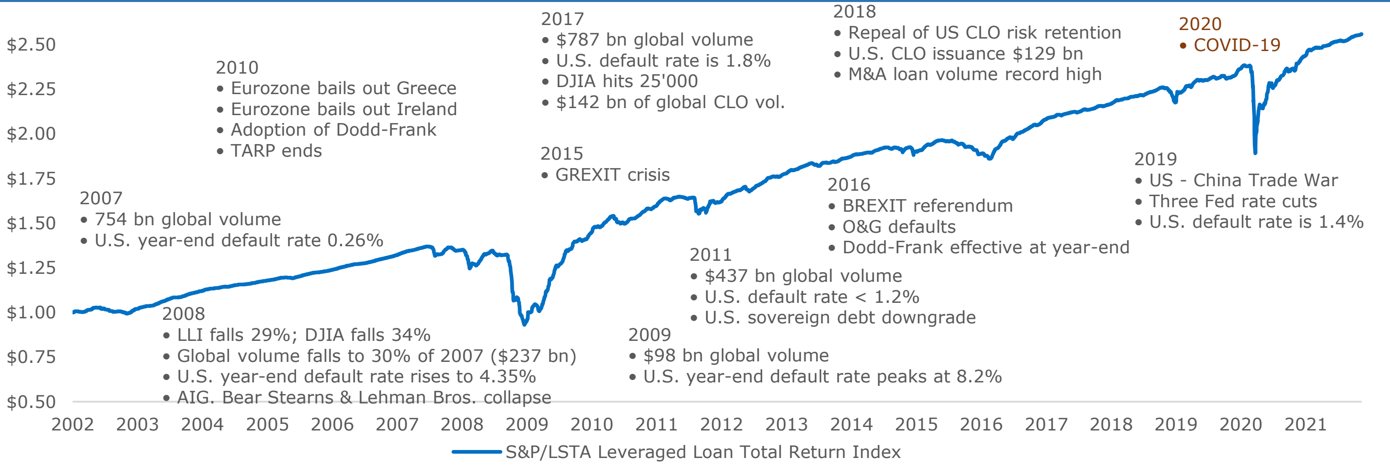
Record high issuance in US high yield bonds in 2021

With USD 462 billion, US high yield companies have raised more debt this year than ever before. The bulk of recent issuance has been for refinancing purposes, as companies take advantage of strong market conditions to clear upcoming debt maturities. But non-refinancing volumes also reached a record high with USD 179 billion.

The low yield environment has allowed high yield issuers to come to market with record-low coupons. The average yield of the US high yield market is 4.7% (see chart 9). In addition, companies have been refinancing further out the curve into longer maturities. Strong issuances are expected to last for the upcoming years.



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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