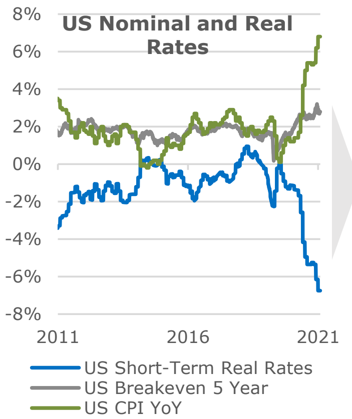
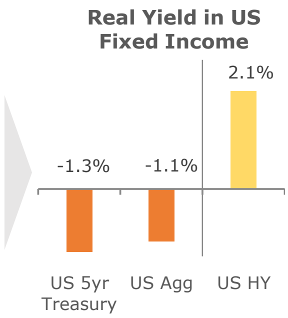
Monthly Spotlight

Real rates reach record low levels of -6.8% in USD

Investors have somehow learnt to deal with low or negative nominal yields. But now, as real yields fell to record low levels such as -6.8% in the example for short-term real rates (see blue line in graph), bond investors need to wake up as this results in severe damage for their personal wealth. Of course, inflation rates are expected to peak soon, but even if inflation rates normalized towards 3% and short-term rates increased to 1%, a real yield of -2% will still persist, what will lead to double digit losses in purchasing power in a timeframe of only 2-3 years (i.e. 2021-2023). Taking into account a more moderate number such as the 5-year US breakeven rate, the negative yield for IG bonds still remains. It's time to look for alternatives!

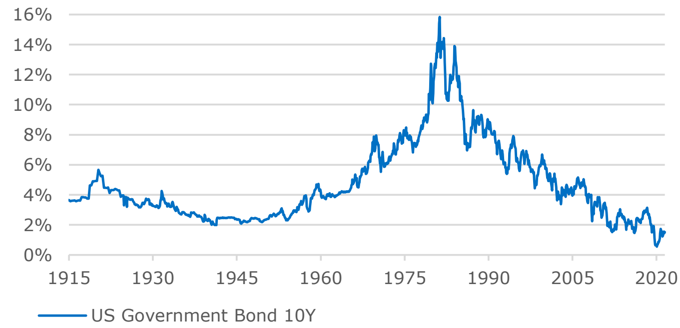




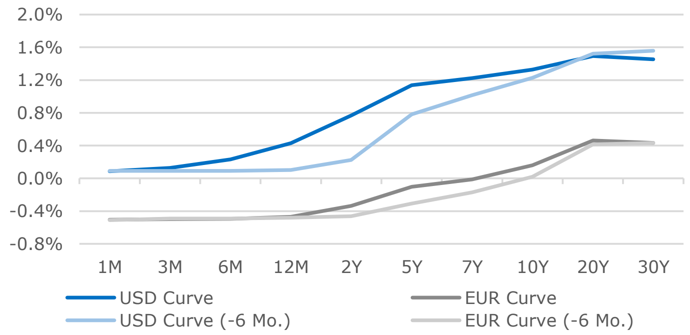
Real rate represented by nominal yield-to-maturity minus US Breakeven 5 year rate.

Rates Perspective

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

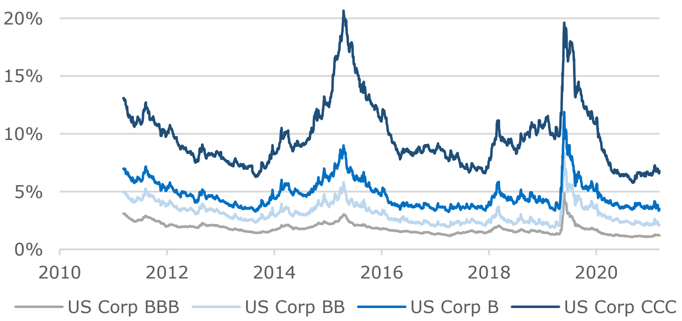


2) Interest Swap Curve: The USD swap curve steepened between 1-2 yrs, while the EUR curve remained unchanged over the last 6 Mo.

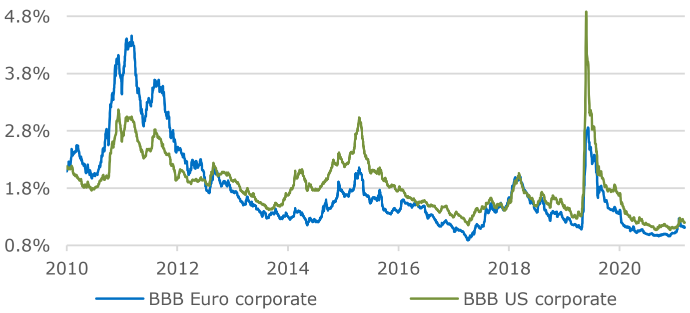


Corporate Perspective

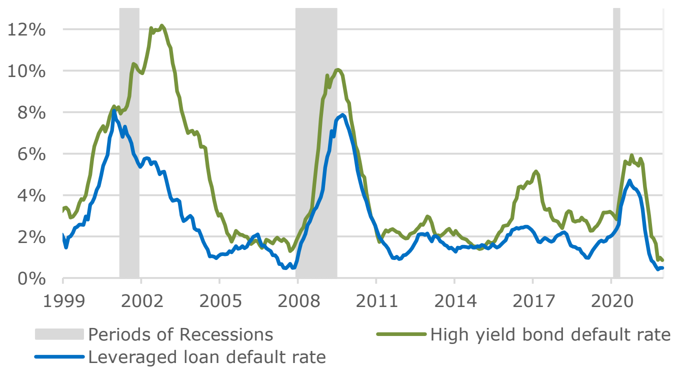
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



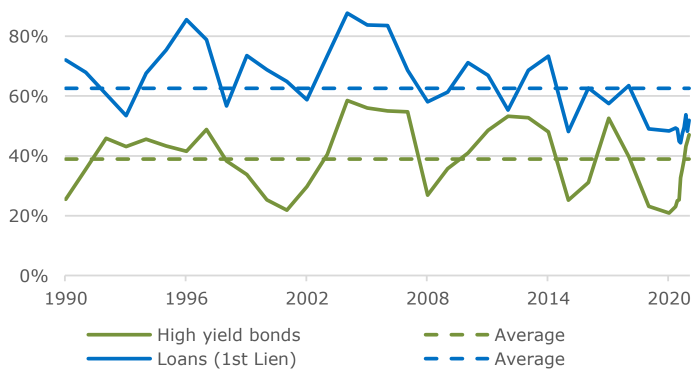
4) EU vs US: Since the Covid-19 spike, credit spreads (OAS) between the USA and EU have converged in tandem to lower levels.



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 (Ø63%) 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	51	-8
AA	62	-5
A	78	-5
BBB	121	-5
BB	211	-52
B	351	-64
CCC	678	-49

Global high yield (bps)

	curr	Δ month
US HY	310	-57
EU HY	331	-40
Asia HY	1118	-259
EM HY	407	-58

CDS spreads (bps)

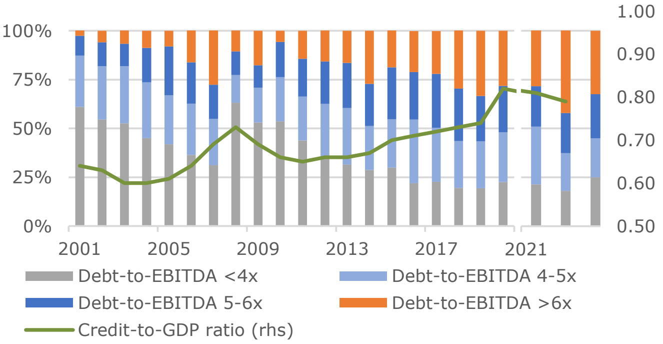
	curr	Δ month
CDX IG - US	50	-8
iTraxx IG - EU	48	-10
CDX HY - US	293	-34
iTraxx XO - EU	242	-47

Loans and CLOs (yld, bps)

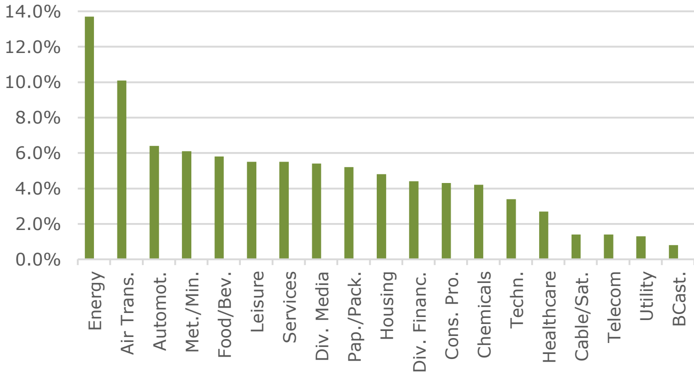
	curr	Δ month
US Loan	388	-18
CLO AAA	197	+22
CLO BBB	441	+14
CLO BB	811	+15

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 Q3 2021 compared to Q4 2020.

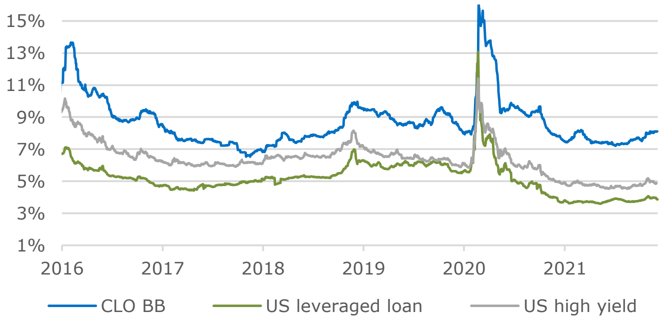


8) YTD Sector High-Yield Returns: Total return of the energy and air transportation sector are highest in 2021.

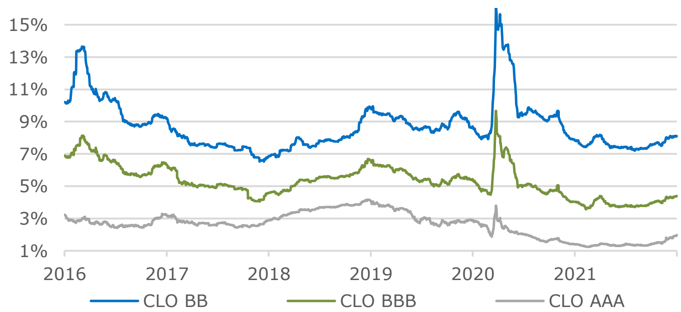


Alternative Perspective

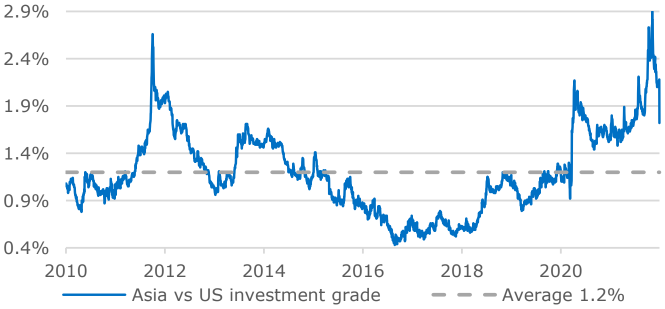
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



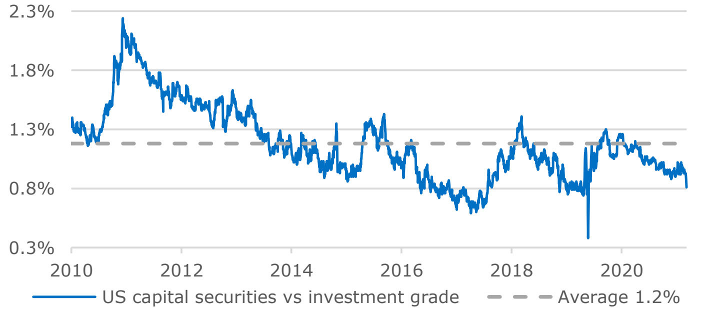
10) CLO Yields: CLOs offer an attractive yield premium over bonds and loans.



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

Asia's record high default rates in 2021

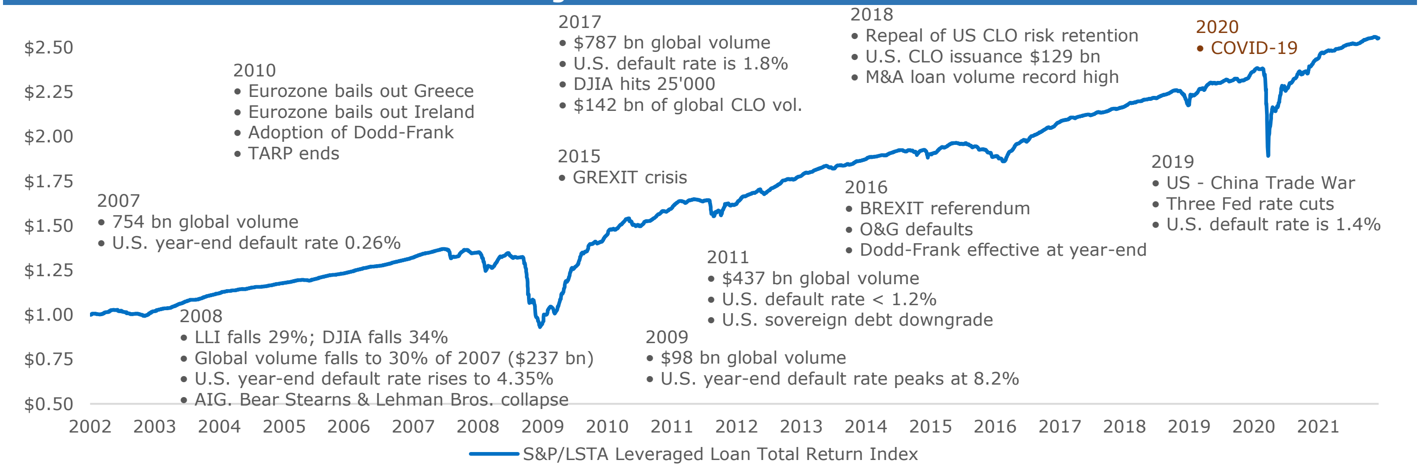
The Chinese property sector is facing a mix of a solvency and liquidity crisis that started with a policy-induced tightening of funding conditions and is now being worsened by slower property sales. This will lead to record high year-end default rates of around 13.6% in China and 9.0% in Asia by the end of 2021 as the table below illustrates.

								2022F*	
Default Rates	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021F**	**Base Case**	**Low Case**
Asia	3.1%	1.0%	1.0%	2.5%	1.8%	3.4%	9.0%	6.5%	3.6%
China	4.8%	0.4%	0.2%	1.9%	1.8%	4.3%	13.6%	9.7%	5.1%
Asia ex China						1.5%	0.8%	1.2%	1.2%

**Corporate default rates are par weighted. Year-end 2021 forecasts and 2022 scenarios are based on JP Morgan estimates.*

According to JP Morgan, default rates in Asia and especially in China are expected to decline in the base case for 2022 to 6.5% and 9.7%, respectively, but remain at very elevated levels. Meaningful policy relaxation and a normalization of markets would help to bring default rates to lower levels.

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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