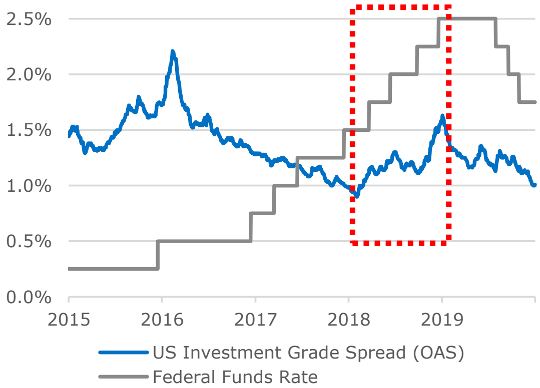
Monthly Spotlight

Credit spreads widen most when economic cycle is mature

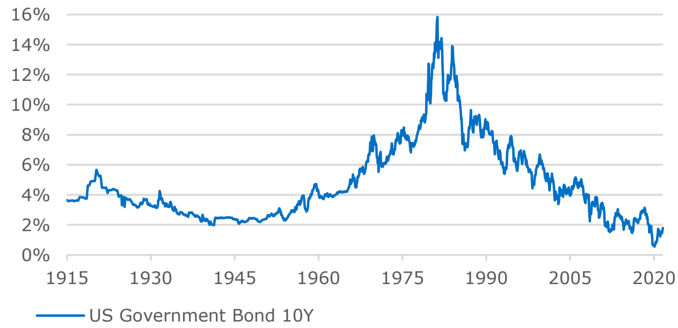
Looking back at the last rate hike cycle (2015-2018), credit spreads for both high yield and investment grade bonds (see blue line) were not immediately negatively affected when the Fed rates started to take off. However, the more mature the economic cycle became, the stronger the negative effect was, as reflected in the widening of spreads in 2018 and the corresponding negative market reaction. What can we expect from the current credit cycle? While there are some similarities, such as the fact that we are dealing with inflation worries, there are also many differences, most notably supply chain disruptions, pent-up consumer demand and fiscal support that is likely to stretch the current economic cycle. However, while the exact experience may not repeat itself, it will certainly rhyme.

US High Grade Spreads over Fed Funds

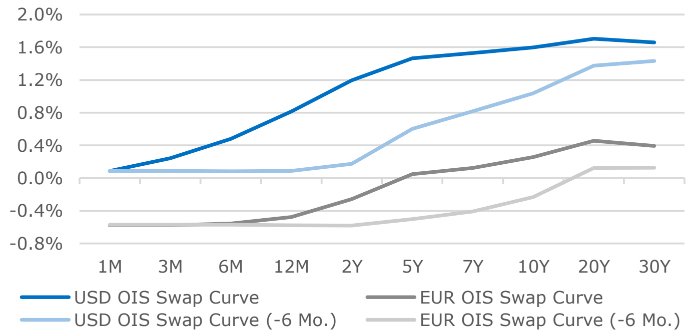


Rates Perspective

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

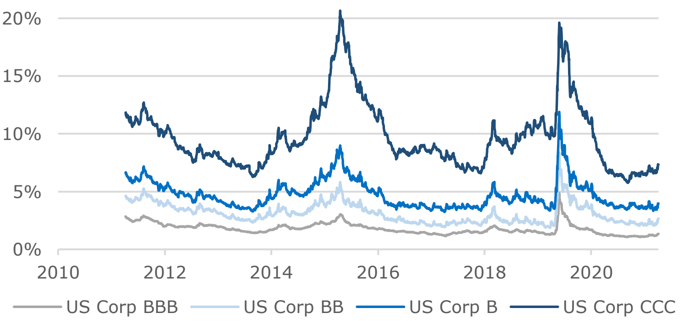


2) Interest Swap Curve: The USD curve steepened predominantly at shorter tenors, while the EUR curve steepened slightly at longer tenors.

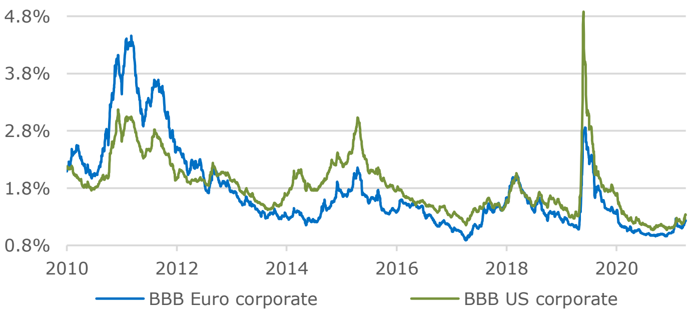


Corporate Perspective

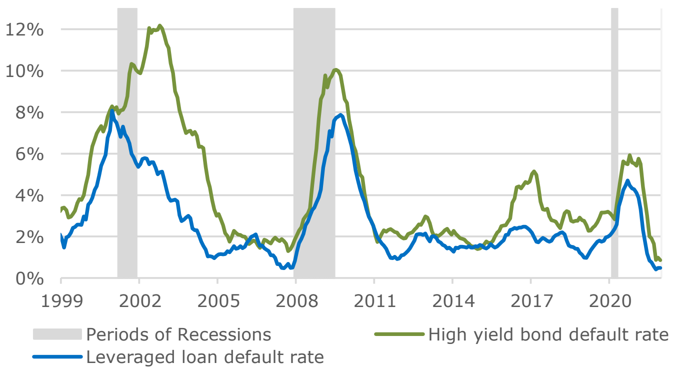
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



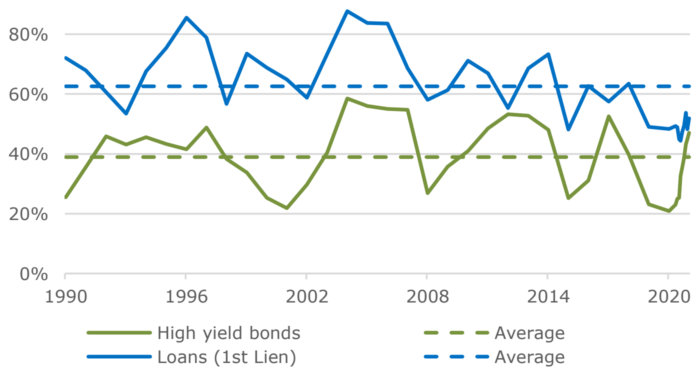
4) EU vs US: Credit spreads (OAS) between the US and EU have narrowed since the beginning of 2022.



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	65	+14
AA	72	+10
A	89	+11
BBB	134	+13
BB	266	+55
B	396	+45
CCC	734	+56

Global high yield (bps)

	curr	Δ month
US HY	363	+53
EU HY	367	+36
Asia HY	1220	+102
EM HY	446	+39

CDS spreads (bps)

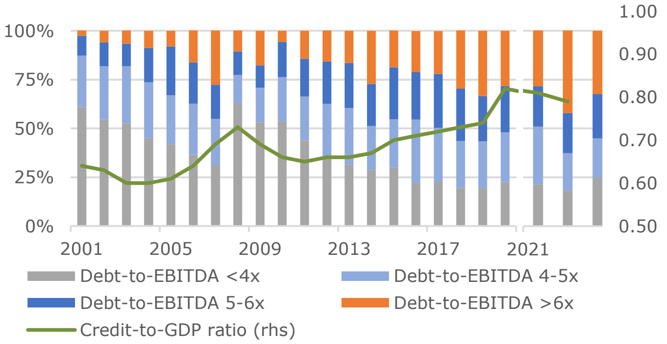
	curr	Δ month
CDX IG - US	60	+11
iTraxx IG - EU	59	+11
CDX HY - US	339	+46
iTraxx XO - EU	286	+44

Loans and CLOs (yld, bps)

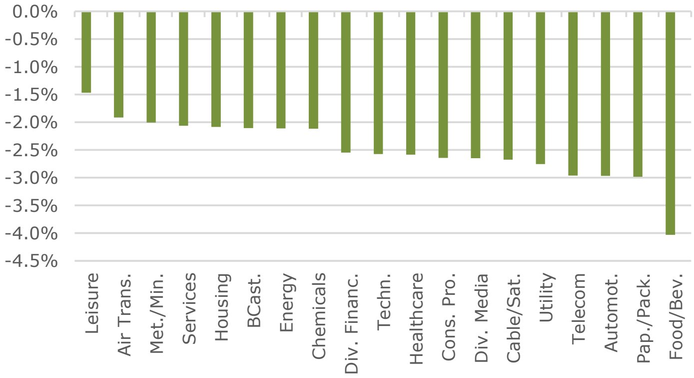
	curr	Δ month
US Loan	401	+13
CLO AAA	216	+18
CLO BBB	472	+31
CLO BB	835	+24

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.

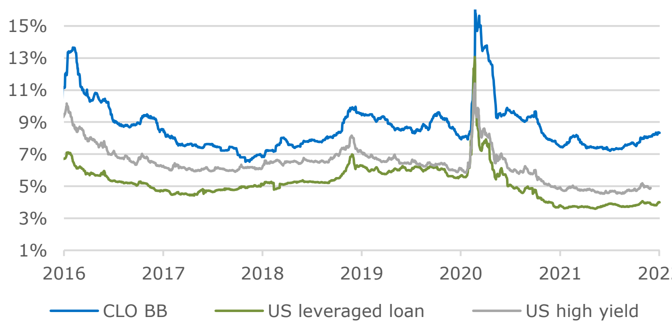


8) YTD Sector High-Yield Returns: Total return of food and beverage suffered the most, while the US HY index is down 2.8%.

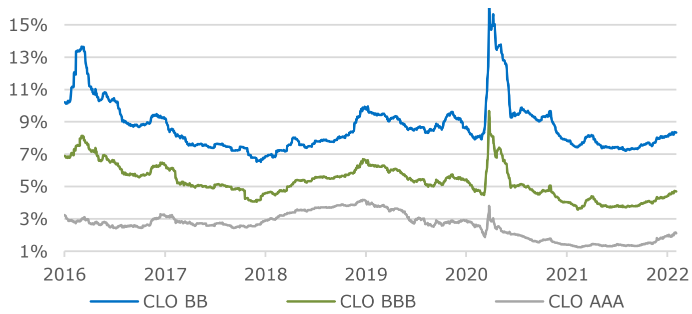


Alternative Perspective

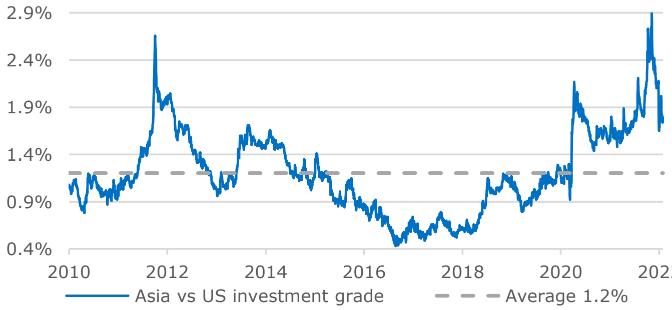
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



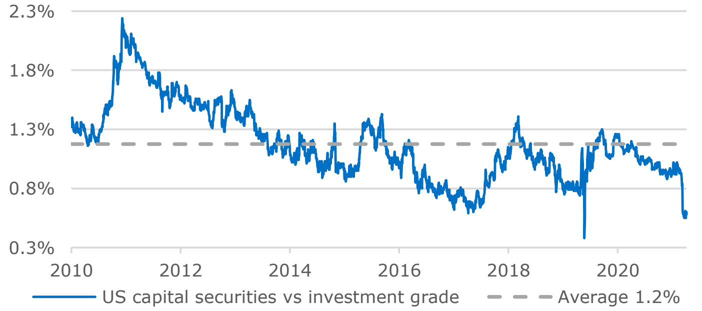
10) CLO Yields: CLOs offer an attractive yield premium over bonds and loans.



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

Transition from LIBOR - Overview of some interbank lending rates

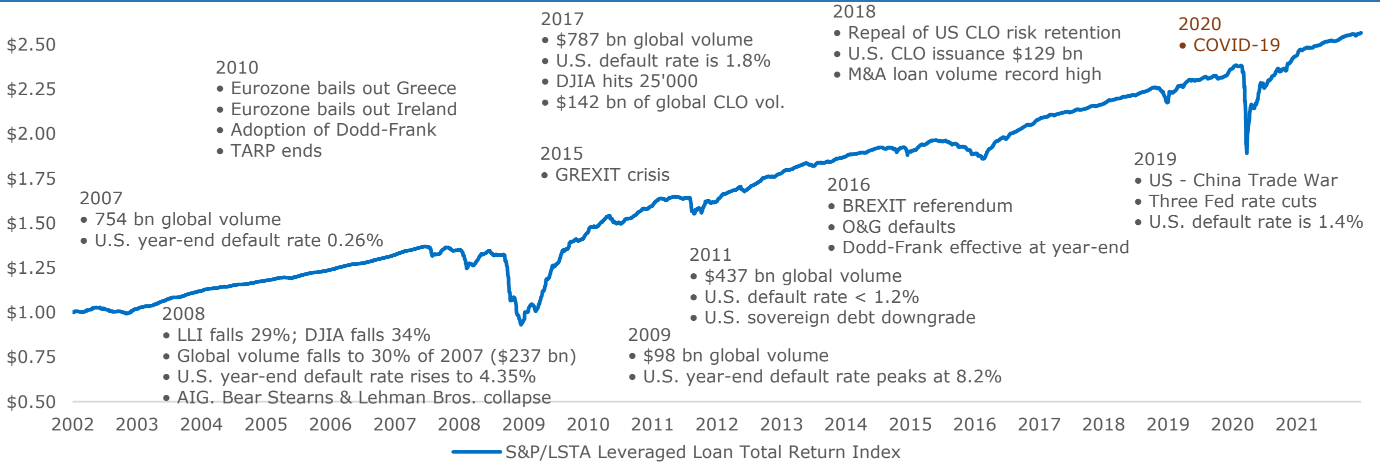
Since LIBOR rates are no longer applicable to new transactions, the alternative rates are based on actual transactions in the overnight money market or repo market and are generally published as overnight rates. This is a considerable change from LIBOR rates, which are published in different maturities (e.g. 1 month, 3 months). Rates can be compounded in two ways to reflect different maturities:

- **Ex-post approach:** Compounding historical rates of a period of time (e.g. 3m) by looking back (general guidance).
- **Ex-ante approach:** Overnight Indexed Swaps (OIS) by using the overnight rates for computing the floating leg.

Alternative reference rate	**SOFR** (Secured Overnight Financing Rate) *	**SONIA** (Sterling Overnight Interbank Average Rate)	**€STR** (Euro-Short Term Rate) / **EURIBOR** **	**SARON** (Swiss Average Rate Overnight) ***
Secured / Unsecured	Secured by T-bonds	Unsecured	Unsecured	Secured by high-grade bonds

* Continued publication of USD LIBOR rates, but no new contracts based on USD LIBOR from January 2022.
** €STR replaced EONIA at the end of 2021. There is no date yet for the EURIBOR to be replaced.
*** SARON has three fixings per day, 12:00, 16:00, 18:00 CET T+0).

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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