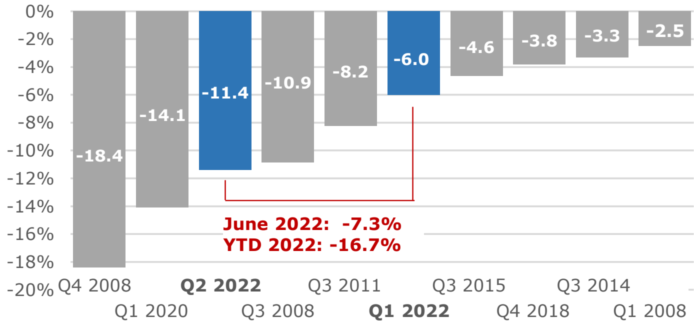
Monthly Spotlight

High yield valuations imply significant economic slowdown

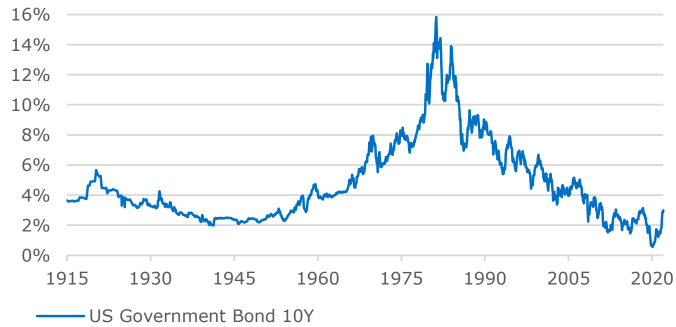
Fixed income markets suffered in June another painful month. For example, high yield ("HY") bonds are down -7.3% and -16.7% YTD, the worst half-year performance since the GFC in 2008. The sell-off this year has been deep, but the pattern has not matched that of previous ones as it was primarily driven by higher rates/input costs. The HY market has seen significant outflows YTD from ETFs and retail funds of nearly USD 35 bn, the highest on record. US HY bond spreads "ex-energy" trade now in the cheapest decile since ~10 years and offer a YTW close to ~9% p.a. A further increase would anticipate a severe recession ahead.

Top 10 largest quarterly drawdowns of global high yield over the last 20 years in given economic cycle.

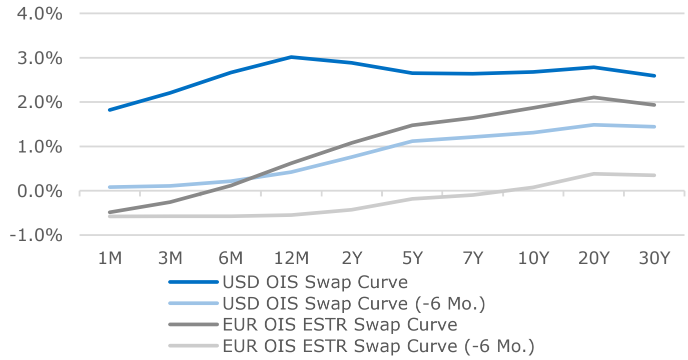


Rates Perspective

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

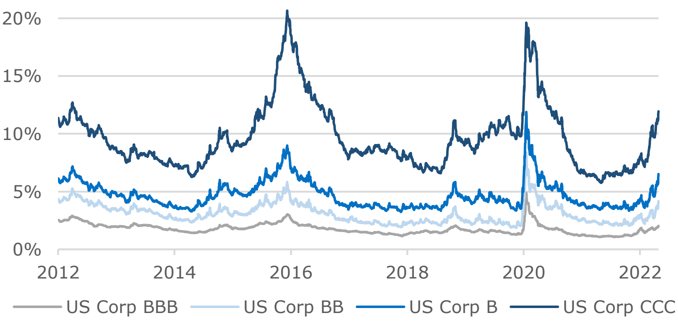


2) Interest Swap Curve: The USD and EUR curve steepened predominantly at shorter and medium tenors.

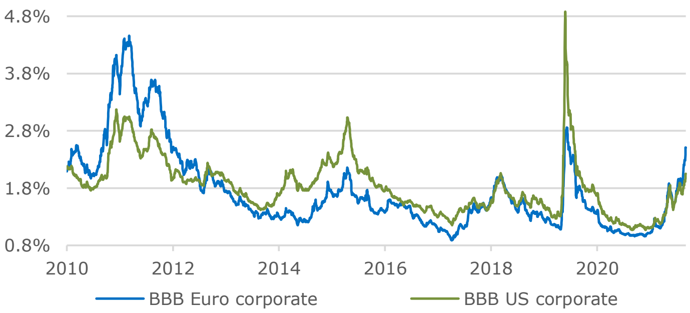


Corporate Perspective

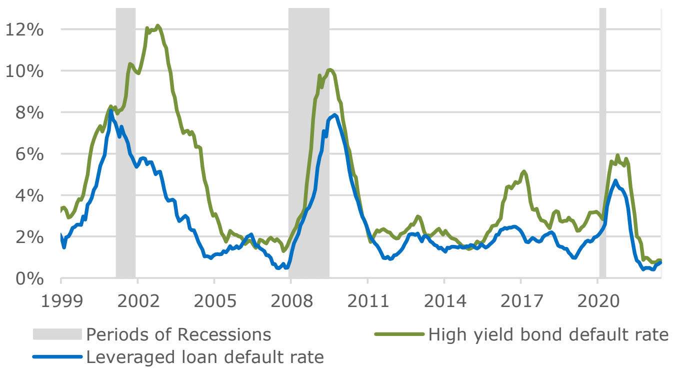
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



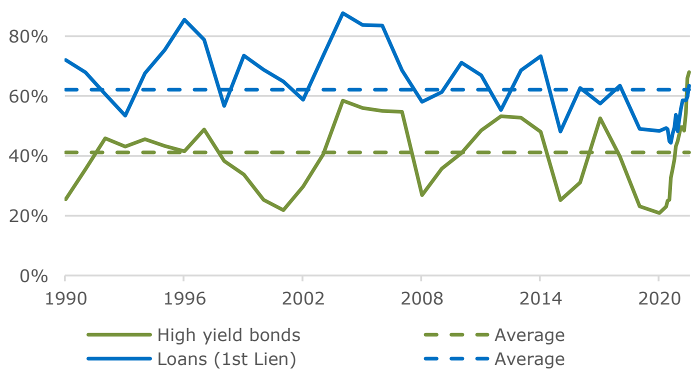
4) EU vs US: Credit spreads (OAS) between the US and EU have narrowed since the beginning of 2022.



5) Default Rates: HY bond default rates are structurally higher (Ø4.3%) vs. loans (Ø2.7%).



6) Recovery Rates: Recovery rates of leveraged loans are higher (Ø62%) vs. high yield bonds (Ø41%) 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	0	-62
AA	0	-83
A	0	-113
BBB	204	+31
BB	417	+143
B	652	+185
CCC	1194	+211

Global high yield (bps)

	curr	Δ month
US HY	587	+165
EU HY	641	+167
Asia HY	1381	+198
EM HY	676	+160

spread tightening (positive price action)

spread widening (negative price action)

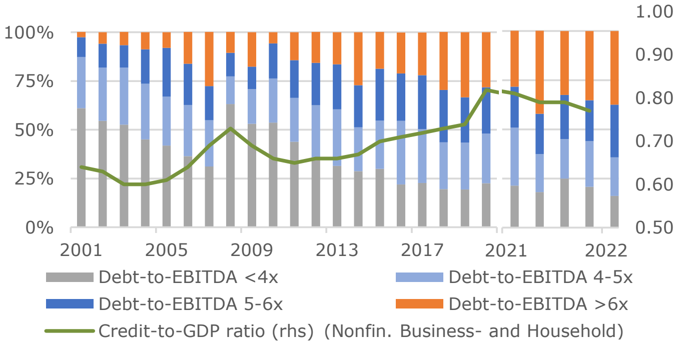
CDS spreads (bps)

	curr	Δ month
CDX IG - US	101	+22
iTraxx IG - EU	119	+34
CDX HY - US	579	+122
iTraxx XO - EU	580	+159

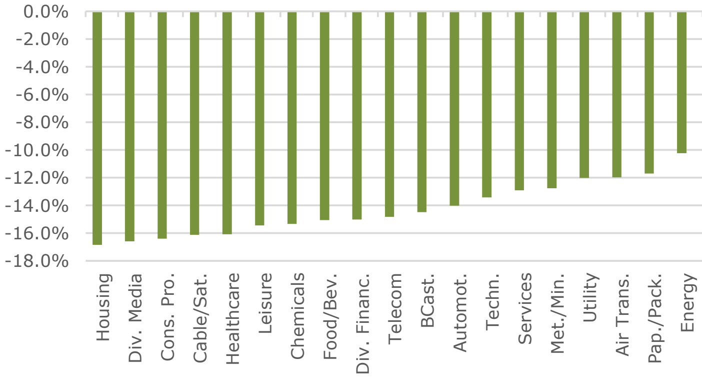
Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	694	+108
CLO AAA	492	+48
CLO BBB	772	+43
CLO BB	1232	+99

7) US Leverage: Debt-to-EBITDA ratio of US companies remained stable at elevated levels.

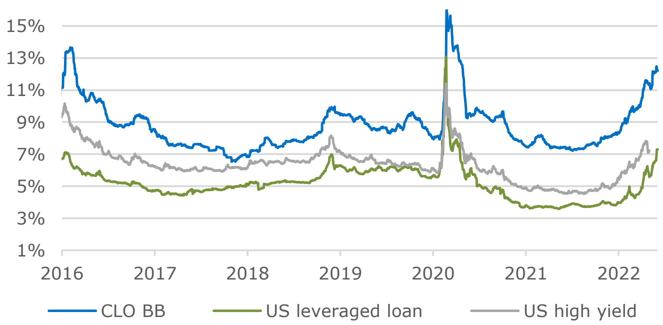


8) YTD Sector High-Yield Returns: Almost all sectors are suffering YTD.



Alternative Perspective

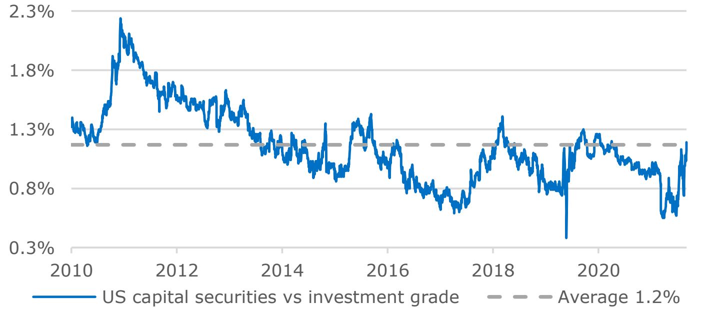
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



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

11) Asia vs. US: Asian IG spreads are elevated primarily driven by 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.

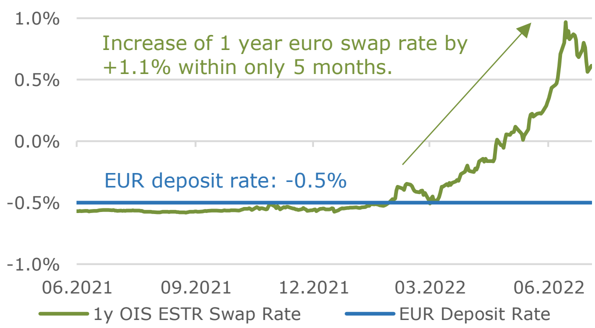


Education Corner

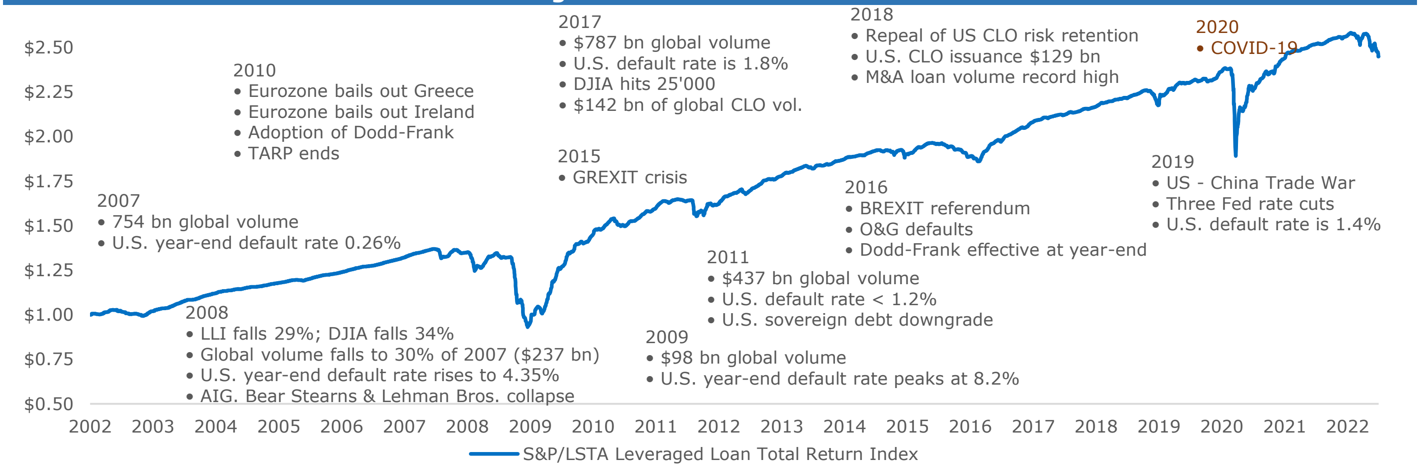
EUR Swaps imply short-term rates to climb above 0.5%

ECB hesitated to hike rates earlier this year but signalled a 25 bps interest rate hike in July and said a bigger increase may be needed in September as inflationary pressures were increasing and broadening. However, the market had anticipated this some time ago, and the risk-free 1-year swap rate started to shoot up at the end of the first quarter '22, reaching 0.65% on June 30. This sharp increase has led to high volatility in the bond market, resulting in heavy losses in short duration bonds, as can be seen in the "ICE BofA 1-3 Year Euro Corporate" index, which closed YTD at -4.4%. The ongoing volatility in the market for short-term Euro bonds is mainly due to uncertainty about the ECB's future response. However, it is a healthy development that interest rates start to normalize and within only a matter of few months, the below-zero policy is a relict from the past.

EUR Riskfree Market vs Deposit Rate



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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