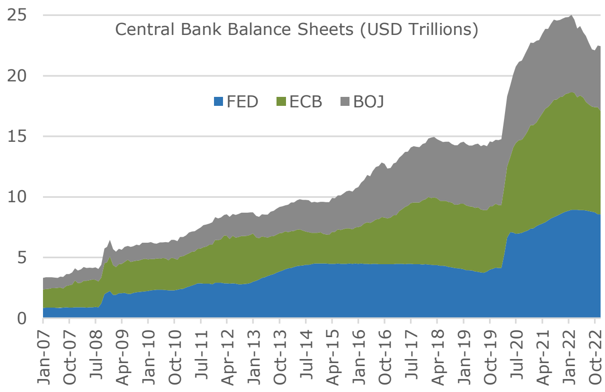
Monthly Spotlight

Central banks' balance sheets changed course

Central banks moved away from easy money policies and changed course. Not only the interest rate hikes but also the liquidity withdrawals have affected the markets and will continue to do so. After years of quantitative easing with ballooning balance sheets, the regime shift means that central banks will no longer backstop markets - unless there is a severe recession.

The withdrawal of liquidity by central banks through unwinding of maturing bond holdings, combined with active selling and reverse repo transactions, has increased volatility in all asset classes.

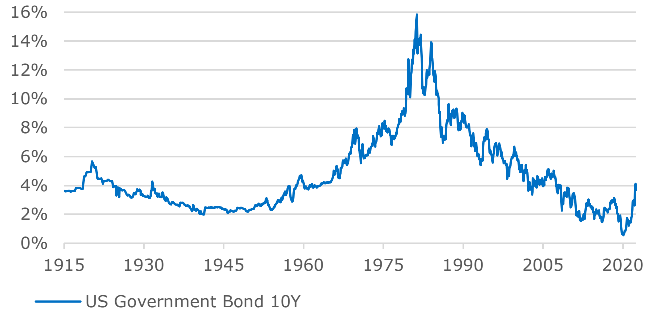
Understanding the ongoing impact of central bank flows in 2023 is a key alpha contributor for managers of liquid fixed income mandates.



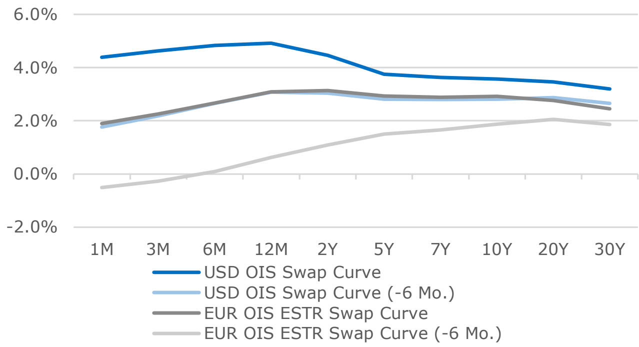
Source: Bloomberg

Rates Perspective

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

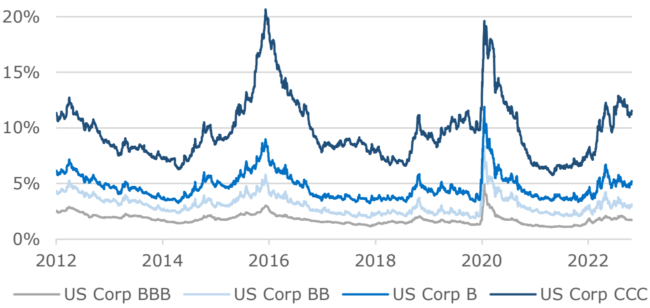


2) Interest Swap Curve: The USD and EUR curve further inverted while shorter tenors continued to increase.

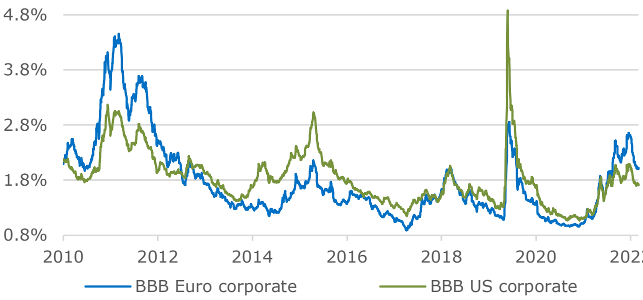


Corporate Perspective

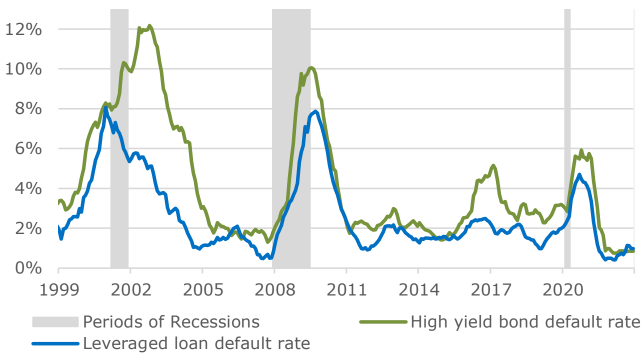
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



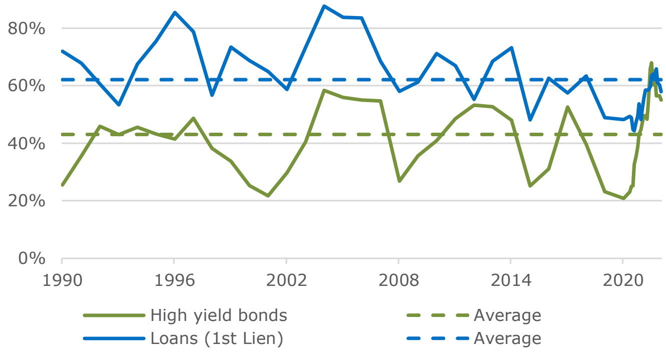
4) EU vs US: Credit spreads (OAS) between the US and EU have started to widen since the second half of 2022.



5) Default Rates: HY bond default rates are structurally higher (Ø4.2%) vs. loans (Ø2.7%).



6) Recovery Rates: Recovery rates of leveraged loans are higher (Ø62%) vs. high yield bonds (Ø43%) 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	57	+4
AA	76	-1
A	113	-4
BBB	171	-6
BB	309	+12
B	519	+40
CCC	1153	+23

Global high yield (bps)

	curr	Δ month
US HY	479	+24
EU HY	494	-12
Asia HY	1001	-91
EM HY	540	+5

CDS spreads (bps)

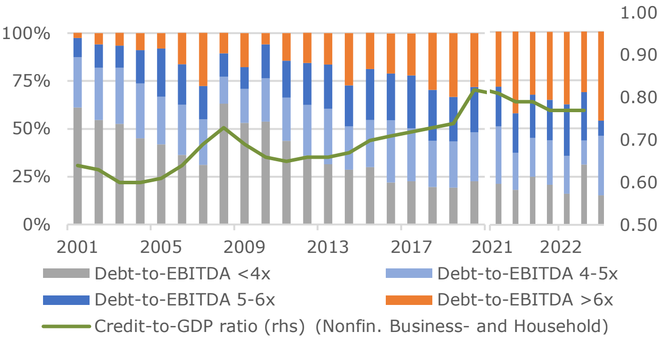
	curr	Δ month
CDX IG - US	82	+6
iTraxx IG - EU	91	-1
CDX HY - US	484	+31
iTraxx XO - EU	474	+15

Loans and CLOs (yld, bps)

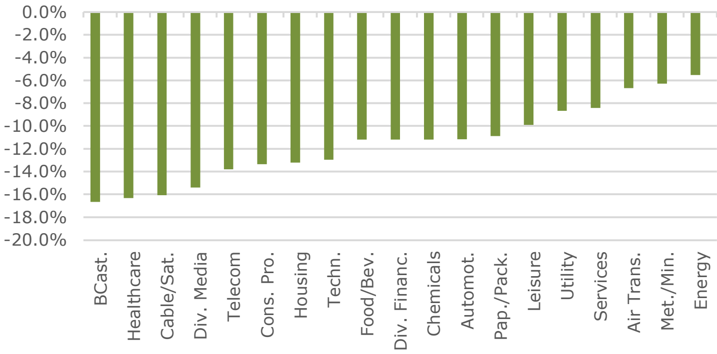
	curr	Δ month
US Loan	910	+35
CLO AAA	609	+9
CLO BBB	912	+27
CLO BB	1404	+33

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

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

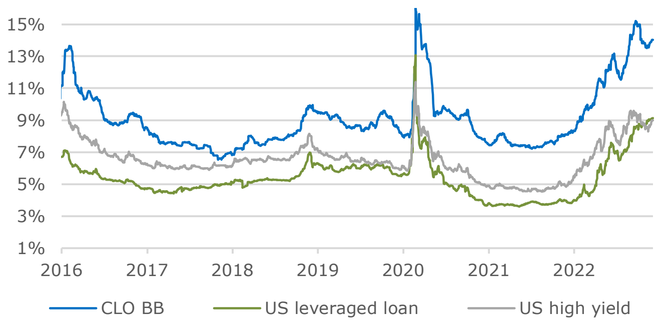


8) YTD Sector High-Yield Returns: All sectors have continued to suffer YTD.

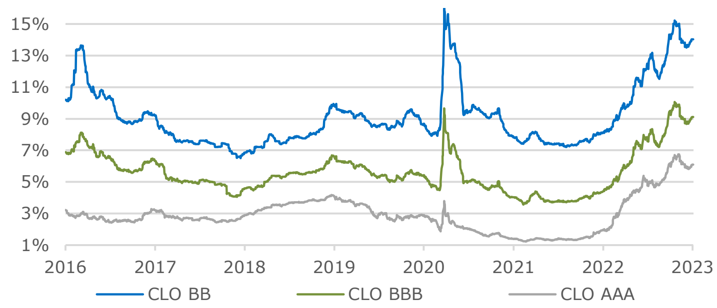


Alternative Perspective

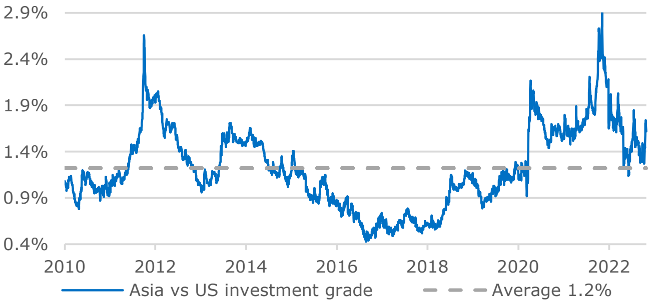
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



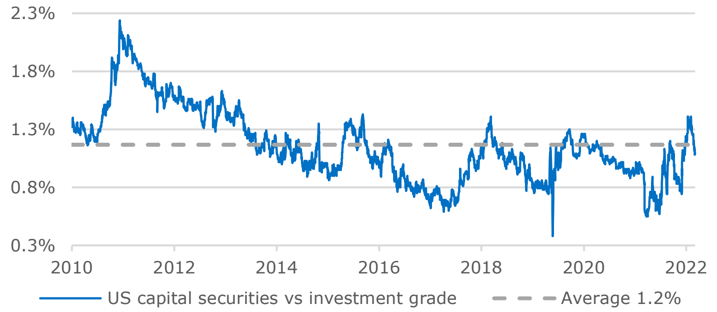
10) CLO Yields: CLOs offer an attractive yield premium over bonds and loans.



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.



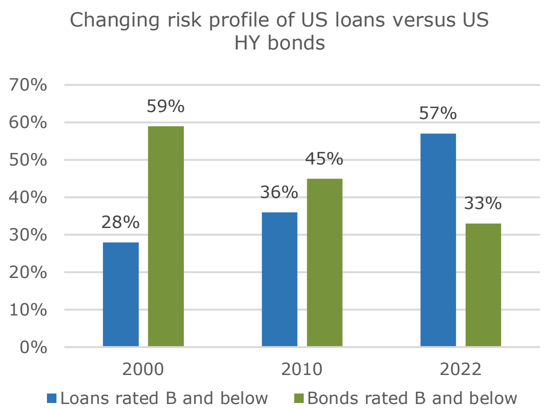
Education Corner

Increased risk-/return profile of US loans vs. US HY bonds

Since 2000 the share of US loans rated B and below has more than doubled and now accounts for 57% of the total loan market. In contrast, the weight of HY bonds rated B and below has almost halved to 33%, partly due to the recent rise of "fallen angels" (IG bonds downgraded from BBB to BB) and upgrades of formerly stressed commodity sector issuers (e.g. from B to BB).

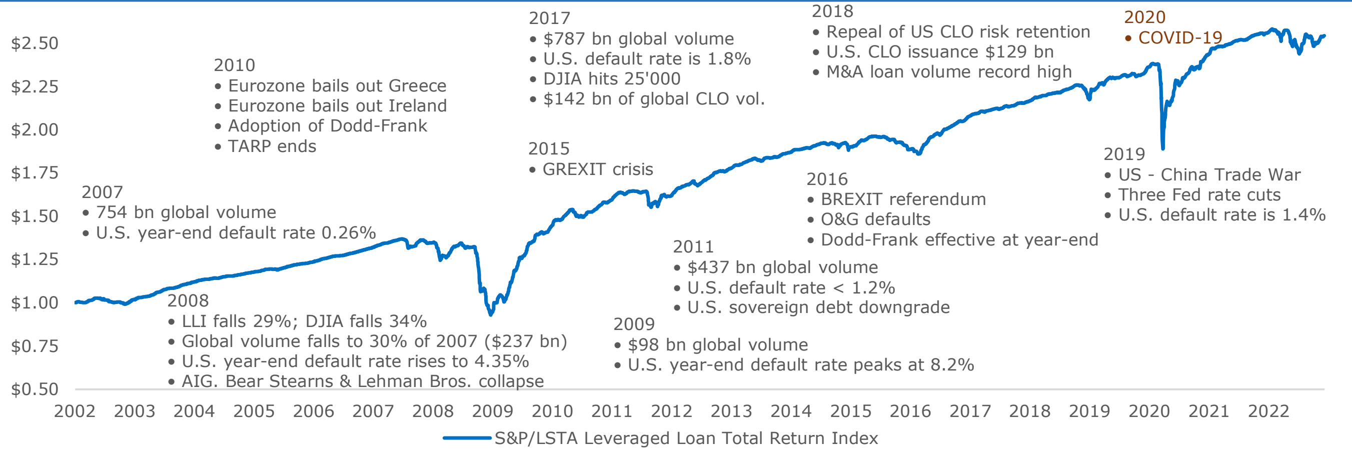
Out of the B and below rated loans, half are assigned a B- rating. Their prices tend to be more volatile because CLO managers, one of the largest loan investors, have limits on CCC-rated positions and actively offload their B- holdings in case of downgrade risks.

However, this general increase in risk of US loans compared to US HY bonds has also led to higher income of loans compared to HY bonds. The current average yield of 10.2% for U.S. loans (versus 8.9% for US HY bonds) well illustrates their higher risk/return profile.



Source: ICE BAML, S&P Leveraged Loans Index

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

Contact Information:
Alpinum Investment Management AG
Talstrasse 82
CH-8001 Zurich
Tel: +41 43 888 79 30
Fax: +41 43 888 79 31
alpinumim.com