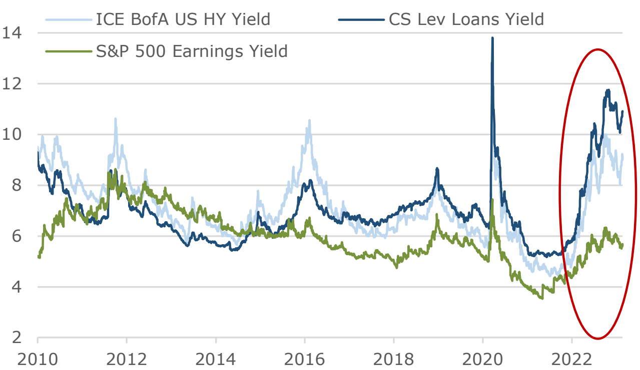
Monthly Spotlight

Credit yields exceed earnings yield on equities

Credit yields are now significantly higher than earnings yields on equities. HY bonds are currently yielding 8.5% and loans 10.4%. Meanwhile, earnings yield on equities ranges from 5.1% current to 7.5% when adjusted for the long term inflation expectations published by the FED.

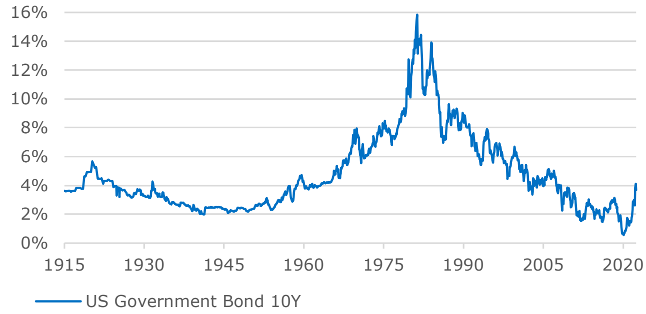
Most of the increase in credit yields is attributable to rising rates. One of the fastest monetary tightening cycles in history have not yet triggered further credit spreads widening. Instead the current spreads remain close to their early 2022 levels. While impact of the central banks' tightening on real economy remains uncertain, a relatively cheaper and safer credit is increasingly more attractive than equity.

Credit yields versus earnings yield on equities

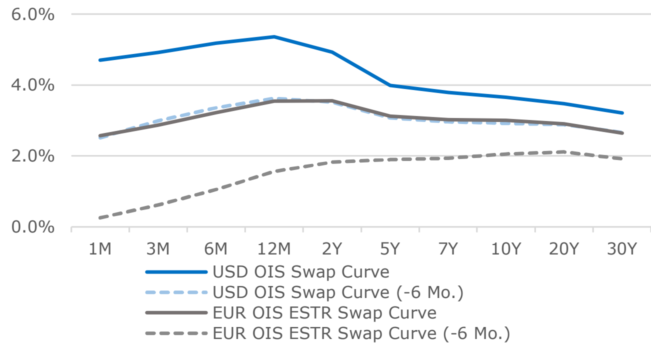


Rates Perspective

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

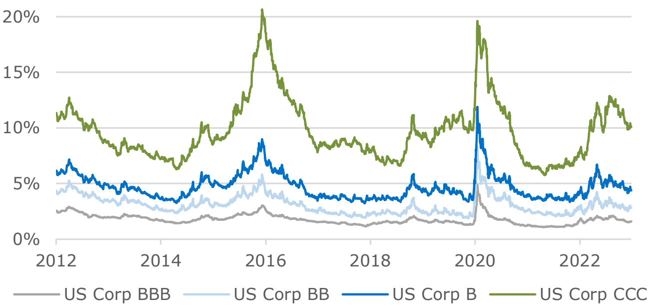


2) Interest Swap Curve: The USD and EUR curve further inverted while shorter tenors continued to increase.



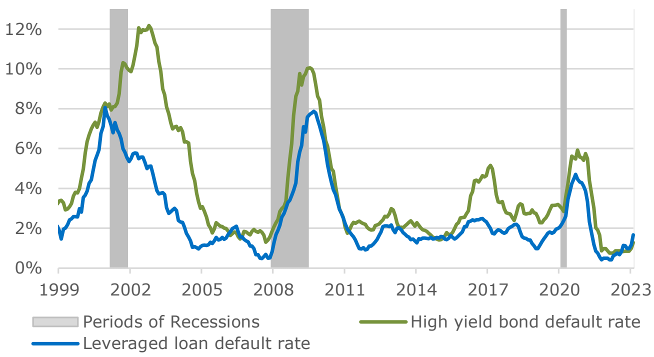
Corporate Perspective

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

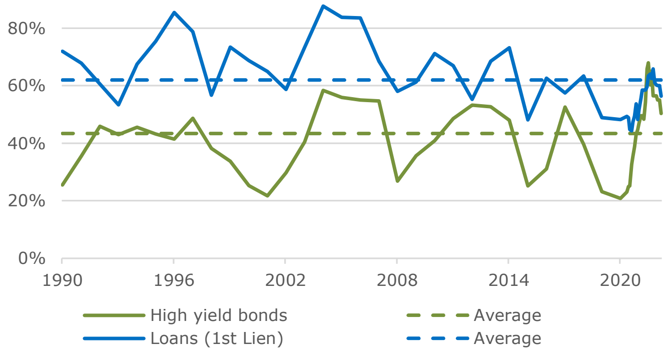


4) EU vs US: Credit spreads (OAS) between the US and EU have started to widen since the second half of 2022.

5) Default Rates: HY bond default rates are structurally higher (Ø4.2%) vs. loans (Ø2.6%).



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	59	+2
AA	75	-1
A	106	-7
BBB	160	-11
BB	282	-27
B	437	-82
CCC	1010	-143

Global high yield (bps)

	curr	Δ month
US HY	422	-57
EU HY	421	-73
Asia HY	872	-129
EM HY	486	-54

spread tightening (positive price action)

spread widening (negative price action)

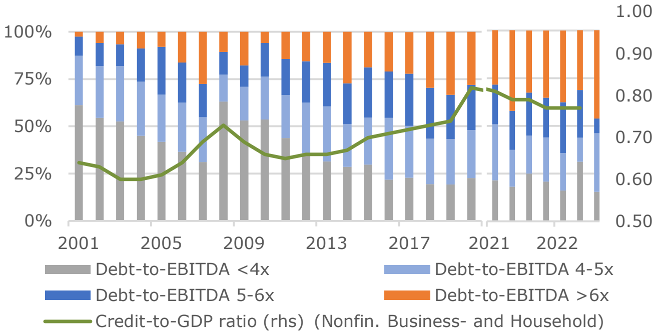
CDS spreads (bps)

	curr	Δ month
CDX IG - US	71	-11
iTraxx IG - EU	79	-11
CDX HY - US	430	-54
iTraxx XO - EU	414	-60

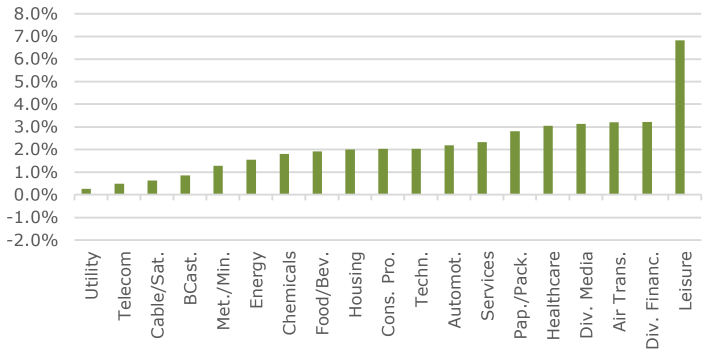
Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	891	-19
CLO AAA	555	-54
CLO BBB	834	-78
CLO BB	1323	-81

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

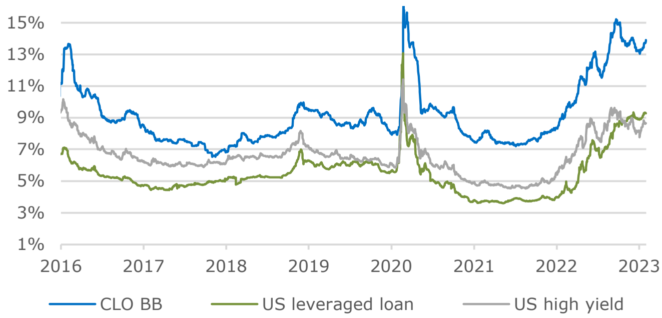


8) YTD Sector High-Yield Returns: All sectors have recovered YTD, with leisure outperforming significantly.

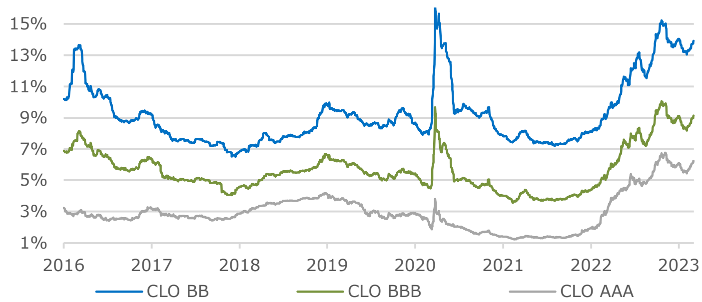


Alternative Perspective

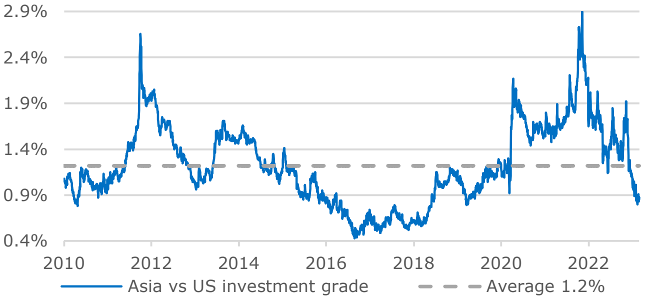
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



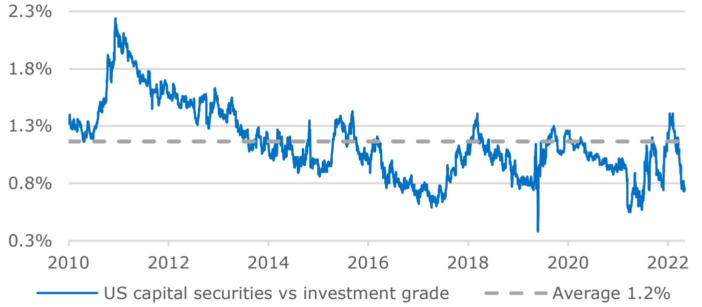
10) CLO Yields: CLOs offer an attractive yield premium over bonds and loans.



11) Asia vs. US: Asian IG spreads have tightened thanks to China's economy reopening and US inflation easing.



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



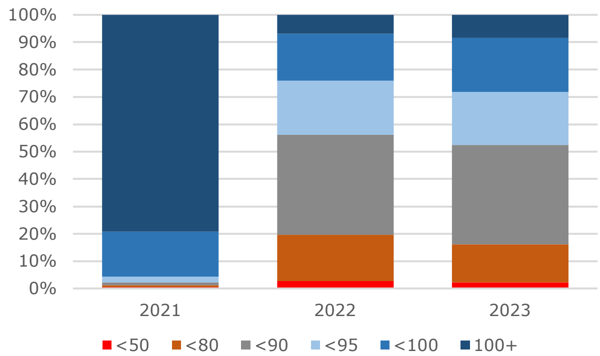
Education Corner

HY bonds continue trading with discount

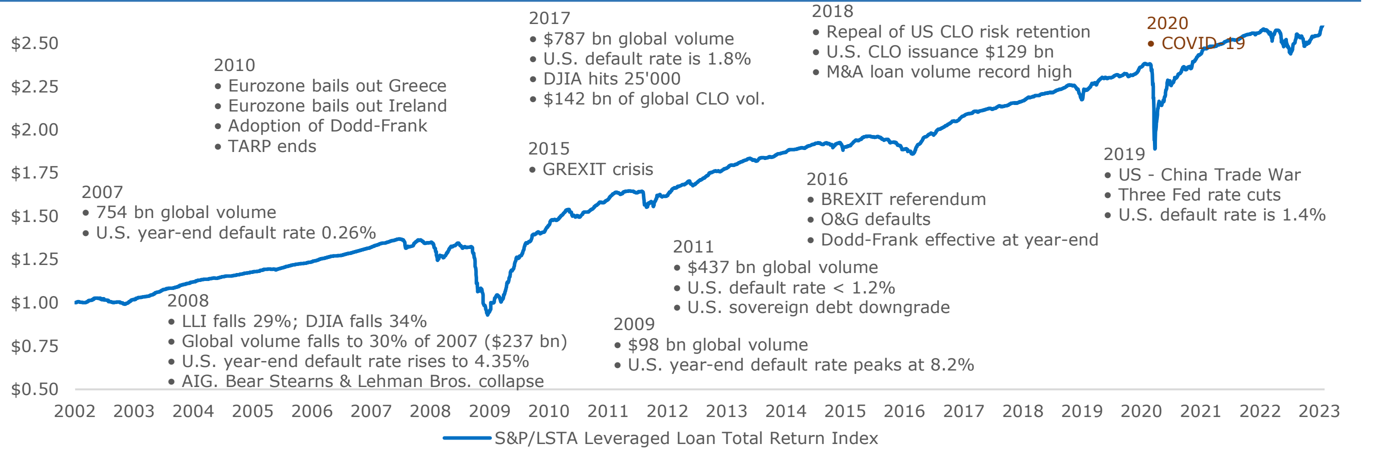
Over half of par value of US HY bond index is priced below 90 cents on a dollar. This is a significant difference vs end of 2021, when the portion was less than 5% and 80% of the HY bond index were trading above par. The increase since 2021 is due to raising risk free rates and widening credit spreads. With weighted average coupon at 5.8%, the additional pull-to-par return potential is now almost 3%.

Since the start of monetary tightening, the portion of high yield trading below 80 cents on a dollar has increased significantly to 18%. Given the impact of rate hikes on longer duration bonds, not all credit priced at these levels is heading into stressed or distressed categories. However the increasing quality dispersion among borrowers is being pointed out by the markets. Such environment will favor active management at the costs of passive basket investments.

Par-weighted price distribution in US HY



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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