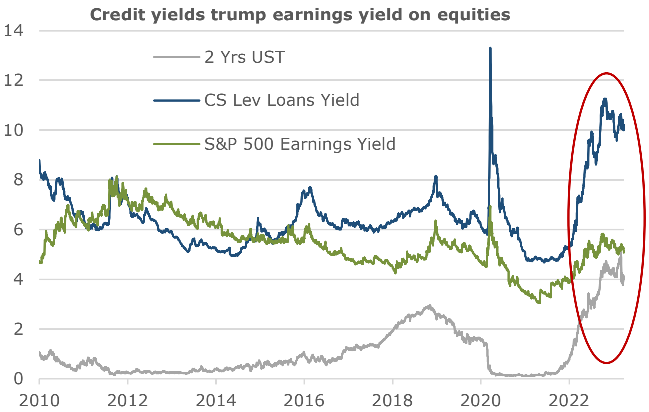
Monthly Spotlight

Credit yields trump earnings yield on equities

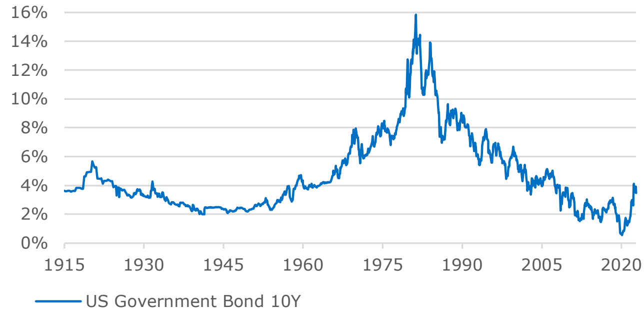
Yields on leveraged loans are currently reaching 10% and remain materially higher than yields on equities. Since 2022 the loan investors have been benefiting from rising rates, which translated into increasing income via quarterly benchmark rate resets. With any new loan refinancings, investors are now also benefiting from increased credit spreads, as lenders incorporate higher risk premia.

This is in stark contrast with equity market yields, which despite the March volatility remained at around 5% (7.5% when adjusted for inflation expectations). Such yields offer little premium over credit risk-free assets, such as a 2-year treasury notes, yielding around 4%.

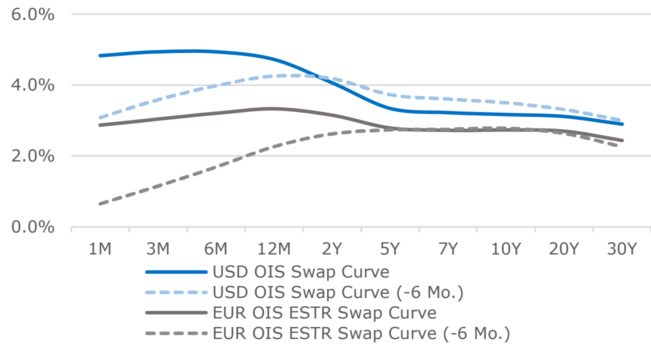


Rates Perspective

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

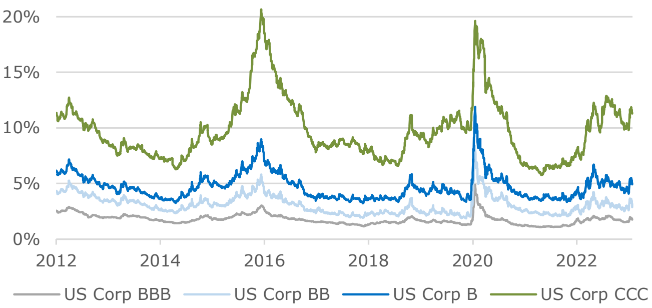


2) Interest Swap Curve: The USD and EUR curve further inverted as shorter tenors continued to increase.



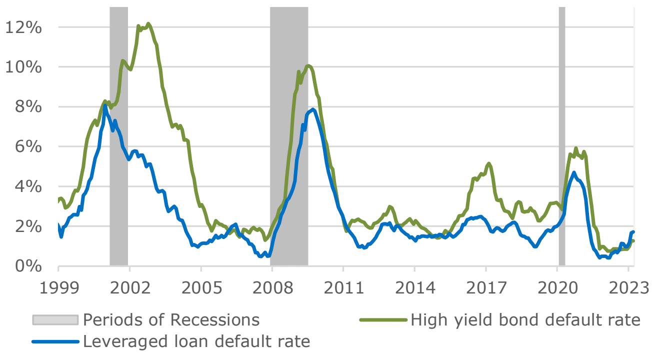
Corporate Perspective

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

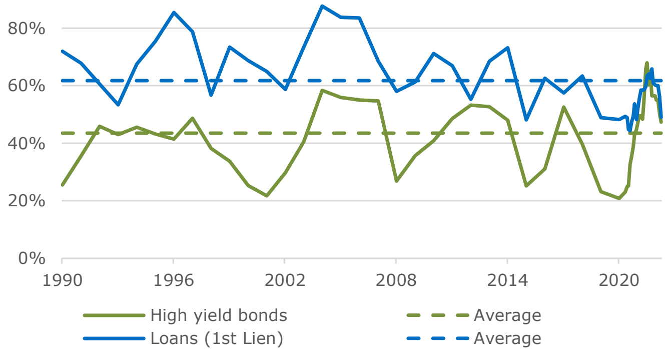


4) EU vs US: Credit spreads (OAS) between the US and EU have narrowed since the start of 2023.

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 (Ø44%) 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	+0
AA	80	+4
A	122	+9
BBB	177	+6
BB	288	-21
B	491	-28
CCC	1130	-23

Global high yield (bps)

	curr	Δ month
US HY	458	-21
EU HY	474	-20
Asia HY	1040	+39
EM HY	536	-4

spread tightening (positive price action)

spread widening (negative price action)

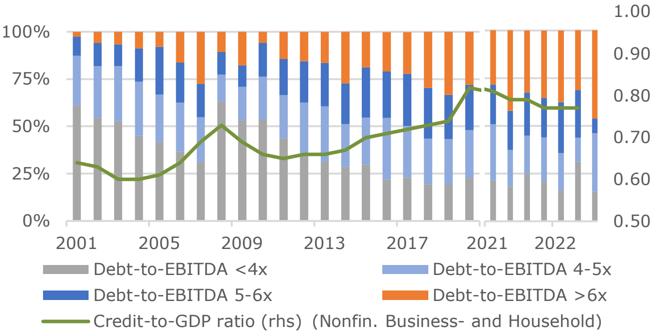
CDS spreads (bps)

	curr	Δ month
CDX IG - US	76	-6
iTraxx IG - EU	80	-11
CDX HY - US	463	-21
iTraxx XO - EU	414	-60

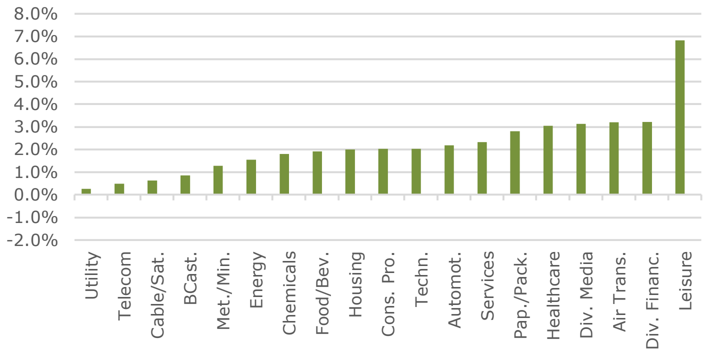
Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	929	+19
CLO AAA	614	+5
CLO BBB	897	-15
CLO BB	1374	-30

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

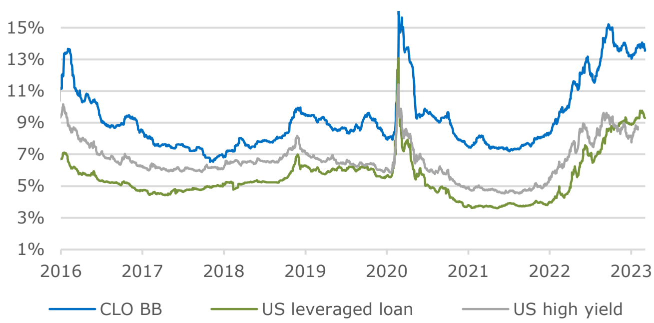


8) YTD Sector High-Yield Returns: All sectors have recovered YTD, with leisure outperforming significantly.

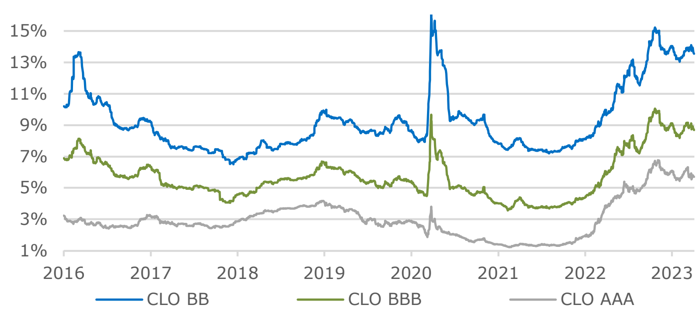


Alternative Perspective

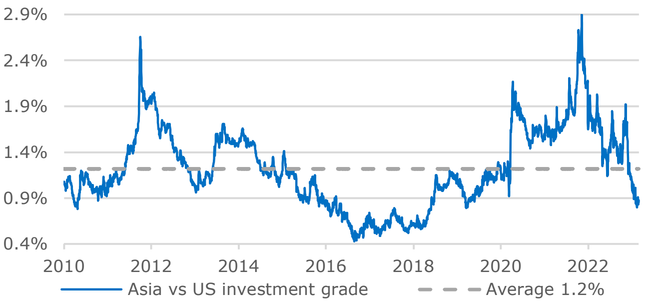
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



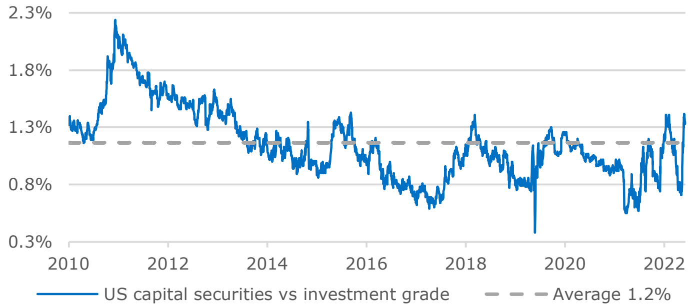
10) CLO Yields: CLOs offer an attractive yield premium over bonds and loans.



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

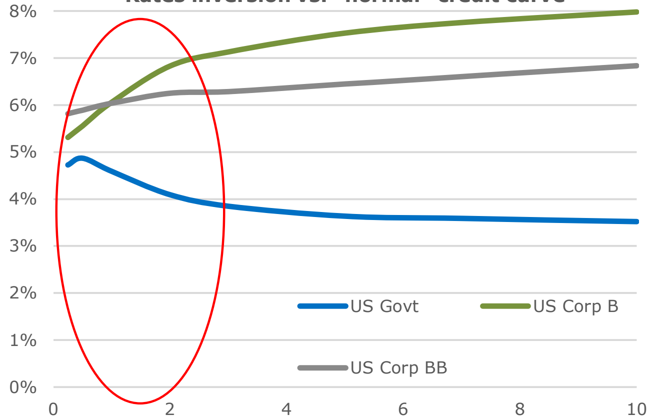
Credit curve with positive "roll-down"

With inverted US government curve, the positive roll-down returns have all but disappeared from investment grade portfolios. The roll-down return is generated via passing of time and repricing from higher longer-term into lower shorter-term yields. The steeper the curve, the higher the roll-down return.

High yield bonds remain among the few market segments with upward sloping yield curves. This is due to credit risk premia, which intuitively increases with duration due to rising uncertainty about companies' future performance.

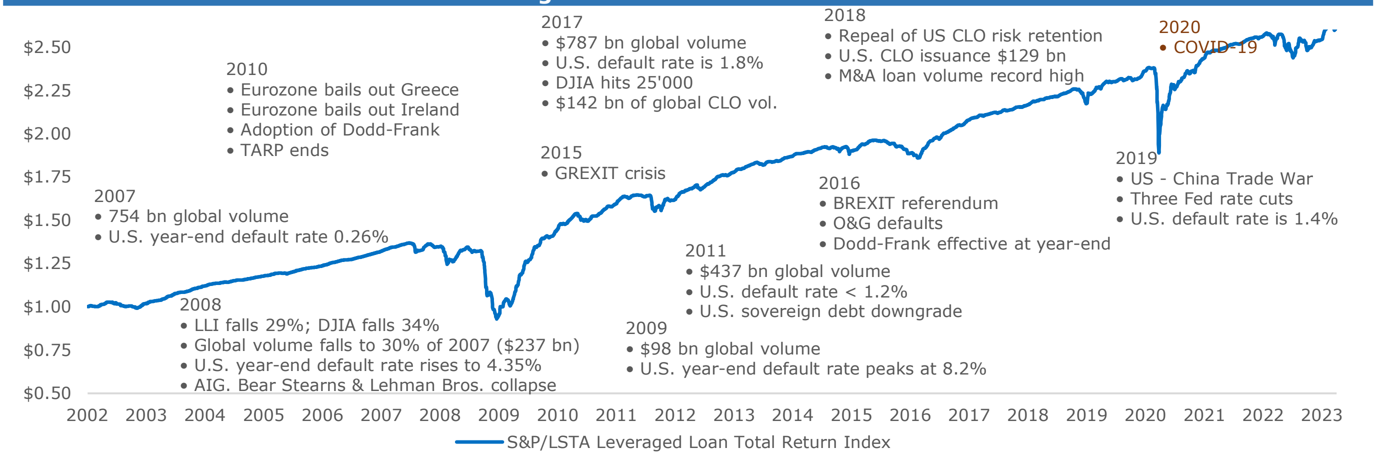
In the highlighted area, among B-rated bonds the 2-year notes offer significant yield pickup by 2% pts versus immediate maturities. Skillful active portfolio managers can use such opportunity and increase investors' returns via rolling down the credit curve while avoiding credit losses.

Rates inversion vs. "normal" credit curve



Alpinum Investment Management

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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