Monthly Spotlight

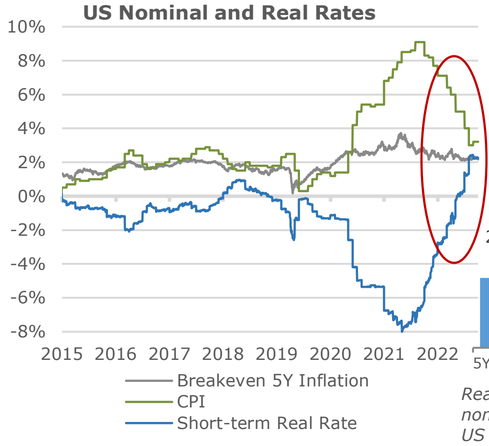
Increase in US real rates supports credit investments

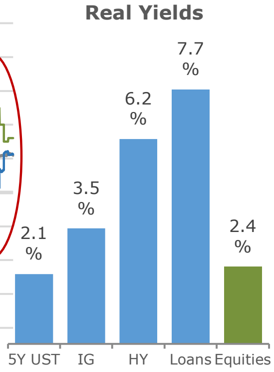
Following further slowdown in inflation expectations, real rates have surged in the last three months and are now exceeding 2%. The positive long- and short-term real rates benefit fixed income investors across entire spectrum of credit market sectors.

Due to relatively tight investment grade credit spreads, real yields of 3.5% on IG corporates only slightly exceed 5-year US treasury real rates of 2.1%.

On the other hand, at 6.2% and 7.7% respectively, the real yields on high yield bonds and syndicated loans comfortably exceed real yield on equities, even under optimistic earnings growth assumptions. In addition to relatively wide credit spreads, syndicated loans benefit from high short-term rates on an inverted nominal rate curve. These short-term rates serve as benchmarks in loans' floating-rate coupons.

High real rates, however, also mean rising refinancing risks for borrowers and require high quality active credit management.

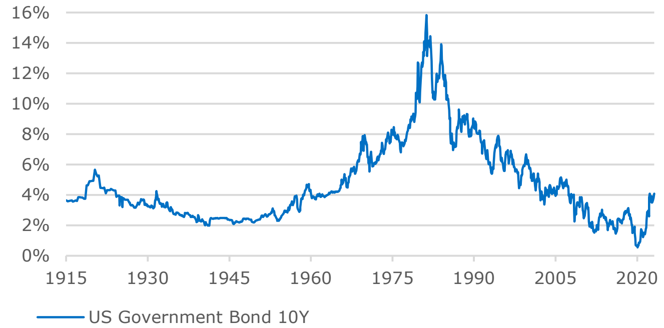




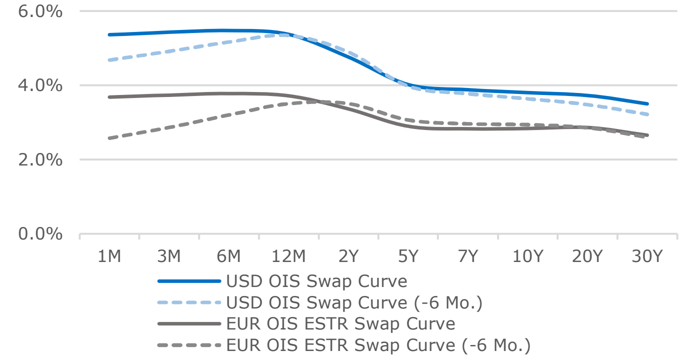
Real rate represented by nominal yield-to-worst minus US Breakeven 5-year inflation

Rates Perspective

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

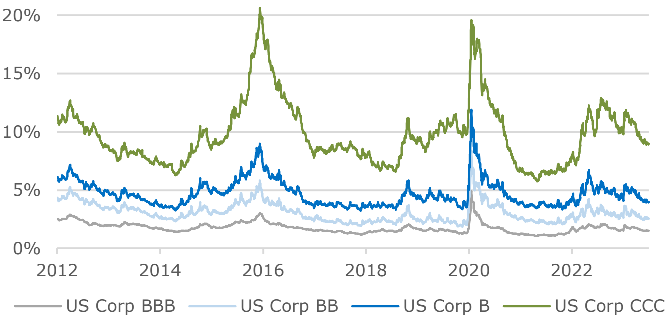


2) Interest Swap Curve: The USD and EUR curve further inverted as shorter tenors continued to increase.



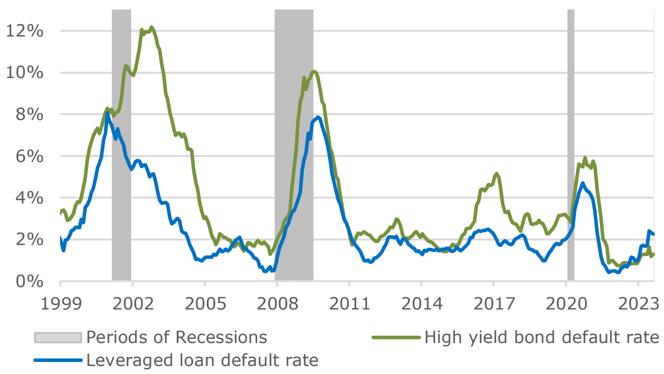
Corporate Perspective

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

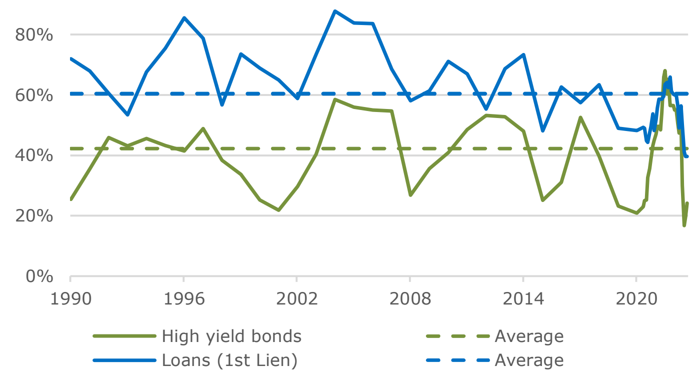


4) EU vs US: Credit spreads (OAS) between the US and EU have narrowed since the start of 2023.

5) Default Rates: HY bond default rates are structurally higher (Ø4.1%) vs. loans (Ø2.6%).



6) Recovery Rates: Recovery rates of leveraged loans are higher (Ø60%) vs. high yield bonds (Ø42%) 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	47	-1
AA	65	+0
A	103	+3
BBB	151	+4
BB	256	+11
B	397	+1
CCC	900	-6

Global high yield (bps)

	curr	Δ month
US HY	385	+6
EU HY	450	+12
Asia HY	796	-5
EM HY	465	+11

CDS spreads (bps)

	curr	Δ month
CDX IG - US	64	+1
iTraxx IG - EU	70	+3
CDX HY - US	425	+16
iTraxx XO - EU	396	+16

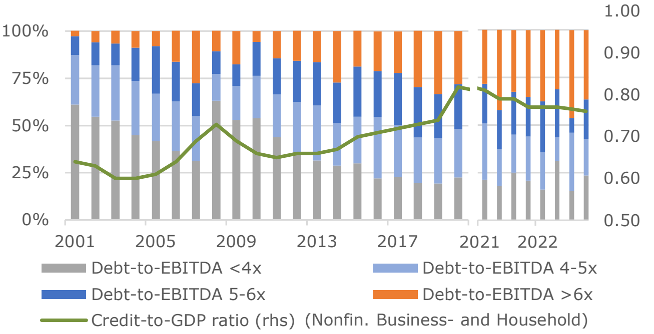
Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	953	-5
CLO AAA	604	-7
CLO BBB	853	-21
CLO BB	1322	-34

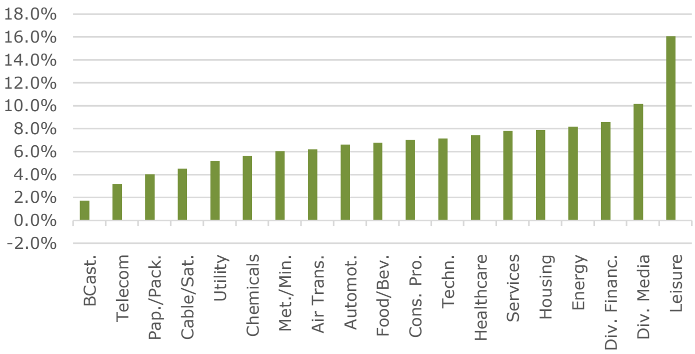
spread tightening (positive price action)

spread widening (negative price action)

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

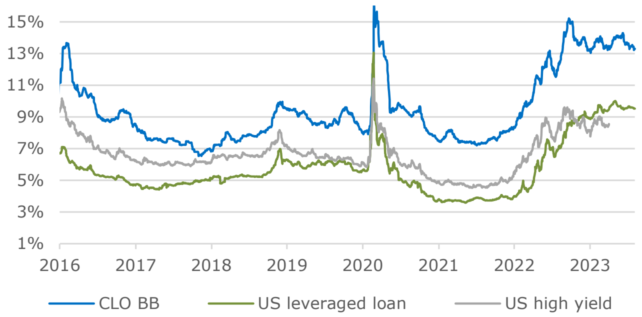


8) YTD Sector High-Yield Returns: Positive YTD results across most of the sectors, with leisure outperforming significantly.

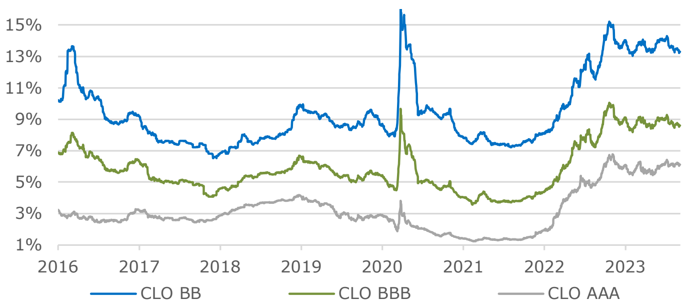


Alternative Perspective

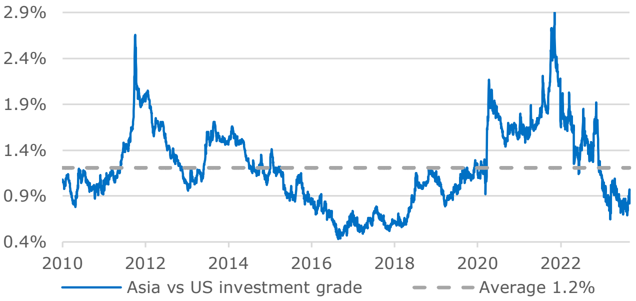
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



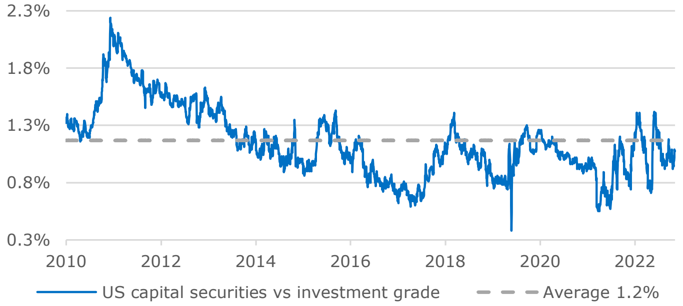
10) CLO Yields: CLOs offer an attractive yield premium over bonds and loans.



11) Asia vs. US: Asian IG spreads have tightened thanks to gradual post-COVID recovery 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

First lien loans keep outperforming other high yield credit markets

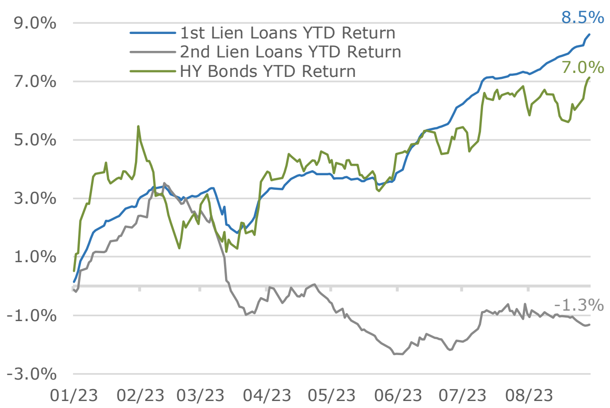
After a difficult 2022, first lien syndicated loans have been generating exceptional performance so far this year, returning 8.5% YTD as of August.

Thanks to floating-rate coupons and consequently short duration, the senior first lien loans have benefited from rising benchmark rates. They have also outperformed fixed-rate HY bonds, which have exhibited higher return volatility, partly due to their longer duration, i.e. sensitivity to rate changes throughout the year, mainly in 2- to 5-year tenors.

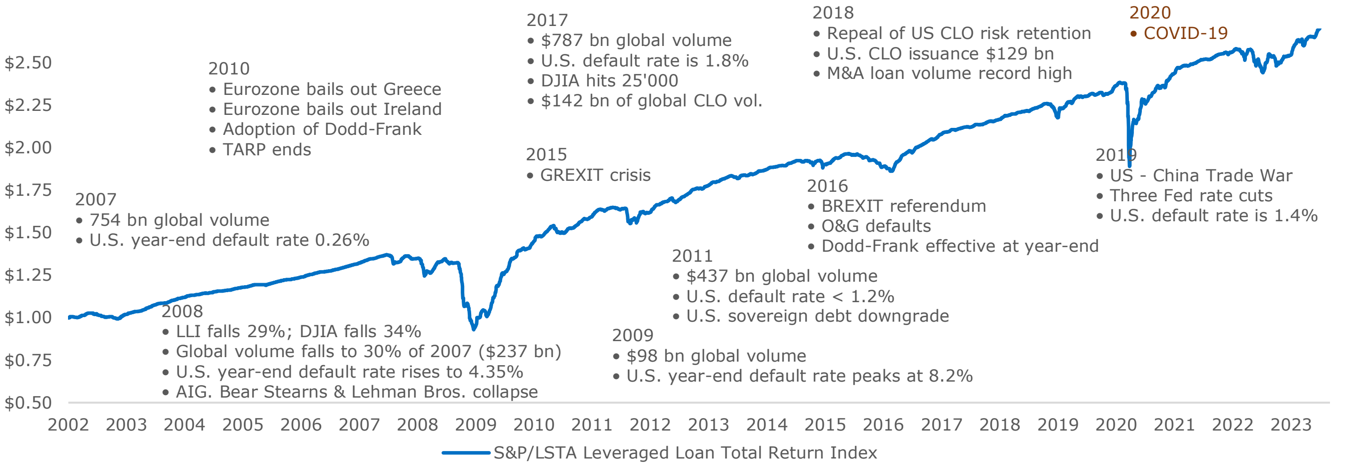
In terms of credit spreads, at 495 bps discount margin, the first lien loans are still priced roughly 130 bps cheaper than HY bonds. While this is partially caused by lower average rating, large portion of syndicated loans remain cheaper also within identical double- and single-B rating buckets. Among the reasons are liquidity premia and slightly higher near-term default rates expected by the market

Active credit portfolio management and understanding of quality of creditor protection are key to successfully navigate current loan market. An effect of lower creditor's protection on portfolio is evidenced by underperformance of subordinated second lien loans (-1.3% YTD loss).

YTD Returns on Syndicated Loans and HY Bonds



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		

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