Monthly Spotlight

Record-high yield breakevens protecting return accruals

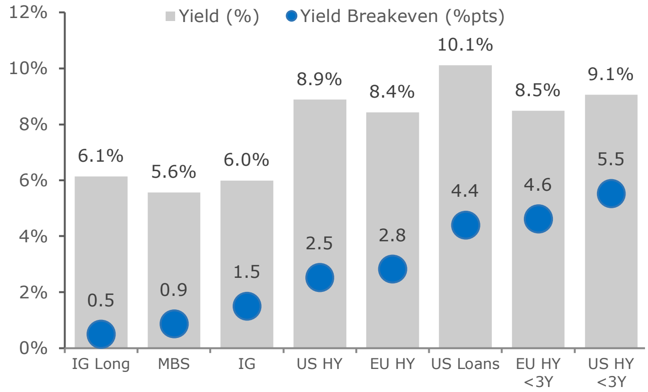
The yield breakevens, calculated as yield divided by duration, indicate by how much can yields rise, or credit spreads widen, before incurring capital loss equal to annual yield accrued on investors' holding. A ratio of 1.0 implies that 1%point increase in yield or spread eliminates the entire year's worth of yield accrual.

As evidenced on the chart, HY (up to 3 years maturity in particular) and syndicated loans (modelled with a 3-year remaining life) offer investors higher protection than more sensitive investment grade credit and agency mortgage-backed securities.

From the yield and breakeven perspective, US HY bonds maturing in less than 3 years are the most attractive. In an environment of lower likelihood of further rising risk-free rates, it would take credit spreads widening of up to 5.5%points from current levels to eliminate their annual 9.1% return accrual. In case of floating rate loans, the risk is limited solely to spreads widening.

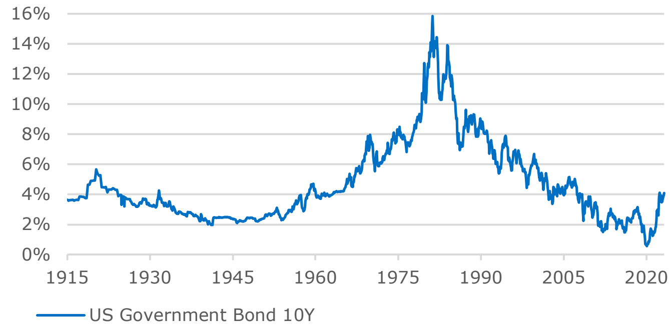
Nevertheless, elevated refinancing risks on shorter term HY require active credit management and deep understanding of each issuer.

Yields in proportion to their breakevens

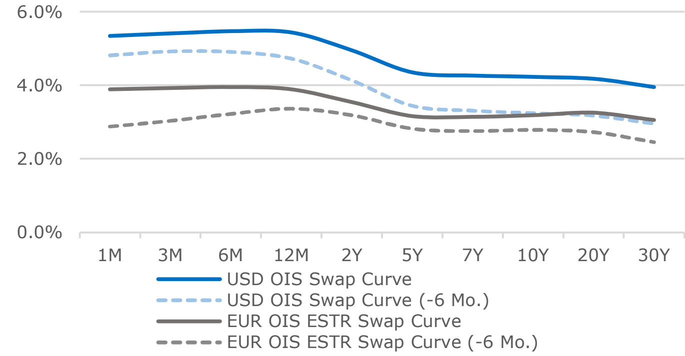


Rates Perspective

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

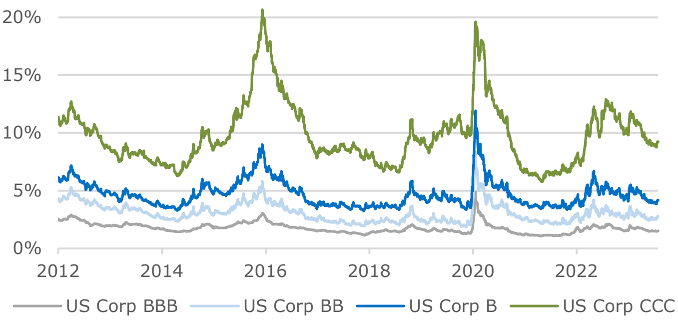


2) Interest Swap Curve: The USD and EUR curves remain inverted with shorter tenors continuously higher.

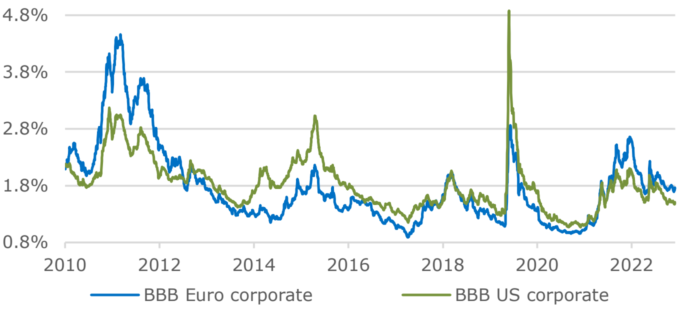


Corporate Perspective

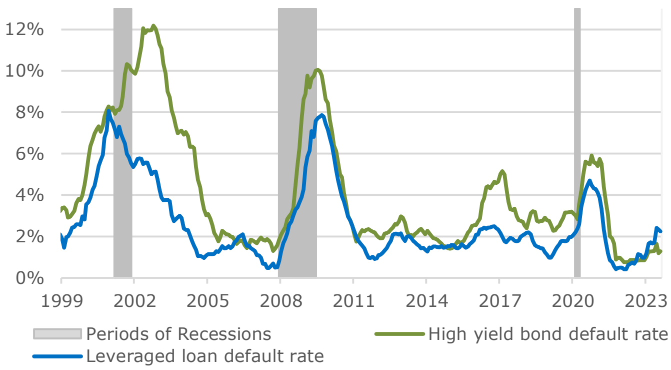
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



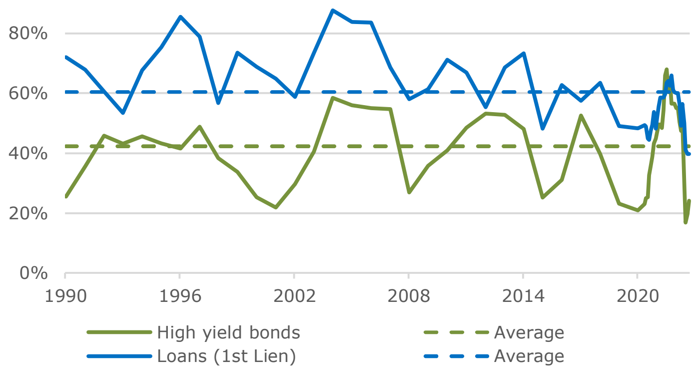
4) EU vs US: Credit spreads (OAS) between the US and EU have narrowed since the start of 2023.



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	+0
AA	64	-1
A	106	+3
BBB	151	+0
BB	274	+18
B	413	+16
CCC	919	+19

Global high yield (bps)

	curr	Δ month
US HY	403	+18
EU HY	437	-13
Asia HY	759	-37
EM HY	472	+7

CDS spreads (bps)

	curr	Δ month
CDX IG - US	74	+9
iTraxx IG - EU	80	+6
CDX HY - US	481	+42
iTraxx XO - EU	428	+14

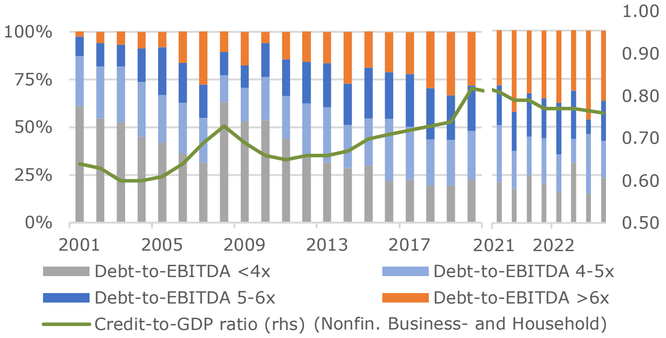
Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	949	-10
CLO AAA	748	+4
CLO BBB	1066	+2
CLO BB	1463	+9

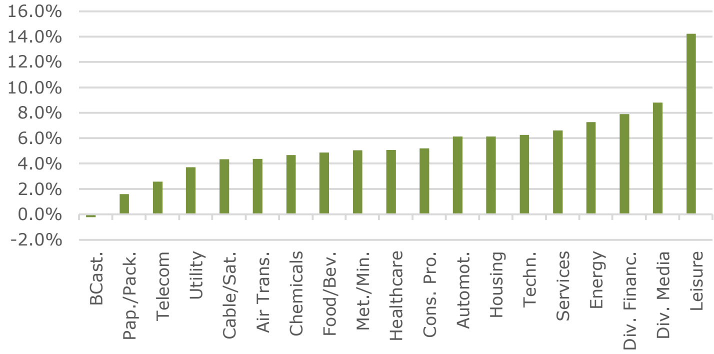
spread tightening (positive price action)

spread widening (negative price action)

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

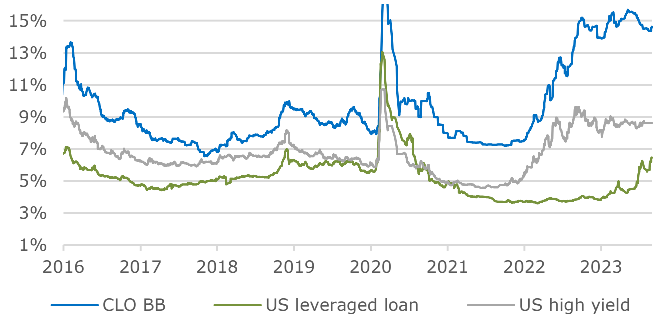


8) YTD Sector High-Yield Returns: Positive YTD results across most of the sectors, with leisure outperforming significantly.

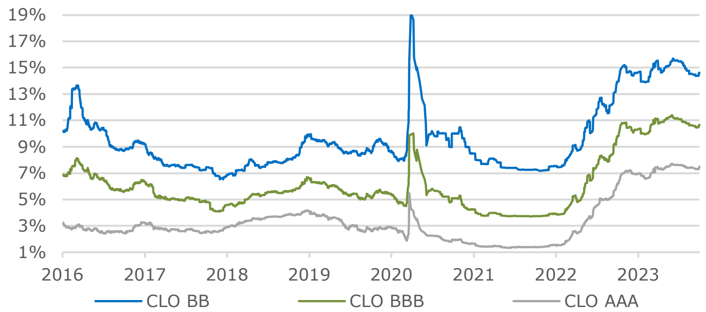


Alternative Perspective

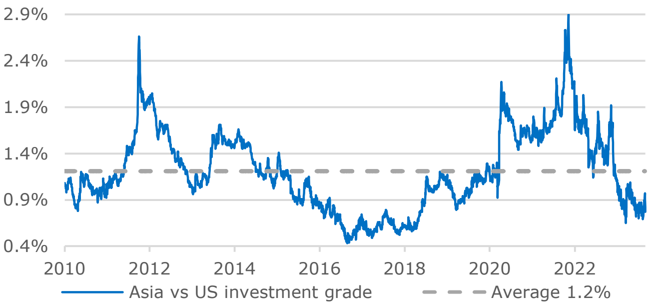
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



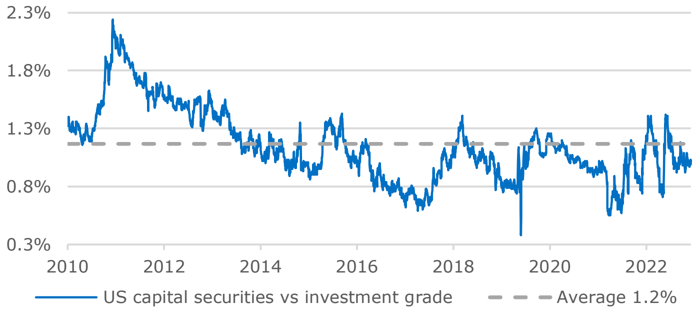
10) CLO Yields: CLOs offer an attractive yield premium over bonds and loans.



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

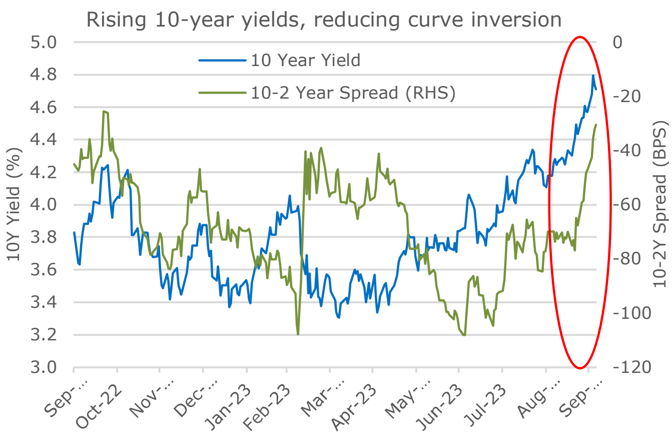
Increase in long-term yields profoundly impacts risk assets

With markets seemingly pricing-in the higher-for-longer state of US interest rates, the 10-year yield has increased within few weeks from 4% to well over 4.6%.

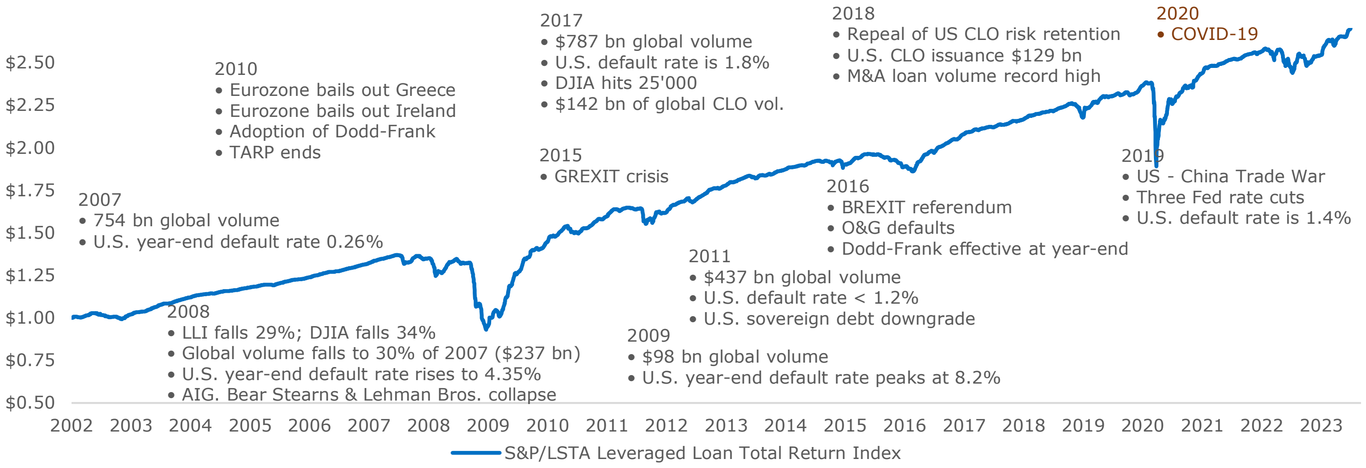
Simultaneously, the rising long term yields have started reducing yield curve inversion, as evident in the narrowing of negative spread between 10-year and 2-year yields from its lows at -110 bps to the current -35 bps.

These moves have profound impact on valuations of long term risk assets, from high yield bonds, to equities and emerging market debt, as future cashflows are now discounted at higher rates, reducing their present value. The flattening yield curve inversion also impacts timing of refinancings and tenors of new credit facilities due to diminishing prospects of future lower rates.

While long term assets are starting to become more attractive from relative value perspective, investors should be aware of their increased volatility and put the recent moves in context with continuous absence of sufficient term premia.



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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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