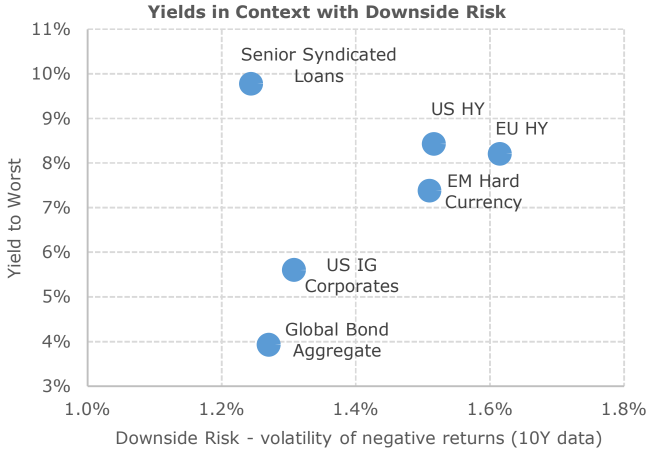
Monthly Spotlight

Yields remain attractive in context with downside risk

Current market yields continue providing an attractive entry point across sectors in context with their historic downside risk, calculated as standard deviation of negative monthly returns over the last 10 years. This includes particularly adverse events, such as March 2020 market selloff (COVID pandemic start) and broad market repricing during one of the steepest rate hikes in history.

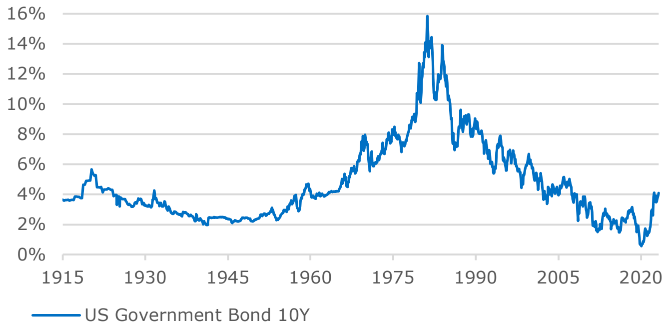
On this yield-over-risk basis, senior syndicated loans stand out, as their yield of 10% is more than eight times the negative return deviation exhibited historically over the 10-year horizon. One of the reasons for this favorable result, in contrast to high yield bonds for example, is that unlike fixed coupon bonds, floating-rate loans have been benefiting from rising risk-free rates, with growing interest income contributing to the sector's strong performance during 2023.

Looking ahead, to maximize the attractive yields on both senior loans and HY bonds, the investors should focus on active credit risk management with robust underwriting to protect invested capital from default losses.

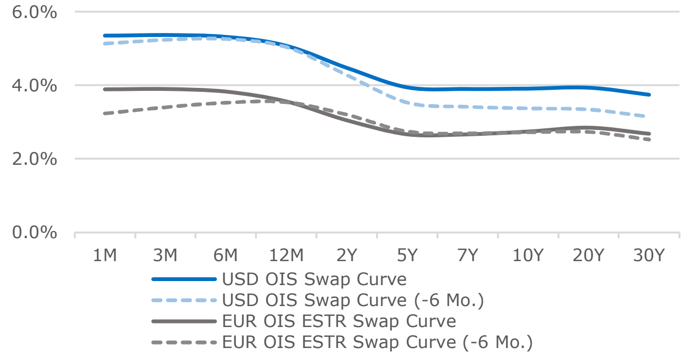


Rates Perspective

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

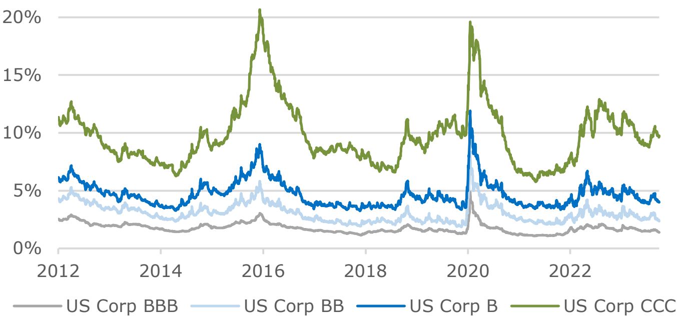


2) Interest Swap Curve: The USD and EUR curves remain inverted with shorter tenors continuously higher.



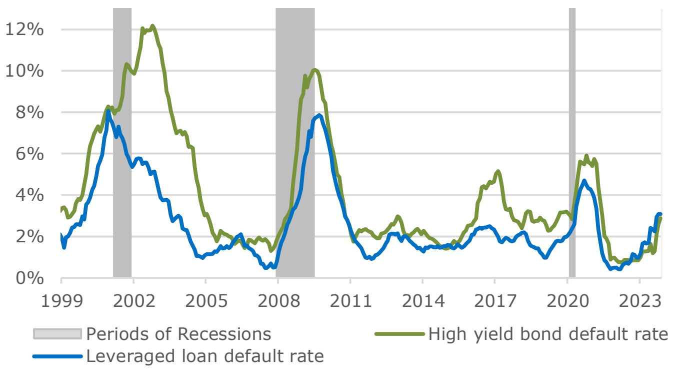
Corporate Perspective

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

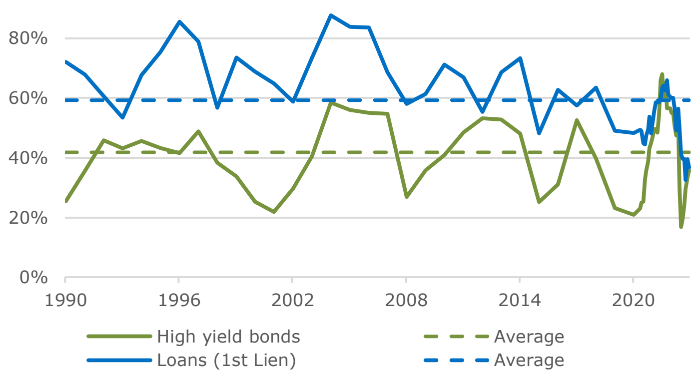


4) EU vs US: Since 2022 EU credit spreads (OAS) have remained wider than in the US

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 (Ø59%) 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	35	-14
AA	54	-14
A	93	-21
BBB	139	-23
BB	236	-56
B	398	-70
CCC	976	-64

Global high yield (bps)

	curr	Δ month
US HY	384	-58
EU HY	432	-51
Asia HY	724	-51
EM HY	457	-51

CDS spreads (bps)

	curr	Δ month
CDX IG - US	62	-17
iTraxx IG - EU	68	-18
CDX HY - US	402	-114
iTraxx XO - EU	374	-77

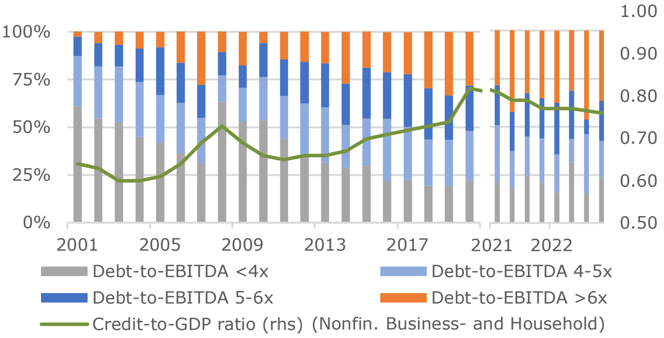
Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	974	-5
CLO AAA	690	-17
CLO BBB	1010	-79
CLO BB	1375	-97

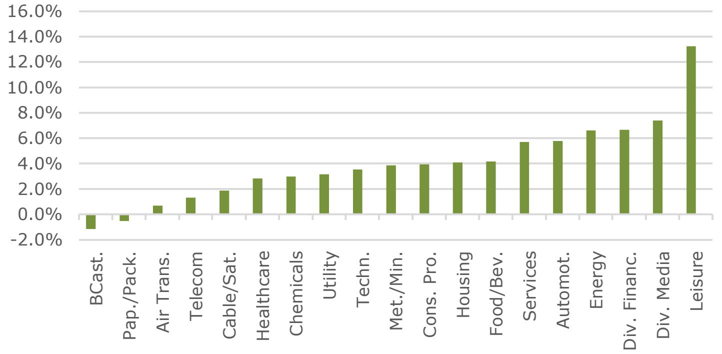
spread tightening (positive price action)

spread widening (negative price action)

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

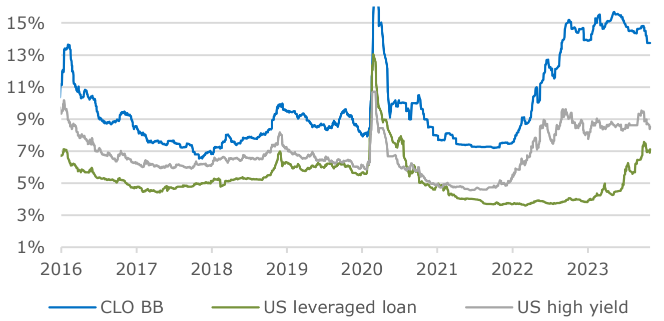


8) YTD Sector High-Yield Returns: Positive YTD results across most of the sectors, with leisure outperforming significantly.

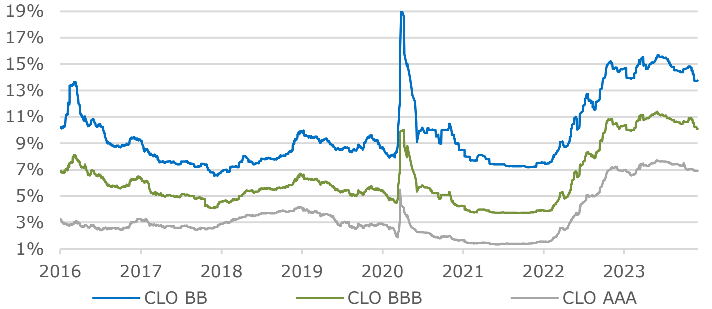


Alternative Perspective

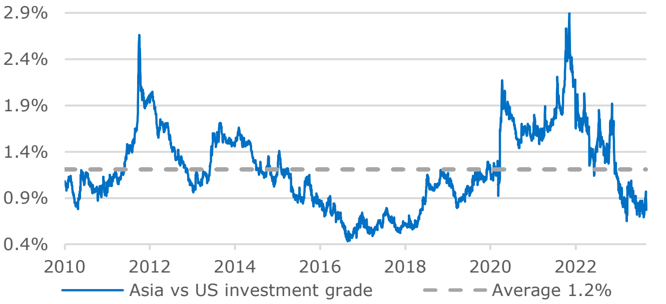
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



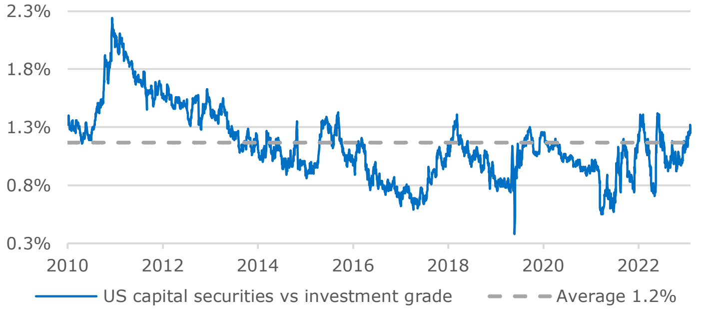
10) CLO Yields: CLOs offer an attractive yield premium over bonds and loans.



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.

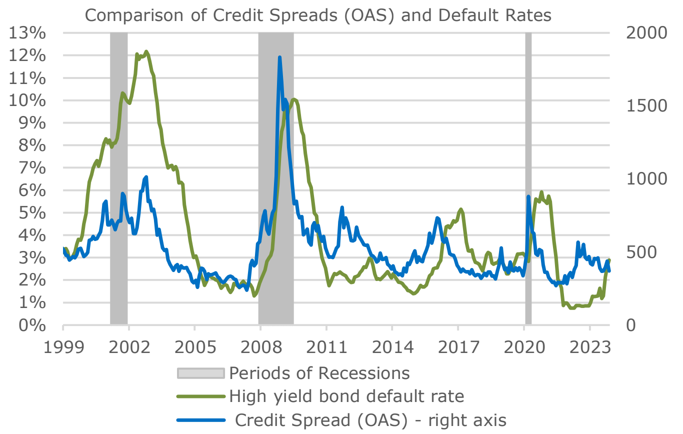


Education Corner

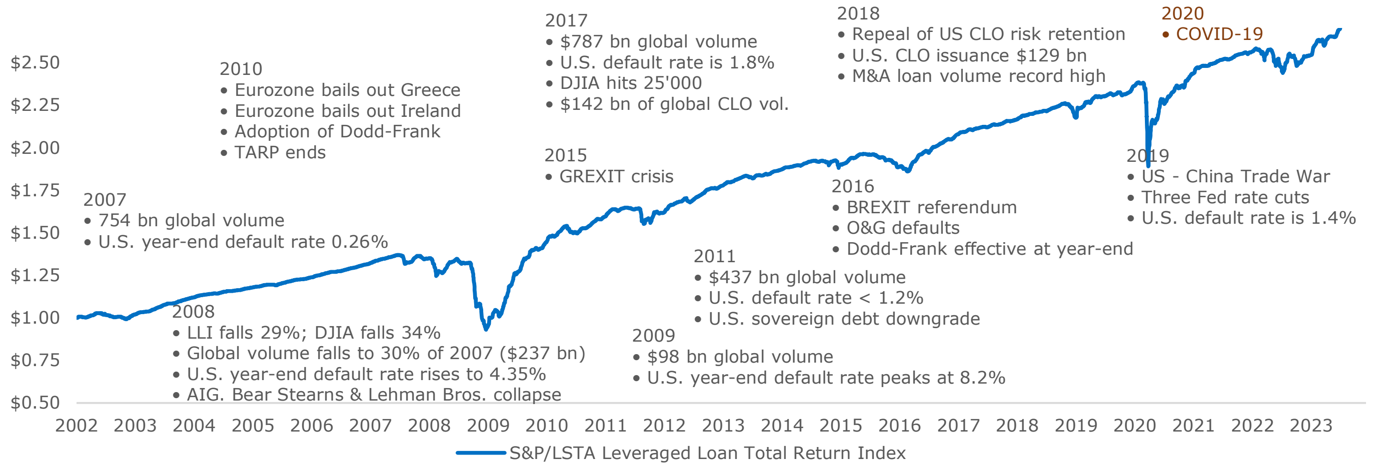
Credit spreads widening indicates upcoming credit losses

Credit spreads widening intuitively indicates upcoming credit losses, especially in the high yield sectors. A time series chart optically confirms this relationship mainly during the periods of relatively short shock events (such as 2008 GFC or 2020 Covid pandemic). Smaller spikes in 2015-16 were primarily driven by challenges within independent shale oil sector.

The latest development, with credit spreads widening in 2022 has been followed by increasing default rates as well. However, the outlook might not necessarily mirror the subsequent spreads tightening throughout 2023. With a potential for gradual economic slow-down, under a higher-for-longer interest rates regime, it is likely, and widely expected by market participants, that default rates would remain elevated for some time as well. From investor's point of view, such scenario benefits active portfolio management strategies with superior credit analysis skills, which can benefit from increasing dispersion on the market.



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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