Monthly Spotlight

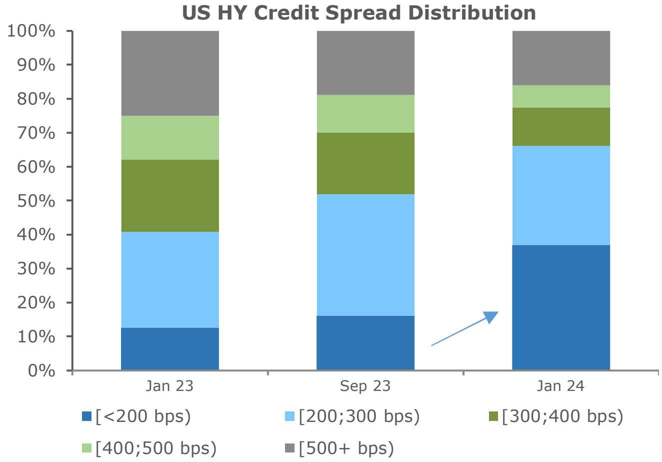
Over a third of US HY keeps tight spreads after Q4'23 rally

Following the rally on credit markets during Q4 2023, more than a third of US High Yield keeps trading at credit spreads below 200bps over risk-free rates. On a risk-adjusted basis, such spreads remain tight from a historical perspective, especially when a challenging macroeconomic outlook is considered.

While overall a yield of 8% on US HY corporate market remains attractive compared to long term averages, there is an increasing dispersion among HY issuers. The differences in HY corporates fundamentals and outlooks, combined with higher refinancing costs due to FED's ongoing tight monetary policy, present opportunities for active credit investors.

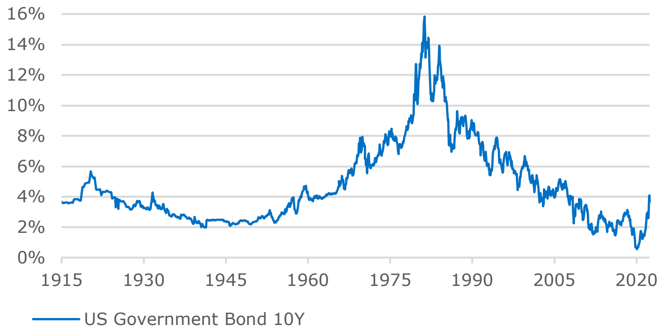
In particular, the portfolio managers capable of extracting idiosyncratic opportunities on both long (undervalued) and short positions (overvalued with tight credit spreads) stand to benefit from the current environment.

US HY Credit Spread Distribution

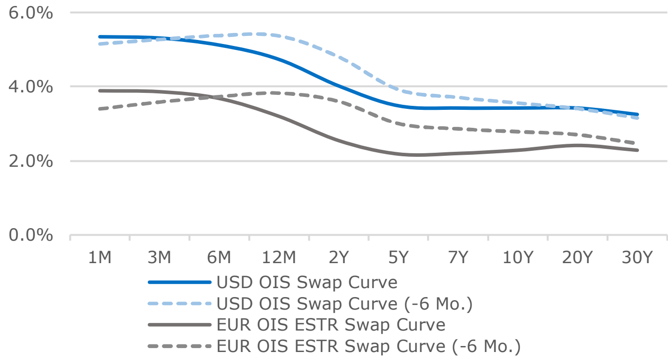


Rates Perspective

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

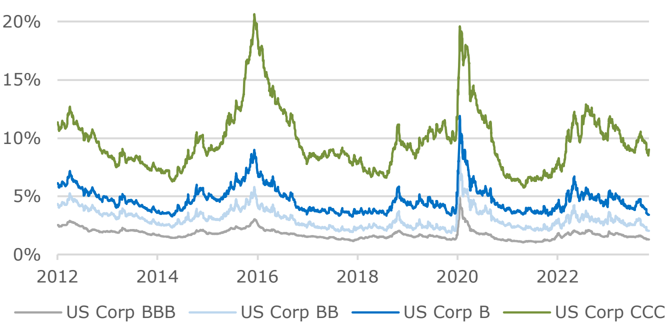


2) Interest Swap Curve: The USD and EUR curves remain inverted with shorter tenors continuously higher.

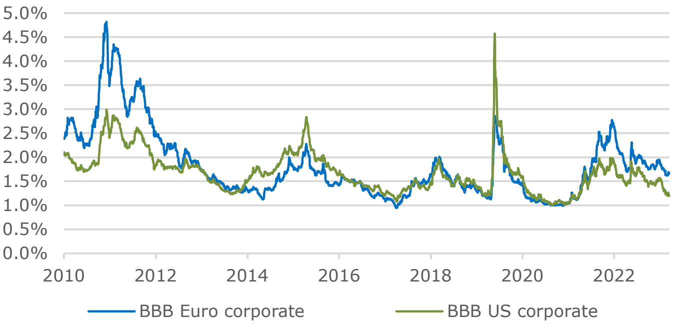


Corporate Perspective

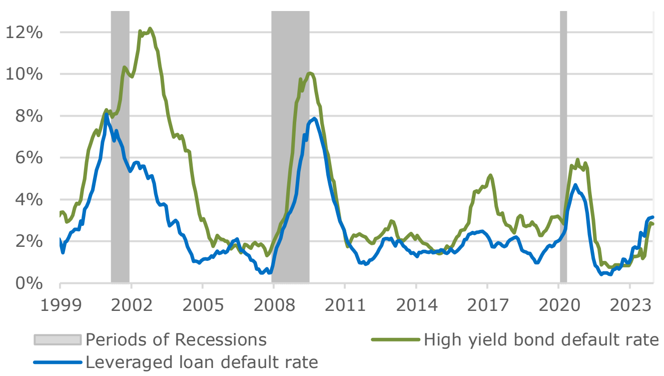
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



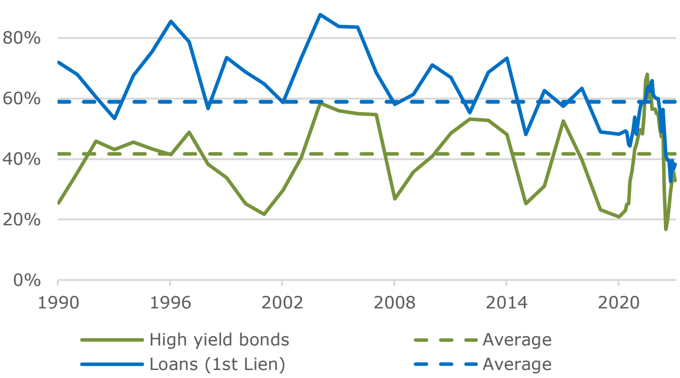
4) EU vs US: Since 2022 EU credit spreads (OAS) have remained wider than in the US



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	40	+5
AA	55	+1
A	88	-5
BBB	129	-10
BB	204	-32
B	342	-56
CCC	851	-125

Global high yield (bps)

	curr	Δ month
US HY	334	-50
EU HY	395	-37
Asia HY	8	-0
EM HY	6	-0

CDS spreads (bps)

	curr	Δ month
CDX IG - US	57	-6
iTraxx IG - EU	58	-10
CDX HY - US	356	-46
iTraxx XO - EU	310	-63

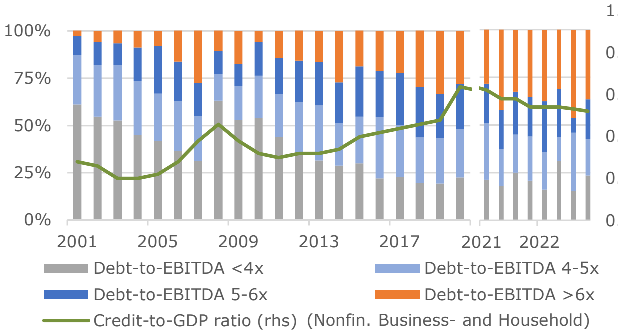
Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	943	-31
CLO AAA	678	-12
CLO BBB	968	-42
CLO BB	1313	-62

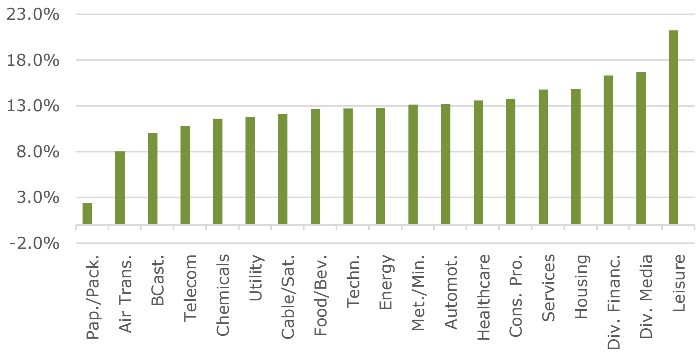
spread tightening (positive price action)

spread widening (negative price action)

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

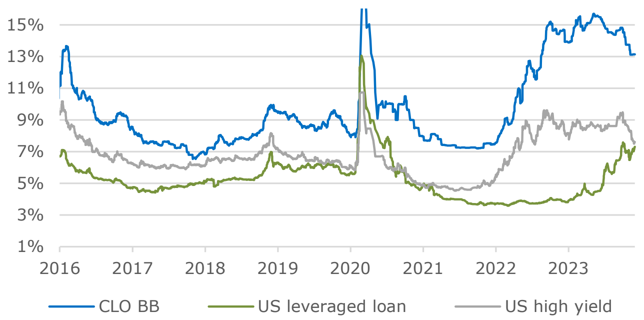


8) YTD Sector High-Yield Returns: Positive YTD results across most of the sectors, with leisure outperforming significantly.

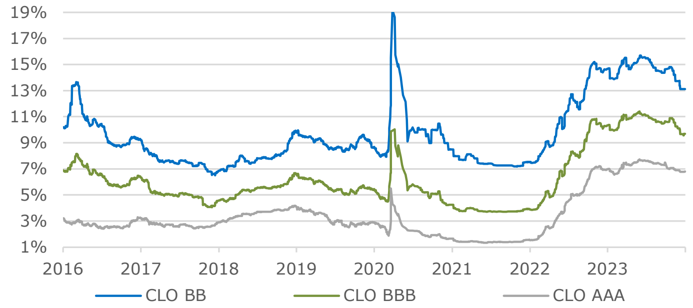


Alternative Perspective

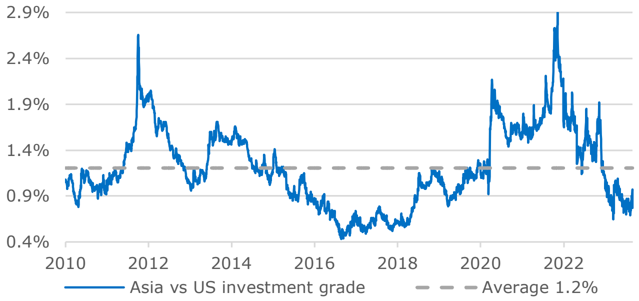
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



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.

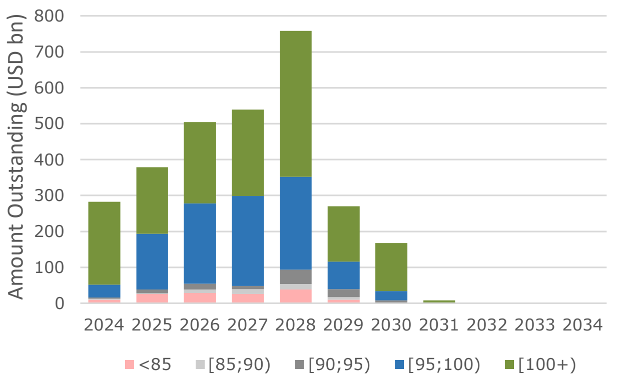
Education Corner

US Loans Maturity Wall in Context of Current Market Prices

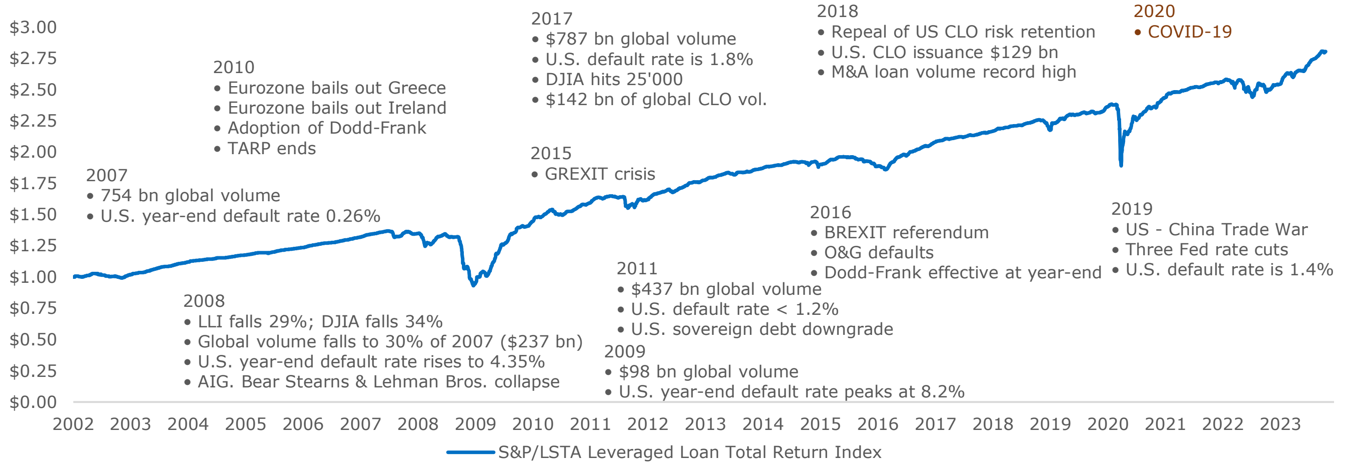
A sample of nearly 3 trillion of USD syndicated loans outstanding suggests that a significant amount of US loans will be maturing in the next three years. Typically, the refinancing is due already one year prior to the contractual maturity. Given most of the loans pay floating interest, and have therefore already reflected current high rates environment, the borrowers will face lesser spike in refinancing costs than fixed coupon bond issuers.

After loan market's strong 2023 returns of over 12%, the start of 2024 suggests increasing dispersion among corporate borrowers going forward. This is evidenced by price distribution of loans maturing in years 2025-2027, where stressed loans priced below 85 cents on a dollar form ~7% of volume outstanding. Last year's positive repricing of the sector significantly shrank the portfolio of loans priced between 90 to 95 cents. However, with about third of the loans still priced between 95 and par, active investors with robust credit due diligence are still in position to earn attractive pull-to-par returns upon refinancings and extensions in addition to an already elevated floating interest income.

US Loans Maturity Wall and Current Prices



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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