

## Monthly Spotlight

### Local EM returns in context with 10-year US treasury yield

The performance of local emerging market debt portfolios has historically been relatively closely negatively correlated with changes in the US 10-year treasury yield. For example, the drop in US 10-year yield during 2020 COVID pandemic preceded rally in local EM debt. Subsequently, rise in US inflation and interest rates in 2022 triggered a selloff across EM markets.

After peaking at almost 5% in October 2023 the subsequent 100 bps decline in US 10-year yield resulted in only relatively modest recovery in local EM, which quickly lost pace after reinforcing of higher-for-longer US rate path.

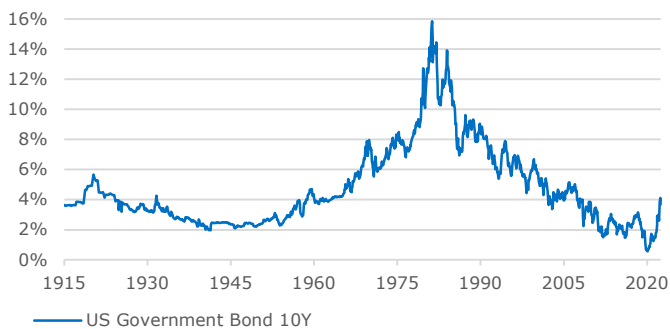
This latest development demonstrates that the relationship between US 10-year treasury yield and EM debt performance is much more complex and multifaceted. It involves factors such as economic conditions, risk appetite, overall interest rate differentials and FX dynamics, including terms of trade ratio of EM's export versus import prices.

Local EM returns in context with 10-year US yield

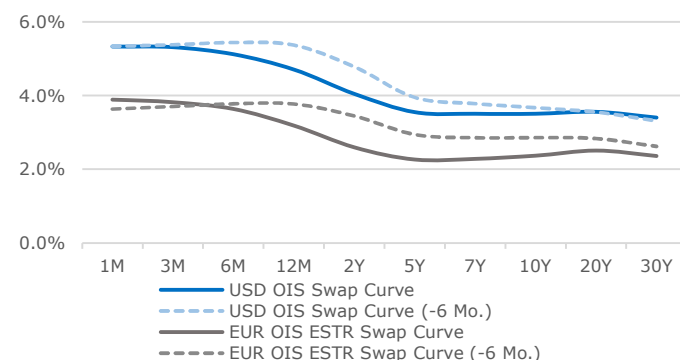


## Rates Perspective

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

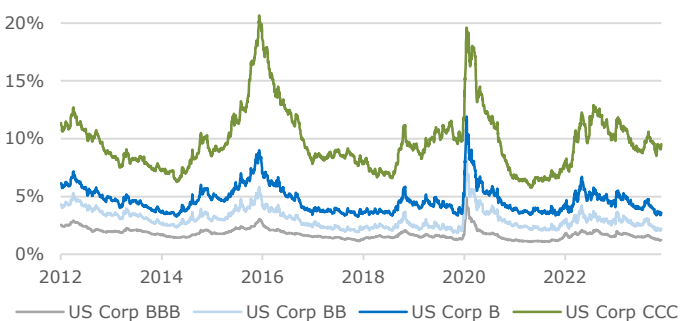


**2) Interest Swap Curve:** The USD and EUR curves remain inverted with shorter tenors continuously higher.

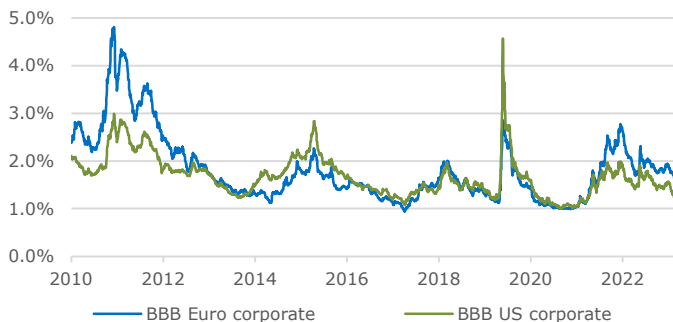


## Corporate Perspective

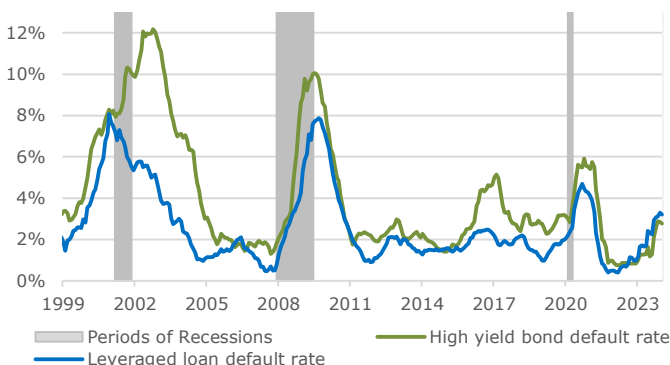
**3) US Corp. Rating:** Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



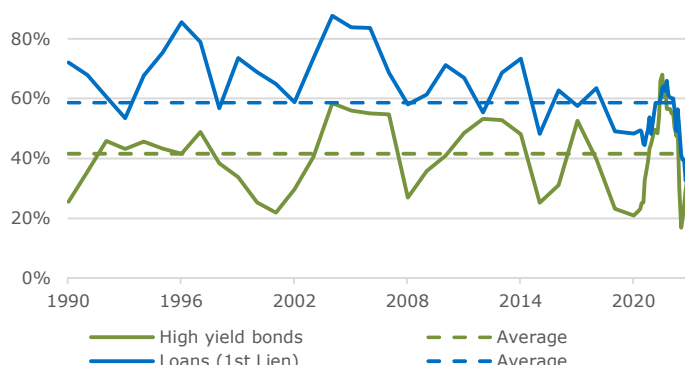
**4) EU vs US:** Since 2022 EU credit spreads (OAS) have remained wider than in the US



**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	+0
AA	56	+1
A	86	-2
BBB	126	-3
BB	222	+18
B	359	+17
CCC	953	+102

### Global high yield (bps)

	curr	Δ month
US HY	359	+25
EU HY	385	-10
Asia HY	7	-2
EM HY	6	+0

■ spread tightening (positive price action)  
■ spread widening (negative price action)

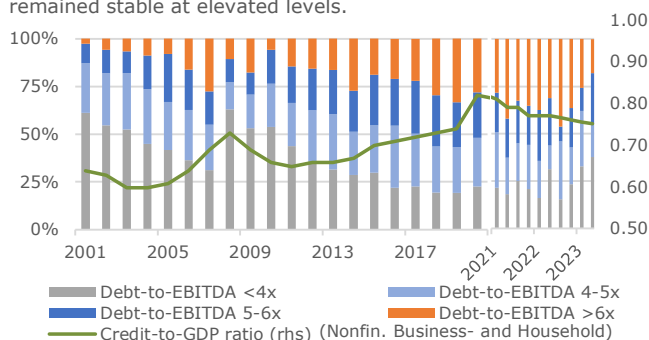
### CDS spreads (bps)

	curr	Δ month
CDX IG - US	57	-0
iTraxx IG - EU	60	+2
CDX HY - US	361	+5
iTraxx XO - EU	328	+17

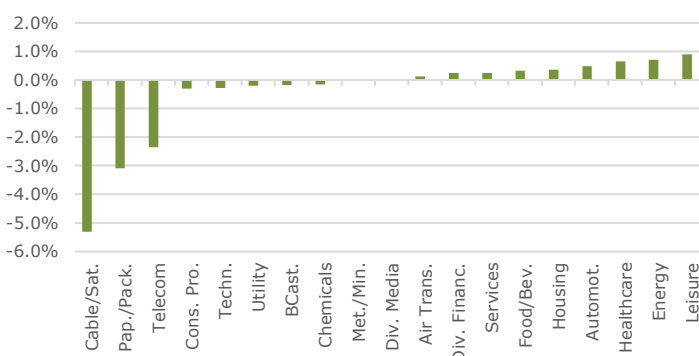
### Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	956	+13
CLO AAA	664	-14
CLO BBB	956	-12
CLO BB	1286	-27

**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.

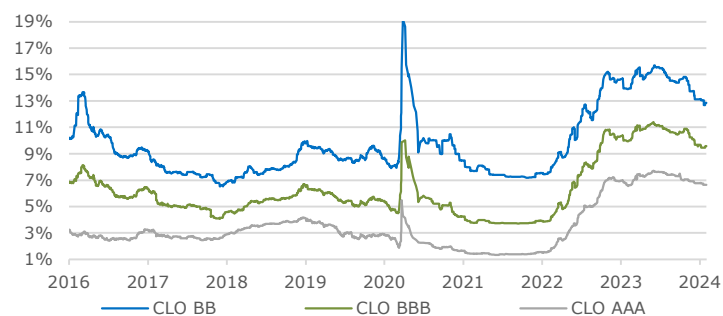


## Alternative Perspective

**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

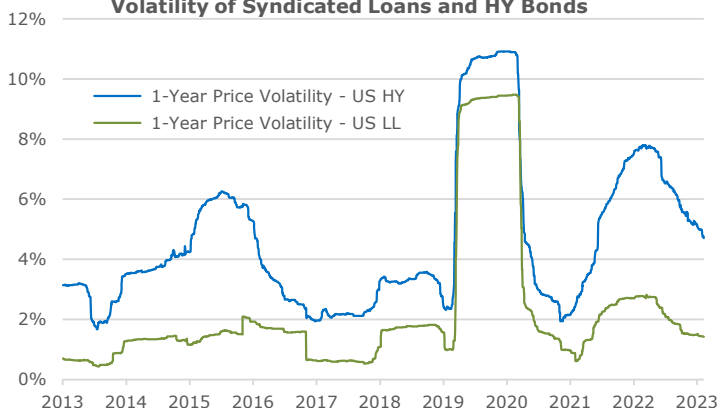
### Price volatility of syndicated loans well below HY bonds

A comparison of 1-year rolling volatility of par-weighted average price of Syndicated Loan index and US High Yield Bond Index reveals consistently lower price volatility of syndicated loans, despite the sector's lower average rating. This is largely thanks to loans' short interest rate duration, as is evident by widening difference during times of increased risk-free rates volatility such as 2022/23.

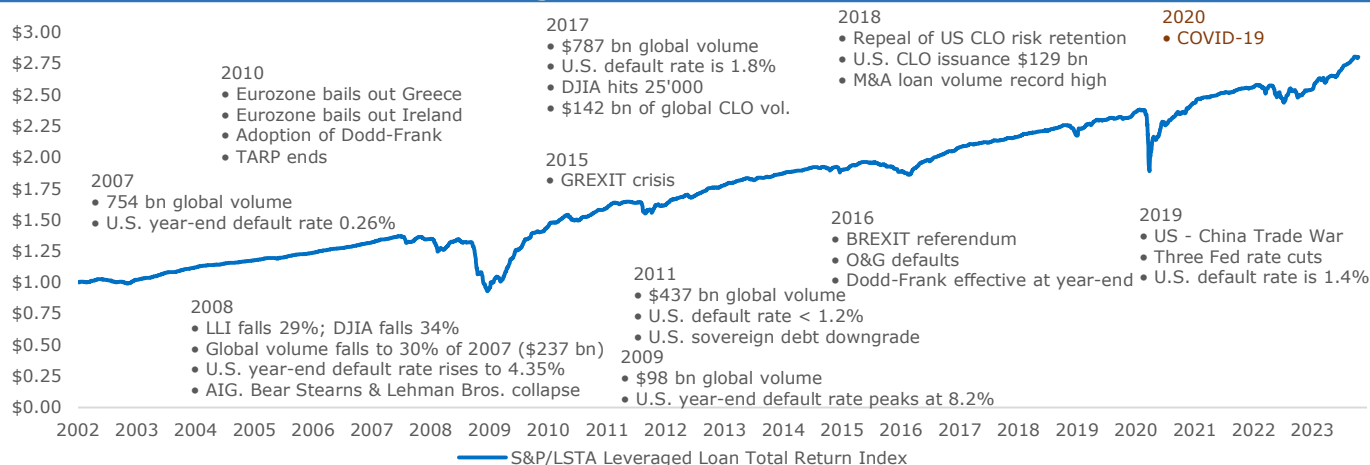
At recent levels of 1.4%, the loan price volatility is 6.6-times the loans' current yield of 9.25%. This suggests that it would take a truly extreme 6.6x standard deviation move in loans prices to wipe out annual yield accrual. For context, in a normal distribution of price outcomes, 99.9% of observations fall within 3x standard deviation move.

Under experienced active credit management, price volatility can be further reduced and return potential enhanced by selection of outperforming loan issuers and avoidance of defaults.

### Volatility of 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 periodically 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

Alpium Investment Management

Bank of America Merrill Lynch indices

Bloomberg

The Federal Reserve

US Census Bureau

Federal Reserve Bank of St. Louis

Markit CDS indices

Moody's Investors Service

J.P. Morgan

Palmer Square indices

Preqin

S&P

Federal Housing Finance Agency

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