Monthly Spotlight

Shrinking new issues underpins European HY market

In the past two years, net issuance of high-yield bonds has declined significantly. A sharp rise in the cost of capital coupled with a phase of enormously increased new issues in 2020 and 2021 led to a slump in the size of the European high-yield market.

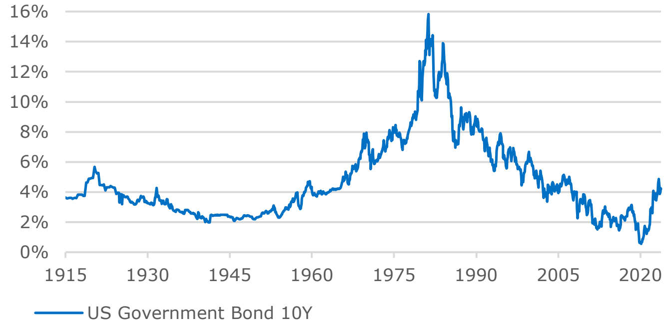
In addition, there are a considerable number of issuers that enjoyed credit rating upgrades and have as a consequence exited the HY market, known as "rising stars" - outpacing the number of "falling angels" (IG-downgrades to HY). On top, a higher number of companies went bankrupt and left the market.

These factors, combined with positive capital flows entering both ETFs and investment funds with high yield focus, have created a scarcity effect and consequently tightened credit spreads, which have provided support during this time.

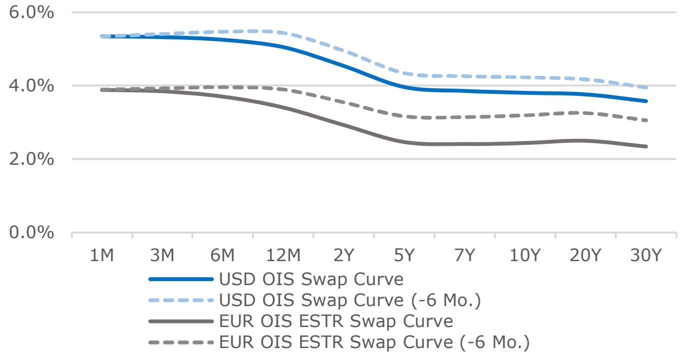
EUR High Yield Bond New Issuance Size

Rates Perspective

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

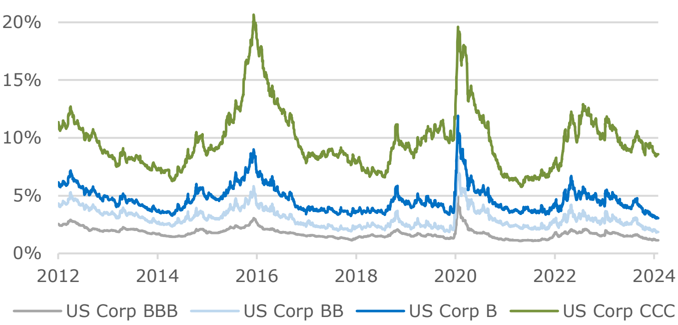


2) Interest Swap Curve: The USD and EUR curves remain inverted with shorter tenors continuously higher.

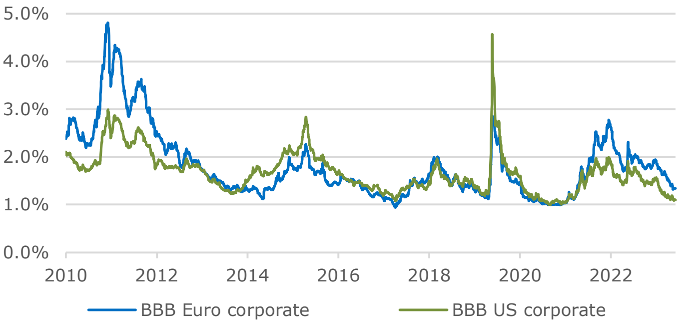


Corporate Perspective

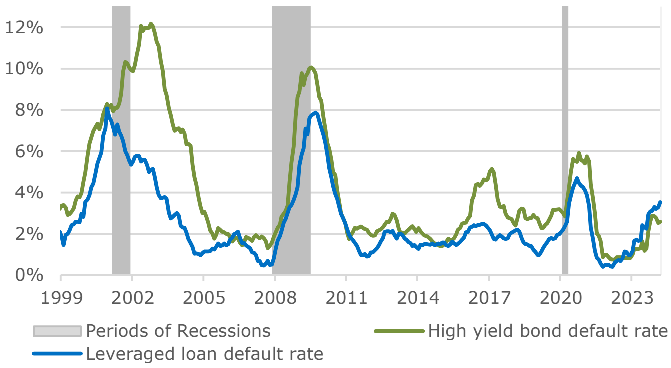
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



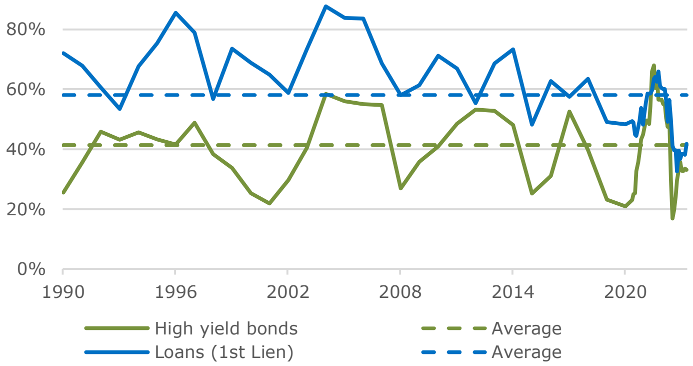
4) EU vs US: Since 2022 EU credit spreads (OAS) have remained wider than in the US.



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 (Ø58%) vs. high yield bonds (Ø41%) 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	37	-5
AA	50	-5
A	78	-6
BBB	115	-9
BB	187	-16
B	311	-15
CCC	852	-28

Global high yield (bps)

	curr	Δ month
US HY	312	-17
EU HY	352	+6
Asia HY	6	+0
EM HY	5	-0

CDS spreads (bps)

	curr	Δ month
CDX IG - US	51	-1
iTraxx IG - EU	54	-1
CDX HY - US	330	-10
iTraxx XO - EU	297	-8

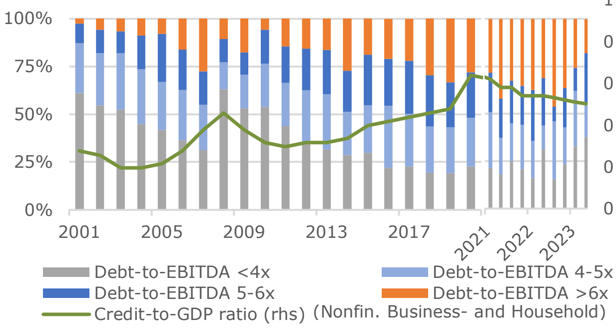
Loans and CLOs (yld, bps)

	curr	Δ month
US Loan	943	+7
CLO AAA	665	+2
CLO BBB	925	-31
CLO BB	1230	-56

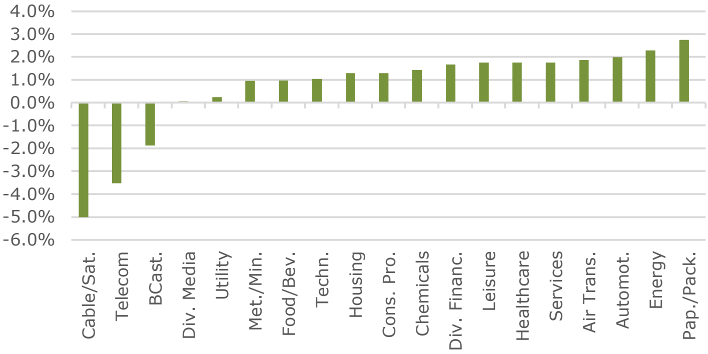
spread tightening (positive price action)

spread widening (negative price action)

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

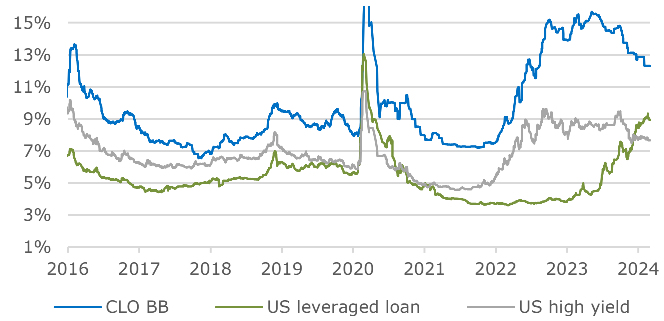


8) YTD Sector High-Yield Returns: Positive YTD results across most of the sectors, with leisure outperforming significantly.

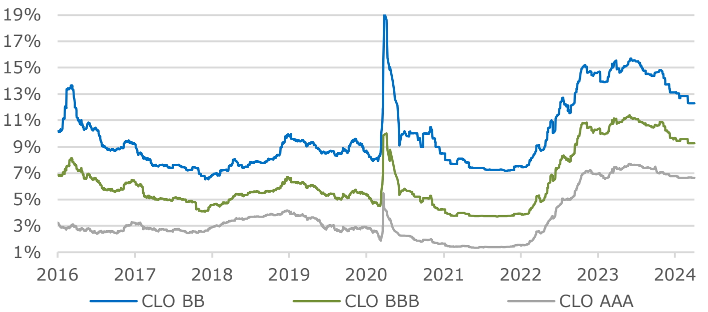


Alternative Perspective

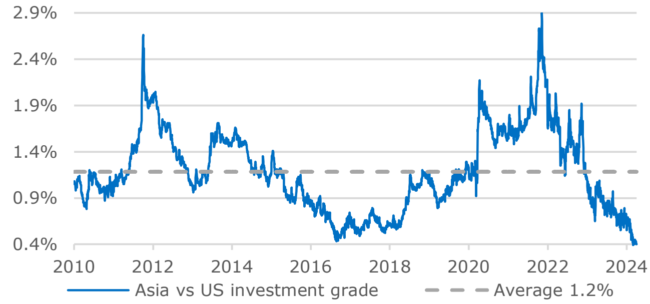
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



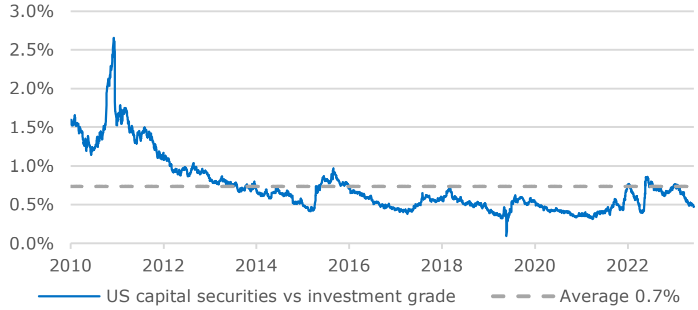
10) CLO Yields: CLOs offer an attractive yield premium over bonds and Loans.



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 - Series: AIM Credit Analysis (2)

Net Working Capital (NWC) and Liquidity management.

Last month, we discussed the importance of cash generation in corporate credit analysis and why the cash flow statement sheds more light than the profit and loss statement in this regard. This month, we delve into a critical aspect of calculating Operating Cash Flow, NWC calculation, and why understanding its dynamics is crucial.

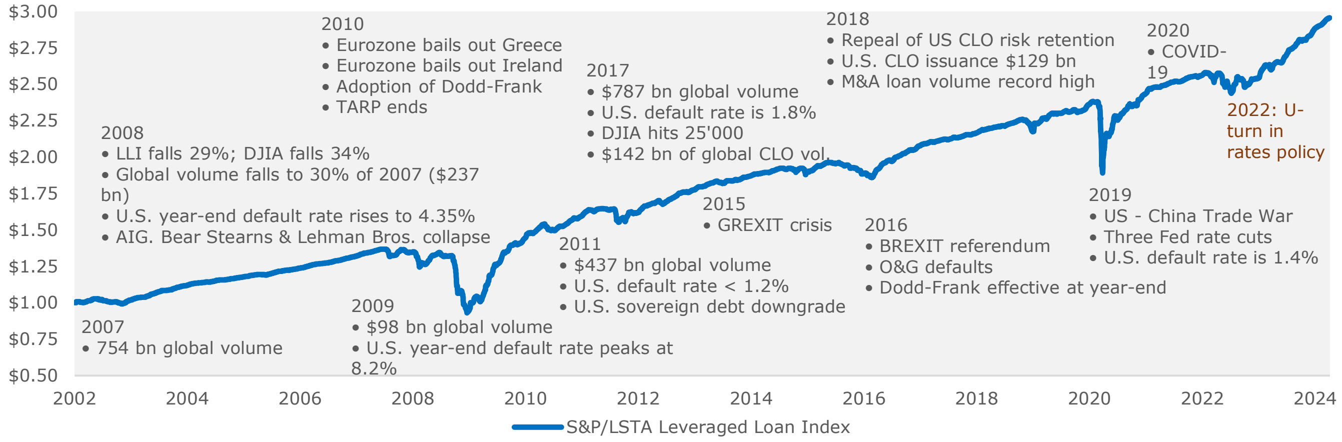
NWC represents the financial resources available for a company's day-to-day operations. Liquidity management is one of the key factors to avoid payment default and to manage the company's financial health. The formula for NWC is as follows: NWC = Inventories + Accounts Receivable – Accounts Payable.

The difference from one year to another indicates whether the company generates or consumes cash through these accounting items. However, it is important to understand the context and the reasons behind the variations in order to be able to judge their evolution.

Segmentation of the WC Components

Item	Balance Sheet	An Increase Will:
Inventories	Assets	Consume Cash
Acc. receivables	Assets	Consume Cash
Acc. Payables	Liabilities	Increase Cash

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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