Monthly Spotlight

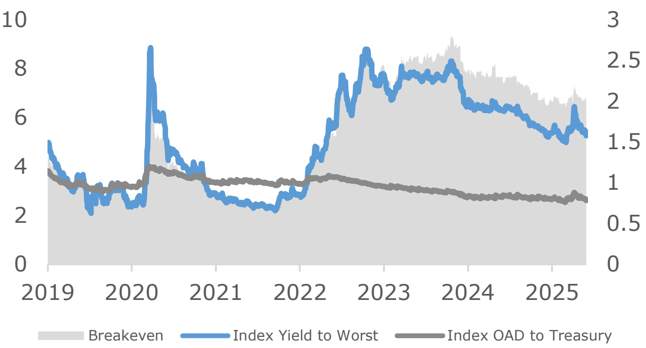
Attractive Breakeven Cushion in European High Yield

As of the end of May, the European High Yield index delivered a return of over 1.3%, fully erasing the losses from March and reaching new highs for the year at 2.30%.

Despite this strong performance, the European High Yield market continues to offer an attractive medium and long-term opportunity, considering that default rates are expected to remain contained and breakevens still provide a cushion of 201 basis points. This is illustrated in the chart on the right, which shows the Pan-European high yield bond index (with the left axis reflecting Yield to Worst and Option Adjusted Duration, and the right axis showing the breakeven).

The current carry provides a substantial buffer against potential increases in yields before investors would begin to experience negative total returns over a 12-month period.

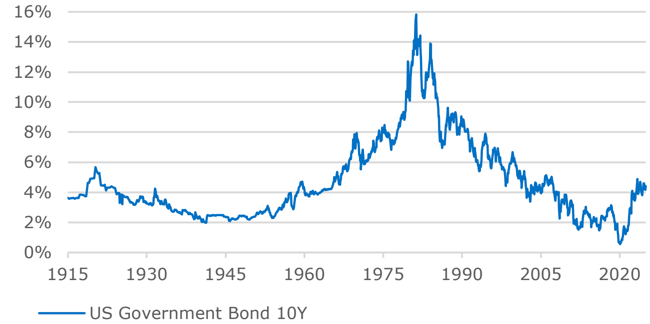
Pan-European High Yield (Euro)



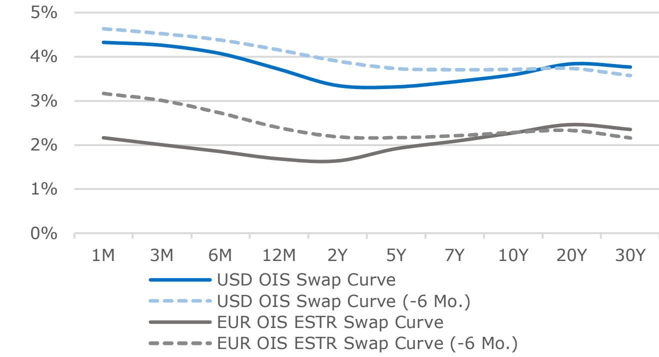
Breakeven: The amount yields can increase before returns turn negative.

Rates Perspective

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

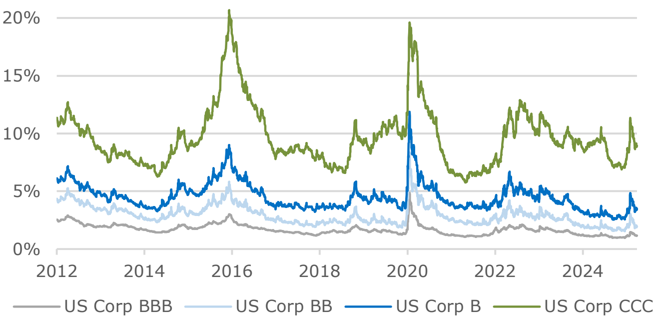


2) Interest Swap Curve: The USD and EUR curves are V-shaped with minima around 2Y maturities.

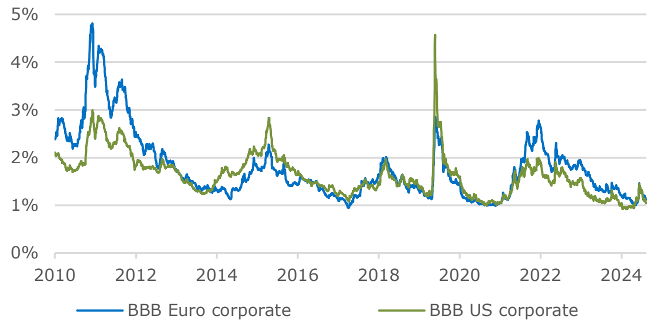


Corporate Perspective

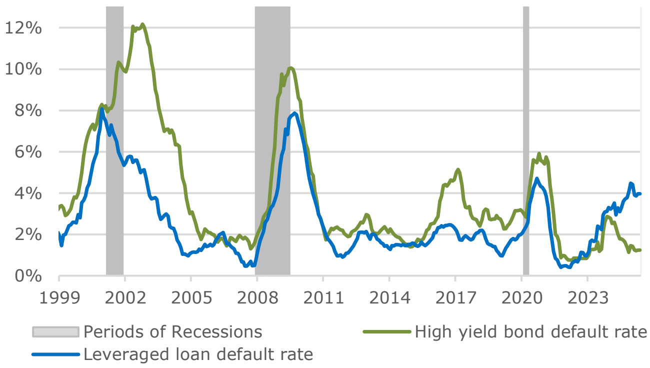
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



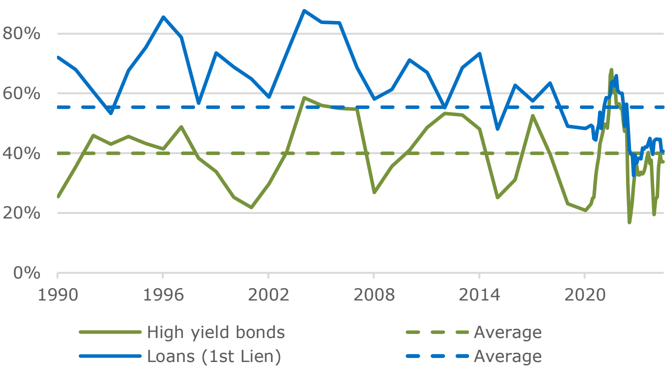
4) EU vs. US: EU credit spreads (OAS) are now at similar levels than in the US.



5) Default Rates: HY bond default rates have been structurally higher (Ø4.0%) vs. loans (Ø2.7%).



6) Recovery Rates: Recovery rates of leveraged loans are higher (Ø55%) vs. high yield bonds (Ø40%) 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	-9
AA	49	-12
A	76	-14
BBB	115	-22
BB	197	-57
B	349	-62
CCC	896	-104

Global high yield (bps)

	curr	Δ month
US HY	331	-63
EU HY	326	-44
Asia HY	575	-29
EM HY	418	-57

CDS spreads (bps)

	curr	Δ month
CDX IG - US	56	-11
iTraxx IG - EU	58	-10
CDX HY - US	351	-56
iTraxx XO - EU	300	-50

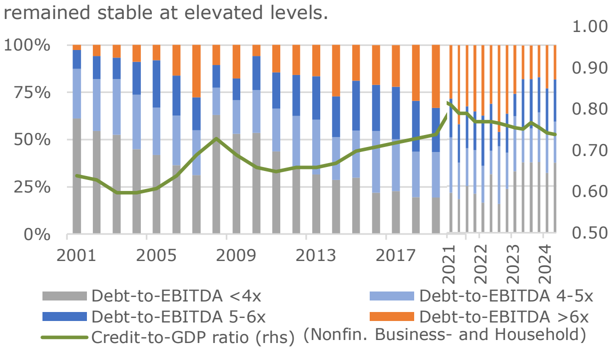
Loans and CLOs yields (bps)

	curr	Δ month
US Loan	796	-19
CLO AAA	567	-1
CLO BBB	795	-1
CLO BB	1095	-1

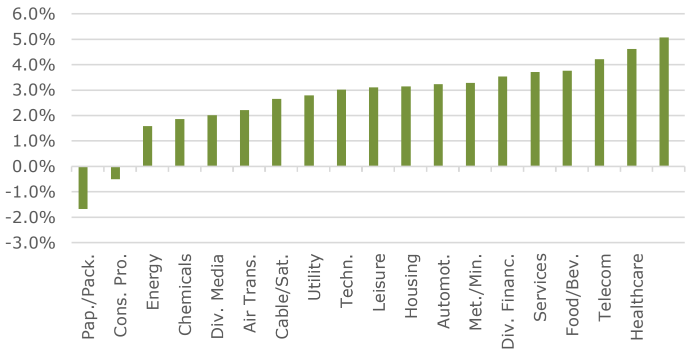
spread tightening (positive price action)

spread widening (negative price action)

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

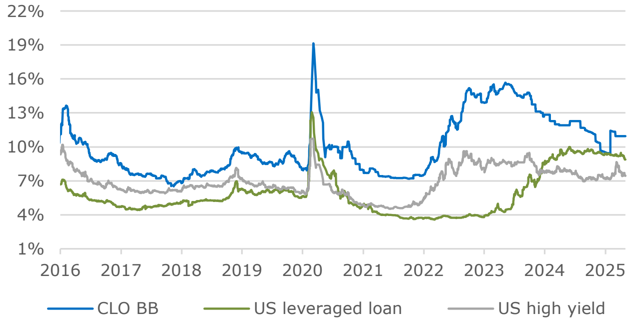


8) YTD Sector High-Yield Returns: Positive YTD results across most of the sectors.

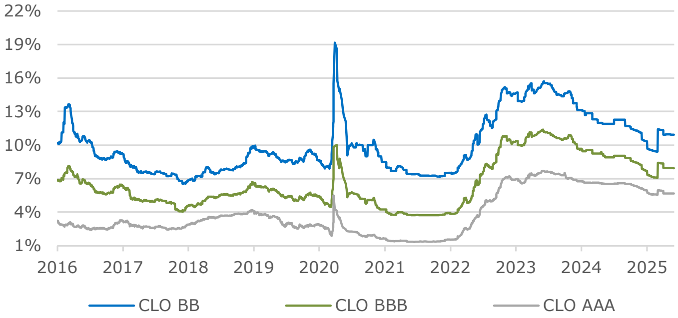


Alternative Perspective

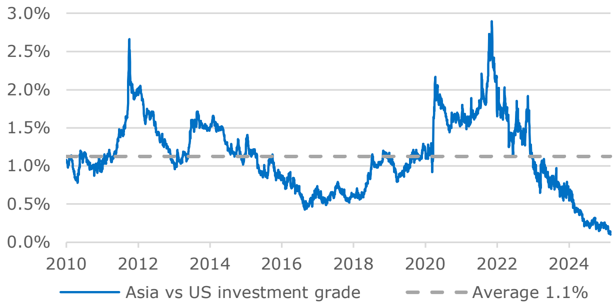
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs. Loans and HY bonds.



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.

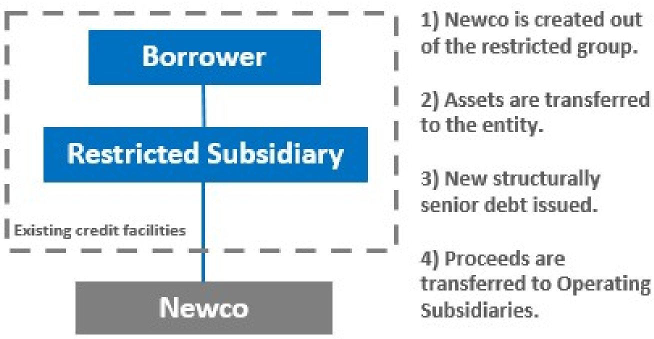
Education Corner - Series: AIM Credit Analysis (15)

Liability Management Exercises: Asset Drop-Downs

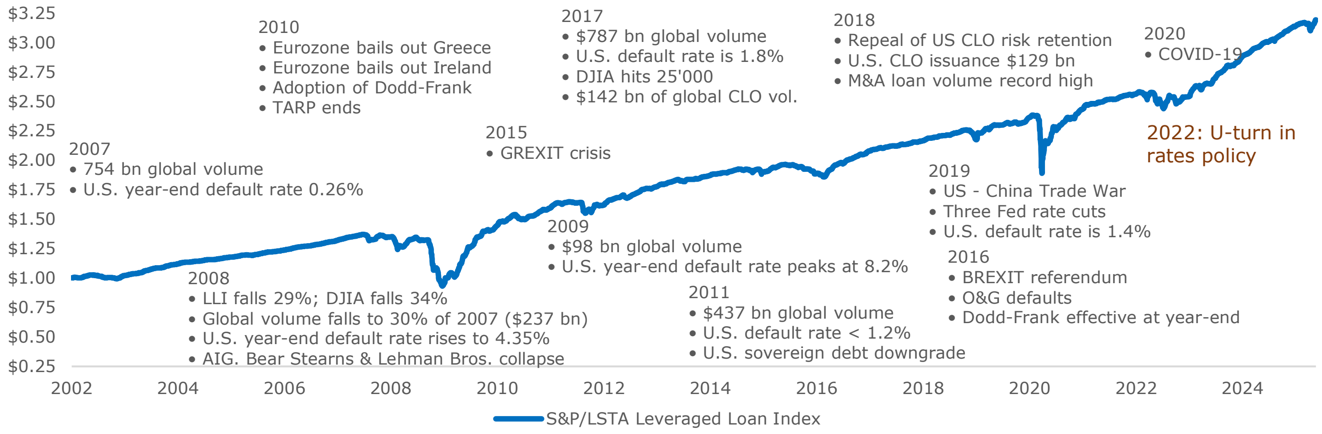
Last month, we explored the growing prevalence of Double-Dip structures in liability management exercises (LMEs). This month, we will take a closer look at another sophisticated liability management tool: Asset Drop-Downs. Famously utilized in high-profile restructurings such as Caesars Palace and J. Crew, Asset Drop-Downs involve transferring assets out of the credit group, thereby making them potentially available as collateral for new lenders.

These transactions typically involve transferring a borrower's assets to an unrestricted subsidiary. The company then issues new debt, securing it with the now unencumbered collateral and effectively subordinating the excluded lenders to a second lien position. This structure provides distressed companies with an effective means to raise additional capital by establishing a new priority claim on the transferred assets.

Asset Drop-Down Example



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

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