

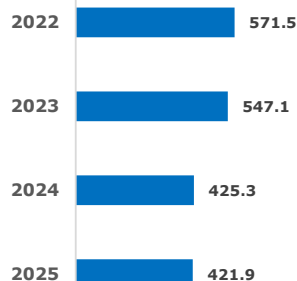
## Monthly Spotlight

## AT1 reset spreads tightening increase the extension risk

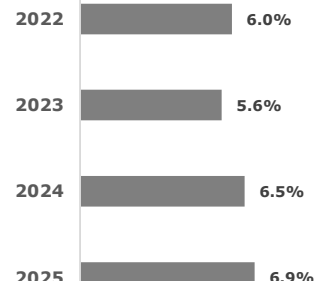
AT1 bonds are trading with historically high yields and coupons, giving some investors the impression of both attractive carry and certainty of calls in the future. However, an important metric that we believe has often been overlooked during this period is the reset spread. The reset spread is the additional yield added to a market rate to determine the coupon the bank will pay if it skips its first call option. While overall yields remain historically high, large orders for new AT1s have allowed banks to offer some of the tightest spreads in their issuance history, which increases the risk of extension in the future (see graph on the right).

Banks are incentivized in many ways to call their AT1 bonds, but if the reset spread is lower than the yield they would pay by issuing a new AT1, the reduced economic incentives for the bank increase the extension risk of the bonds.

## Average Reset Spread (bps)



## Bid Yield To Call (%)

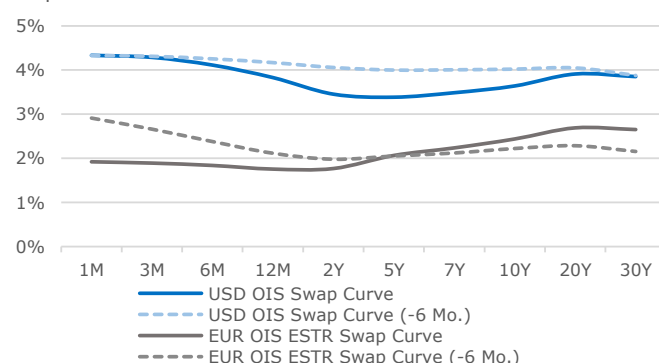


## Rates Perspective

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

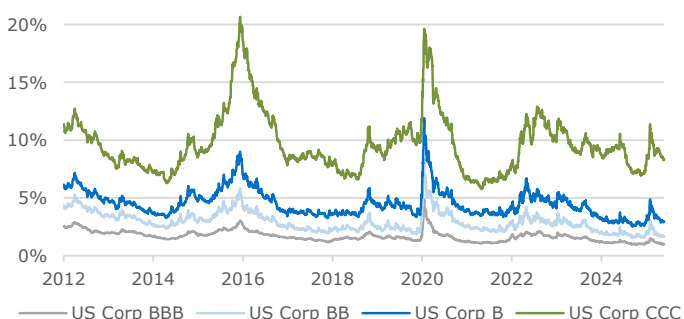


**2) Interest Swap Curve:** The USD and EUR curves are V-shaped with minima around 2Y maturities.



## Corporate Perspective

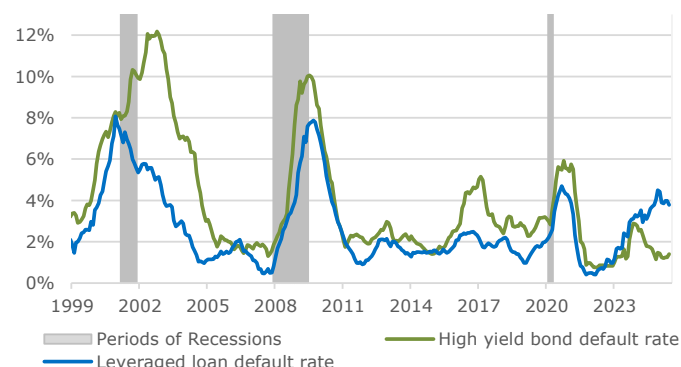
**3) US Corp. Rating:** Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



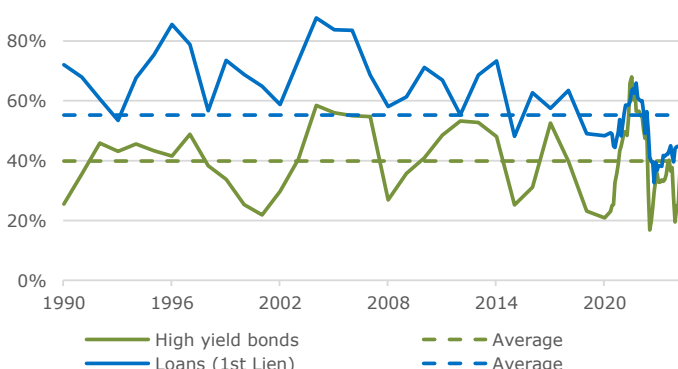
**4) EU vs. US:** EU credit spreads (OAS) are now at similar levels than in the US.



**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	35	-2
AA	49	+0
A	73	-3
BBB	108	-7
BB	171	-26
B	305	-44
CCC	886	-10

### Global high yield (bps)

	curr	Δ month
US HY	296	-35
EU HY	310	-16
Asia HY	537	-39
EM HY	405	-14

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

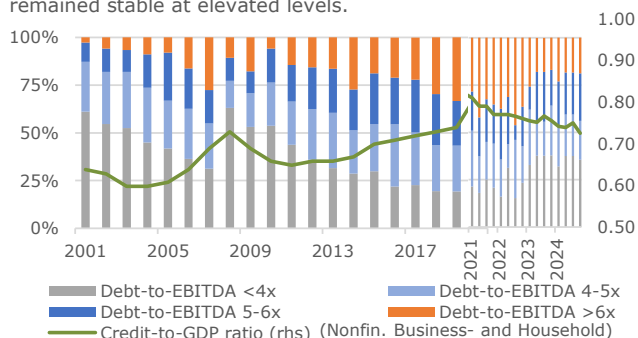
### CDS spreads (bps)

	curr	Δ month
CDX IG - US	51	-5
iTraxx IG - EU	55	-3
CDX HY - US	318	-33
iTraxx XO - EU	283	-18

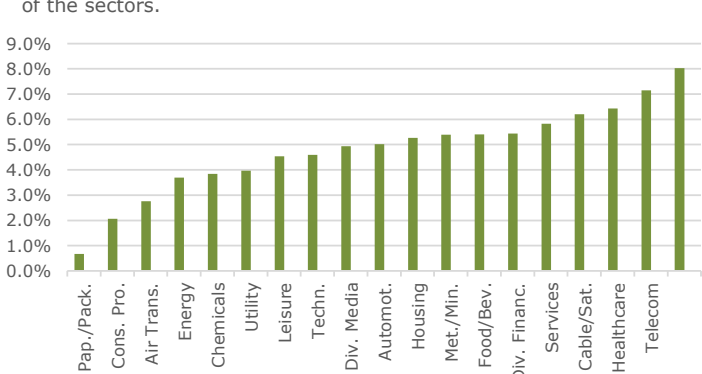
### Loans and CLOs yields (bps)

	curr	Δ month
US Loan	777	-19
CLO AAA	547	-21
CLO BBB	752	-43
CLO BB	999	-96

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

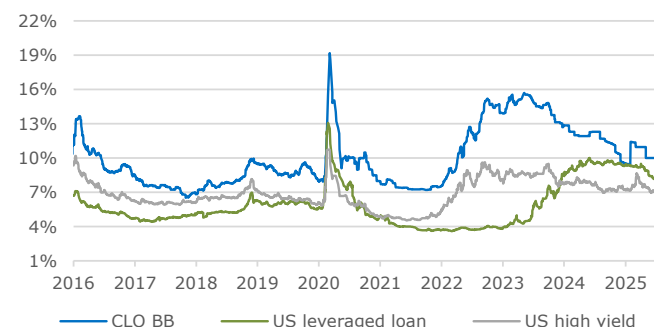


**8) YTD Sector High-Yield Returns:** Positive YTD results across most of the sectors.

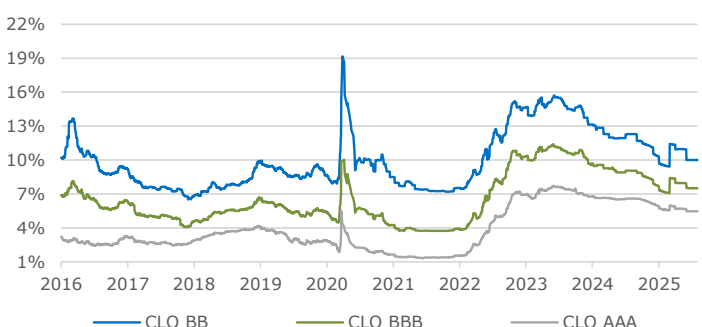


## Alternative Perspective

**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 (17)

### Creditor Protection: Covenant types

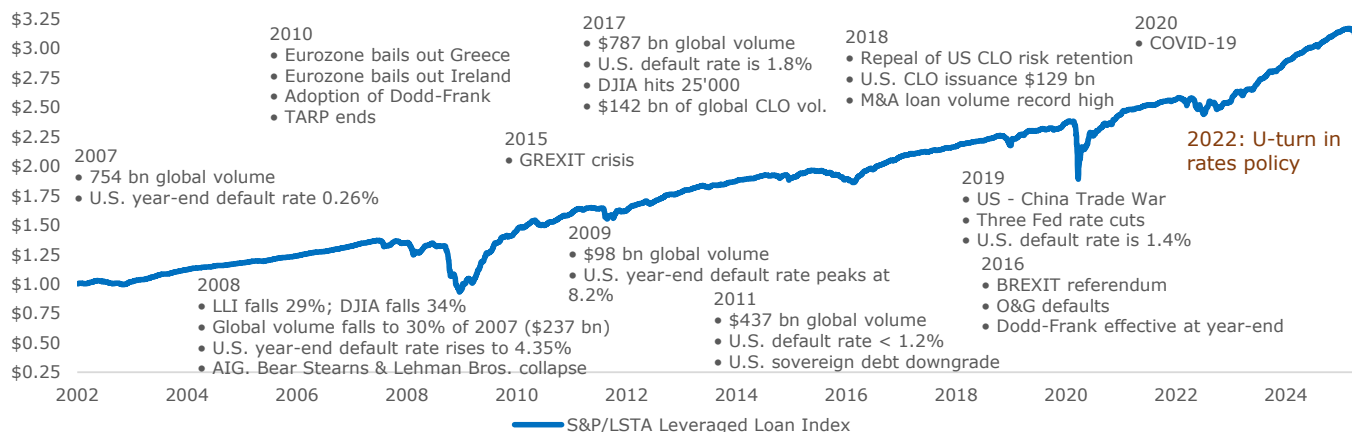
Covenants are legally binding clauses included in the documentation of a bond or lending agreement and they are designed to protect the interests of bondholders by placing certain restrictions or requirements on the issuer.

Credit agreements and bond indentures generally contain three main types of covenants. Affirmative covenants require the borrower to take certain actions, such as fulfilling financial reporting obligations. Negative covenants restrict the borrower from undertaking specific activities like incurring additional debt, and these are tested only upon particular events. Financial covenants must be continuously maintained and regularly tested, often involving metrics such as maximum senior and total leverage ratios assessed on a quarterly basis. Non-compliance with financial covenants constitutes a default event, requiring debt holders to approve a waiver or amendment to the credit agreement.

### Types Of Covenants & Examples

<b>Affirmative Covenants</b>	Financial reporting requirements Compliance with laws
<b>Negative Covenants</b>	Limitation on indebtedness Restrictions on liens
<b>Financial Covenants</b>	Maximum senior and total leverage Minimum interest coverage

## 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

Alpinum 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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