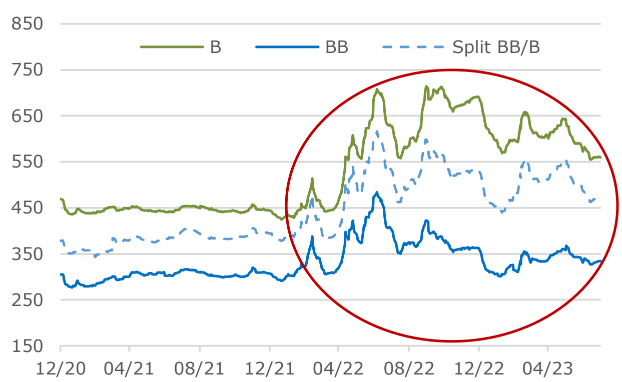
Monthly Spotlight

Syndicated loans discount margins are still elevated

While increasing risk free rates have been the key drivers of rising yields and returns of syndicated loans during the last twelve months, the credit spreads, represented as discount margins over floating benchmark rate, have exhibited significant volatility during the same period.

Single B-rated loans have been widening disproportionately, with increasing risk premia sensitivity evident also on recently-downgraded split-rated BB/B loans. On a YTD basis, the discount margins have tightened due to multiple factors and also thanks to the economy avoiding a recession so far. At current discount margins of 560 bps (-130 bps YTD), single B loans are still pricing-in an annual default rate in the range to 8 to 9 percent. This is well above long term average except for recession periods. Nevertheless, diligent credit selection and proactive approach at times of high spread volatility remain key for a successful loan strategy.

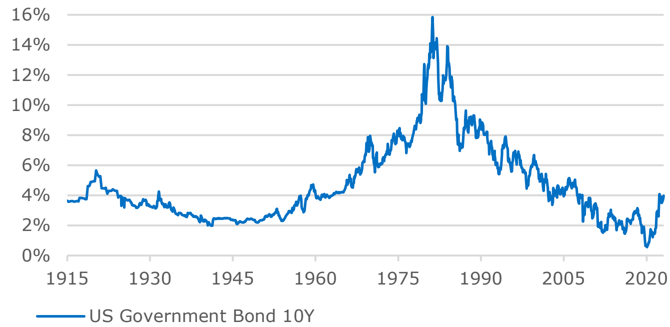
Elevated syndicated loans discount margins



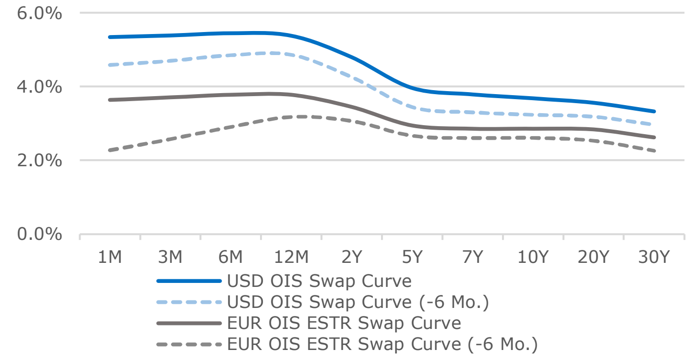
Source: CS Lev Loan Index

Rates Perspective

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

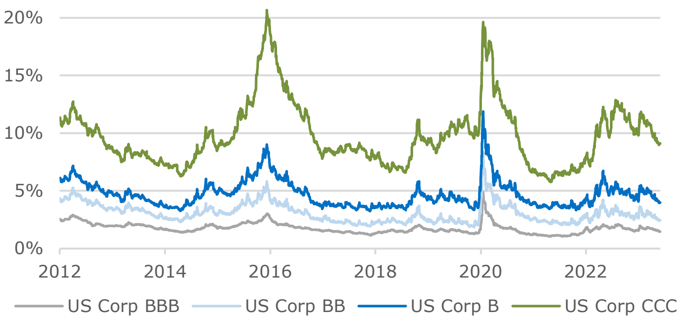


2) Interest Swap Curve: The USD and EUR curve further inverted as shorter tenors continued to increase.



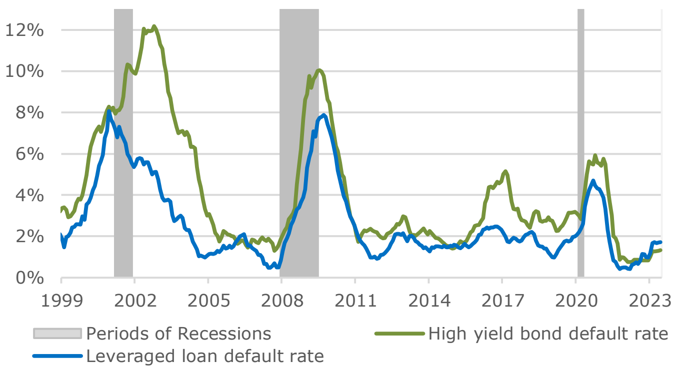
Corporate Perspective

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

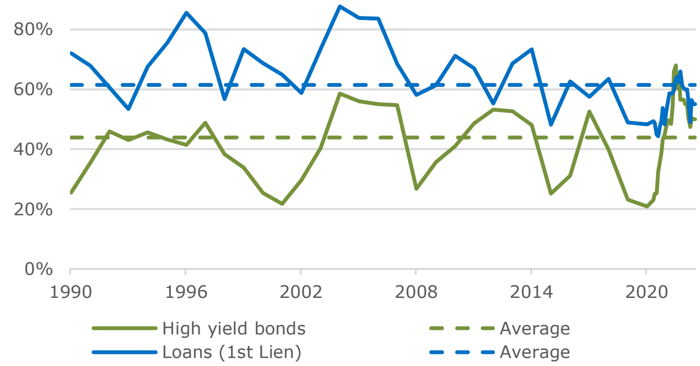


4) EU vs US: Credit spreads (OAS) between the US and EU have narrowed since the start of 2023.

5) Default Rates: HY bond default rates are structurally higher (Ø4.2%) vs. loans (Ø2.6%).



6) Recovery Rates: Recovery rates of leveraged loans are higher (Ø61%) vs. high yield bonds (Ø44%) 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	48	-6
AA	65	-9
A	100	-13
BBB	147	-18
BB	245	-35
B	396	-55
CCC	906	-75

Global high yield (bps)

	curr	Δ month
US HY	379	-48
EU HY	438	-12
Asia HY	801	-122
EM HY	454	-49

CDS spreads (bps)

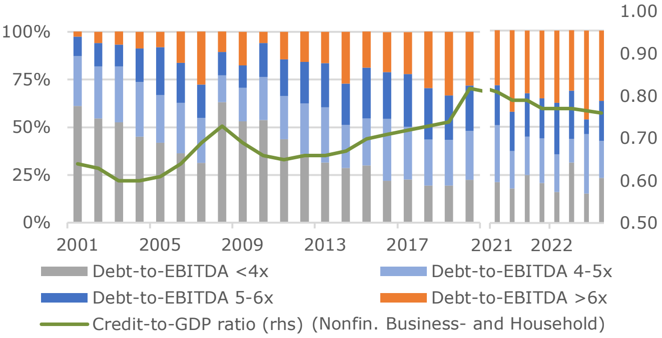
	curr	Δ month
CDX IG - US	63	-7
iTraxx IG - EU	68	-9
CDX HY - US	409	-44
iTraxx XO - EU	380	-36

Loans and CLOs (yld, bps)

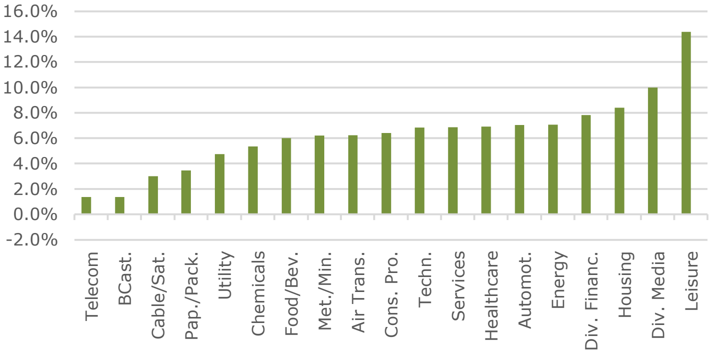
	curr	Δ month
US Loan	958	-6
CLO AAA	611	-1
CLO BBB	874	-21
CLO BB	1356	-41

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.

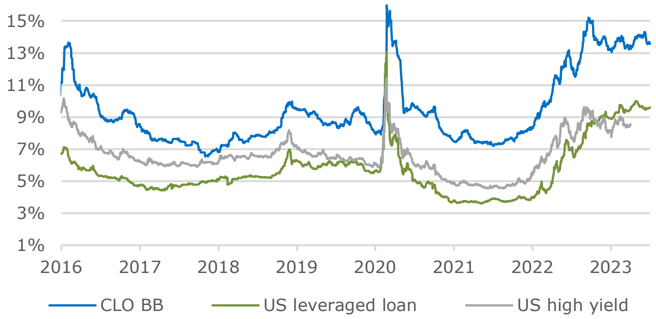


8) YTD Sector High-Yield Returns: Positive YTD results across most of the sectors, with leisure outperforming significantly.

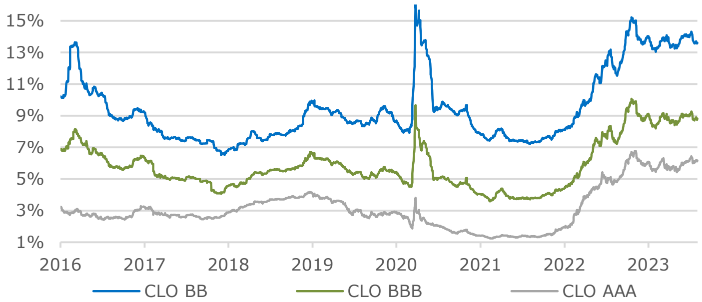


Alternative Perspective

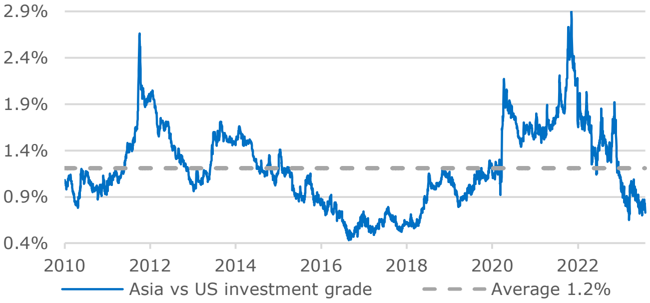
9) Loans vs. CLO vs. HY: CLO BB yields are wider vs Loans and HY bonds.



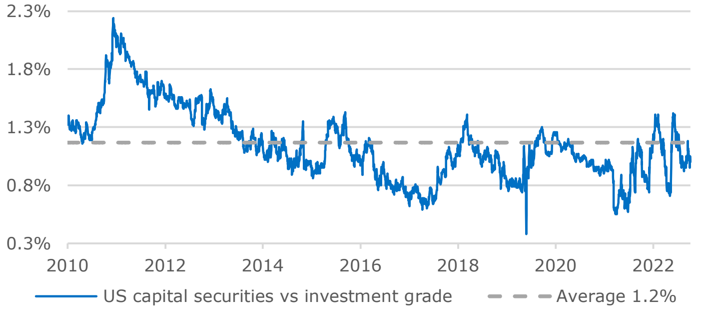
10) CLO Yields: CLOs offer an attractive yield premium over bonds and loans.



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

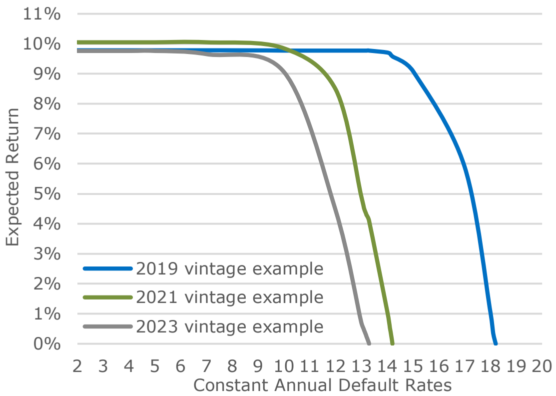
Spreads on BBB CLOs remain high despite structural strengths

At 430 bps, the spreads on BBB-rated US CLOs remain well above BBB bonds (140 bps) and even split-rated BBB/BB loans (270 bps) - see chart 10 above for overall CLO yield context. There are various reasons for this anomaly, including higher flows-driven volatility.

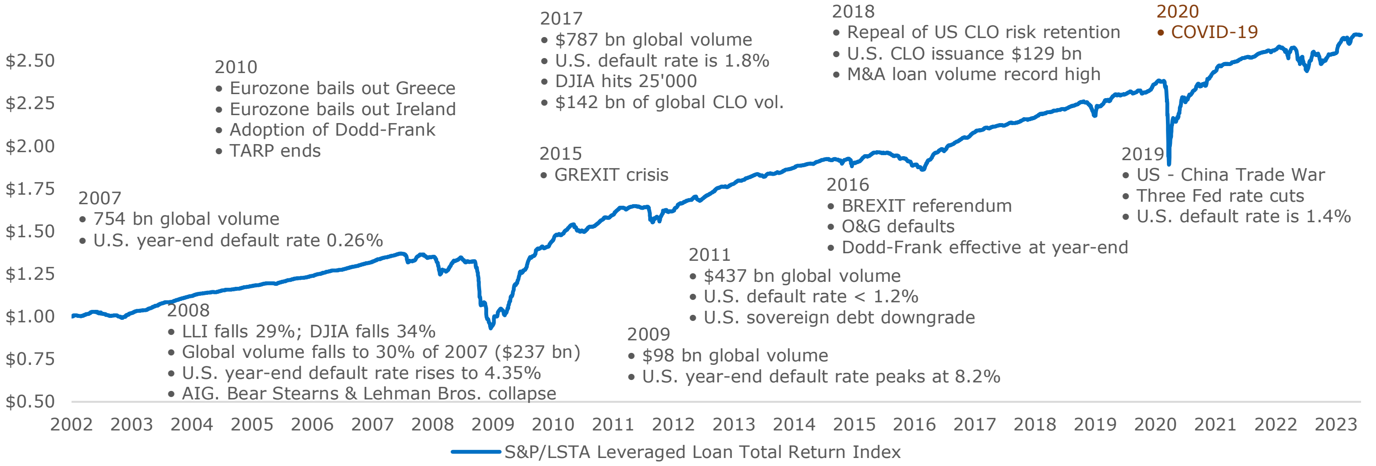
From the pure credit loss-perspective, the BBB CLO tranches are extremely resilient thanks to structural features, such as diversification of underlying loans across obligors and sectors, overcollateralization and credit support of junior tranches. In addition, active management and rebalancing of loans further mitigates losses and increases yield.

The credit resilience can be illustrated by stress-testing CLOs for expected returns under different annual default rates (held constant over the remaining life of the CLO). As evidenced on the charts, the expected returns, when priced at the current 430 bps spread, start collapsing only after higher than 10% default rates on the 2023-issued vintage. The more seasoned, and thus further de-levered, 2019 vintage does not start reducing returns until 15% default rates are reached. These scenarios represent extreme conditions with default rates held permanently higher than even the worst short term default spikes during 2008 GFC.

BBB CLOs resilient under high default rates



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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