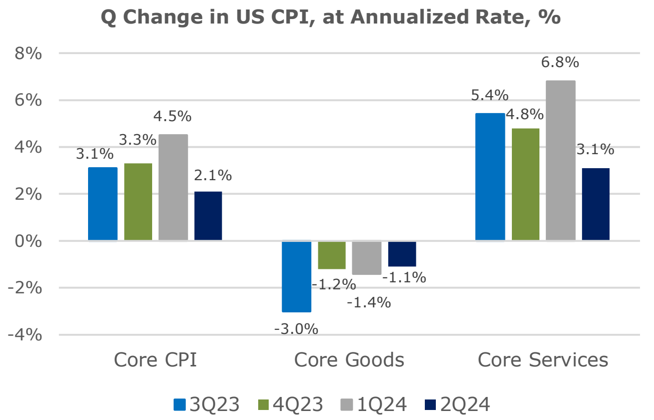

## Monthly Spotlight

**Service inflation in the U.S. is cooling down**

The global economy has to deal with higher structural inflation forces driven by aspects such as geopolitics (i.e. new tariffs, near-/on-shoring), energy transition, demographics or elevated fiscal spending. However, over the next 12 months, the US inflation could tame somewhat towards 2.5% as service inflation is expected to cool (see chart on the right side).

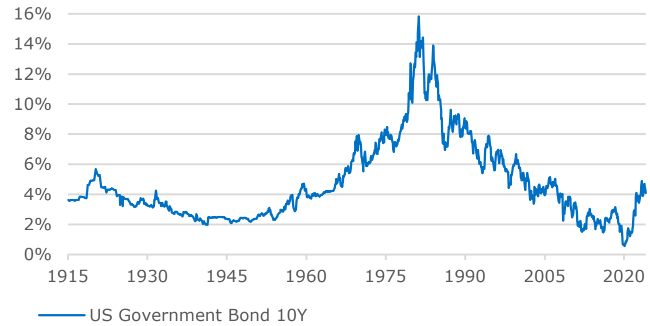
This current disinflation trend is expected to be driven primarily by a decline in service prices, including shelter inflation, which is the largest component of the CPI. Nonetheless, inflation is unlikely to reach the FED's target level of 2%.

Given the FED's dual mandate of price stability and full employment, there is now scope to reduce Fed rates to around 4% over the next 12 months or 3.5% in case the US-employment market is going to cool meaningfully ahead of us.

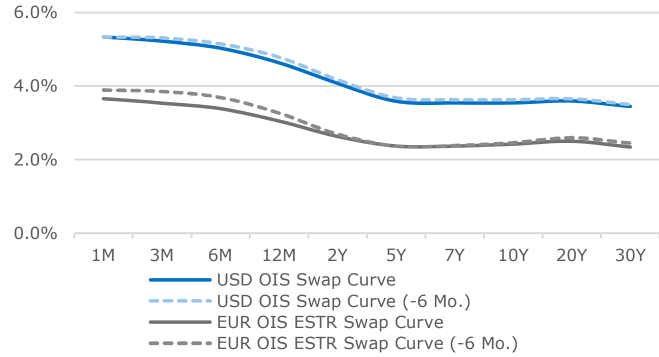



## Rates Perspective

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

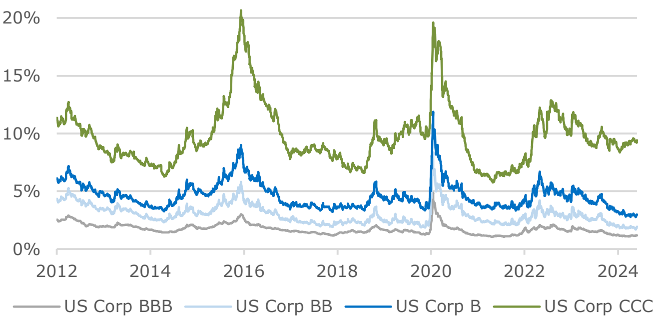



**2) Interest Swap Curve:** The USD and EUR curves remain inverted with shorter tenors continuously higher.

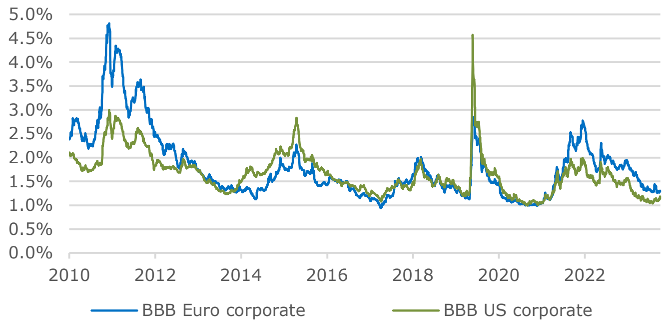



## Corporate Perspective

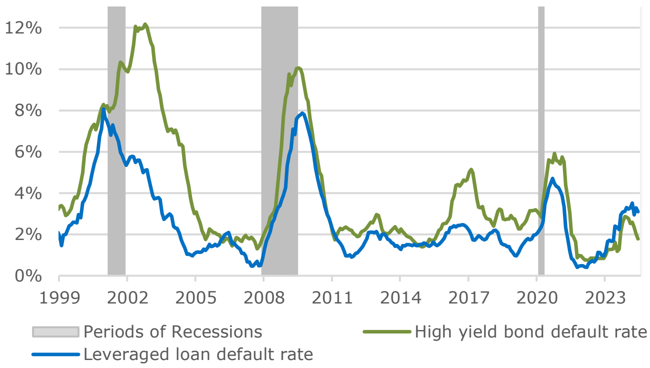
**3) US Corp. Rating:** Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



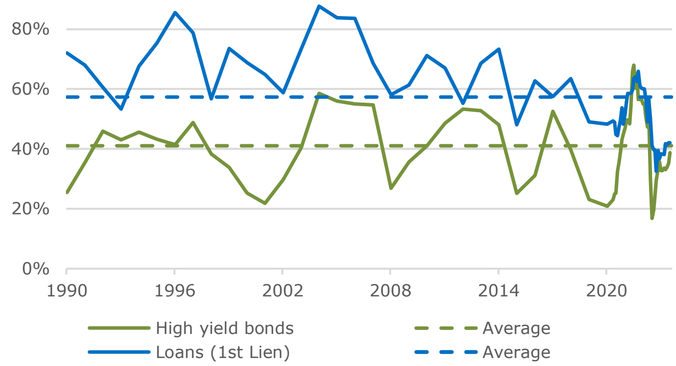

**4) EU vs US:** Since 2022 EU credit spreads (OAS) have remained wider than in the US.




**5) Default Rates:** HY bond default rates are structurally higher (Ø4.1%) vs. loans (Ø2.7%).




**6) Recovery Rates:** Recovery rates of leveraged loans are higher (Ø57%) 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** | 40 | -1 |
| **AA** | 56 | +1 |
| **A** | 83 | +1 |
| **BBB** | 120 | +3 |
| **BB** | 194 | +10 |
| **B** | 301 | +11 |
| **CCC** | 942 | +0 |

**Global high yield (bps)**

| | curr | Δ month |
|---|---|---|
| **US HY** | 325 | +7 |
| **EU HY** | 356 | +8 |
| **Asia HY** | 420 | -40 |
| **EM HY** | 531 | +13 |

**CDS spreads (bps)**

| | curr | Δ month |
|---|---|---|
| **CDX IG - US** | 52 | -2 |
| **iTraxx IG - EU** | 55 | -6 |
| | | |
| **CDX HY - US** | 331 | -13 |
| **iTraxx XO - EU** | 295 | -24 |

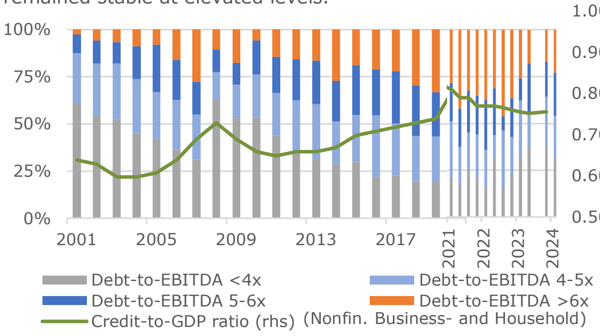
**Loans and CLOs (yld, bps)**

| | curr | Δ month |
|---|---|---|
| **US Loan** | 920 | -13 |
| | | |
| **CLO AAA** | 536 | -117 |
| **CLO BBB** | 536 | -354 |
| **CLO BB** | 536 | -657 |

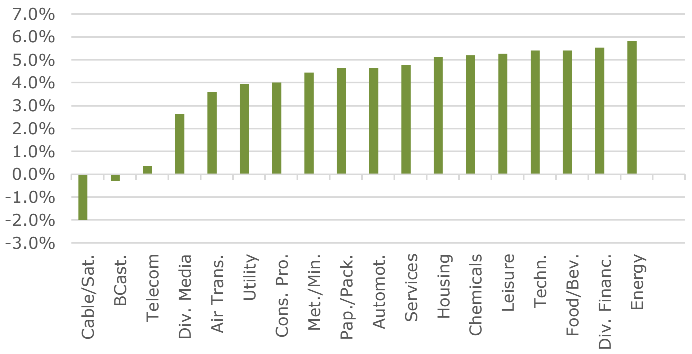
spread tightening (positive price action)

spread widening (negative price action)

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

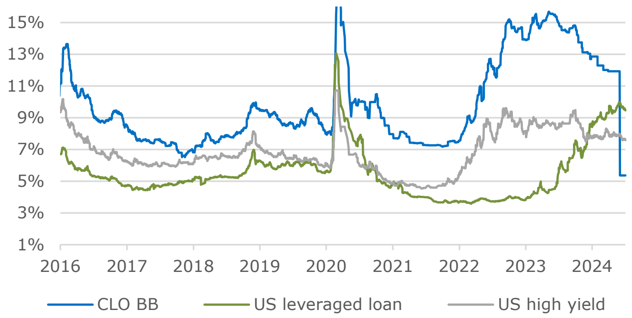



**8) YTD Sector High-Yield Returns:** Positive YTD results across most of the sectors, with leisure outperforming significantly.

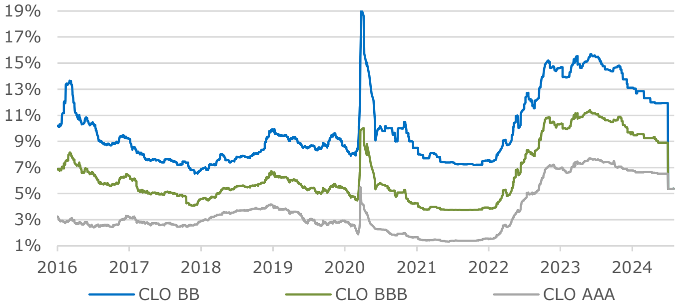



## Alternative Perspective

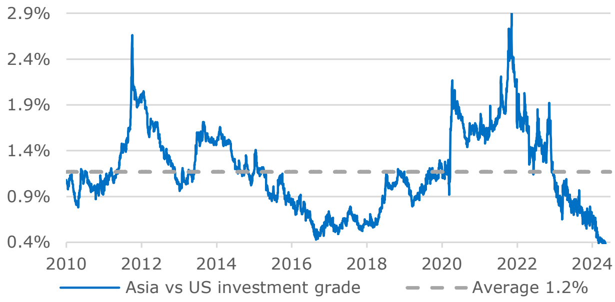
**9) Loans vs. CLO vs. HY:** CLO BB yields are wider vs Loans and HY bonds.



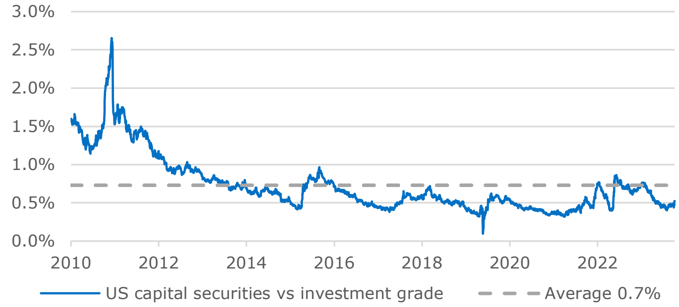

**10) CLO Yields:** CLOs offer an attractive yield premium over bonds and Loans.




**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 (6)

### Capital Structure Evaluation: Covenants and Guarantors

Issuers of bonds and loans typically have extensive corporate structures, including various holding and operating companies, often operating across multiple countries and owning diverse assets. It is therefore of the utmost importance analyzing the capital structure and understanding the position of our debt within it.

Debt is issued by an issuer entity, which serves as the primary obligor and is bound by all associated covenants. Guarantors are entities that commit, via a guarantee, to assume responsibility for the issuer's debt and adhere to the same covenants. Restricted Subsidiaries are entities that agree to abide by certain covenants but are not necessarily guarantors. Unrestricted Subsidiaries are not subject to covenants and do not act as guarantors. Holding companies, which include the parent company of the issuer, may serve as guarantors, be subject to some or all of the covenants (if they are part of the Restricted Group), or have their own financing arrangements with separate covenants.

| | Obligor | Covenants |
|---|---|---|
| **Issuer** | + | + |
| **Guarantor(s)** | + | + |
| **Restricted Subsidiaries** | - | + |
| **Unrestricted Subsidiaries** | - | - |
| **Holding Companies** | +/- | +/- |

## 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

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