Alternative Credit Letter

November 2024

Monthly Spotlight

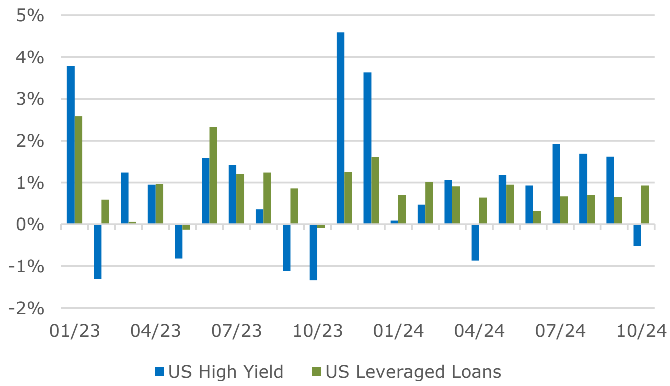
Strength of US Leveraged Loans evident in October

Leveraged loans delivered one of the strongest gains of the year during October, outperforming the high yield market by 1.45% (as shown in the right chart: blue bars high yield, green bars represent leveraged loans). The month was marked by heavy CLO issuance, robust primary market activity, and substantial fund and ETF inflows.

A sectoral breakdown reveals that telecommunications was the only positive performer in the high yield market, whereas in the leveraged loan market, only one sector, automotive, posted negative returns.

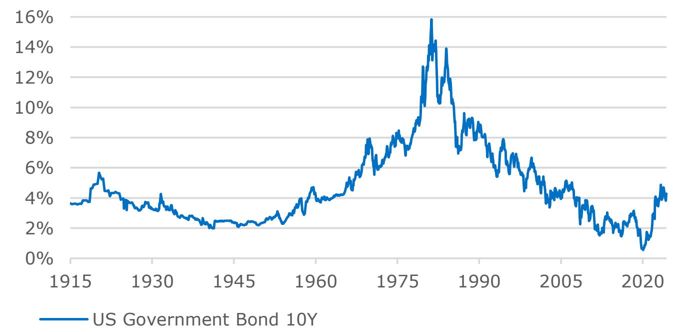
Despite the disparity in monthly performance between both indices, YTD returns are nearly identical, with the leveraged loan index returning 7.75% vs a 7.78% return for the High Yield Index. Our default rate projections, which are still low, indicate strong support for both asset classes in the coming months.

US High Yield and Leveraged Loans Performance

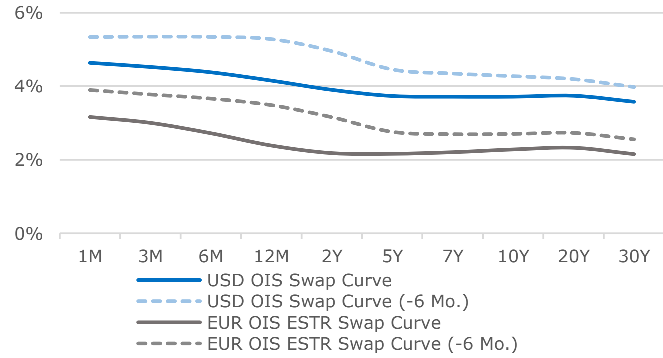


Rates Perspective

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

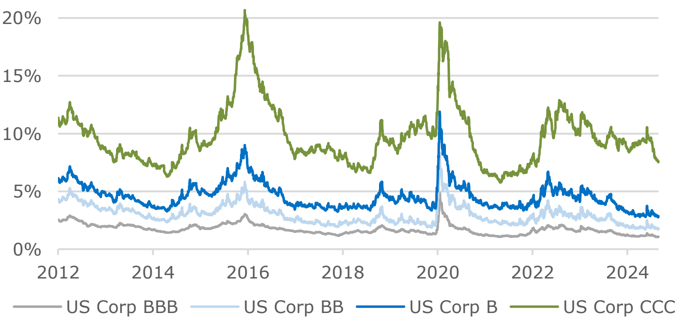


2) Interest Swap Curve: The USD and EUR curves remain inverted with shorter tenors continuously higher.

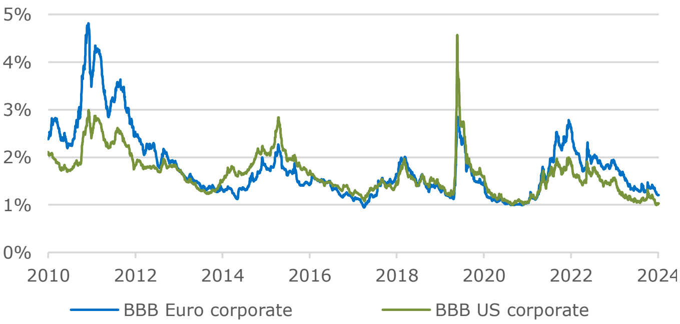


Corporate Perspective

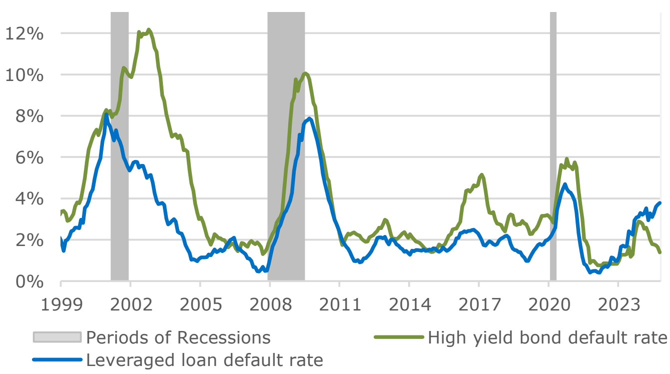
3) US Corp. Rating: Credit spreads (OAS) of lower rated high-yield bonds widened disproportionately.



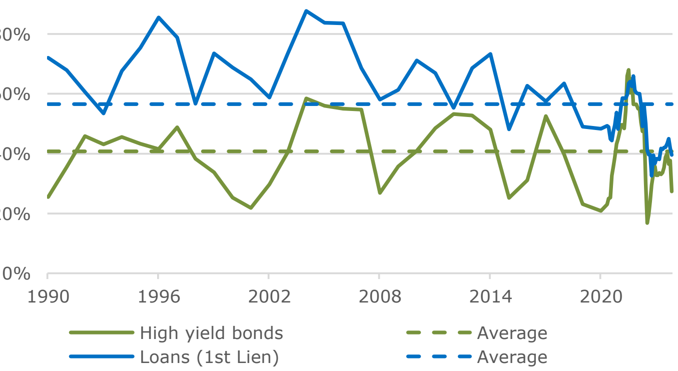
4) EU vs. US: Since 2022 EU credit spreads (OAS) have remained wider than in the US.



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	35	+1
AA	49	-3
A	71	-5
BBB	108	-8
BB	180	-9
B	286	-13
CCC	756	-46

Global high yield (bps)

	curr	Δ month
US HY	288	-15
EU HY	317	-25
Asia HY	385	-45
EM HY	431	-48

CDS spreads (bps)

	curr	Δ month
CDX IG - US	54	+1
iTraxx IG - EU	59	-0
CDX HY - US	336	+7
iTraxx XO - EU	314	+3

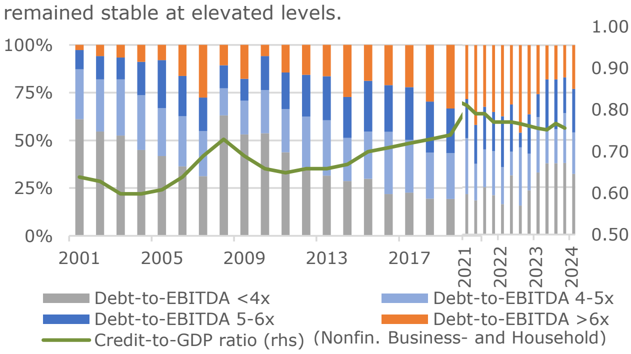
Loans and CLOs yields (bps)

	curr	Δ month
US Loan	842	-45
CLO AAA	632	-17
CLO BBB	844	-37
CLO BB	1131	-32

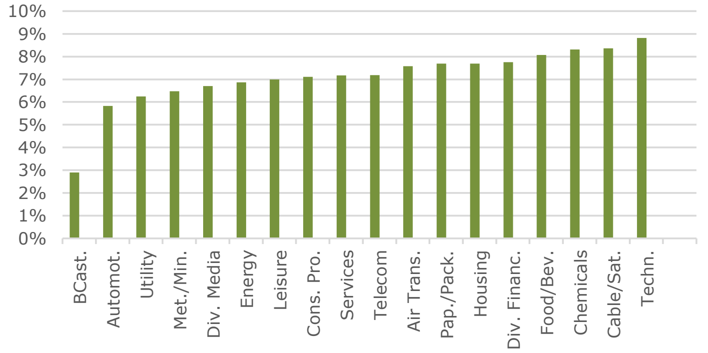
spread tightening (positive price action)

spread widening (negative price action)

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

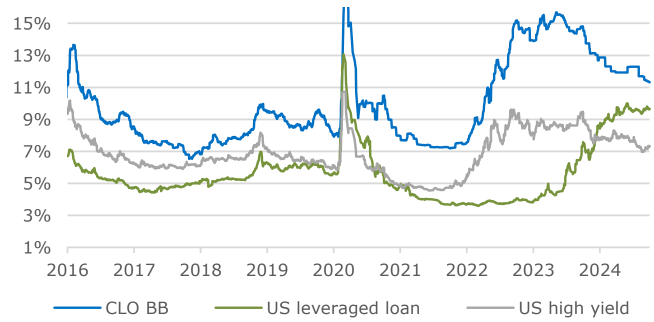


8) YTD Sector High-Yield Returns: Positive YTD results across most of the sectors.

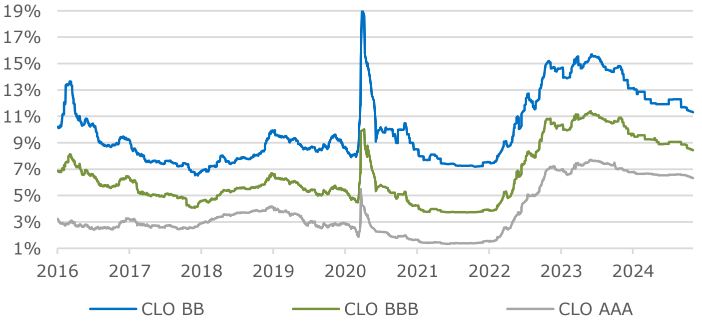


Alternative Perspective

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 (9)

Debt and off-balance sheet adjustments

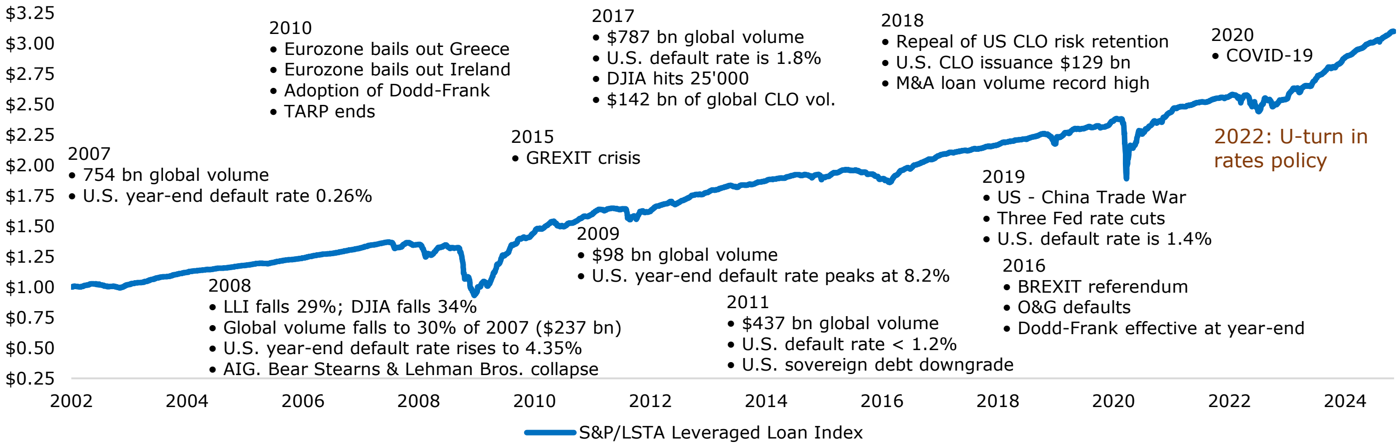
Accounting standards allow for a degree of subjectivity in how financial statements are classified and presented, which companies may use to bias their financial results in various ways. This often serves to improve their financial image, potentially leading to better financing terms, favorable analyst recommendations, and higher credit ratings.

To avoid overly optimistic or, in some cases, misleading figures, it is important to recognize the accounting adjustments that can offer a clearer understanding of the company's actual financial position and enable better comparisons with industry peers.

Examples of such adjustments, frequently applied by credit analysts, include adding securitized receivables back to debt if the risk has not been transferred, incorporating lease obligations, including unfunded and post employment benefits, or adding Guarantees and Contingent Liabilities on behalf of other entities of the group.

Reported Debt	$	850
EBITDA	$	220
Cash	$	120
Debt Adjustments		
Receivables Securitization (SPE)	$	65
Lease Liabilities	$	165
Post Retirement Benefit Obligations	$	120
Adjusted Debt	$	1'200
Net Debt/EBITDA		**x3.3**
Adj. Net Debt/EBITDA		**x4.9**

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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