Monthly Spotlight

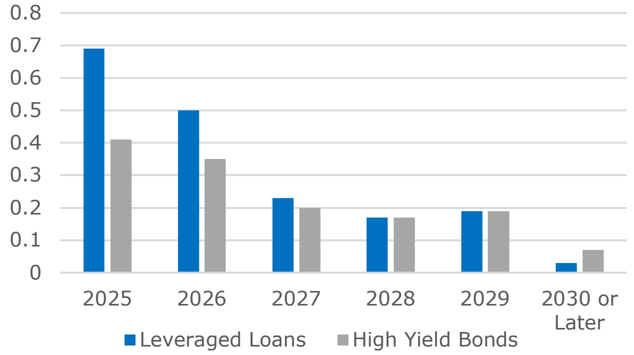
Strong Performance and Outlook for US Leveraged Loans

Year to date, the US leveraged debt market posted strong performance, with returns of 8.3% in the leveraged loan (syndicated bank loans) segment and 8.7% in high yield bonds.

In contrast to previous years, the short-term maturity profile of the leveraged loan market is heavily weighted toward lower-rated issuers (single B's/CCC's) compared to the high yield bond market, where most maturities in the upcoming year are concentrated within the BB rating category, indicating a relatively higher credit quality and lower defaults (Graph on the right).

Nevertheless, we remain optimistic about the leveraged loan market, anticipating high single-digit returns driven by several supportive factors including coupons exceeding 7%, sustained demand from investors, robust CLO issuance and moderate increase of defaults. These structural strengths and positive dynamics are expected to underpin positive performance.

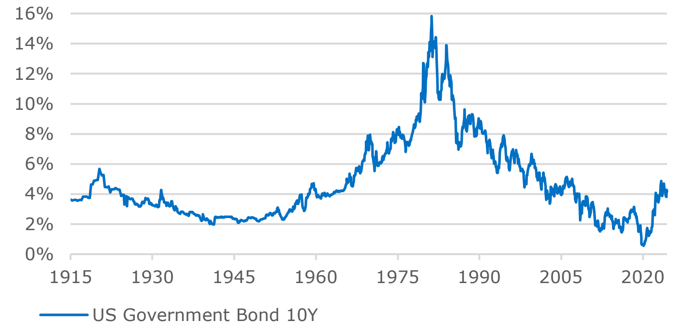
LL/HY Exposure to lower rated Issuers



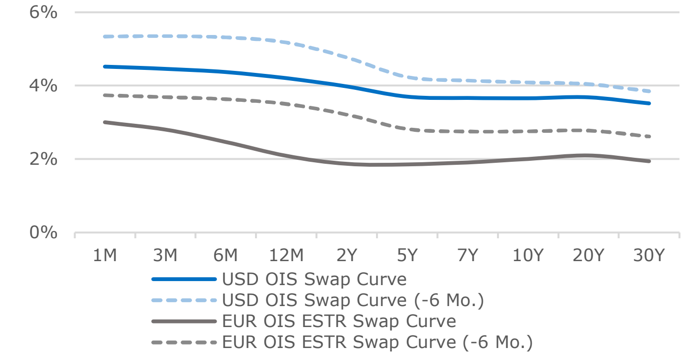
Lower rated Issuers: B's, CCC's, and Non Rated

Rates Perspective

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

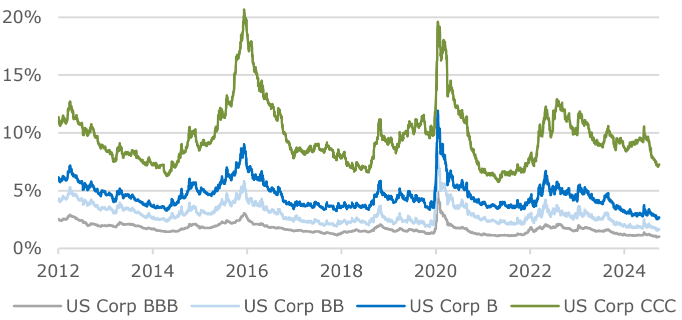


2) Interest Swap Curve: The USD and EUR curves remain inverted with shorter tenors continuously higher.



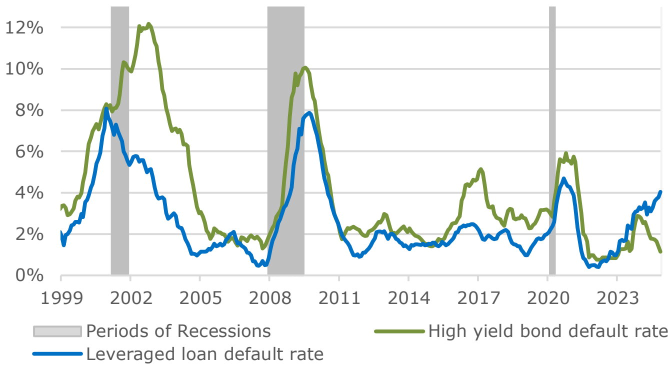
Corporate Perspective

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

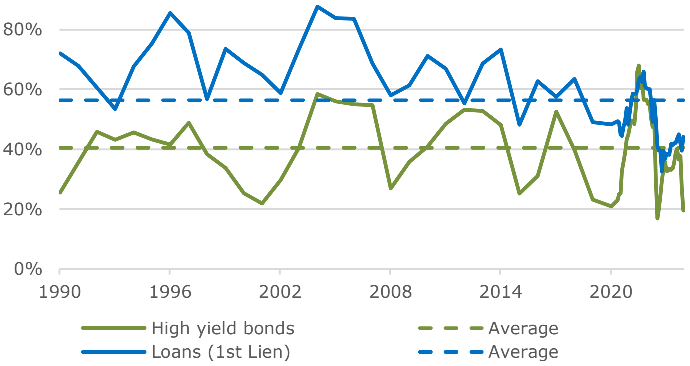


4) EU vs. US: Since 2022 EU credit spreads (OAS) have remained wider than in the US.

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



6) Recovery Rates: Recovery rates of leveraged loans are higher (Ø56%) 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	34	-1
AA	47	-2
A	68	-3
BBB	102	-6
BB	167	-13
B	269	-17
CCC	726	-30

Global high yield (bps)

	curr	Δ month
US HY	272	-16
EU HY	341	+24
Asia HY	437	+52
EM HY	410	-20

CDS spreads (bps)

	curr	Δ month
CDX IG - US	48	-6
iTraxx IG - EU	56	-3
CDX HY - US	295	-41
iTraxx XO - EU	298	-16

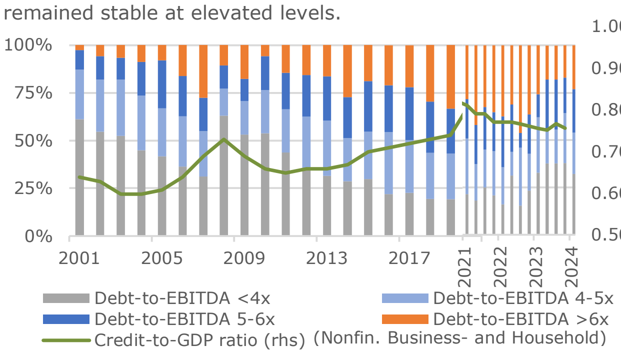
Loans and CLOs yields (bps)

	curr	Δ month
US Loan	811	-31
CLO AAA	610	-22
CLO BBB	821	-22
CLO BB	1109	-22

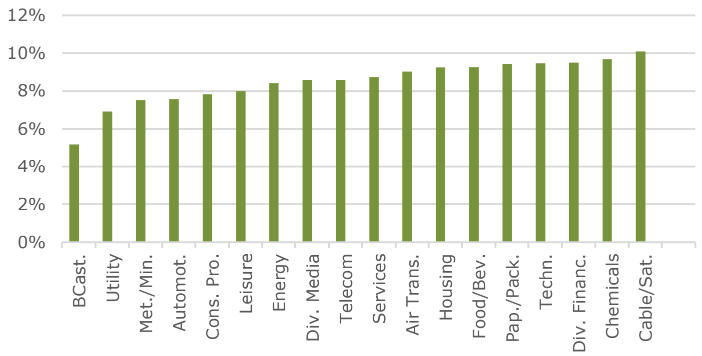
spread tightening (positive price action)

spread widening (negative price action)

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

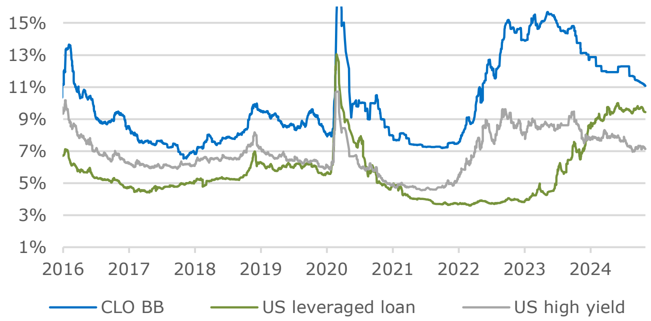


8) YTD Sector High-Yield Returns: Positive YTD results across most of the sectors.

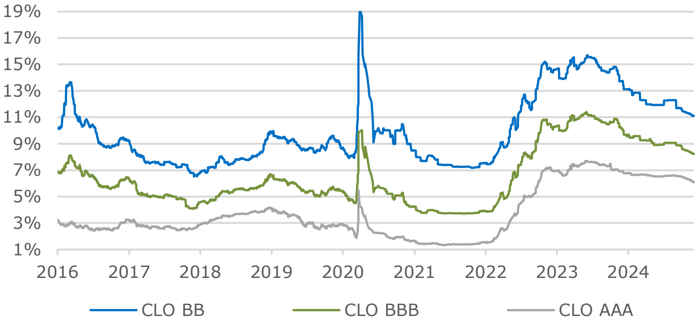


Alternative Perspective

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 (10)

Bank Capital Structures

Banks operate under unique frameworks due to their systemic importance and leverage, resulting balance sheets that are both distinct and more intricate compared to other types of corporations. Their capital structure includes shareholder equity, retained earnings, debt and deposits, which allows lending, supports investments, and ensures liquidity. Maintaining a robust capital buffer is essential to safeguard depositors from unforeseen losses, with regulatory oversight ensuring strict compliance.

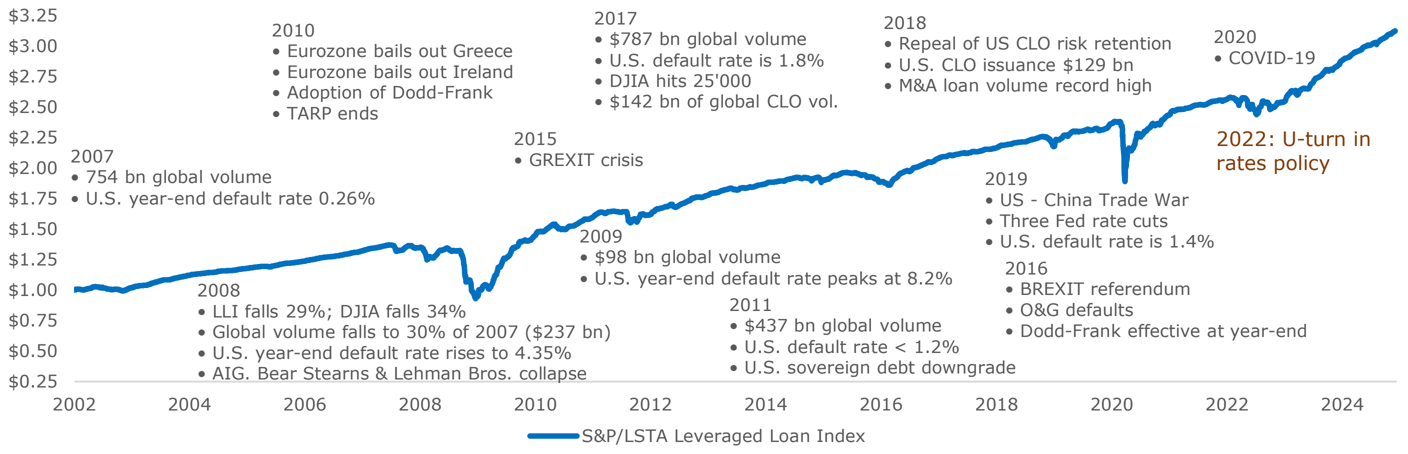
For fixed income investors, the riskiest instruments are Additional Tier 1 (AT1) securities. These are deeply subordinated, can be extended to perpetuity, and allow coupon deferral at the bank's discretion. Tier 2 instruments, while subordinated, offer fixed maturity and mandatory coupon payments, making them less risky. Senior debt, a safer segment, is split into bail-inable and non-bail-inable categories, reflecting its treatment in crises. Each tier offers varying risk-reward profiles, emphasizing the need for careful evaluation by investors.

Typical Bank Capital Structure

	Equity	AT1	Tier 2	Bail-In Sr	Senior Pref
Seniority	Jr Subordinated	Deeply Subordinated	Subordinated	Senior Subordinated	Senior
Maturity	Perpetual	Perpetual, Usually NC 5	Usually, 10 NC 5	Usually, >5y	Usually, 3-5y
Payments	Discretionary	Discretionary non-cumulative	Mandatory	Mandatory	Mandatory

NC: Non Call Period in years

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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