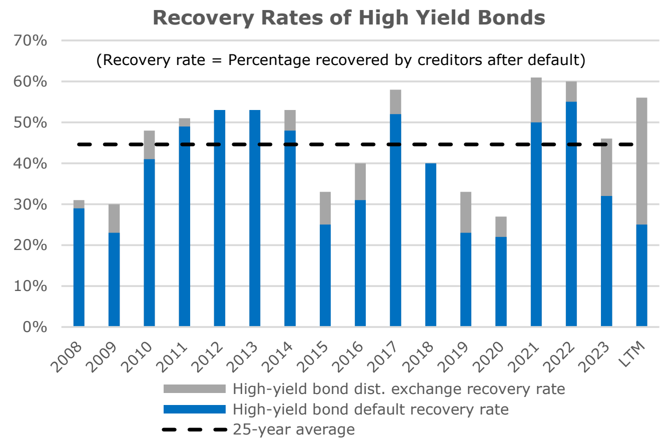
Monthly Spotlight

High Yield Bond Recoveries in the Era of Covenant Lite

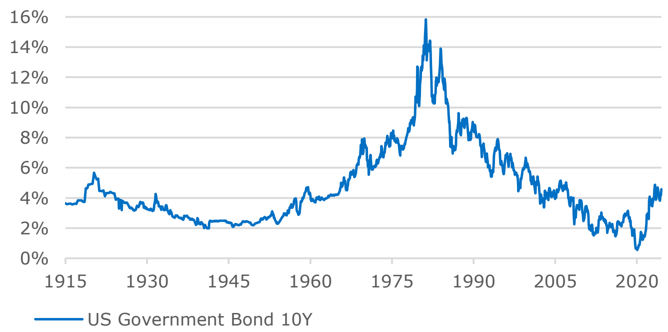
The rise of Liability Management Exercises (LMEs) among high yield issuers has primarily been driven by covenant-lite structures. These conditions allow managers reallocate assets, modify terms, and exchange instruments, also leading to a large increase of "distressed exchanges" (where troubled issuers offer bondholders reduced-value securities for existing bonds). This helps ease financial distress and avoiding an outright default.

Default rates vary across data sources. While high yield recoveries are currently very low in a historical context, the numbers improve significantly when distressed exchanges are included. In 2024, over half of recoveries are expected from distressed exchanges, marking a notable increase (see graph on the right). Looking ahead, we expect these activities to remain a key focus for all investors. As creditor-on-creditor conflicts increase, management teams are likely to be more open to negotiations in a challenging credit environment.

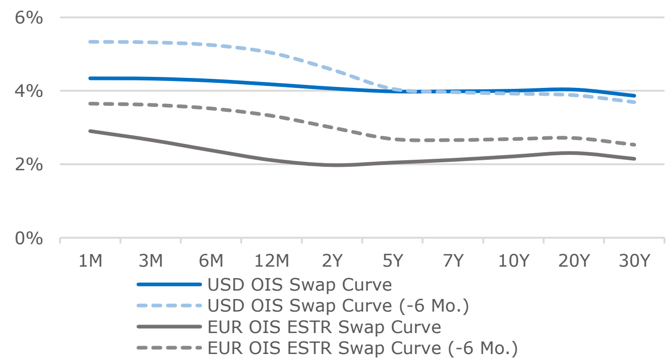


Rates Perspective

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

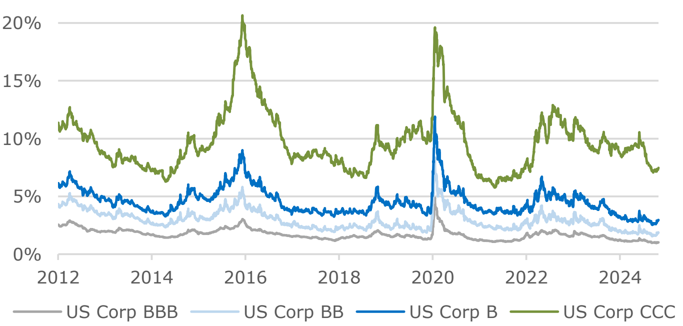


2) Interest Swap Curve: The USD and EUR curves remain inverted with shorter tenors continuously higher.



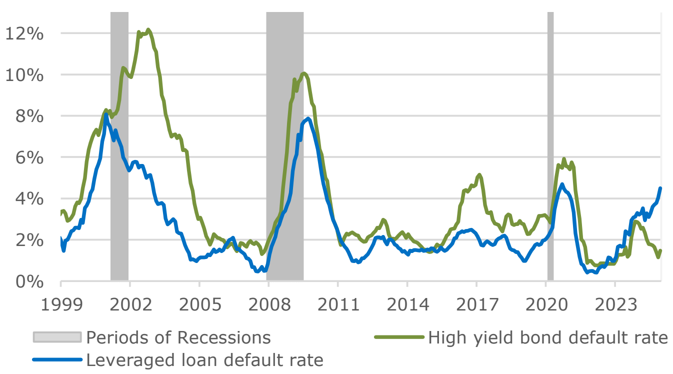
Corporate Perspective

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

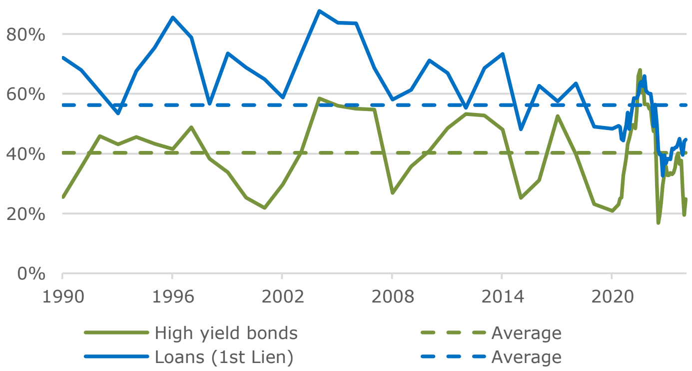


4) EU vs. US: Since 2022 EU credit spreads (OAS) have remained wider than in the US.

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	+0
AA	48	+1
A	69	+1
BBB	102	+0
BB	186	+19
B	296	+27
CCC	746	+20

Global high yield (bps)

	curr	Δ month
US HY	292	+20
EU HY	311	-30
Asia HY	454	+17
EM HY	401	-10

CDS spreads (bps)

	curr	Δ month
CDX IG - US	50	+2
iTraxx IG - EU	58	+2
CDX HY - US	311	+16
iTraxx XO - EU	313	+15

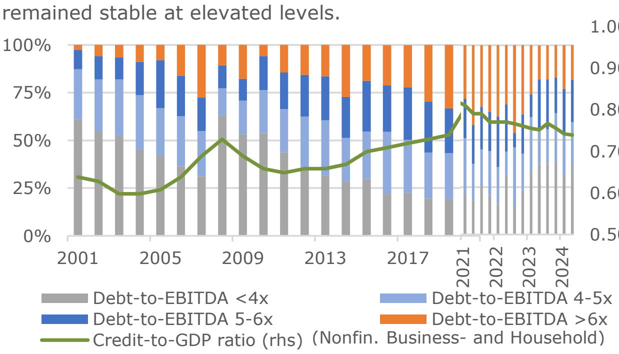
Loans and CLOs yields (bps)

	curr	Δ month
US Loan	796	-15
CLO AAA	592	-18
CLO BBB	769	-52
CLO BB	1032	-77

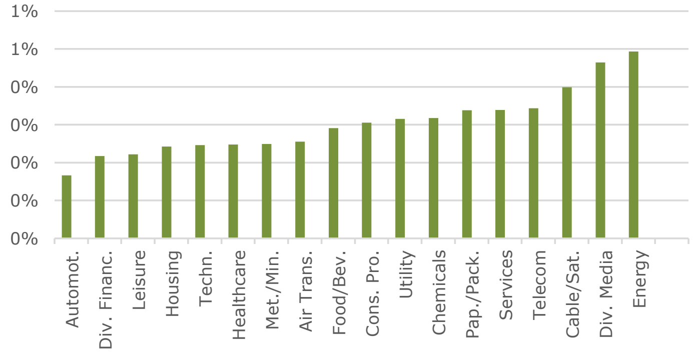
spread tightening (positive price action)

spread widening (negative price action)

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

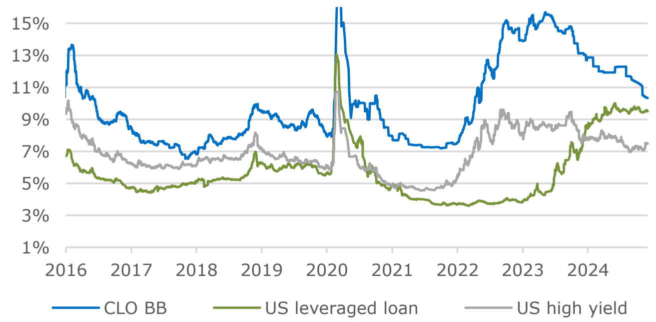


8) YTD Sector High-Yield Returns: Positive YTD results across most of the sectors.

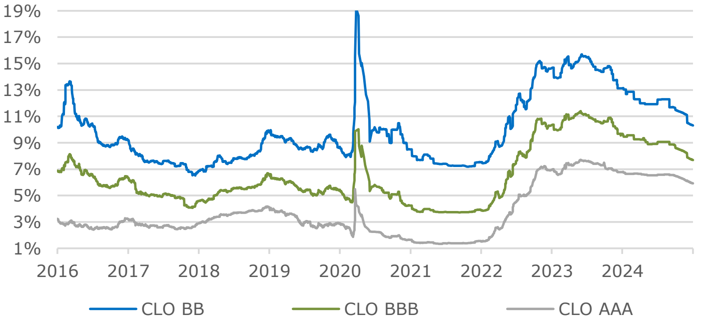


Alternative Perspective

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 (11)

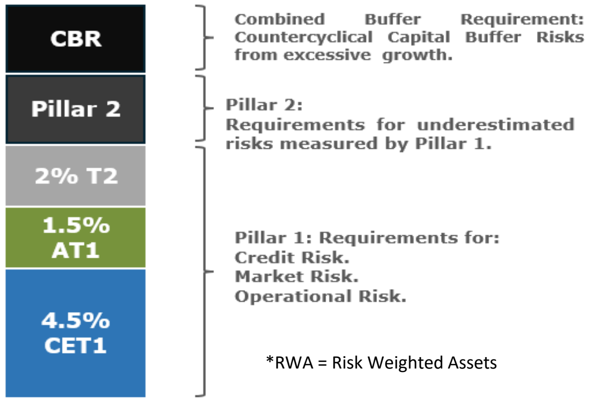
Bank Capital Requirements

Banks are highly regulated entities subject to specific capital and liquidity requirements. Their balance sheets are calibrated based on credit, market and operational risks, known as Risk-Weighted Assets (RWAs) and calculated by multiplying the exposure amount of each asset by its corresponding risk weight.

The capital framework consists of two primary pillars: Pillar 1 and Pillar 2. Pillar 1 is a fixed requirement comprising common equity and subordinated instruments like Additional Tier 1 (AT1) and Tier 2 (T2) capital. Pillar 2 is individually calibrated accor-ding to each bank's specific characteristics and risk profile.

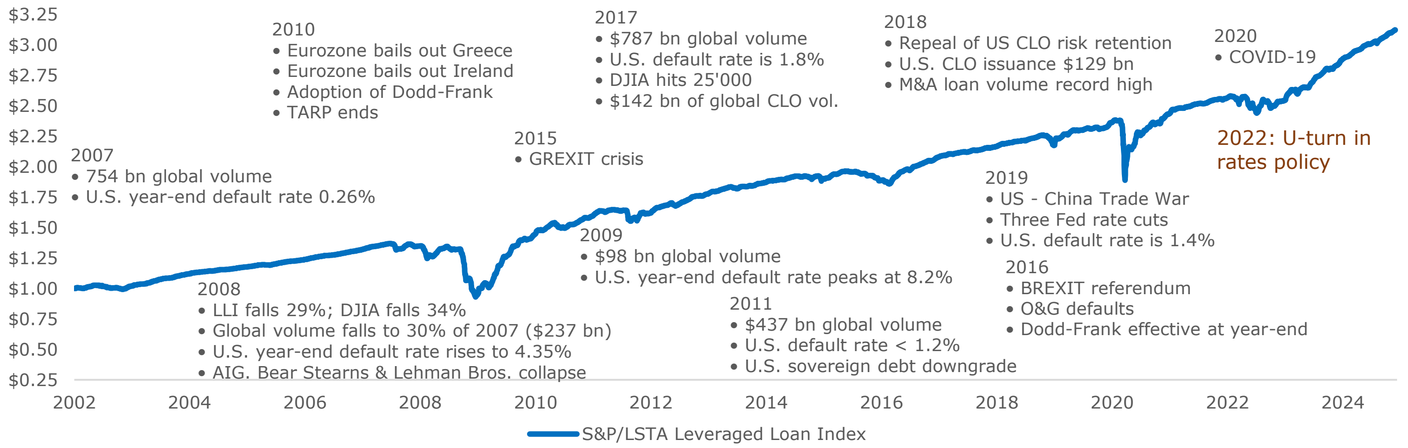
This regulatory approach ensures banks maintain adequate capital buffers to absorb potential losses and remain resilient during financial stress, balancing standardized systemic require-ments with institution-specific risk management strategies.

*RWA Capital Requirements



*RWA = Risk Weighted Assets

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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