

A shifting underlying landscape: The longer-term case for US high-yield



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In a world of economic uncertainty and evolving market dynamics, US high-yield stands out as a compelling opportunity for investors seeking enhanced returns, balanced risk, and portfolio diversification.

Breaking down the opportunities and risks amid structural change

High-yield (HY) bonds have continued to garner significant investor interest, and the case for investing in the asset class is built on several compelling factors, including attractive yields, strong fundamentals, and favorable legislative tailwinds. However, the economic landscape remains in flux as investors navigate a complex mix of resilient data, policy uncertainty, and geopolitical tension.

In addition, rising US government debt has become a focal point of concern for investors, particularly regarding its implications for macroeconomic stability. At the same time, broad market valuations look high suggesting that these risks may not currently be reflected in asset prices. In the case of US high-yield, valuations on certain measures (spreads) US HY look tight, and spreads are what typically get the most airtime as a measure of valuation in corporate bond markets. But on other metrics (yield and price), valuations, though on the higher end, may not be as rich as they seem.

This is not to say that we won't see bouts of volatility that could lead to meaningful periods of spread widening, but rather, that there are several factors unique to the US high-yield market that may make it better able to weather shorter term volatility than what we have historically seen.

Here, we explore the factors that make US HY bonds an attractive investment option, even amidst a challenging macroeconomic backdrop.

Distinct Risk Profiles

US HY corporate bonds are primarily influenced by company-specific fundamentals, such as earnings, cash flow, and default risk, rather than government debt levels. The sector has demonstrated strong financial health in recent years:

- Aggregate leverage has increased modestly to 4.20x, driven in a large part by the CCC cohort, which increased +11% Q/Q, compared to BB increasing 3.6% and single B +0.3%.
- Interest coverage ratios remained unchanged in 2Q at 4.71x, above the long-term average of 4.51x.
- Both leverage and coverage remain comfortably below and above their long-term averages.

These metrics highlight the improved fundamental position of many companies in the HY universe, which has been on a broadly based upward trend with 54% of the universe now rated BB, the highest quality rating in the high-yield category.

Chart 1: Aggregate Leverage

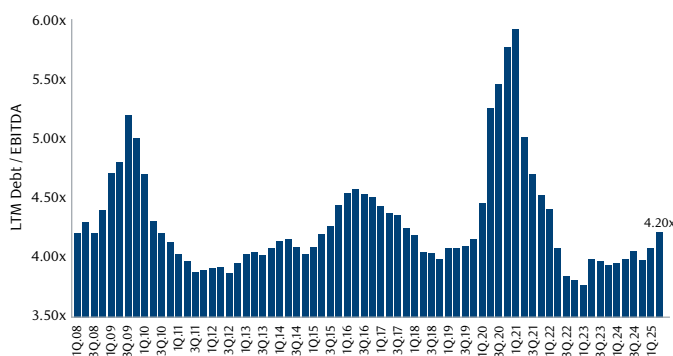
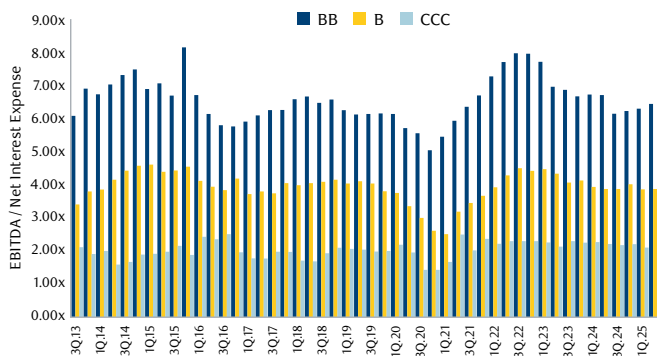


Chart 2: Interest Coverage



Source: J.P. Morgan; S&P Capital IQ, 2Q 25 results as of September 15, 2025.

Valuations: Higher Yields as Compensation for Risk

Spreads are stretched. But it is important to not forget the attractive all in yields offered relative to the post-financial crisis era. And US HY bonds offer not only significantly higher yields compared to investment-grade bonds or Treasuries but also higher yields for what is now a higher quality opportunity set than historically. The current yield premium for HY bonds has remained steady in recent history, trading within a range of 260-310 basis points for the majority of last year (with the exception of the short sell off post Liberation day).

This suggests that spread levels could remain within a tight range for long periods of time, while still providing a buffer to what is likely a structurally higher rate environment wrought with macroeconomic uncertainties and rising government debt level. Additionally, the asset class and spreads should benefit from an accommodative, but not aggressive, Federal Reserve over the coming months and into the first half of 2026.

Chart 3: ICE BofA indices (yield %)

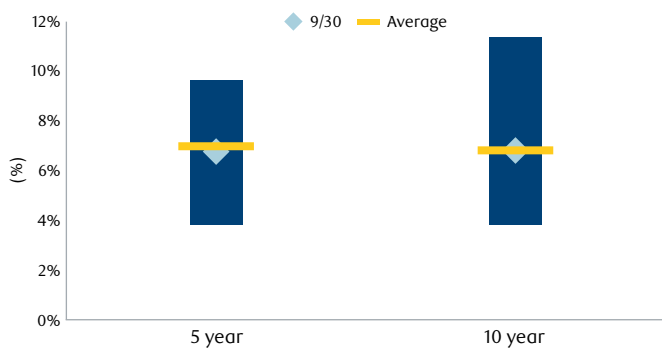
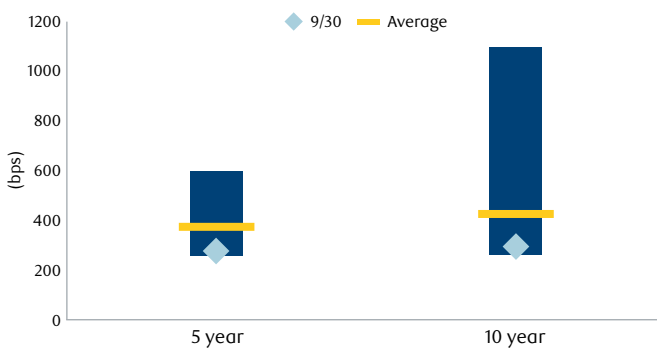


Chart 4: ICE BofA indices (spread bps)



Source: ICE BofA Indices from Bloomberg as of September 30, 2025.

Diversification and Lower Interest Rate Sensitivity

HY bonds are less sensitive to interest rate fluctuations due to their shorter maturities and lower duration profile (e.g., 2.9 years for the US HY Index). The duration of the US HY Index has decreased, making these bonds less vulnerable to steepening Treasury yield curves and allowing them to act as a diversifier to longer-dated fixed income. Additionally, certain sectors, such as telecoms, have benefited from inflation as the ability to increase prices has outpaced growth of debt. During periods of high, but anchored inflation, which is the likely environment we will be in over the near to intermediate term, high-yield bonds benefit on both sides of the tape: it naturally deleverages issuer balance sheets on one end while offering a high-yield buffer to help portfolios keep up with inflation on the other.

Supportive Economic Growth Outlook

In the current environment, supportive catalysts for US high-yield companies include a resilient economy and stable to falling short term interest rates. The fact is that the US consumer and most corporations are in a position of historic balance sheet strength. At the same time, the US economy's medium-term growth prospects remain constructive, with estimates for 2026 trending higher.

- RBC BlueBay forecasts 1.5% GDP growth in the second half of 2025, with core CPI peaking near 4%.
- The 12-month trailing par-weighted US HY default rate is 1.39% (or 0.49% excluding distressed exchanges), significantly below the 25-year annualized average of 2.9%.

In the near term, growth should have continued support as the market digests the 25bps cut in September. While we do not expect a sharp move lower in interest rates, we do expect the path of financial conditions to trend easier over the months to come. This could help buoy individuals and companies' propensity to spend. This comes at a time when de-regulation should lead to increased M&A volumes and generate corporate activity and corporations are increasingly incentivized to spend cash due to a combination of legislative (the, "One Big Beautiful Bill,") and competitive (AI and infrastructure race) factors. And in there lies another potential driver of better-than-expected growth going into 2026.

Active Management as a Key Advantage

The high-yield universe is a challenging one to beat, with less than 50% of managers outperforming their benchmark over the last 1yr, 3yr, and 5yr time periods*. In up markets, very low quality issuers can have an outsized impact on returns relative to their investability and risk. In market sell-offs, the opposite is often true, to the effect of outside returns on the downside. Active management is key to managing these risks and providing investors access to high-quality issuers while avoiding those most vulnerable to economic or interest rate pressures.

Conclusion

Despite concerns about rising US government debt, US HY corporate bonds remain a compelling long term investment option for those seeking income and total return potential. Their performance is more closely tied to corporate fundamentals, economic growth, and credit conditions than macro-level government debt dynamics. The market should further benefit from a strong technical backdrop as the high level of income, and diversification benefits continue to fuel demand for the asset class. While risks such as inflation surprises or geopolitical shocks remain, the overall case for US HY bonds is robust, supported by a constructive economic outlook and active management strategies.

*as of 6/30/2025 Nasdaq eVestment.



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