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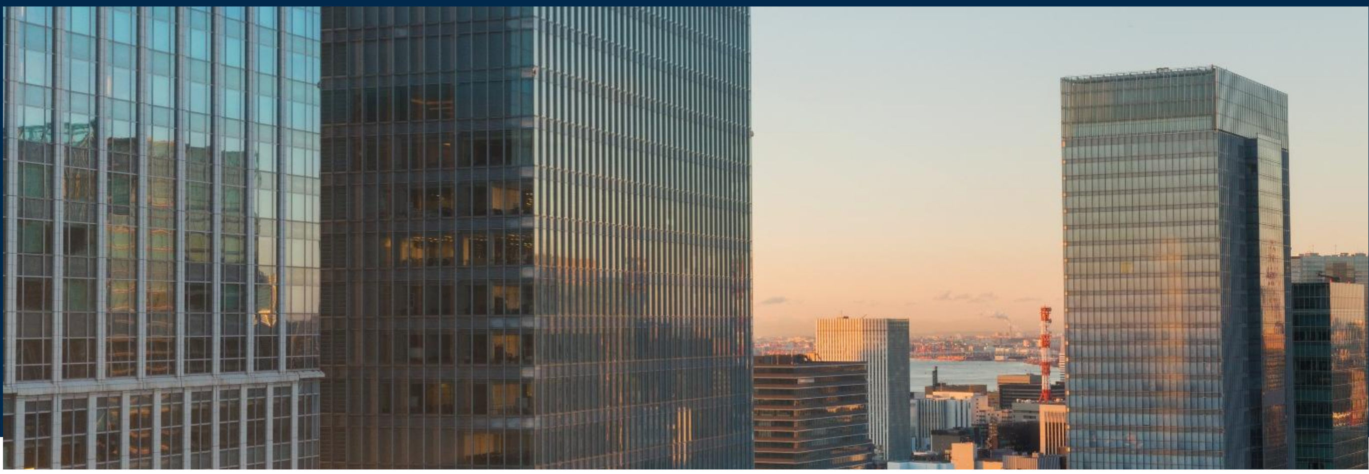

High Yield: Investing in a transformed credit ecosystem

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Key Takeaways

- The high yield universe has fundamentally evolved. It is now a much higher-quality market, with BB-rated bonds over half the index. Alternative financing channels now absorb weaker credits, leaving public high yield markets structurally higher in quality and more stable across market cycles.
- The US high yield market remains the anchor for global investors due to its sheer size, depth and diverse participant base. This ecosystem ensures reliable liquidity and more efficient price discovery, especially during stress, setting it apart from the structurally shallower European and Asian markets.
- Today's high yield market requires a new investment framework. With defaults trending below historical averages and transparency materially improved, generating alpha now hinges on consistent returns in normal markets, index-aware positioning and nuanced security selection rather than just avoiding the losers.
- High yield now offers a compelling combination of attractive income, reduced downside risk, daily liquidity, and strong returns across cycles. This combination underpins the case for maintaining a structural allocation to high yield within fixed income portfolios.

The high yield market has changed dramatically over the last two decades. Yet many institutional investors continue to view the asset class through a backward-looking lens shaped by earlier eras of weaker credits, episodic liquidity shocks, and pronounced default cycles.

This perspective is increasingly misaligned with the modern market reality. Today's high yield universe is structurally higher in quality and materially more resilient in its behaviour across market cycles. These changes reflect shifts in the financing options available to sub-investment grade companies, the evolution of market participants, and broader improvements in corporate financial discipline.

The modern high yield landscape therefore requires a more nuanced understanding, which recognises how these structural features have altered the asset class's risk profile and its role within fixed income portfolios.

The US market anchors the modern high yield landscape

The starting point for understanding the modern high yield ecosystem is the structural difference between regional markets. The US market remains unparalleled in its size, liquidity and diversity. It hosts a broad ecosystem that ranges from distressed specialists and hedge funds, to insurance companies, pensions and multi asset income strategies. This ensures that even during periods of severe volatility, there is typically a functioning bid for credit. Such depth provides reliable price discovery and liquidity, enabling more efficient and predictable market behaviour.

By contrast, high yield markets outside the US, particularly in Europe and Asia, are materially shallower. Liquidity can disappear during stress periods, leaving investors with limited ability to reposition portfolios. This makes position sizing, liquidity assessment, and country selection as important as fundamental credit work.

Global investors tend to be more attuned to FX risk, political dynamics, and cross-border volatility than US peers, but the structural resilience of the US market continues to make it the natural anchor allocation for most sophisticated portfolios. The US market is not only more than four times larger than the European, but also much more diversified across different sectors.

	US HY	Euro HY	Asia HY
Market Capitalisation	US$1,477bn	€357bn	US$114bn
Issues	1,969	646	195
OAS	268bps	264bps	441bps (spread to worst)
Duration	2.7 years	2.8 years	2.9 years
Average rating	BA3/B1	BA2/BA3	BA3/B1

Data as of 31 December 2025. Source: Bloomberg, JP Morgan. OAS: Option-Adjusted Spread

A fundamentally changed borrower universe

One of the most consequential shifts in today's credit ecosystem is the explosion of financing alternatives available to sub-investment grade companies. Historically, borrowers relied on three avenues: banks, the syndicated loan market, or public high yield. Over the past decade, however, private credit has grown from a niche corner of the market into a $2.1 trillion[1] competitor,

[1] Source: Prequin, a part of Blackrock, as at 31 December 2024

accompanied by increasingly specialised loan structures and unit tranche financing packages.

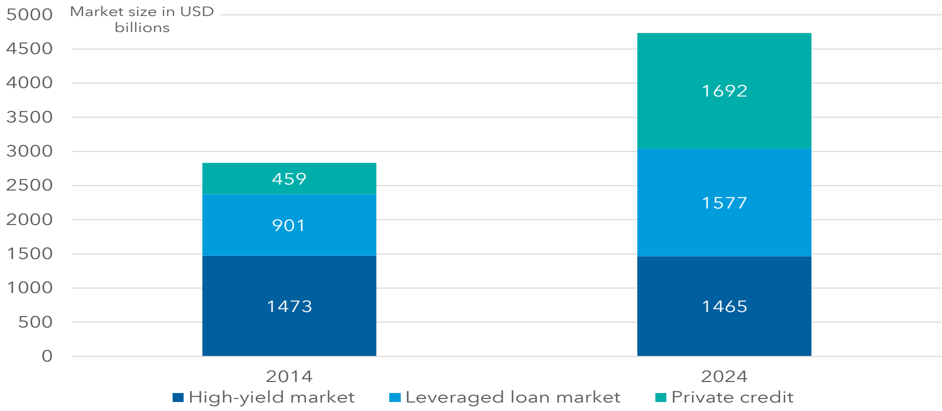
The result is a self-selection effect:

- Companies with more volatile earnings, bespoke financing needs, or elevated leverage increasingly borrow in private credit or leveraged loans.
- Public high yield has become home to cleaner and fundamentally stronger issuers.

Today, the BB segment constitutes the majority of the index, while the CCC cohort has shrunk. Remarkably, the size of the public high yield market has remained stable – roughly $1.5 trillion for over a decade – despite enormous credit growth elsewhere. Much of the incremental risk that historically populated the lower-quality tail of the high yield index is now absorbed by alternative financing channels.

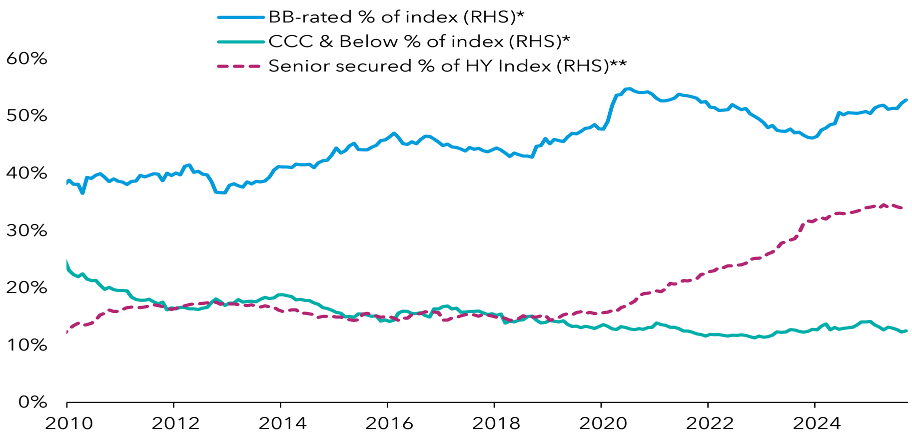
This shift in borrower composition changes how alpha is typically generated. With fewer distressed candidates, the traditional defensive approach to simply avoid losers is less effective. Outperformance increasingly depends on identifying companies whose business quality or strategic positioning is stronger than their spreads reflect and exploiting temporary dislocations within a higher-quality universe, making security selection more important than ever.

Strong growth in alternative financing for sub-investment grade borrowers



Data as at 31 December 2024Source: Capital Group, JP Morgan.

High yield: a higher quality index



Data as at 31 December 2025. Sources: Barclays, JP Morgan. *US HY is represented by Bloomberg US High Yield Bond Index 2% Issuer. BB rated is a sub-set of this index. **Represented by JP Morgan High Yield Index. Senior secured bonds is a sub-set of this index.

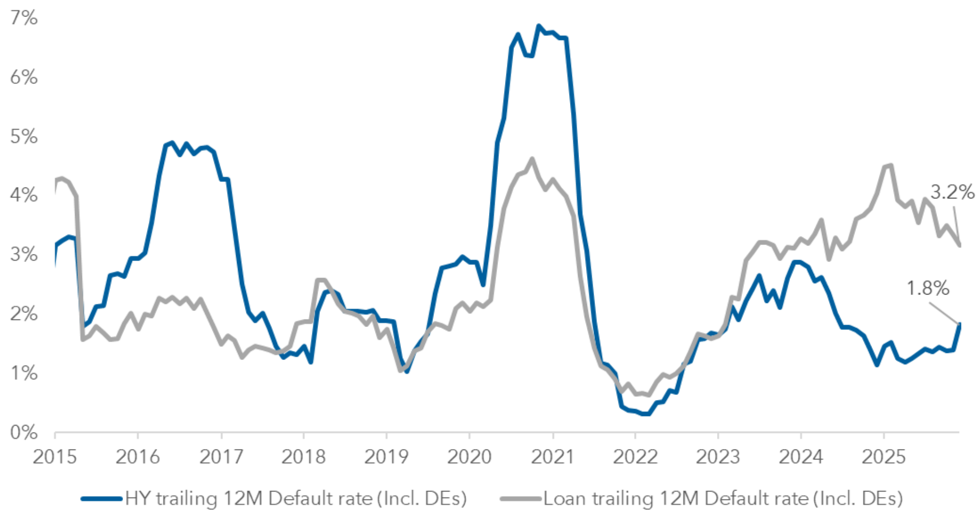
Enhanced financial discipline is driving lower defaults

These structural improvements were tested in real time during the recent tightening cycle. As central banks hiked, investors could observe how today's high yield market behaves under stress and the resilience of different parts of the credit spectrum. The rapid rise of US policy rates, which saw the Fed Funds tightened by 500 basis points in under two years, had an immediate and significant impact on floating-rate leveraged loans. Borrowing costs rose sharply, pressuring interest coverage ratios and free cash flow across the loan market.

High yield issuers were largely shielded by the fixed-rate structure of public bonds, which meant interest costs rose only gradually. Corporate fundamentals remained stable, supported by balance sheets that had been strengthened in the years following the Global Financial Crisis. Many companies also opted for shorter-dated bonds to maintain refinancing flexibility, further mitigating risk.

Consequently, high yield defaults have stayed contained, trending slightly below long-term historical averages of 2–3%. In contrast, the leveraged loan market has faced greater stress, with default rates exceeding those in high yield.

Comparison of high yield and leveraged loan default rates



Data as of November 2025. Source: JP Morgan.

US high yield duration is much lower

Data as at December 2025. Source: Bloomberg. Index: Bloomberg US high yield 2% issuer capped.

Strengthened transparency and liquidity have improved market functioning

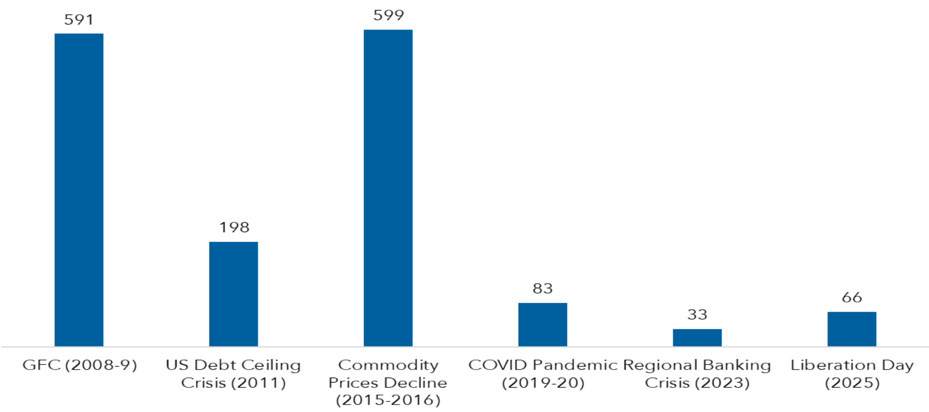
Another important evolution in the high yield landscape is the improvement in transparency and liquidity across public markets. While transparency has long been a defining advantage of public high yield, the systems, data availability, and depth of market participation have expanded significantly over the past decade. This has strengthened investor protection and improved market efficiency.

Today, high yield investors benefit from more robust reporting standards, better access to information, and far deeper trading markets than in earlier eras. Quarterly financials are audited, public transcripts provide forward-looking insight, and trading levels across the curve are observable in real time. The breadth of market participants, which today include institutional investors, hedge funds, insurers, and multi-sector income strategies, supports consistent two-way markets even during stress periods.

Alongside the higher-quality theme, these developments help explain not only how much more resilient high yield has become since the global financial crisis but also how quickly it has recovered during times of extraordinary stress over the recent years.

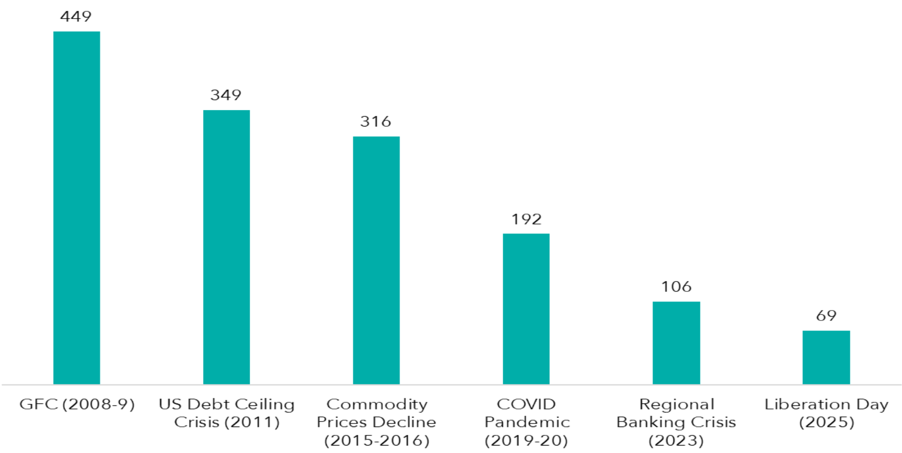
Event Shock

Number of days credit spreads widened from low to peak level



Recovery

Number of days credit spreads rallied from peak back to 80% normalisation level



Data as of 31 December 2025. Source: Bloomberg.. Days is average days from low to peak. 80% normalisation is defined as 80% change from low to peak.

A modern investing framework for today's high yield market

Taken together, the evolution of market structure, issuer quality, and public-market discipline reshapes not only how high yield behaves, but also investment. A successful framework today requires:

a. **Index awareness and structural positioning:** With fewer distressed companies, outperformance comes from positioning relative to index composition, including sector weights, quality buckets, and concentration risks, rather than simply avoiding defaults.

b. **Delivering strong results in "normal markets":** Most periods are not crises. To achieve top-quartile results over time, a portfolio must consistently beat the market in regular conditions, not just during downturns.

c. **Downside protection and restructuring expertise:** Credit cycles are shaped by the depth of losses during downturns. Strong managers identify areas where spreads look tight but carry hidden fragility, adjusting exposure before stress emerges. When defaults do occur, active involvement in restructurings is critical. This not only helps maximise recovery values but also builds experience and pattern recognition that sharpens future underwriting decisions.

d. **Cross-asset insight and equity collaboration:** Integrating equity perspectives into credit analysis enhances forward-looking insights, strengthens valuation discipline, and provides a more holistic view of issuer fundamentals.

Together, these principles of index awareness, consistency of results, downside protection, and integrated research provide a cohesive framework for navigating the modern high yield market and compounding returns steadily through the cycle to generate top quartile results.

Conclusion: A redefined asset class for modern fixed income portfolios

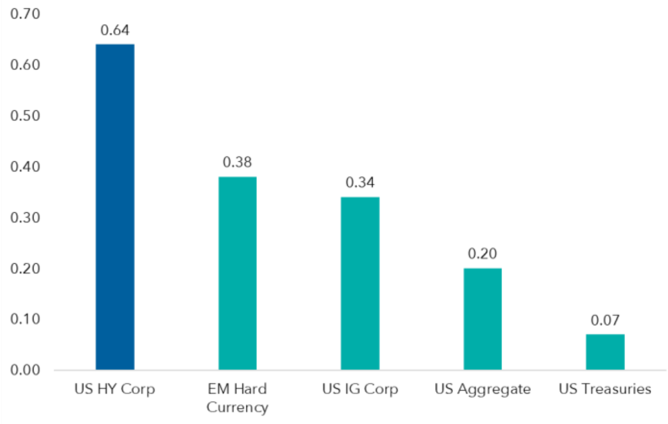
The structural evolution of the high yield market, driven by a transformed borrower universe, improved liquidity, stronger issuer fundamentals, and a more diverse array of financing alternatives, has reshaped the asset class into something fundamentally different from its origins. It is now cleaner, higher in quality and liquidity, and structurally more resilient.

For investors, this evolution alters how high yield should be evaluated within portfolios. It now offers a compelling combination of attractive income, reduced downside risk, daily liquidity, and strong returns across cycles.

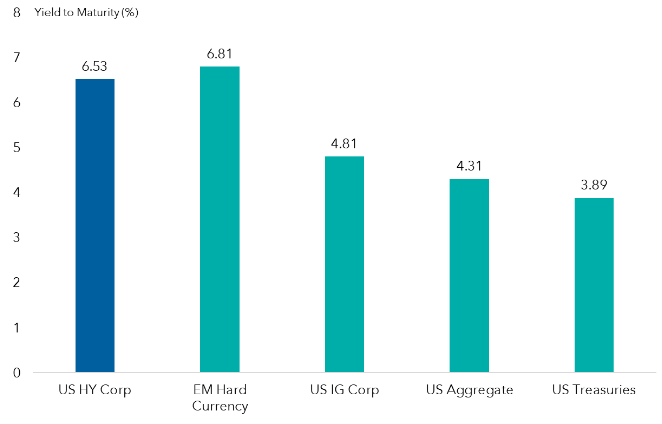
This underpins the case for maintaining a structural allocation to high yield within fixed income portfolios. Historically, the majority of fixed income total returns come from carry, and high yield naturally offers the highest and most consistent source of income alongside the strongest risk-adjusted returns, as measured by the Sharpe ratio, over long horizons across the market.

Even when spreads appear tight, the income component has been a powerful driver of long-term returns and current all-in yields remain attractive. Remaining invested, rather than attempting to time re-entry, has been essential to capturing this compounding effect.

15-year Sharpe ratio



Yield



Past results are not a guarantee of future results.
Data as at 31 December 2025. Source: Bloomberg.

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