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Money Matters

Investing in the Yield Era, One Layer Down

In our Credit Quarterly Outlook, we introduced the Yield Era. High government debt, persistent deficits, an ageing workforce, geopolitical tension and a triple capex boom in defence, artificial intelligence and the energy transition, all bidding for the same scarce resources. That keeps inflation sticky and yields high and volatile. The consequence is the thesis we keep coming back to: returns will come mostly from the income you collect, not from falling rates or tightening spreads.

Through the Debt Supercycle, when a two-decade fall in yields lifted everything, simply being in the market was most of the answer for most investors. Now, the income is the return, and the main threat to it is a borrower who cannot refinance. Hence, as part of our Yield Era thesis, we expect more credit events to occur. Understanding where we are in the credit cycle, and which companies survive, is our core job. A focus on quality and margin of safety (valuation) will be key!

Picture the market as a *K*: strong balance sheets, pricing power and cheap funding on the rising arm; higher rates, weak demand and too much debt on the falling one. The average flattens out even as the gap grows, and that divergence is where both the opportunities and the accidents live. This month we took the K one layer down, into the bottom of the US high yield market, and did the work bond by bond. The *K* is there too, running inside a single rating bucket.

One Bucket, Two Populations

Over the past year the average spread on the CCC part of the index widened. Read that alone and you would conclude the lower-rated part of high yield is underperforming. The median CCC bond went the other way: its spread narrowed and its price rose. Same bucket, same twelve months, opposite signs.

The difference is the tail. A handful of companies account for more than the entire move, one of them for close to half of the change. More than half of the borrowers present in both years trade tighter than they did. This is not a bucket underperforming. It is a bucket where dispersion is increasing - see Figure 1. The share of CCC trading at tight spreads grew, and the share trading at distressed levels grew by about as much. The middle, where a normal distribution keeps most of its weight, fell by the same amount.

Two fifths of the CCC bucket now trades close to par and yields barely more than a single-B rated bond: rated CCC, priced like B. A seventh trades near sixty cents on the dollar and yields over thirty per cent. This distinction is lost in the rating itself, underscoring that security selection matters more than the letter grade.

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Quick Read

The bottom of the US high yield market looks like it is getting worse. Look closer and it is splitting in two.

The average CCC spread widened over the past year. The typical CCC bond went the other way. A handful of companies explain the whole difference.

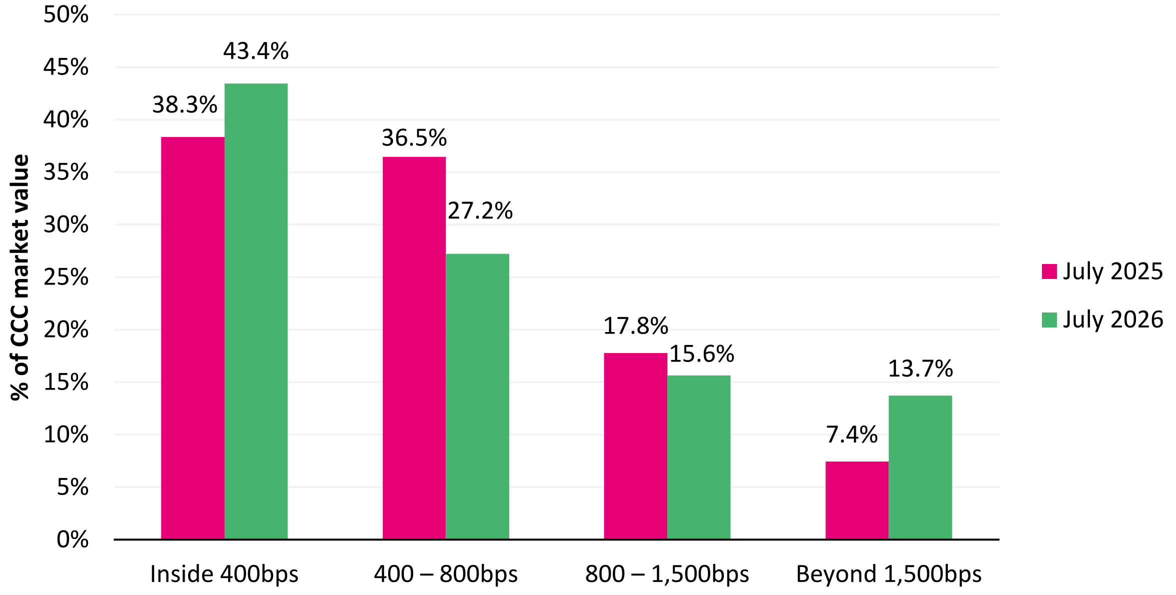
Healthy CCC companies keep leaving the index: upgraded, bought out or repaid above face value. Weaker ones get downgraded in. The index looks better while the bucket gets more extreme.

Two fifths of CCC now trades close to par and yields little more than a single-B bond. A seventh trades near sixty cents and yields over thirty per cent. The rating cannot tell them apart.

Refinancing is the real test. The bonds in the index pay less than their borrowers would have to pay to refinance today, and the gap is widest for the weakest.

In the Yield Era the income is the return. Protecting it takes research on individual companies, not exposure to a rating bucket. Stock picking, in other words.

Figure 1: The middle of the CCC bucket is emptying



Source: Bloomberg index constituent files and Osmosis Calculations. Market-value weighted, CCC bucket only. July 2025 versus July 2026.

Why so split? Migration. Of all the CCC companies in the US HY index a year ago, more than a third were upgraded and almost a fifth left the index altogether, mostly bought out, called or refinanced at or above face value, not defaulted. The bucket is then refilled from above with single-B borrowers downgraded in, arriving at far wider spreads. The average index rating is the best it has been in more than thirty years, but we would argue much of that is turnover, not repair.

Refinancing is the Test

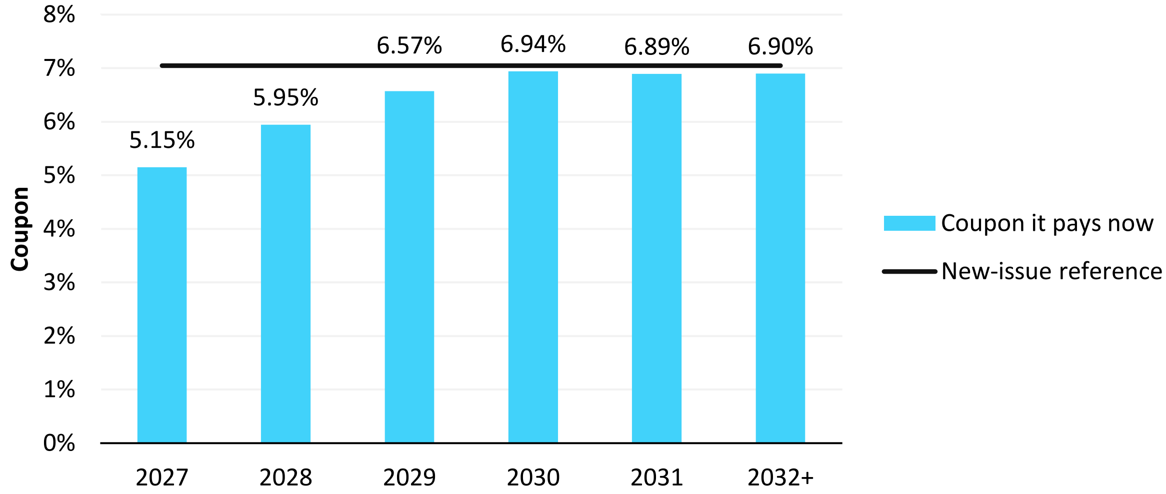
Higher-for-longer shows up in one number: what new debt costs against what old debt cost. The bonds in the US HY index carry an average coupon of 6.7%, while new paper has been coming to the market at around 7%. The bonds falling due first are the oldest and cheapest of all: those maturing in 2027 pay barely 5%. As they roll, the interest bill steps up, as highlighted in Figure 2.

Two thirds of the index must be refinanced within five years, and almost all of the step-up sits in the first three years. The step-up is steeper the lower the credit rating, too: over the past year new BB paper arrived about 60bps above the paper it replaced, new B paper more than 110bps above, and new CCC paper more than 200bps above.

It is worth separating two things that often get combined. Leverage is how much debt a company carries; coverage is whether its earnings comfortably pay the interest on it. Across public high yield the first is not the problem: debt is high, but it is slowly coming down. The second is where the Yield Era bites, because coverage falls the moment cheap debt is replaced with expensive debt, whatever the company does. That is why the two halves of the US high yield market are drifting apart on both measures: leverage and interest coverage have been improving for the better half of high yield (BB- and B- rated issuers) while deteriorating for the worst of it (CCC-rated issuers).[1]

[1] Apollo Global Management, "2026 Credit Outlook: From Scarcity to Selection – The Return of a Buyer's Market", January 2026, Exhibits 30 and 31 (data as of September 2025).

Figure 2: The interest bill steps up as the cheapest paper matures



Source: Bloomberg index constituent files and Osmosis Calculations. Market-value weighted coupon by year of maturity, on index holdings as at July 31, 2026. New-issue reference is the weighted average coupon on bonds entering the index over the twelve months to July 2026 (543 bonds, 360 issuers).

There is another, quieter reason the public high yield market looks better in terms of credit quality: the percentage of the weakest borrowers is slowly falling over time. They sit increasingly in private credit and the loan market, where payment-in-kind features let a struggling company defer cash interest rather than default, and where stress surfaces late. Public high yield is flattered by the companies that have left it.

Stock Picking

The conclusion is not to avoid the bottom of the market, but to acknowledge that the letter grade has lost its informational value, making independent analysis indispensable. This is what the Yield Era does to our work. The income is the predominant part of the return, so protecting it means knowing which borrower can refinance, at what price, and whether the credit fundamentals are improving or not. The average will not tell you, and neither will the index. Only research on the individual company will, done name by name and before the market reprices rather than after.

So, we buy names, not buckets: companies that are cheap, offer a genuine margin of safety, and whose fundamentals are stable or improving. Finding those and avoiding the ones dressed up to look like them is what we do. It is something we have been doing in our Global High Yield Strategy since the start. Stock picking it is!

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