

The Global HY playbook for late 2025: Opportunity with discipline

Bottom line: The global high yield (HY) market enters the final quarter of 2025 with a rare combination of elevated starting yields, resilient credit fundamentals, and a macro backdrop that is neither fully benign nor overtly hostile. The past two months have seen a convergence of supportive and cautionary signals: central bank policy is expected to be easier across major markets, yet inflation progress has stalled above target in several economies. Against this backdrop, HY investors face a familiar challenge – capturing attractive carry while navigating the cross currents of policy, growth, and credit risk.

- ▶ Carry remains king: with yields at multi-year highs, income can drive returns even if spreads stay range bound.
- ▶ Global diversification matters: issuance trends are broadening the investable universe but require active currency and jurisdictional risk management.
- ▶ Macro vigilance is essential: inflation surprises, policy shifts, and term premia swings can all reprice risk quickly.
- ▶ Credit selection is the differentiator: avoiding vulnerable segments while capturing “rising star” potential can materially improve outcomes.

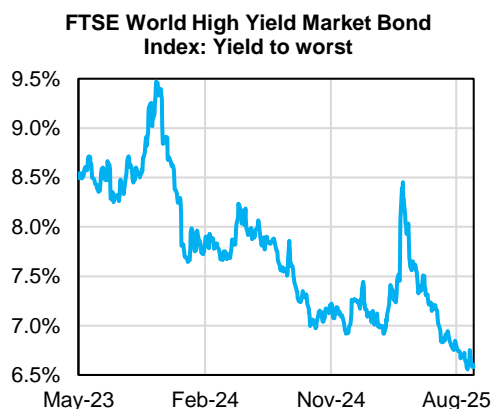
Macro Backdrop: resilient growth and sticky inflation

The US economy has avoided recession, supported by resilient consumer spending and a cooling labour market. However, inflation progress has plateaued above the Fed's 2% target, with core services inflation proving sticky. In the euro area, growth remains subdued but positive, aided by fiscal support and easing energy prices. Japan continues to normalise policy cautiously, while China's targeted stimulus has stabilised credit growth without reigniting property sector excesses. For HY markets, this environment supports credit fundamentals but limits the scope for aggressive spread compression. Inflation surprises could slow the pace of easing, keeping funding costs elevated for longer.

Elevated starting yields: a strong foundation for returns

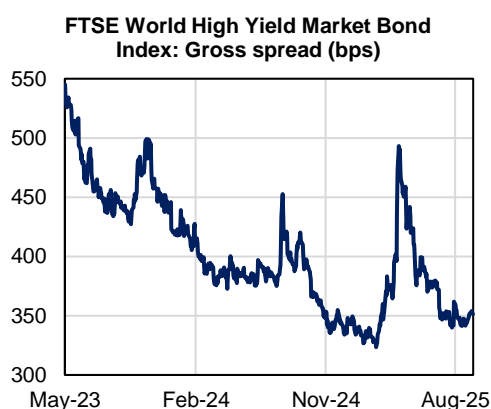
Starting yields remain one of the most reliable predictors of forward HY returns. As of early September, global HY yield-to-worst hovered at elevated levels (exhibit 1) in cross asset comparison, offering investors a historically attractive entry point. The income component is poised to dominate total returns in the coming quarters, especially as policy rates drift lower. Even if the growth were to slow, elevated yields can provide a cushion against moderate spread widening (exhibit 2). However, the persistence of sticky inflation at levels above their central bank targets – particularly in the US and UK – means real yields remain high, keeping refinancing costs above pre-2022 norms.

Exhibit 1: Yield-to-worst levels for global high yield index remains high despite falling in recent years



Source: FTSE, LSEG Workspace, and ADCB Asset Management

Exhibit 2: Spread levels are off their all-time lows but still compressed



Source: FTSE, LSEG Workspace, and ADCB Asset Management

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Sovereign yield volatility and term premia effects

In recent months, developed market bond yields have risen on stronger-than-expected growth and fiscal expansion. US treasuries, UK gilts, German bunds, French bonds, and Japanese Government bonds have all seen a sharp rise in bond yields on increasing fiscal uncertainty. While real rate and inflation expectations have not moved much, the rise in yields was contributed to a major extent by growing term premium. HY spreads are sensitive to these moves. Falling core yields can compress all-in yields, but volatility in the risk-free curve often triggers risk-off sentiment, widening credit spreads in the short term. Duration positioning in HY portfolios is no longer just about anticipating rate cuts – it is also about managing exposure to term premia shocks, which can ripple through credit markets even in the absence of fundamental deterioration.

Credit fundamentals: resilient but uneven

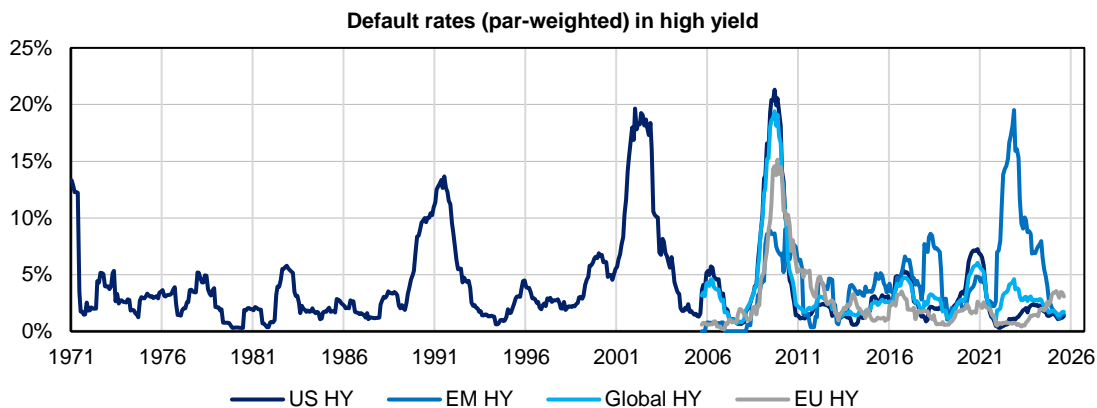
Overall HY credit quality has held up well post-rate-hike cycle. Default rates remain below long-term averages (exhibit 3), and the share of “rising stars” – issuers upgraded from HY to investment grade – has increased. The number of fallen angels – issuers that have lost their investment-grade status – has declined.

However, vulnerabilities may emerge in specific segments:

- ▷ Lower-rated corporates (CCC) face refinancing cliffs in 2026–27.
- ▷ Commercial real estate exposures remain under pressure from higher vacancy rates and refinancing costs.
- ▷ Leveraged loans show signs of stress in sectors with cyclical earnings.

Fiscal deterioration in most advanced economies could add to funding pressures if growth slows or risk premia rise. Credit selection remains critical. Investors should focus on issuers with strong free cash flow, manageable maturities, and sector tailwinds.

Exhibit 3: Default rates are far from concerning levels

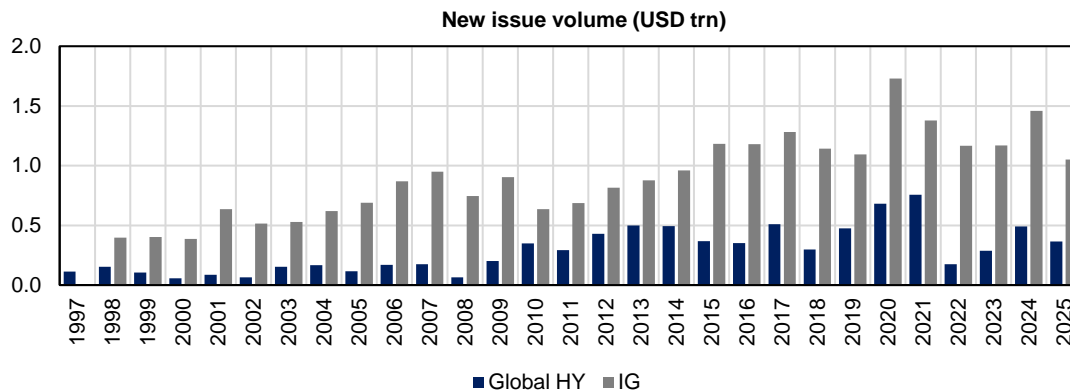


Source: ICE Data, BofA Global Research, LSEG Workspace, and ADCB Asset Management

Issuance trends: globalization and sector rotation

Overall issuance of high yield credit has been limited in recent years (exhibit 4). Cross-border deals have increased, with more issuers from Asia and the Middle East tapping USD and EUR HY markets. Sector composition is also evolving: energy and industrials remain active, but technology, healthcare, and consumer discretionary have gained share. Divergent monetary policy paths are shaping issuance incentives. In Europe and parts of Asia, lower policy rates have encouraged opportunistic refinancing and liability management exercises. In the US, issuance has been more selective, with higher all-in yields prompting issuers to wait for further rate cuts. For investors, the globalisation of HY issuance offers diversification benefits but also introduces currency and jurisdictional risks. Hedging strategies and local market expertise are increasingly valuable.

Exhibit 4: High yield issuances have been limited and have lagged issuances in the investment grade space



Source: PitchBook/LCD, BofA Global Research, LSEG Workspace, and ADCB Asset Management

Fed rate cuts: a tailwind for high yield, with caveats

The Federal Reserve is widely expected to cut rates at its September 16-17 meeting, with markets pricing in a 90% chance of a 25bps reduction and a growing minority anticipating a 50bps move. This shift follows weaker-than-expected jobs data and signs of cooling inflation (US PPI for August unexpectedly fell), prompting the Fed to prioritize its employment mandate over inflation concerns. For high yield investors, rate cuts typically act as a tailwind: lower benchmark rates reduce refinancing costs, support risk appetite, and compress spreads. However, the impact may be uneven. Lower-rated issuers (CCC) may still face elevated funding costs due to lingering risk aversion, while BB-rated credits could benefit more directly from improved liquidity and sentiment. Importantly, the Fed's easing cycle is not guaranteed to be aggressive beyond 2025. Sticky inflation could eventually limit the pace of cuts — making credit selection and duration management critical in capturing upside without overreaching.

Conclusion: opportunity with discipline

Global high yield enters the final stretch of 2025 with a compelling yield profile and a macro environment that, while imperfect, is far from hostile. The challenge for investors is to harness the income opportunity without underestimating the latent risks – from inflation stickiness to refinancing cliffs. This means staying plugged into both the big picture and the issuer-level detail – the very essence of disciplined high yield investing.

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