Where income meets volatility

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High yield

For those seeking attractive yields, the high yield market continues to offer a compelling case, especially when complemented by resilient risk management, in a rapidly evolving world.

As we look ahead to 2026, the global economic landscape is marked by persistent uncertainty. Global growth is forecast to decelerate to the slowest pace since the pandemic, amid ongoing geopolitical tensions, shifting trade policies, and the risk of policy missteps. From conversations with investors, a common concern that keeps being raised is the combination of worries over expensive valuations in the market and fear at missing any further potential upside.

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Where do we sit?

Central banks are expected to continue easing, but the path of rates is clouded by inflation volatility and fiscal pressures, especially in the US and Europe. The US Federal Reserve and Bank of England are projected to cut rates further, but the pace and depth remain highly data dependent. Euro area rates are near neutral, with limited room for further cuts unless growth falters.

Fiscal support is likely to remain robust, particularly in the US and Europe, with increased spending on infrastructure and defence. Elevated volatility and policy uncertainty are expected to persist, reinforcing the need for defensive positioning and careful risk management.

What areas within high yield offer an attractive option?

As such, with those conditions hovering in the background, where can investors look in high yield markets? In our view, a short duration bias, focusing on bonds being redeemed in less than two years, can offer a defensive stance in a mature high yield market. This approach minimises exposure to interest rate and spread volatility, which is especially valuable as we look at central banks on different rate paths in 2026, unlike longer-duration strategies that are more vulnerable to negative returns in such environments.

Historical data can show that focusing on short duration high yield can deliver similar total returns to the broader high yield market, but with significantly lower volatility and drawdowns. As bonds approach maturity, price volatility diminishes, and the 'pull-to-par' effect helps insulate portfolios from market swings. Despite tighter spreads, we feel yields in the short duration segment remain relatively attractive and above historical averages.

A strategy that focuses on 'battle-tested' bonds, those nearing maturity, should mean default risk is lower, and also benefit from a higher proportion of higher-rated sub-investment-grade securities.

Another aspect to consider is the self-liquidating nature of a strategy that focuses on short duration bonds. It should see constant cashflow from positions being redeemed, allowing for a somewhat organic re-positioning opportunity as market conditions evolve, as you re-invest and tilt and tweak positioning.

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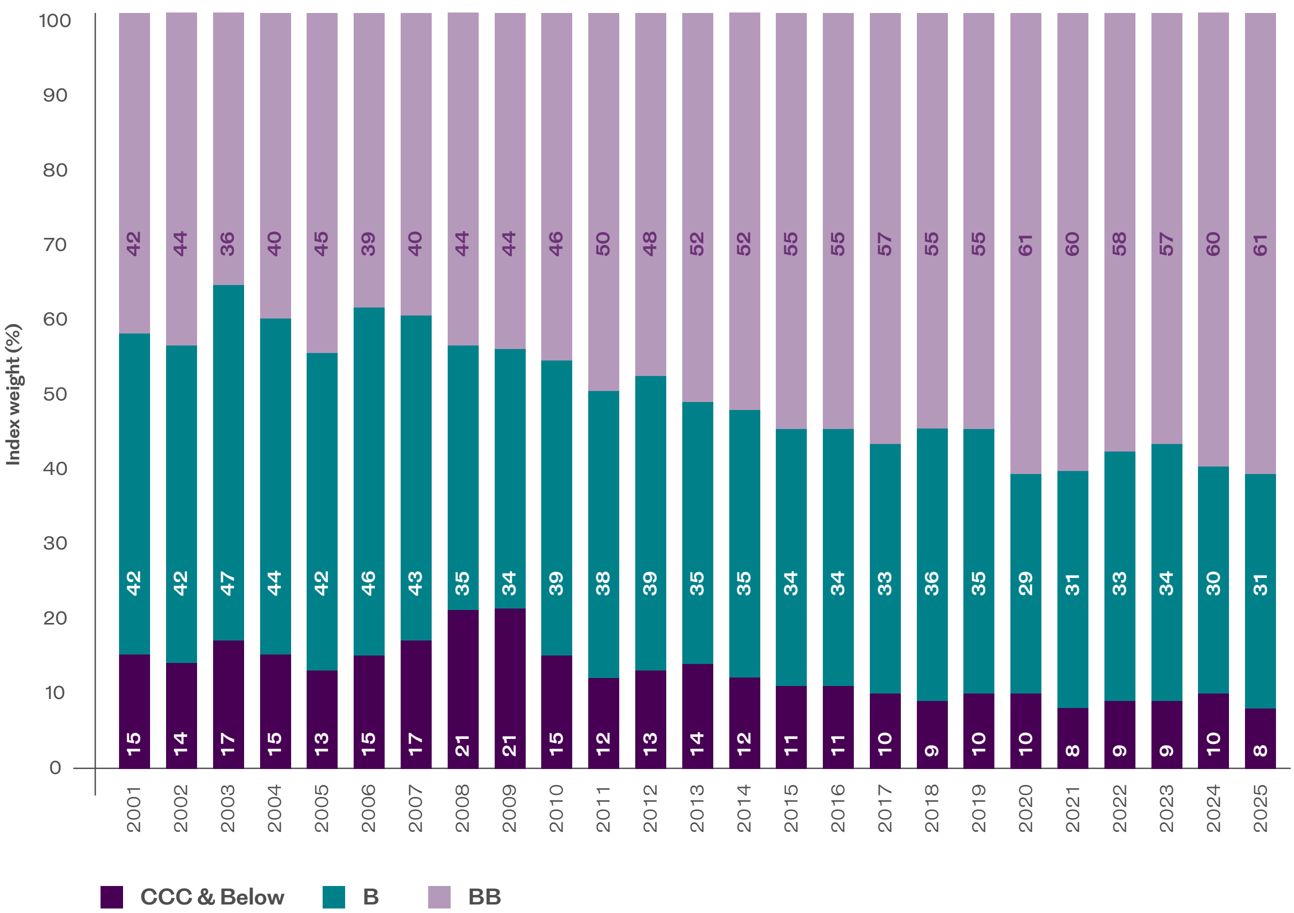
The high yield market has matured, with BB rated bonds now making up a larger share, and some lower-quality issuers have exited the market (chart 1). This has been brought about by the ever-growing presence of private debt. We are seeing private debt markets grow in size, hoovering up lower rated companies. This results in public markets being left in a structurally stronger place. As the CCC portion of the market continues to diminish, taking the most stressed part of the market out of public hands, we can see clear signs of why default rates remain so low.

Is now the right time?

Heading into 2026, could a short duration bias offer a reliable and repeatable process? We believe so, as it is ultimately an evergreen strategy. Whether entering or exiting a slowdown, a short duration high yield strategy that provides defensive positioning and access to high coupon bonds from resilient issuers could protect investors from the expected volatility that next year may bring.

Chart 1



Source: ICE Data Indices LLC using ICE BofA Global High Yield Index (HW00) as at 31 October 2025. Percentages subject to rounding.

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