Compression and commoditisation

Paola Binns
Head of Credit

Sterling credit

Navigating 2026 in sterling credit

Sterling credit markets have shown remarkable resilience in 2025, weathering external noise and tightening spreads. Despite elevated interest rates and persistent volatility, investment grade credit still offers attractive yields underpinned by robust fundamentals. The commoditisation of the market, driven by new buyers like insurers and ETFs, brings opportunities for active managers to add value through research-led approaches. With sound corporate health and well-capitalised banks, selectivity and discipline remain key. As we look to 2026, navigating compressed spreads demands a focus on fundamentals to uncover income potential and manage risks in sterling credit.

The story of 2025 was one of persistent external noise that generated headlines but did not ultimately undermine credit markets. In our view, despite relatively low credit spreads in an historic context, credit continues to compensate investors for fundamental risks and provides potential for attractive income generation. While volatility seems to be the new normal, credit markets have shown a remarkable ability to cut through the noise. Although we believe this resilience will persist, built off relatively robust corporate fundamentals, tighter credit spreads demand discipline and selectivity.

The year in review

At the start of the year, concerns around heightened volatility—particularly following Donald Trump's inauguration as US President—were front of mind for many investors. Yet, credit has largely held firm. Market fundamentals have reasserted themselves, with spreads tightening and income generation continuing to underpin performance. While political headlines have dominated the narrative, credit markets have demonstrated their ability to absorb shocks.

Sterling investment grade spreads reduced over the year from 0.86% at the start of January to 0.77% (iBoxx) by the end of the third quarter and also compressed – with the additional spread for owning riskier credits falling further. However, we have seen renewed, strong demand for the asset class.

> **Navigating compressed spreads demands a focus on fundamentals.**

Interest rates have remained elevated for longer than expected, pressured by sticky inflation. While investment grade credit continues to offer attractive all-in yields, the composition of those yields has shifted. Credit spreads have tightened significantly in recent years, and contrary to expectations, government bond yields have not fallen as many expected they would. As a result, a greater proportion of the total credit yield now stems from the underlying government component. Recent volatility in fixed income markets has largely been driven by underlying government bond yields responding to geopolitics and macroeconomic uncertainties and we expect this to remain a factor next year.

Compressed credit spreads demand fundamental discipline

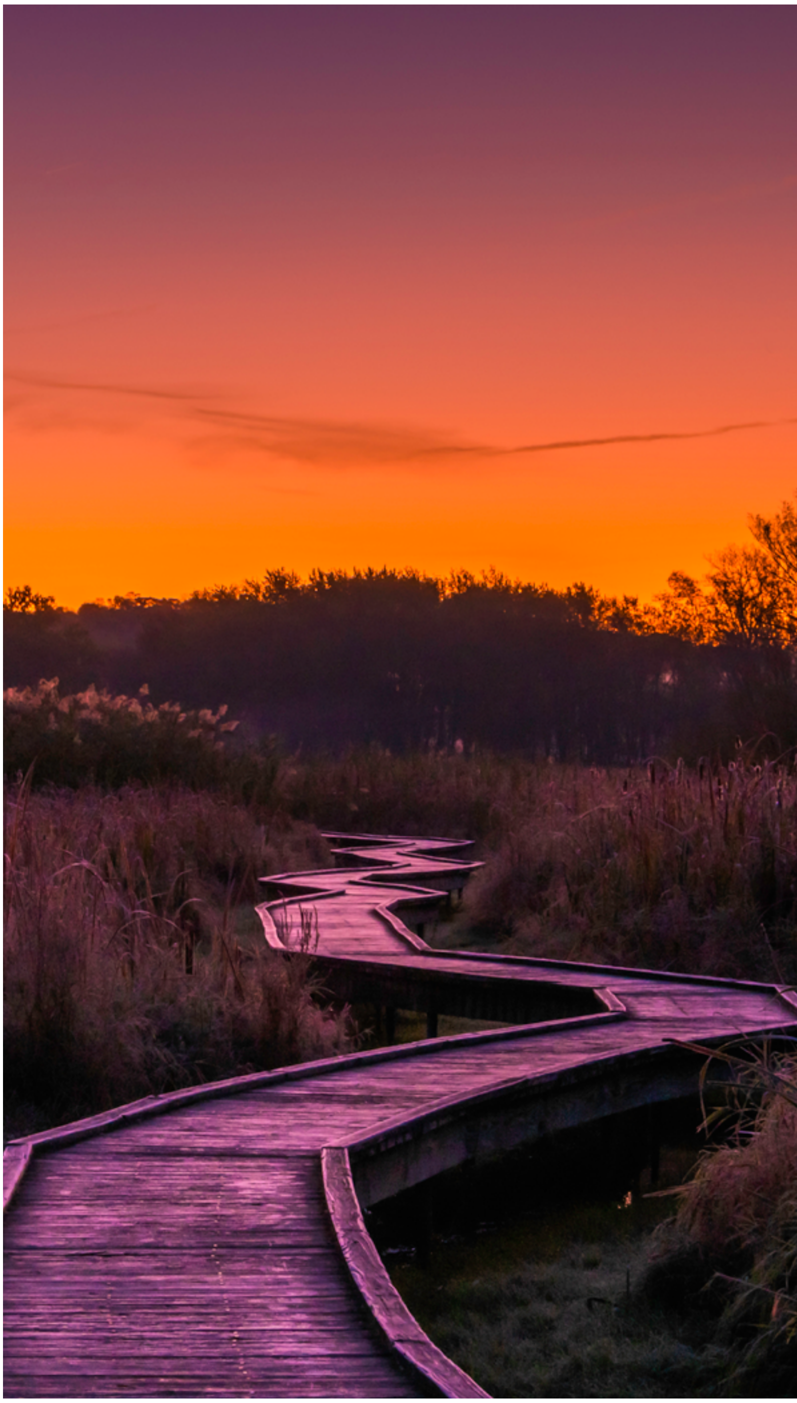
Clearly, there is a lot of uncertainty ahead from a political and economic perspective. Combined with tighter and more compressed credit spreads, effective credit investing requires a foundation built on strong fundamental analysis. Given the importance of banks to both economic activity and credit markets, this feels like the right place to start. The sector, at a broad level, is well capitalised, liquid, and operates within a supportive regulatory system. There are also few immediate signs of stress in banks' loan books.

Looking at corporates more widely, profitability is relatively healthy, leverage is not spiking, and balance sheets remain liquid and diverse. As ever, with cycles extending, risk is increasing but there are limited early signals of significantly rising default rates to imply that investment grade credit spreads no longer compensate for fundamental loss risk.

Commoditisation of the credit market

The relative recent strength of credit markets has, in a large part, been due to the emergence of significant new buyers of corporate bonds, such as insurance companies managing annuity liabilities and ETFs. As well as pushing spreads tighter, this also leads to further commoditisation of credit – with marginal buyers matching their prescriptive investment requirements by favouring more generic bond characteristics. In an asset class that has always been welcomingly idiosyncratic, this dynamic creates real opportunities for active managers, with a fundamental, research-led approach, focusing on bond specifics to build better credit portfolios. In our view, one area that is particularly fertile in this respect remains secured credit, where fundamental attractions are often under-appreciated by the market.

> **Effective credit investing requires a foundation built on strong fundamental analysis.**



> **In an asset class that has always been welcomingly idiosyncratic, this dynamic creates real opportunities for active managers.**

Navigating the new normal

Even if spreads widen, attractive income generation should still be available. Based on future rate expectations, 10-year gilts seem a good entry point at current levels (read the thoughts of our Head of Rates & Cash, Craig Inches) . So, although spreads are near to historically tight levels, the potential for strong returns built on all-in credit income looks attractive. It is up to us to find the best ways to access it in our portfolios.

Active management has always been critical in credit due to enduring inefficiencies. Moving into 2026, it feels the driving forces of compression and commoditisation mean that it is more important than ever. Building portfolios with allocations to secured corporate bonds materially in excess of typical bond benchmarks, while maintaining higher yield and income than the index through bottom-up selectivity and appropriate diversification, should continue to give us a strong base for navigating clear headwinds.

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Contact us

For more information about our range of products and services, please contact us.
Royal London Asset Management, 80 Fenchurch Street, London, EC3M 4BY

UK

For advisers and wealth managers

bdsupport@rlam.co.uk
+44 (0)20 3272 5950

For institutional client queries

institutional@rlam.co.uk
+44 (0)20 7506 6500

Switzerland

For all investors:

john.parkin@rlam.com
+44 (0)20 3272 5912

Germany

For all investors:

immo.gatzweiler@fundrock.com
+49 151 54 72 5296

FundRock provide EU Management Company services to RLAM.

Spain

For all investors:

mrona@altamarcam.com|
+34 91 290 07 28

Proud to partner with Altamar Capital to serve clients in Spain.

All other EEA investors

For all investors:

arnaud.gerard@fundrock.com
+352 691 992 088

FundRock provide EU Management Company services to RLAM.

Australia

For all investors:

kevin.haran@rlam.com
+61 (0)413 138 055