NCRAM Mid-Year 2025 High Yield Bond Outlook

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NCRAM's Mid-Year 2025 High Yield Bond Outlook

- NCRAM anticipates a soft landing for the US economy, with growth expected at 1-1.5% in 2H25, followed by a more robust expansion in 2026.
- Spreads inside of 300 bps are at the tight end of the historical range, but remain well-supported by solid fundamentals and average credit quality data that is near its all-time strongest.
- We believe yields close to 7% and NCRAM's forecast for a sustained low default rate position the asset class to deliver attractive forward returns to investors.

Year-to-Date Review

The high yield market returned 6.25% in US dollars in the first 8-months of 2025, as measured by the ICE BofA US High Yield Constrained Index (HUC0). Spreads were little changed, starting and ending the YTD period inside of 300 bps. Treasury yields drifted lower on concerns about the growth outlook for the US economy and expectations for easier monetary policy. The 10-year UST yield declined roughly 35 bps to 4.2%. High yield bond prices rose modestly, but carry has been the main driver of YTD returns.

President Trump's surprisingly aggressive "Liberation Day" tariff announcements in April caused a spike in high yield spreads, without a corresponding flight-to-quality decline in Treasury yields. Investors questioned the "American exceptionalism" thesis, shunning US dollar exposure. The high yield market quickly recovered as it became clear that the Trump administration was open to negotiations and effective tariff rates would likely settle well below headline numbers. As the northern hemisphere summer unfolded, the rock-solid employment market in the US showed some cracks, tariffs failed to spark significant inflation (not withstanding surprisingly high PPI inflation in July), and certain members of the FOMC began to speak out in favor of lower interest rates. In this environment, non-cyclical, US-centric businesses generating consistent cash flow and companies positively levered to lower interest rates generally outperformed, while economically sensitive issuers conducting business across borders lagged. Top performing sectors in the overall market included Telecom, Healthcare, and Real Estate, while Transportation, Retail, and Technology & Electronics trailed.

Exhibit 1: Year to Date Returns

Industry	Total Return YTD (%)
Automotive	6.39
Banking	4.36
Basic Industry	5.53
Capital Goods	5.89
Consumer Goods	5.22
Energy	5.37
Financial Services	6.55
Healthcare	8.22
Insurance	6.56
Leisure	5.16
Media	7.34
Real Estate	8.18
Retail	4.48
Services	6.99
Technology & Electronics	5.08
Telecommunications	8.90
Transportation	2.44
Utility	5.29

Rating Segment	Total Return YTD (%)
BB	6.41
B	5.89
CCC	7.06

Sources: NCRAM, ICE BofA US High Yield Constrained Index (HUC0), as of August 31, 2025

US Economic Outlook

NCRAM anticipates a soft landing in the US economy. Growth was near 3% in both 2023 and 2024, but slowed to 1.4% in the first half of 2025. We expect the economy to expand at a similar 1-1.5% pace in 2H25. At that rate of growth, it would not require much disappointing data to tip the US into a mild recession, and we acknowledge this possibility. However, we believe a hard landing recession is highly unlikely, barring a Black Swan event. We observe numerous pockets of growth supporting the US economy, including resources pouring into AI and technology (Q2 GDP data showed private fixed investment in information processing equipment and software was up 18.8% annualized). Power production to support AI and broader electrification is another key source of expansion. In the energy space, rig counts are down meaningfully this year, but monthly oil production reached a record high in June as the industry innovates to extract more hydrocarbons from fewer wells.

Mild stagflation is a plausible negative economic scenario for the US, though not well-supported by recent data. We do not expect tariffs to sustainably impact inflation, unless the Fed intervenes with a policy error. NCRAM aligns with Carl Menger (prices drive input costs) rather than Karl Marx (input costs drive prices) in the debate surrounding inflation and tariff rates.

NCRAM expects a more robust economic expansion in 2026. Growth will likely benefit from the simulative effects of easier monetary policy, reduced taxes, lighter touch regulation, targeted fiscal loosening in a competitive mid-term election year, and potential productivity gains as AI investments begin to deliver impactful results.

Outlook for High Yield

NCRAM views a soft landing economic environment as favorable for high yield, further enhanced by our expectations for a stronger expansion next year. Slow but positive growth is accommodating for the high yield market; the economy will likely remain sufficiently resilient for most issuers to continue generating requisite cash flow to service debt, but soft enough to enable the Fed to resume easing in 2025 and into 2026. This is a positive backdrop for the asset class, but spreads inside of 300 bps are at the tight end of the historical range. We do not anticipate a material spread-driven rally, nor do we forecast a sharp decline in Treasury rates over the next 12 months. However, we remain constructive on the asset class given the attractive market yield near 7% and a low default rate (0.5% in the 12 months ended August 2025, or 1.5% including distressed exchanges).

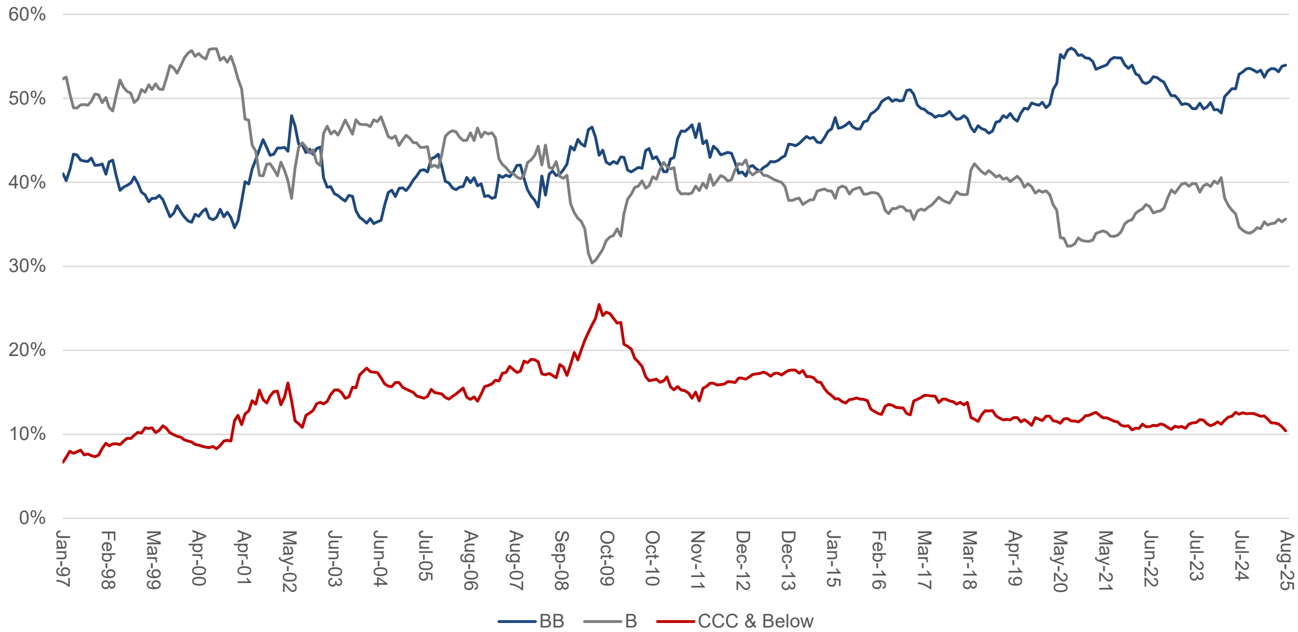
While spreads are unlikely to tighten significantly from current levels, we also do not foresee substantial widening (assuming the economy avoids the aforementioned Black Swan event). A mild recession would raise the spread premium, but Treasury rates would likely fall, entrenching high yield bond yields close to the recent trading range.

Our constructive outlook for the asset class is based on three key positive factors:

- High yield issuers' income statements and balance sheets are solid. Operating earnings have improved year-over-year for six consecutive quarters, and 2Q25 is likely to add a seventh quarter of earnings expansion. High yield companies' net leverage ratio at 3.9x (per BofA Global Research) remains below the 10-year average of 4.1x.
- The credit quality of the high yield market is as strong as it has ever been. 55% of the index is rated BB, with only 10% CCC and below (see Exhibit 2). High yield spreads declined to a historic low of 240 bps in 2007. At that time, only 41% of the market was BB-rated, vs. 17% at CCC. Arguably, spreads could continue to grind tighter in current conditions, but that is not our base case expectation.
- Technicals remain modestly positive, but are less supportive than observed in recent years. The first eight months of 2025 have seen $209 billion of gross new issuance. $150 billion of the proceeds from those bonds were directed to refinancing, so only $59 billion was fresh capital, a manageable supply increase for a $1.4 trillion market. However, an additional $35 billion of net fallen angels dropped into the high yield market ($57 billion fallen angels vs. $22 billion rising stars), further expanding the supply of debt. Demand for high yield from both dedicated and crossover investors has been robust, as evidenced by positive flows into high yield ETFs and mutual funds, the tight pricing of attractive new issues, and the 21% y/y trading volume increase in 1H25.

Given the economic backdrop, yields close to 7%, and our forecast for continued low default rates, NCRAM believes the high yield market is positioned to deliver attractive returns to investors over the balance of 2025 and into 2026.

Exhibit 2: US High Yield Ratings Breakdown



Sources: NCRAM, ICE BofA US High Yield Constrained Index (HUC0), as of August 31, 2025

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