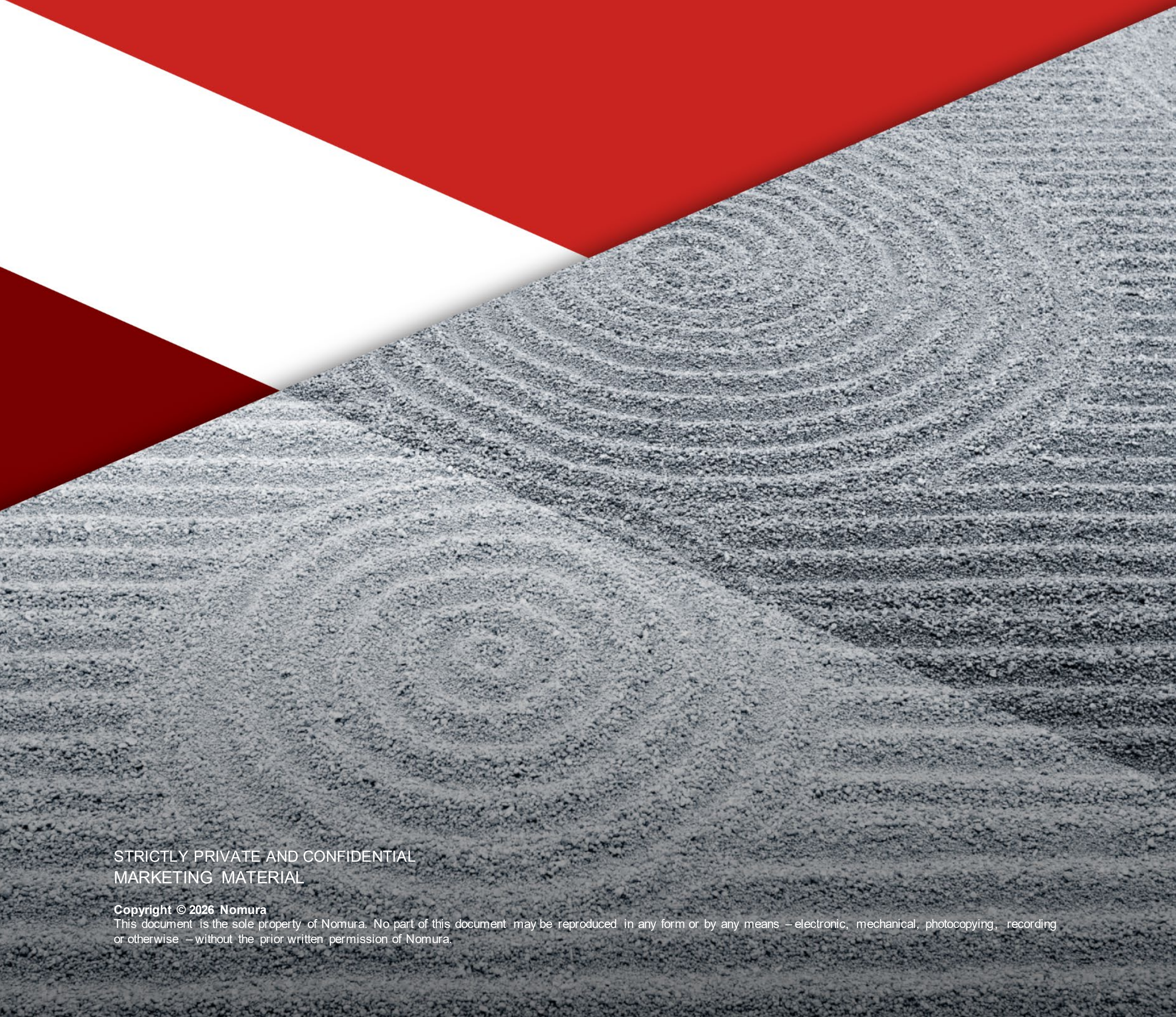
NCRAM US High Yield Outlook

Connecting Markets East & West

JANUARY 2026



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MARKETING MATERIAL

NCRAM's 2026 High Yield Bond Outlook

- NCRAM forecasts moderate but improving US economic growth in 2026, a solid foundation for high yield performance.
- We expect the default rate to remain low, due to strong issuer fundamentals and elevated credit quality relative to historical levels.
- The high yield market offers skilled active managers alpha generation opportunities via credit differentiation and identifying discount bonds positively exposed to event risk.
- Spreads of approximately 300 bps are lower than long-term averages, but risk premia often persist at the low end of the range until a catalyst (a recession or black swan event) forces widening.
- Yields in the 6.5-7% range offer an attractive entry point, given NCRAM's expectation of continued low default rates. We believe high yield is positioned to deliver strong risk-adjusted returns to investors in 2026.

2025 Year in Review

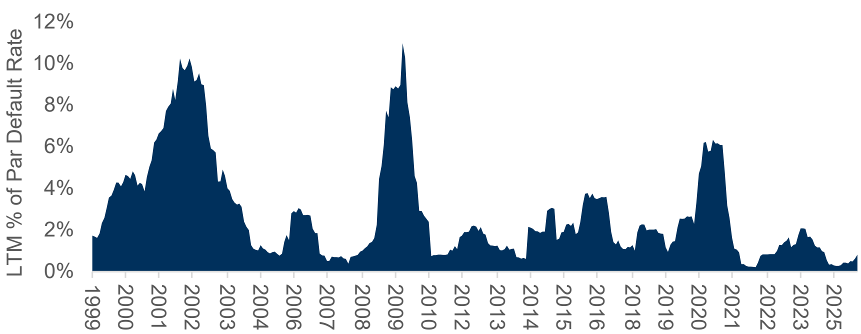
The high yield market was up 8.50% in 2025, the third consecutive year of strong performance, following returns of 8.20% in 2024 and 13.47% in 2023, as measured by the ICE BofA US High Yield Constrained Index (HUC0). High yield credit spreads started and ended the 2025 period just inside of 300 bps (281 bps as of December 31), weathering a post-"Liberation Day" spike and recovery. Yield to worst spent most of the year in the 6.5-7.5% range, drifting lower from 7.5% at the start of 2025 to 6.62% at year-end, with similar tariff-related volatility during the second quarter.

Spreads bottomed in January, after President Trump was inaugurated promising lower taxes, lighter touch regulation, and a new Department of Government Efficiency focused on sparking growth by limiting bureaucracy and slimming the size of government. Spreads widened modestly during Q1 as policy makers' enthusiasm for efficiency waned, before President Trump's Liberation Day tariff hikes in April caused spreads to blow out to 461. The market quickly recovered as investors concluded that continued negotiations and widespread exemptions would lead to an effective tariff rate closer to 10%, rather than the threatened headline rates. By June, high yield spreads were back down to 300 bps, then spent most of 2H25 in a 275-325 range.

10-year US Treasury yields moved lower during 1Q25, falling from 4.6% to start the year to 4.0% in early April, on expectations that Fed interest rate cuts and technological innovation could lead to declining rates across the curve. However, Liberation Day volatility caused rates to retrace back to 4.6%. Normally, a significant disruption such as an unexpected trade war would lead to a flight-to-quality rally in US Treasuries. This time was different, as investors questioned the future of American exceptionalism and the primacy of the US dollar. Fears abated, and the 10-year mostly traded between 4% and 4.25% from August through December (4.2% at year-end).

Attractive carry, low default rates (1.0% in the 12 months ended December 31), and supportive fundamentals and technicals kept high yield bonds well-bid during the year. The same factors encouraged investors to buy any dips, constraining selloffs during the second half of 2025.

US High Yield Default Rate



Sources: NCRAM, JPMorgan, as of December 31, 2025

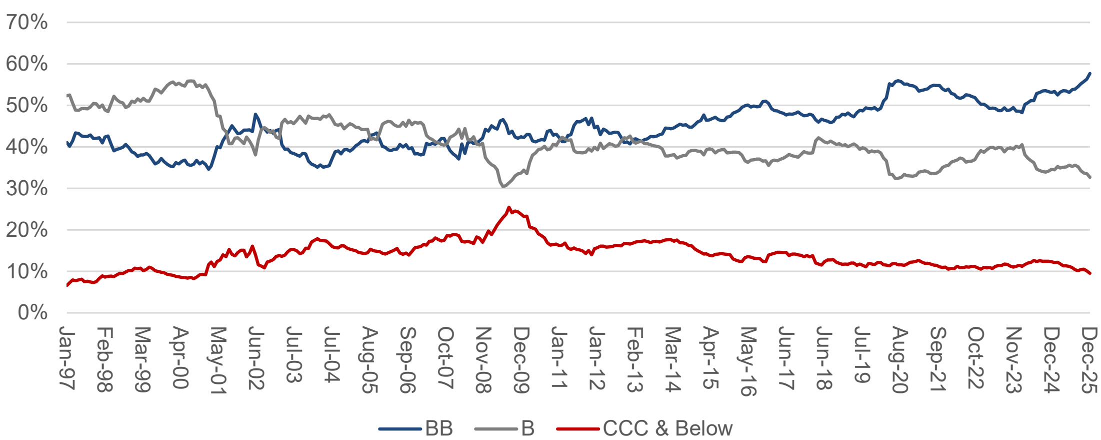
2026 Outlook

NCRAM's base case assumption for US economic growth is moderate activity for the first 3-6 months of 2026, with increasing momentum as the year progresses. The US grew at 2.5-3% in 2023 and 2024, while growth in 2025 likely decelerated to roughly 2%. We expect that rate to persist in the early months of 2026. However, 2026 is a midterm election year, thus fiscal policy is likely to loosen even further. The Fed eased three times in 2025, and at least two more cuts are expected over the next 12 months. The Trump administration has locked in lighter tax rates and lessened the tax burden on corporations and lower income workers. The administration has also prioritized slashing regulatory red tape to reduce operating costs and stimulate business investments. Furthermore, NCRAM expects recent hefty investments in artificial intelligence (AI) to begin delivering a positive ROI to users, lifting productivity and margins. These factors are likely to lead to stronger economic growth in the second half of the year.

Moderate but improving growth in 2026 provides a solid foundation for high yield performance. The economy will likely remain sufficiently resilient for default rates to stay low, but uneven enough for the Fed to follow through on expected rate cuts. With OAS inside of 300 bps, NCRAM does not expect declining spreads to lead to robust capital gains. Likewise, Fed rate easing could cause some downward pressure on interest rates across the curve, but the 10-year US Treasury yield has already dropped from a high of 4.8% in 1Q25 to 4.2% at year-end, and the yield curve has progressively steepened since early 2025. We do not expect a rate rally unless growth disappoints, and believe Treasury yields will remain range-bound. While substantial capital gains at the market level are unlikely in 2026, we believe high yield is poised to deliver attractive total returns to investors thanks to the carry.

Competitive, carry-driven performance requires the default rate to remain low. High yield issuers defaulted at a 1.0% rate over the last 12 months, or 1.9% including distressed exchanges, vs. the historical average around 3.3%. We expect the default rate to remain depressed, given persistently strong issuer fundamentals. Operating earnings grew 1.7% y/y in 3Q25, the eighth consecutive quarter of positive results. High yield issuers are using internally generated resources to shore up their balance sheets. Net leverage and interest coverage have both stabilized at close to 4.0x, favorable levels vs. the past ten years. Furthermore, the market's credit quality has evolved in a markedly positive direction in recent years. 58% of the high yield market is rated BB, which is near the historical peak, and less than 10% is CCC-rated, close to the nadir. These conditions could continue, as CCC issuers have increasingly targeted the private credit market, or in some cases the broadly syndicated loan market, for financing. CCC high yield issuance in 2025 was only $10bn, vs. total issuance above $330bn. Looking at history, high yield spreads reached an all-time tight of 240 bps in 2007. At that time, 41% of the market was BB rated and 17% CCC, a significantly lower aggregate credit quality vs. today. With these factors in mind, NCRAM expects the 2026 default rate to remain comfortably below the long-term average.

Ratings Breakdown: ICE BofA US High Yield Constrained Index (HUC0)

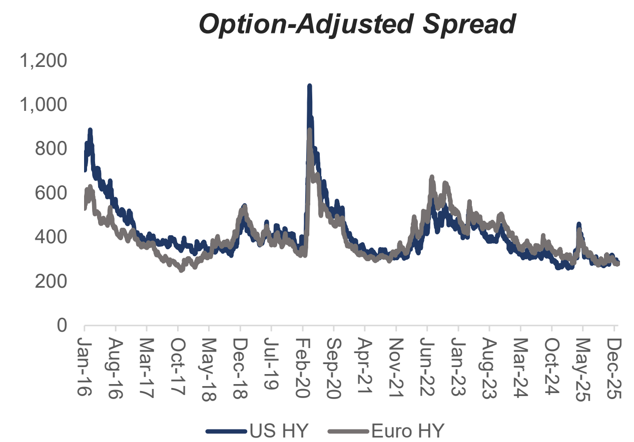


Sources: NCRAM, ICE BofA, as of December 31, 2025

Technicals to date have been very supportive of high yield bond prices in the post-pandemic environment. High yield's market value contracted by close to $100bn in both 2022 and 2023, a meaningful decline in the roughly $1.5tn investment universe. 2024 saw a minimal increase in supply countered by continued vigorous demand for the asset class. 2025 experienced a larger increase in net supply. Total issuance was greater than $330bn, but the majority of activity was refinancing, while net issuance was less than $100bn. This manageable bump was readily absorbed by sturdy demand from both dedicated and crossover investors. US high yield ETF and mutual fund net flows in 2025 exceeded 5% of start-year NAV. Most reasonably priced high yield new issues were well oversubscribed, buoyed by a plethora of orders originating from go-anywhere fixed income strategies, pension funds, sovereign wealth funds, and hedge funds, illustrating crossover investor interest in the asset class' healthy yields. Looking forward to 2026, the favorable supply/demand dynamic could modulate, given heavier expected new issuance to fund M&A transactions, AI investments and other capital projects, along with a steady flow of refinancing deals.

The high yield market also offers skilled active managers plentiful alpha generation opportunities, via both avoiding problem credits and identifying bonds trading at depressed levels relative to fundamentals. Many of these situations lie in the less efficient B and CCC-rated segments of the market, where experienced analysts can differentiate between improving and deteriorating credits. Discount bonds positively exposed to event risk also create opportunities to potentially generate outsized returns. Many issuers have been willing to retire existing bonds at a premium in order to extend debt maturities. Similarly, M&A transactions can deliver positive outcomes for discount bonds, thanks to change-of-control covenants or a reduced spread premia when a high yield issuer is acquired by a company with a stronger credit rating. We expect 2025's active refinancing and M&A environments (more than $230bn of high yield bonds were refinanced, and high yield M&A rose 10% y/y to $360bn) to remain in place in 2026.

High yield valuations are less robust relative to the long-term average, with spreads inside of 300 bps. However, spreads often persist at the tight end of the historical range until a catalyst forces widening, typically a recession or a black swan event. By nature, black swans are unknown, but NCRAM does not expect a recession in 2026. Important pockets of activity in the US, including IT investment, energy production, and the build-out of power generation capacity, sharply reduce the probability of negative economic growth. NCRAM believes that high yield bond yields in the 6.5-7% range offer a solid entry point, given our forecast for continued low default rates. In our view, this level positions the asset class to deliver attractive returns to investors in 2026.



Sources: NCRAM, ICE BofA, 10 years ended December 31, 2025
US HY as measured by the ICE BofA US High Yield Constrained Index (HUC0), Euro HY as measured by the ICE BofA European Currency High Yield Constrained Index (HPC0). Percentiles are based on daily data, and measure current valuation relative to the full distribution of daily values over the last 10 years.

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