CIO View
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Marketing material

High-yield bonds under a new rates regime

How risk, valuation and liquidity are evolving in credit markets

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IN A NUTSHELL

- High-yield bonds may once again offer carry, but current tight spread levels reduce the buffer against adverse market moves and bring the risk profile into sharper focus.
- The environment points to a late stage of the credit cycle: while default rates remain moderate, vulnerability to macroeconomic surprises and idiosyncratic risks is increasing.
- Similar yield levels increasingly mask different risk profiles. Diversification, sector allocation and, above all, careful issuer selection are becoming more important.

Assessing risk in a changing credit environment

High-yield corporate bonds have returned to the spotlight, mainly because income has become meaningful again. After years of very low interest rates, yields have increased to around 6 to 7%. This means that investors can generate a visible stream of income simply by holding these bonds, a concept often referred to as 'carry.' This shift is not temporary. It reflects a broader structural change in the financial environment following the global rise in interest rates, redefining how this market operates.

High-yield bonds play a well-established role in global credit markets. They enable companies with lower credit ratings to access financing and, in return, offer investors higher yields to compensate for the increased risk. This segment sits between safer government or high-quality corporate bonds and more volatile investments, such as equities. As such, it has long been a staple of diversified portfolios, providing income while also being linked to the underlying health of companies and the economy.

The difference today lies not in the existence of this market, but in how returns are generated within it. Historically, investors often benefited when the risk premium over government bonds narrowed. Currently, however, that additional compensation – the spread – is already relatively low. At the same time, however, overall yields are higher. This creates a different balance: returns now depend more on steady income than on price gains. Put simply, investors are being paid more upfront, but have less protection if conditions deteriorate.

Demand for high-yield bonds is still being driven by investors seeking income in a world where many traditional fixed-income instruments offer lower returns. At the same time, companies continue to issue bonds to secure financing in the new interest rate environment. The market remains large, liquid and transparent, meaning that prices adjust quickly to new information. This makes risks visible early on, but also means that prices can fluctuate significantly.

This responsiveness highlights one of the key challenges. Although default rates remain moderate, the overall environment is becoming more challenging. Higher financing costs and slower economic growth are putting pressure on companies, particularly those with weaker balance sheets. Consequently, differences between issuers are becoming more pronounced. Even if their yields appear similar, not all high-yield bonds carry the same level of risk.

Another important constraint is the limited 'risk buffer.′ Since spreads are already tight, there is less capacity for markets to absorb unexpected shocks. Consequently, events such as economic slowdowns or company-specific problems can more quickly translate into price losses. This makes the market more sensitive than in earlier phases of the cycle.

Structural factors also matter. The composition of the market varies by region and sector. For instance, certain business models are subject to greater uncertainty in the current environment, particularly in relation to technological shifts. Differences between regions can also lead to similar headline yields masking different underlying risks.

The broader context points to a later stage of the credit cycle. During this phase, the focus typically shifts from broad market exposure to more careful selection. Investors can no longer rely on general market trends to drive performance. Instead, outcomes are increasingly determined by individual company fundamentals, such as debt levels, profitability and refinancing ability.

The implications for investors may be considered. While high-yield bonds can still offer attractive income, they require a more disciplined approach. Investing in the overall market may be less effective when risks are unevenly distributed. It may therefore important to diversify across sectors and issuers, and to understand what drives risk at the company level.

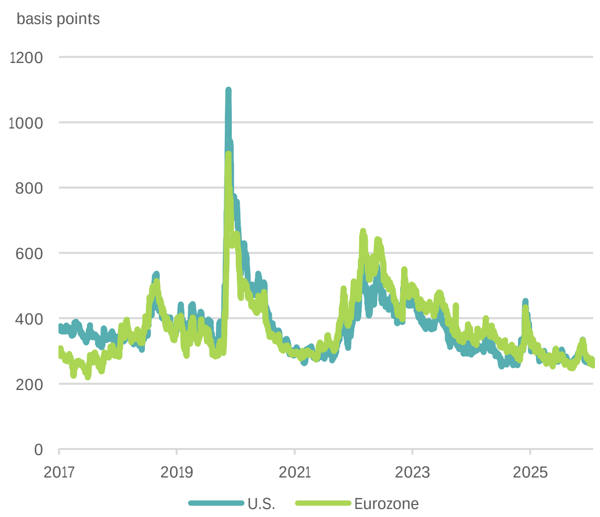
At the same time, the relatively high level of transparency and liquidity in the public high-yield market remains advantageous. Unlike less frequently priced segments of the credit market, risks are reflected continuously in prices. This makes it easier to monitor developments and adjust exposures when needed.

In this environment, the key question is no longer whether high-yield bonds can generate income, but how stable that income will be. The answer lies in credit quality, resilience to changing economic conditions and issuers' ability to manage higher financing costs. As the margin for error narrows, careful selection may become more important.

High yield: high yields, tight spreads

Carry is back – yields of the Bloomberg High Yield Index for the U.S. and the Eurozone, and for comparison the dividend yields of selected indices

Spreads are tight again – yield differentials of the Bloomberg High Yield Index for the U.S. and the Eurozone vs. respective government bonds



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 06/10/26

If you are interested in the whole piece (English only), here is the link

Glossary

The carry (of an asset) is the cost or benefit from holding the asset.

The credit cycle is the expansion and contraction of access to credit over time and is usually connected to the business cycle.

The default rate refers to the proportion of borrowers who cannot service their loans.

Eurozone is the group of European Union member states that have adopted the euro as their common currency and legal tender.

High-yield bonds are issued by below-investment-grade-rated issuers and usually offer a relatively high yield.

Liquidity refers to the degree to which an asset or security can be bought or sold in the market without affecting the asset's price and to the ability to convert an asset to cash quickly.

The risk premium is the expected return on an investment minus the return that would be earned on a risk-free investment.

The spread is the difference between the quoted rates of return on two different investments, usually of different credit quality.

Volatility is the degree of variation of a trading-price series over time. It can be used as a measure of an asset's risk.

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