

Spreads Revert to Tights as Policy Uncertainty Eases

This report is excerpted from the *Third Quarter 2025 Fixed-Income Sector Views*.

Solid fundamentals and low default rates highlight the appeal of high yield in a shifting policy landscape.

High yield markets were volatile in the second quarter of 2025, initially due to widening spreads from tariff concerns. Spreads retraced, however, after the administration's postponed reciprocal tariffs. Progress on trade agreements, stable earnings, and fiscal stimulus discussions have reduced policy uncertainty. Spreads tightened from 355 to 296 basis points, nearing historic lows, marking the sector's eleventh consecutive positive quarter. Strong inflows, robust credit fundamentals, and low default rates support the market, favoring higher quality high yield bonds for their risk-reward balance.

Sector Commentary

- Spreads on the ICE BofA U.S. High Yield Master II Constrained Index tightened from 355 to 296 basis points in the second quarter, remaining in the 4th percentile of historical levels.
- The high yield index achieved a 3.6 percent total return for the quarter, marking the eleventh consecutive quarter of positive returns, aided by a modest decline in benchmark Treasury yields.
- Year to date, higher quality is outperforming lower quality, with BBs, Bs, and CCCs posting returns of 4.9 percent, 4.2 percent, and 3.2 percent, respectively. However, CCCs led in the second quarter as risk appetite increased following the tariff pause.
- As of quarter-end, high yield bonds yielded 7.4 percent on average, 40 basis points above the decade average, despite a shortened maturity profile of 4.7 years compared to a 6.8-year average since index inception.

Investment Themes

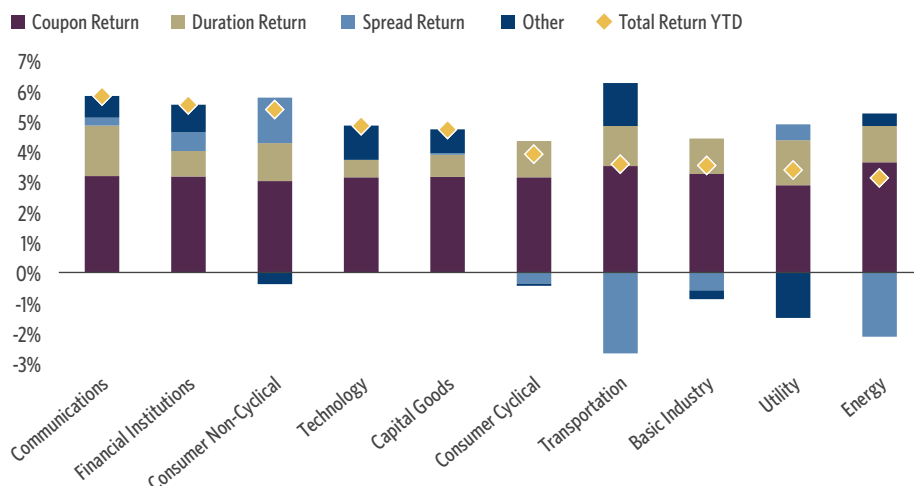
- Investors continue to find high yield corporate bonds attractive despite policy uncertainty, with \$9.2 billion in net fund inflows this year. Expectations of Fed rate cuts are fueling additional appetite as high coupons support returns.
- Strong credit fundamentals make weak periods attractive entry points to add yield. The trailing 12-month par-weighted default rate declined to 1.1 percent, well below the 20-year average of 3.5 percent.
- Refinancing activity is dominating primary issuance, keeping net supply low and containing spreads near historically tight levels.
- The spread difference between weakest and strongest credits is narrower than year-to-date wides. In a slowing growth environment, we prefer higher quality high yield bonds (rated B or above) for their stronger fundamentals and lower default risk, offering attractive yields and relative risk mitigation.

By Thomas Hauser and Maria Giraldo

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Carry and Spread Tightening Supported Positive Returns

YTD Returns through June 30, by Industry



Source: Guggenheim, Bloomberg. Data as of 6.30.2025. Attribution returns are estimates. "Other" may capture other sources of return including roll down and index constituent changes.

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One **basis point** is equal to 0.01%.

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