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High Yield and Bank Loan Outlook

From Carry to Credit: How Rate Cuts Will Impact High Yield and Bank Loan Borrowers

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Summary

Credit markets remained steady through the fall, supported by resilient growth and improving sentiment following the April tariff policy shock. Year-to-date returns for both high yield and loans have been strong, with high yield generating additional performance from falling interest rates. These results leave both high yield bond spreads and leveraged loan discount margins near historical tights.

Looking ahead, Federal Reserve (Fed) rate cuts will likely impact relative value across leveraged credit. While easing would support overall credit conditions, it could compress loan yields, reducing the sector's carry advantage over high yield bonds. Fundamental challenges for the lowest quality loan borrowers seem likely to persist in 2026 even as funding costs decline. Against this backdrop, we continue to favor higher quality credits and selective positioning.

Report Highlights

- High yield bonds and bank loans have delivered positive returns this year, as strong demand and limited supply have compressed spreads.
- Bonds outperformed due to lower credit losses and a modest tailwind from declining Treasury yields. In contrast, repricing and defaults have eroded loans' yield advantage.
- Additional Fed rate cuts over the next year and ongoing loan repricing activity could shift relative value toward bonds, particularly for retail investors. Careful credit selection remains critical in a bifurcated economy, as challenging conditions persist for some borrowers.
- We believe active strategies are best positioned to navigate credit dispersion, and shifting relative value, and expect high yield bonds to deliver coupon-like returns near 6.5 percent over the next year.

Leveraged Credit Scorecard

High Yield Bonds

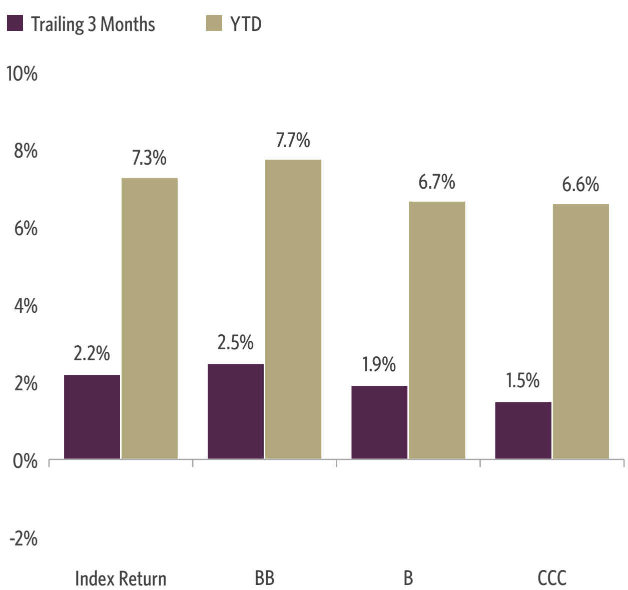
	December 2024		August 2025		September 2025		October 2025	
	Spread	Yield	Spread	Yield	Spread	Yield	Spread	Yield
ICE BofA High Yield Index	310	7.5%	304	6.8%	299	6.7%	310	6.8%
BB	205	6.4%	200	5.8%	198	5.7%	197	5.7%
B	318	7.5%	320	6.9%	304	6.7%	322	6.9%
CCC	751	11.9%	806	11.7%	814	11.9%	867	12.4%

Bank Loans

	December 2024		August 2025		September 2025		October 2025	
	DMM*	Price	DMM*	Price	DMM*	Price	DMM*	Price
S&P UBS Leveraged Loan Index	475	96.37	457	96.47	451	96.42	454	96.13
BB	261	100.09	263	99.68	261	99.68	256	99.75
B	431	98.87	420	98.28	411	98.40	415	98.16
CCC/Split CCC	1,406	76.48	1,334	78.11	1,351	76.84	1,416	76.01

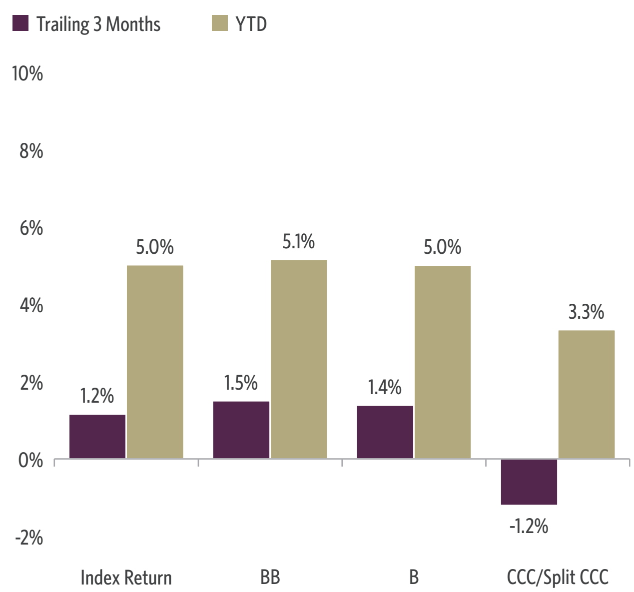
Source: ICE BofA, S&P UBS. *Discount Margin to Maturity assumes three-year average life. Past performance does not guarantee future results.

ICE BofA High Yield Index Returns



Source: ICE BofA. Data as of 10.31.2025. Past performance does not guarantee future results.

S&P UBS Leveraged Loan Index Returns



Source: S&P UBS. Data as of 10.31.2025. Past performance does not guarantee future results.

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Financial conditions have eased, and sentiment has improved following the April shock, when tariffs and shifting policy expectations weighed on confidence. Beneath the surface, however, the expansion has become increasingly uneven.

Macroeconomic Outlook
Resilient Growth Despite Uneven Momentum

The U.S. economy has been resilient this year to a shifting policy environment. Growth recovered from first quarter lows and looks robust in the third quarter, driven by consumer spending and strong technology investment.

However, economic growth continues to be characterized by meaningful bifurcation. Sentiment has diverged sharply across consumer cohorts, as higher income households benefit from rising financial wealth, while lower income households are squeezed by high interest rates and moderating real income gains. For businesses, AI-driven technology investment continues to surge, while other areas of business and housing investment languish. Companies remain cautious, and the labor market has settled into a “low hire, no fire” pattern creating vulnerability to new shocks.

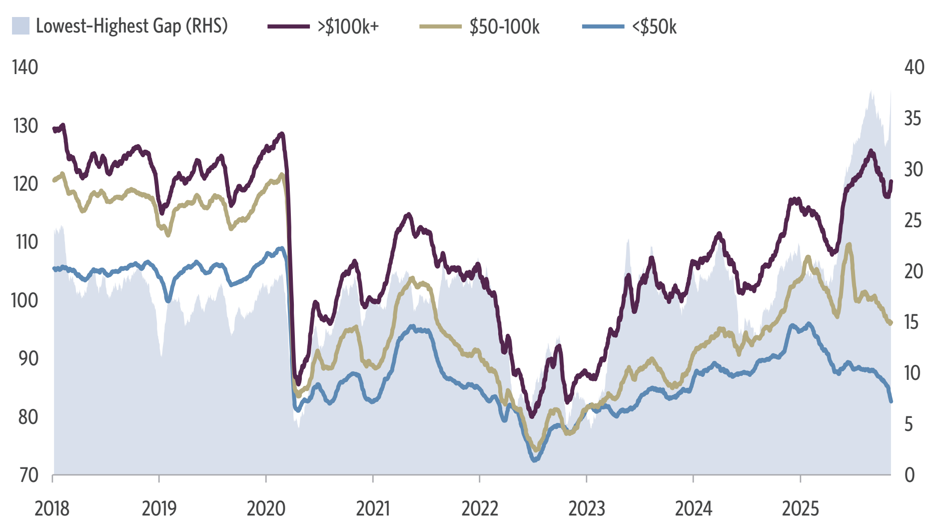
The U.S. government shutdown represented a new challenge for the economy and will weigh on fourth quarter growth. The lapse in data from the shutdown reduces visibility into economic conditions at a transitional moment. Alternative, private data sources paint a picture of a mostly stable private jobs market. Although the economy should recover as the government reopens, risks are tilted to the downside, in particular, if the shutdown weakens sentiment or hiring further.

Tariff-driven inflation has been less pronounced than initially feared. Strong corporate profitability in some sectors has allowed firms to absorb higher import costs, while others are passing through price increases gradually, prolonging the adjustment process. We expect these effects to fade by the second half of 2026, allowing the Fed to continue lowering the policy rate to around 3 percent.

Consumer sentiment has diverged across income groups, with higher income households benefiting from rising financial wealth, while lower income consumers are squeezed by high interest rates and moderating real income gains.

High Income Consumers Are Feeling Good from Wealth Gains

Morning Consult Sentiment by Household Income, 20-Day Moving Average



Source: Guggenheim Investments, Bloomberg. Data as of 11.6.2025.

Overall, we see a constructive backdrop for credit markets. Our base case is for moderate growth and cooling inflation in 2026, with the Fed easing back toward neutral. Risks are tilted to the downside, in particular if the labor market cools more sharply or a shift in investor sentiment sparks a pullback in financial markets.

Leveraged Credit Review

Bonds Outperform Loans this Year

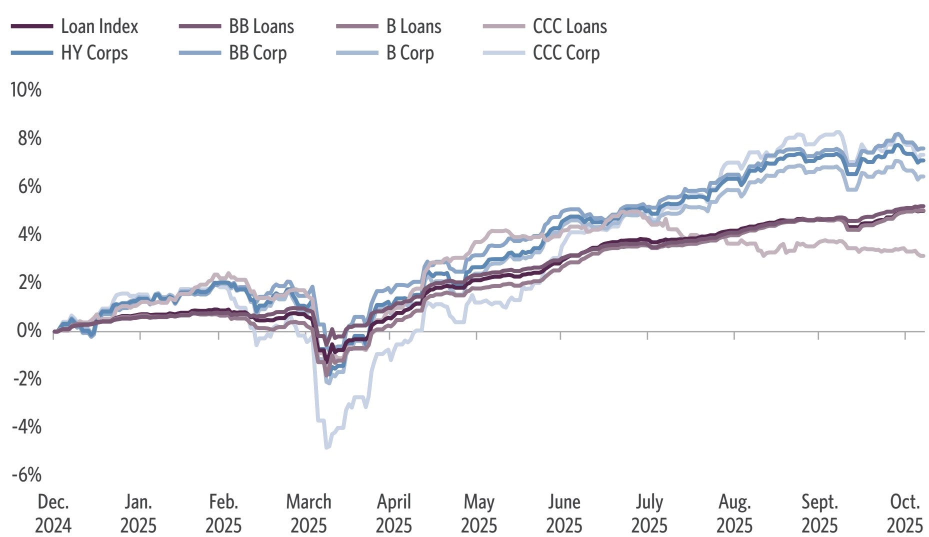
Both bonds and loans have delivered positive returns in 2025, benefitting from strong demand tailwinds and limited supply. Bonds outperformed at every rating level as a moderate default cycle limited credit losses.

Despite entering the year with higher starting yields, the loan market has struggled to translate income advantage into realized performance due to repricing activity and persistent challenges among the lowest quality borrowers. Repricing activity is when a borrower and its lenders amend an existing loan so that the margin (i.e. spread) over the benchmark is lowered, which can reflect an improvement in the borrower's credit quality or in the current market, supply/demand conditions. Usually other terms of the loan, such as the maturity date, are unchanged in repricing activity. At the index level, loans underperformed bonds by almost 2.5 percentage points, with underperformance particularly stark further down the credit spectrum.

Despite entering the year with higher starting yields, the loan market has struggled to translate that income advantage into realized performance, due to persistent challenges among the lowest quality borrowers.

Loans Have Lagged High Yield Bond Returns This Year

Cumulative Return Since 12.31.2024



Source: Guggenheim Investments, Bloomberg, S&P UBS, ICE Index Services. Data as of 11.5.2025.

Repricings and Credit Losses Weigh on Loan Returns

For higher quality loans, repricing activity moderated returns. Loan amendments reduced spreads by an average of 51 basis points year to date, as lenders refinance stronger credits at tighter risk premiums. With roughly 40 percent of the index still trading above par and another 35 percent between 98–100 percent of par, repricing activity could persist. This is because when loans trade at or above par, it indicates that investor demand for certain loans exceeds available supply of them, in this case being higher quality loans. As a result, investors are willing to pay more than the loan's face value, which reduces their all-in yield. This dynamic typically signals to borrowers that investors may be willing to accept a lower contractual spread in order to hold the loan.

At the lower end of the credit quality spectrum, defaults and credit losses have eroded loan returns. Credit losses in the sector were about 1.1 percent year to date, compared to 0.4 percent for bonds. Defaults and liability management exercises have spanned industries, from consumer-facing sectors like auto makers, retail, and food/beverage, to healthcare, technology, cable/satellite, and chemicals. The common thread in the activity has tended to be structural rather than industry-driven, concentrated among lower rated and more leveraged borrowers, more typically in loan-only structures with no subordinated debt to absorb losses. And while credit stress remains concentrated in CCCs, which make up just 7 percent of the loan market, the combined effect of repricing at the top end and higher defaults at the bottom has hindered performance in the loan market.

Leveraged Credit Outlook

Higher Credit Quality and Declining Policy Rates Favor High Yield at the Index Level

Looking ahead, declining policy rates and a moderate default cycle may further compress index-level loan returns relative to bonds. Although lower rates may provide some relief to select loan borrowers, the extent of rate reductions appears insufficient to meaningfully improve outcomes for the majority. As a result, careful credit selection will be essential to capture opportunities.

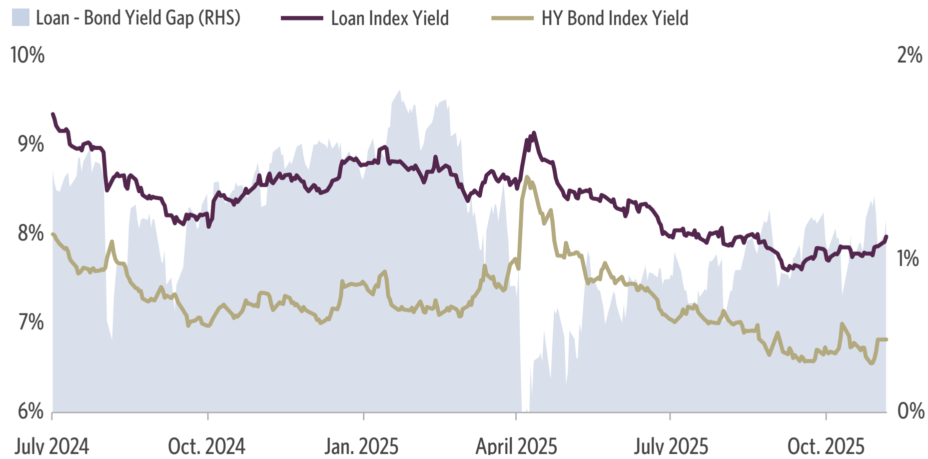
Ongoing Moderate Default Cycle May Continue to Erode Loan Returns

Loan yields near 8 percent offer 100 basis points over high yield bonds, but most of that advantage reflects the loan market's heavier concentration in lower rated credits. The largest yield differences are in the lowest ratings—with CCC loans offering an over 8 percent premium to bonds—reflecting higher default and downgrade risk in the loan market. Diving deeper, the areas where we see the most yield premium in loans over bonds is in technology, healthcare, and certain consumer sectors in particular among credits facing secular headwinds or softening demand. Current index yields therefore don't offer a clear advantage to loans at the index level given the default and repricing risk.

The areas where we see the most yield premium in loans over bonds is in technology, healthcare, and certain consumer sectors, driven by varied exposure to ongoing end market softness, delayed enterprise technology spending, and weaker industrial investment. Adjusting for these, the yield differential narrows, and may fall further as the Fed lowers its policy rate toward 3 percent.

Loans Still Offer a Yield Advantage Over Corporate Bonds…

HY Bond and Leveraged Loan Yields



Source: Guggenheim, Bloomberg, S&P UBS, ICE Index Services. Data as of 11.5.2025.

…That Advantage Narrows Once Controlling for Quality Differences

Rating	High Yield Bond Index YTM	Leveraged Loan Index 3-Year Yield	Differential
Index Yield	**6.8%**	**7.9%**	**+1.0%**
BB+	5.5%	5.4%	-0.2%
BB	5.5%	5.6%	+0.1%
BB-	6.0%	6.2%	+0.2%
B+	6.7%	6.8%	+0.1%
B	6.9%	7.6%	+0.6%
B-	7.2%	8.4%	+1.2%
CCC+	10.3%	15.0%	+4.8%
CCC	10.8%	19.4%	+8.5%

Source: Guggenheim, Bloomberg, S&P UBS, ICE Index Services. Data as of 11.5.2025.

Retail Flows into Loans Could Wane, Even as Institutional Demand Remains Robust

We anticipate lower retail demand for loans in 2026 but expect institutional demand to remain robust. Retail flows into mutual funds and ETFs have already been negative this year, with roughly $6 billion in outflows year to date through October, and rate cuts could accelerate that trend.

However, collateralized loan obligations (CLOs) account for roughly 70 percent of loan demand. As their liability costs fall, the arbitrage between asset yields and funding costs should be maintained. CLO issuance hit record highs this year as the largely AAA-rated structure appeals to institutional investors with a need to stay high in quality, and we expect this to continue.

The backdrop for other institutional investors also remains stable. In 2027, changes to capital requirements for European insurance companies could expand the institutional buyer base for U.S. AAA CLOs, with foreign investors likely assessing the opportunity next year. Separately managed accounts (SMAs) also tend to be stickier because of their longer time horizon for allocation changes.

Rate Cuts Are Unlikely to Address Credit Challenges for Lower Quality Borrowers

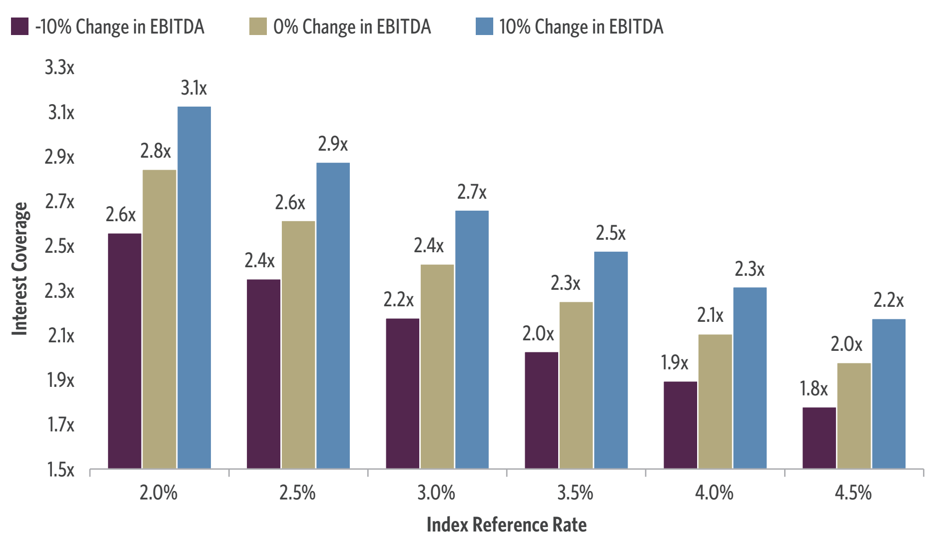
In terms of credit fundamentals, we do not expect Fed rate cuts to materially improve conditions for many lower-quality loan issuers, creating an environment that favors careful credit selection. Prior to 2020, leverage ratios for B-rated loan borrowers were typically 5–6x before earnings before interest, taxes, depreciation, and amortization (EBITDA), with coverage of about 2.5x. Today, many B-rated borrowers have debt equaling 7x EBITDA, with only a 2X interest coverage ratio. For those borrowers, interest coverage would improve only modestly from 2.1x to roughly 2.4x if the Fed lowers its policy rate to 3 percent.

Highly levered capital structures explain the rise of liability management exercises, as sponsors look to extract value from lenders. Many of today's loans were originated in 2021, when company valuations averaged 9–10x earnings. With valuations now closer to 8x, sponsors face a more challenging exit environment, which has left many private equity owners incentivized to pursue amendments and exchanges that improve capital structure flexibility, often at lenders' expense. As a result, liability management exercise activity seems likely to persist into 2026, particularly among smaller and lower-rated credits.

Prior to 2020, leverage ratios for B-rated loan borrowers were typically 5–6x before EBITDA, with coverage of about 2.5x. Today, many B-rated borrowers have debt equaling 7x EBITDA, with only a 2X interest coverage ratio.

Rates Cuts Could Modestly Boost Interest Coverage Ratios

Impact Analysis for a Floating-Rate Borrower with 7x Leverage and 2x Interest Coverage



Source: Guggenheim Investments, Bloomberg, S&P UBS. Data as of 10.31.2025.

The key swing factor for 2026 will be the trajectory of EBITDA growth—stronger corporate performance could stabilize defaults, while flat earnings would keep credit losses near or above 1 percent. Even so, defaults remain concentrated among smaller, highly leveraged issuers, and stronger companies continue to maintain healthy access.

Investment Implications

Stay Selective and Up in Quality as Value Shifts

At present, loans still offer a modest carry advantage over high yield bonds. The key for investors is to navigate repricing activity and avoid pockets of credit weakness.

In the current environment of tight spreads, we continue to favor higher quality credits and careful credit selection. Downgrades in the loan market continue to outnumber upgrades, signaling ongoing strain among lower-rated issuers, while rating actions in high yield have remained more balanced. We expect high yield bonds to deliver coupon-like returns near 6.5 percent over the next year, remaining attractive compared to the last 10 years' average. We also favor active selection of loan credits to take advantage of elevated yields and help protect against downside risks.

Important Notices and Disclosures

The referenced indices are unmanaged and not available for direct investment. Index performance does not reflect transaction costs, fees or expenses.

The **S&P UBS Leveraged Loan Index** tracks the investable market of the U.S. dollar denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/ BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries.

The **ICE BofA U.S. High Yield Index** tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market. Qualifying securities must have a below investment grade rating (based on an average of Moody's, S&P and Fitch), at least 18 months to final maturity at the time of issuance, at least one year remaining term to final maturity as of the rebalancing date, a fixed coupon schedule and a minimum amount outstanding of $250 million. In addition, qualifying securities must have risk exposure to countries that are members of the FX-G10, Western Europe or territories of the United States and Western Europe. The FX-G10 includes all Euro members, the United States, Japan, the United Kingdom, Canada, Australia, New Zealand, Switzerland, Norway, and Sweden.

AAA is the highest possible rating for a bond. Bonds rated **BBB** or higher are considered investment grade. **BB, B, and CCC-rated bonds** are considered below investment grade and carry a higher risk of default, but offer higher return potential. A **split bond** rating occurs when rating agencies differ in their assessment of a bond.

A **basis point (bps)** is a unit of measure used to describe the percentage change in the value or rate of an instrument. One basis point is equivalent to 0.01 percent.

Carry is the difference between the cost of financing an asset and the interest received on that asset.

The three-year **discount margin to maturity (DMM)**, also referred to as discount margin, is the yield-to-refunding of a loan facility less the current three-month Libor rate, assuming a three year average life for the loan.

Dry powder refers to highly liquid assets, such as cash or money market instruments, that can be invested when more attractive investment opportunities arise.

EBITDA stands for earnings before interest, taxes, depreciation, and amortization.

The **interest coverage ratio** is a debt and profitability ratio used to determine how easily a company can pay interest on its outstanding debt.

The **leverage ratio** is a metric that expresses how much of a company's operations or assets are financed with borrowed money.

Spread is the difference in yield to a Treasury bond of comparable maturity.

Investing involves risk, including the possible loss of principal. In general, the value of a fixed-income security falls when interest rates rise and rises when interest rates fall. Longer term bonds are more sensitive to interest rate changes and subject to greater volatility than those with shorter maturities. During periods of declining rates, the interest rates on floating rate securities generally reset downward and their value is unlikely to rise to the same extent as comparable fixed rate securities. High yield and unrated debt securities are at a greater risk of default than investment grade bonds and may be less liquid, which may increase volatility. Investors in asset-backed securities, including mortgage-backed securities and collateralized loan obligations (CLOs), generally receive payments that are part interest and part return of principal. These payments may vary based on the rate loans are repaid. Some asset-backed securities may have structures that make their reaction to interest rates and other factors difficult to predict, making their prices volatile and they are subject to liquidity and valuation risk. CLOs bear similar risks to investing in loans directly, such as credit, interest rate, counterparty, prepayment, liquidity, and valuation risks. Loans are often below investment grade, may be unrated, and typically offer a fixed or floating interest rate.

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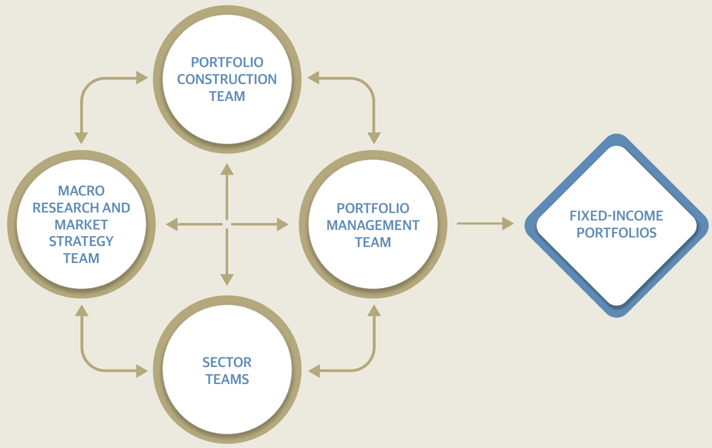
Guggenheim's Investment Process

Guggenheim's fixed-income portfolios are managed by a systematic, disciplined investment process designed to mitigate behavioral biases and lead to better decision-making. Our investment process is structured to allow our best research and ideas across specialized teams to be brought together and expressed in actively managed portfolios. We disaggregated fixed-income investment management into four primary and independent functions—Macroeconomic Research, Sector Teams, Portfolio Construction, and Portfolio Management—that work together to deliver a predictable, scalable, and repeatable process. Our pursuit of compelling risk-adjusted return opportunities typically results in asset allocations that differ significantly from broadly followed benchmarks.



Guggenheim Investments

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For more information, visit GuggenheimInvestments.com.

1. Total Assets are as of 9.30.2025 and includes $249bn in GI Assets Under Management (AUM), plus $108.2bn in non-advisory GI Assets Under Supervision (AUS) for a total of $360+bn. AUM includes leverage of $14.2bn. Guggenheim Investments represents the following affiliated investment management businesses of Guggenheim Partners, LLC: Guggenheim Partners Investment Management, LLC, Security Investors, LLC, Guggenheim Funds Distributors, LLC, Guggenheim Funds Investment Advisors, LLC, Guggenheim Corporate Funding, LLC, Guggenheim Wealth Solutions, LLC, Guggenheim Private Investments, LLC, Guggenheim Partners Europe Limited, Guggenheim Partners Japan Limited, GS GAMMA Advisors, LLC. Numbers may not total due to rounding.

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