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# European High Yield: A Compelling Case in an Uncertain World

INSIGHTS

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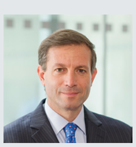

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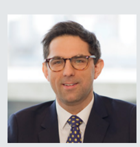

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Amid a rapidly evolving global economy, investors are navigating the intersection of policy uncertainty, geopolitical tensions, and diverging macroeconomic data—a landscape as unpredictable as it is consequential. Naturally, concerns over the outlook and what it means for global growth have cast a shadow over many risk asset classes, including high yield.

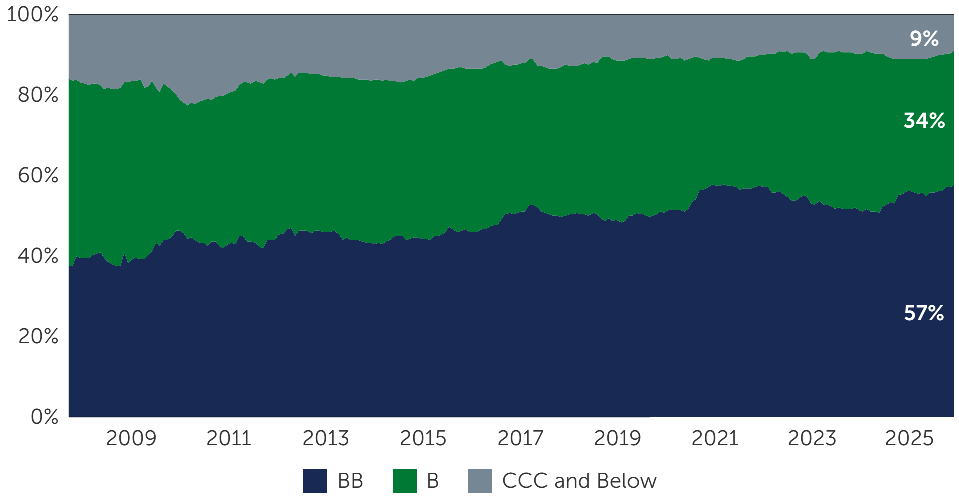
However, historically, European high yield has been resilient during periods of lower growth. And, looking forward, we believe there are several key reasons why the asset class remains well-positioned, despite the unknowns on the horizon.

## 1. The Market Has Shifted Up in Credit Quality

There is a common misconception that high yield means high risk, but that is not necessarily the case. Over the last several years, high yield companies have been bolstering their financial positions, resulting in a healthy picture for corporate fundamentals today. While uncertainty around the longer-term effects of tariffs continues to cloud visibility, issuers have largely maintained discipline, with leverage and interest coverage metrics holding steady.[1]

Reflecting the resilient fundamental backdrop is the upward shift in credit quality of the market, which is much higher today than it has been historically. In fact, 57% of the global high yield bond market is rated BB, while the lowest-rated CCC and below issuers account for around 9% **(Figure 1)**. Looking back to the beginning of 2010, BB issuers made up a much smaller 43%, while CCC issuers accounted for a much higher 21%.

**Figure 1: Global High Yield Bonds: A Historical Shift Toward Higher Quality**



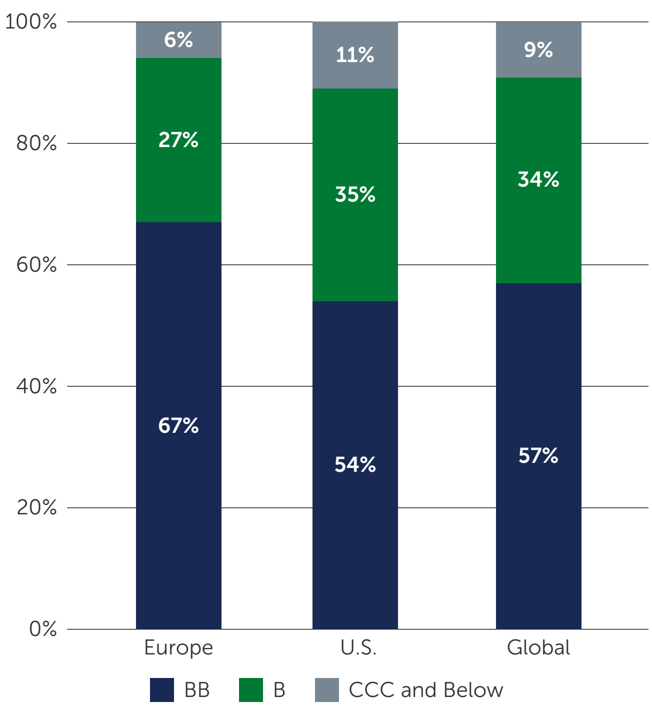

Source: ICE BofA. As of August 31, 2025.

1. Source: CreditSights. As of June 30, 2025.

### FEWER RISKIER CREDITS IN EUROPEAN HIGH YIELD

In the European high yield bond market, this theme has been particularly pronounced, with two-thirds of issuers rated BB **(Figure 2)**. More importantly, CCC issuers constitute around 6% of the market, compared to nearly 14% 20 years ago. CCC issuers are typically highly levered and have low interest coverage ratios, and are often "stressed" with spreads in excess of 1,000 basis points. These companies may be facing challenging business conditions or may be part of a larger secular trend in a specific industry—such as telecoms during 2002–2004 or the U.S. energy sector during 2014–2015. Both of these periods were characterized by over-investment, over-leverage, and over-ambitious growth plans, and defaults across the sectors rose accordingly. In particular, compared to the U.S. market, the CCC segment is a smaller and more concentrated part of the European market, with almost 40% of this segment either stressed or distressed.[2]

**Figure 2: Credit Rating Composition by Region**

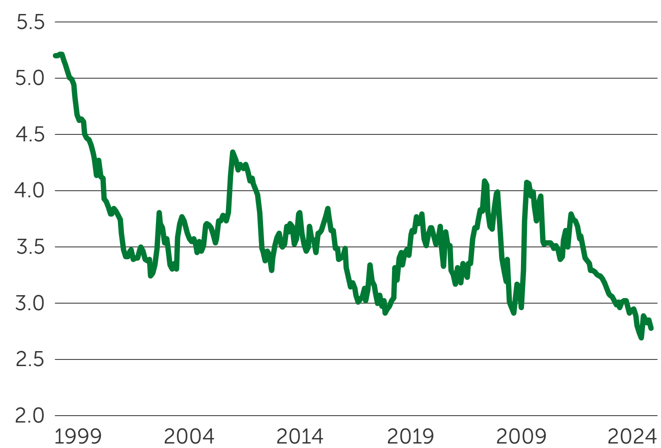



Sources: ICE BoA; Bloomberg. As of August 31, 2025.

## 2. Duration is Near Record Lows

Duration is a measure of how sensitive a bond's price is to changes in interest rates, and in general, shorter duration indicates lower interest rate risk. Looking at the European high yield bond market, duration has declined notably over the years, from around 5.1 years in 2000 to around 2.8 years currently **(Figure 3)**. With duration hovering near record lows—and likely to remain near these levels as issuers continue to shorten the legal final maturity profile of their debt to retain early repayment optionality—the asset class overall has become short duration.

**Figure 3: European High Yield: A Shorter Dated Market**




Source: ICE BofA. As of August 31, 2025.

This shift in duration over the years, coupled with the increase in credit quality, is particularly interesting in the context of the current spread environment. Specifically, spreads today appear tight relative to history—but arguably, it may be somewhat misleading to compare current spread levels to historical levels as the market composition has changed significantly. Spreads should be considered too tight when they undercompensate for the risk of permanent losses—and we do not believe this is currently the case in European high yield given the improved resilience of the market.

2. Source: ICE, Barings' analysis. As of August 31, 2025.

Tighter spreads are also more justified in a shorter-dated market given there is greater visibility into an issuer's earnings as the bond nears maturity. Despite tight spreads and a shorter duration profile today, yields for European high yield remain attractive. On a currency hedged basis, the yield for European high yield on an index level is 7.6%, which compares favorably to the 6.9% yield offered by U.S. high yield—and this is despite the higher credit quality of the European market.[3]

## 3. Structural Composition Offers Diversification & Downside Risk Mitigation

Bolstering the overall healthy picture for European high yield is the structural composition of the market, which provides additional support from a downside risk perspective:

### CORPORATE HYBRIDS

An important issuance trend in European high yield over the last decade has been the significant increase in corporate hybrids. Corporate hybrids are subordinated, long-dated, often perpetual securities issued predominantly by investment grade companies to diversify capital structures, while receiving favorable equity treatment by rating agencies (not to be confused with financial subordinated debt, such as AT1s and contingent convertibles issued by banks and insurers as regulatory capital). **While corporate hybrids are mainly issued by investment grade-rated companies, the actual hybrid instruments often are rated high yield due to their subordination and risk of loss absorption**. There are certainly risks associated with investing in subordinated debt, but with high yield-rated corporate hybrids, there is also the potential for attractive yields with default risk more closely tied to the parent issuer.

Today, corporate hybrids represent over 18% of the European high yield market, up from 7% in 2015 **(Figure 4)**. In contrast, corporate hybrids make up only 2% of the U.S. high yield market today—although USD-denominated issuance is on the rise given the changes in balance sheet treatment for corporate hybrids by Moody's in 2024.[4] The vast majority of corporate hybrids in the European high yield market are rated BB. By sector, the majority of corporate hybrids are in telecommunications and utilities, which are typically stable, defensive, and cashflow generative parts of the market.

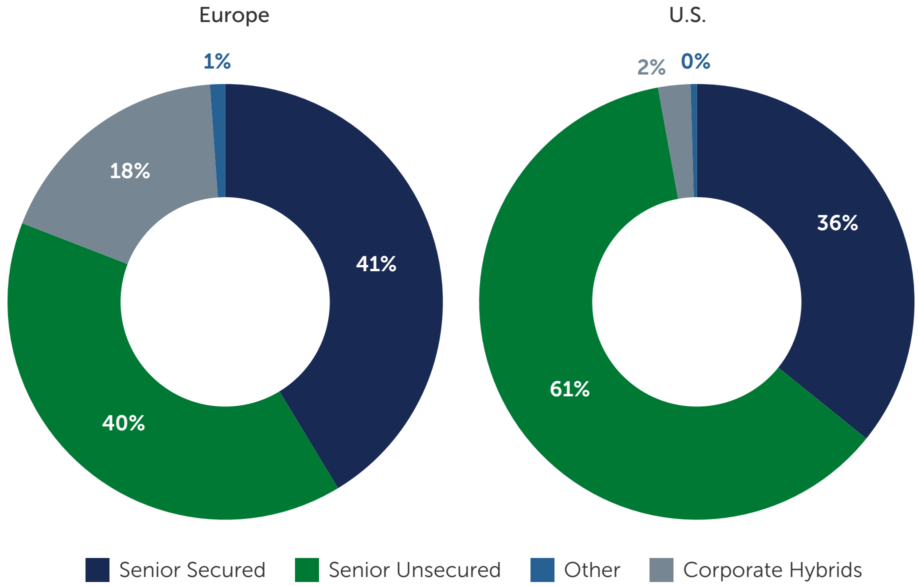
### SENIOR SECURED BONDS

Senior secured bonds are a segment of the high yield bond market that is both senior and secured in the capital structure. This means that if a company defaults on its debt obligations, these bonds are the first in line to be repaid, ahead of junior (subordinated) debt. They are also secured by collateral, which can comprise a range of assets including real estate, equipment and vehicles, as well as intangible items such as software or trademarks. Issuers, many of whom are private equity-backed companies, often choose to issue senior secured bonds to access lower borrowing costs by pledging a first lien on the referenced asset pool. Due to these defensive characteristics, in the case of bankruptcy or default, senior secured bonds have historically offered a higher recovery rate than unsecured bonds.[5]

3. Source: Bloomberg, Barings' analysis. As of August 31, 2025. Yields are measured by yield-to-worst.
4. Source: CreditSights, Corporate Hybrids: The What, Why and Rise. As of May 8, 2025.
5. Source: Moody's Investors Services, Annual Default Study. As of February 28, 2025.

In Europe, senior secured bonds make up around 41% of the high yield market, and surprisingly, 80% of all European high yield BB bonds are senior secured. In terms of new issuance, senior secured bonds represented over 60% of supply in the European high yield market last year.[6]

**Figure 4: Senior Secured and Hybrid Bonds Make up a Larger Portion of European High Yield**




Source: ICE BoA. As of August 31, 2025.

## 4. High Yield Doesn't Need High Growth

Trade policy uncertainty weakens the outlook for global growth, and while the full impact of the recently introduced tariffs hasn't been felt yet, economic activity will likely decelerate in the coming year. But a slow-growth environment isn't necessarily a negative backdrop for high yield.

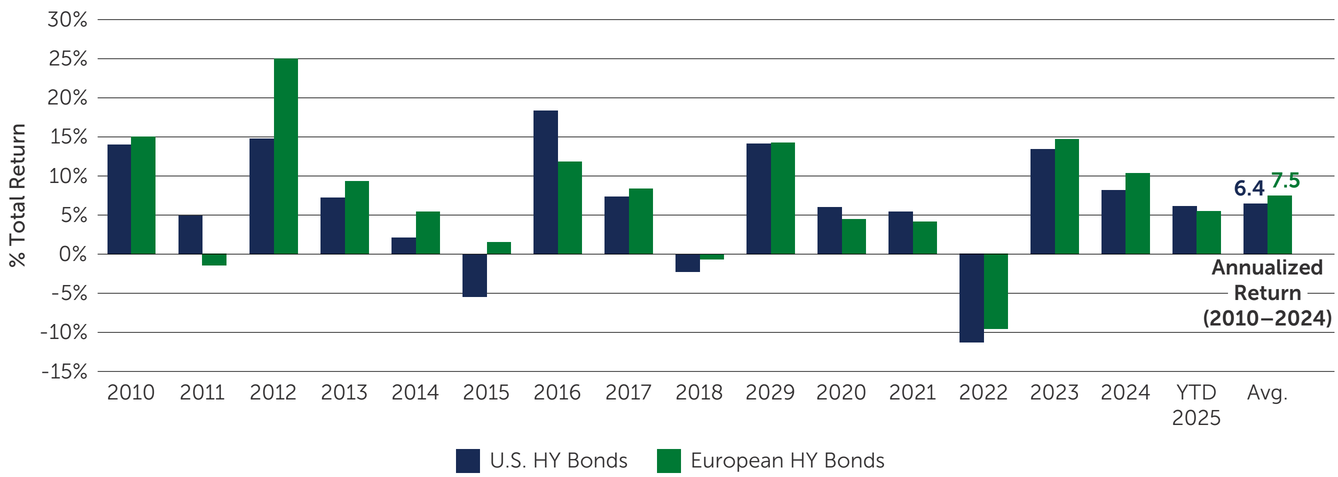
While a sharp slowdown in the economy can present a challenging operating environment for certain high yield companies, the asset class does not require strong economic growth to perform well. This is because what matters most in high yield is an issuer's ability to continue to meet the interest payments on its outstanding debt obligations. As a result, an extended period of low growth is unlikely to result in a spike in defaults, especially given the healthier fundamentals of the primarily BB-rated European high yield market today. In addition, during a period of low growth, companies tend to be more disciplined with their balance sheets.

6. Source: European High Yield Q2 Review, JP Morgan. As of July 8, 2025.

Indeed, in the years since the Global Financial Crisis, European high yield performed strongly during periods of low or even negative growth. From 2010 onwards, the Eurozone experienced a meaningfully lower annual real GDP growth rate, underperforming the U.S. on an absolute basis in 10 of the last 15 years and by an average of just over 1% per year **(Figure 5)**. However, European high yield bonds outperformed U.S. high yield in 11 of those 15 years, by over 1% annualized on currency hedged terms.

**Figure 5: Low Growth is Not an Impediment for High Yield Performance**

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025E | AVG (2010–2024) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| U.S. | 2.7% | 1.5% | 2.3% | 1.8% | 2.3% | 2.7% | 1.8% | 2.5% | 3.0% | 2.5% | -2.2% | 6.1% | 2.5% | 2.9% | 2.5% | 1.6% | 2.3% |
| Eurozone | 2.1% | 1.6% | -0.9% | -0.2% | 1.4% | 2.0% | 1.9% | 2.6% | 1.8% | 1.6% | -6.1% | 6.2% | 3.3% | 0.4% | 0.7% | 1.2% | 1.2% |




Sources: Bloomberg; ICE BofA. As of August 31, 2025. Returns in USD hedged terms.

## Key Takeaway

Despite the uncertain and volatile market backdrop, we believe high yield will remain resilient—particularly European high yield, given its higher-quality profile, structural composition, and lower duration. But the asset class is far from homogenous and there are risks, and potentially deteriorating credits, that will need to be navigated.

In this context, partnering with a manager who brings both a global perspective and local expertise across the U.S. and Europe is crucial to understanding risk and identifying relative value as it emerges across regions. Furthermore, deep resources and experience in the market can better position investors in this uncertain environment. Robust fundamental credit research and active management are key to uncovering opportunities as they arise, and especially for high yield credit investors, avoiding weaker credit profiles.

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**As of June 30, 2025*

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