

High yield case study: How an index allocation can complement an active manager lineup

Insights
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Arkady Ho, CFA

Vice President, Client Portfolio Manager
Global Fixed Income Solutions

High yield investors are increasingly recognizing that an optimal approach is not necessarily choosing between active and indexed approaches, but instead, thoughtfully combining both.

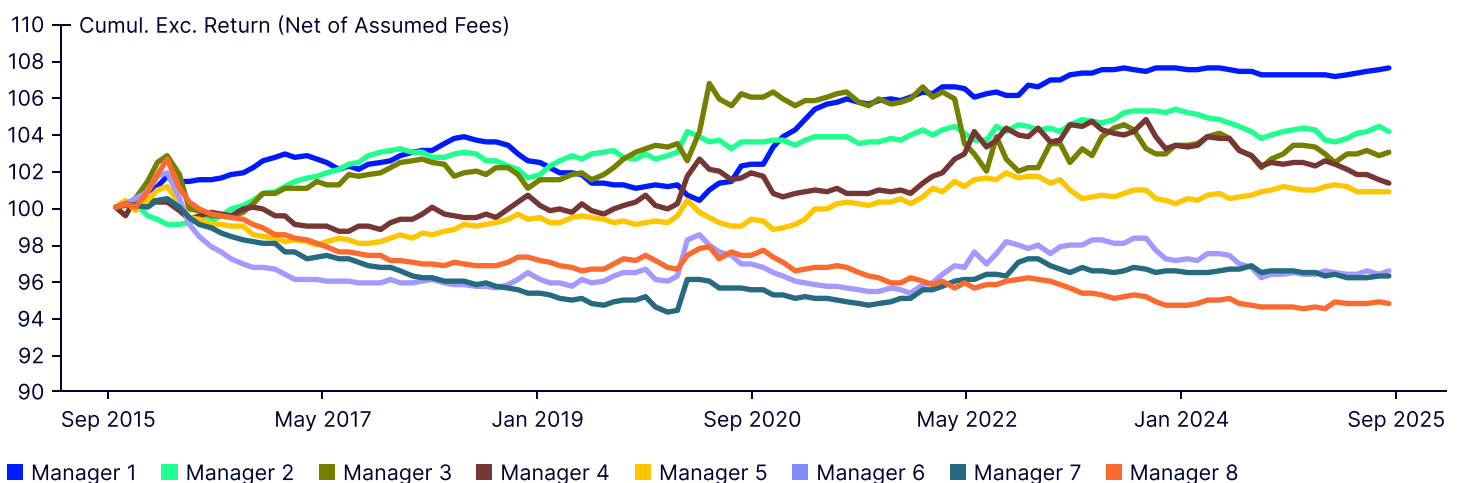
In high yield, it's not “either or”

By leveraging the alpha potential of active management along with the consistency and cost efficiency of an indexed approach, investors can construct more resilient and balanced portfolios. This piece discusses how a

blended approach to a high yield portfolio may enhance outcomes by aligning return potential with risk control and cost management. This may be particularly valuable in an environment where evolving market structure and trading techniques are reshaping traditional sources of alpha by creating new ways for issuers to obtain financing.

We present a case study evaluating the active high yield manager lineup of an actual client—an exercise undertaken at their request. We found that several of their managers have underperformed over the long run on a net-of-management fee basis (Figure 1). As a result, the client wanted to explore the potential benefits of incorporating an indexed approach alongside their active high yield allocation.

Figure 1: Many active high yield managers have underperformed over the long run, net-of-fees



Sources: Client, eVestment. As of September 30, 2025. Analysis uses monthly excess returns over manager preferred benchmarks from September 2015–September 2025, factoring in an assumed fee of 30 bps for active managers.

Considerations for replacing managers

We used three main criteria to evaluate the client's existing slate of managers:

1) Performance

According to Figure 1, three of the client's eight managers have underperformed net-of-fees over the trailing 10-year period through September 2025. Prime candidates to substitute out of the lineup for an index allocation would naturally be among these underperformers. On one hand, in the context of the active high yield manager universe in eVestment, this set of managers performed reasonably well. There were a few clear underperformers, but most generated first or second quartile gross alpha over the long term. Figure 2 summarizes benchmark-relative performance over different trailing periods for the eight managers and the universe overall, gross-of-fees.

Figure 2: Many high yield managers have struggled to add long-term value, even gross of fees

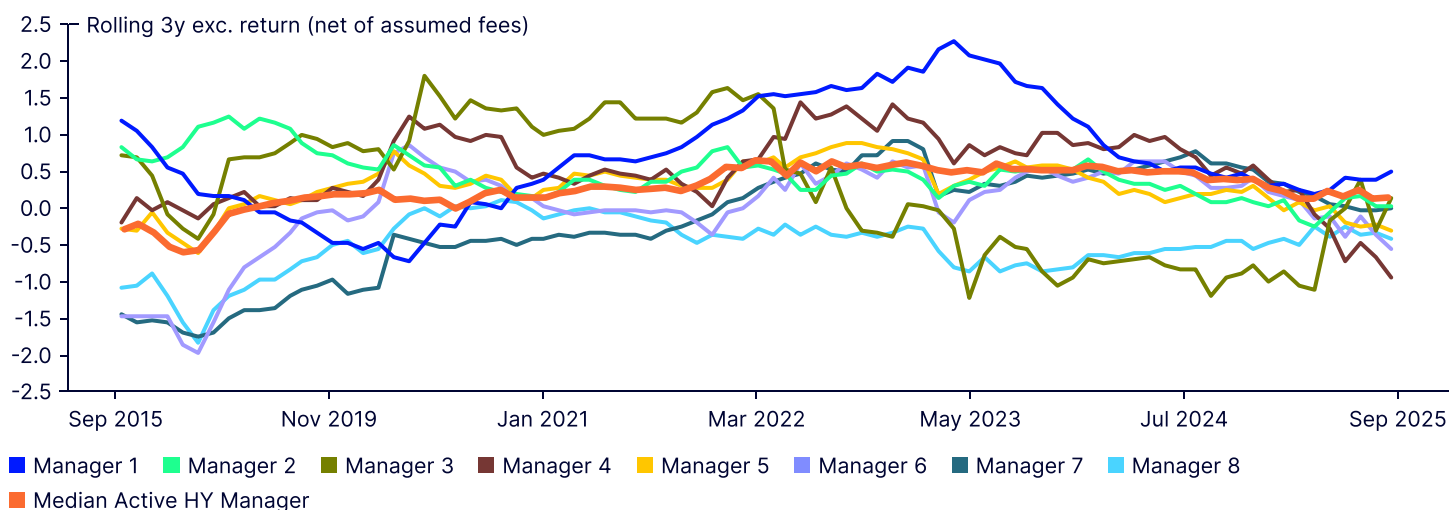
	1	2	3	4	5	6	7	8	1st Quartile	Median	3rd Quartile
Alpha											
1Y	0.68	0.71	1.22	-0.65	0.37	0.71	0.05	0.49	0.75	0.28	-0.17
3Y	0.86	0.32	0.44	-0.68	-0.01	-0.26	0.30	-0.14	0.68	0.15	-0.36
5Y	1.35	0.42	-0.30	0.28	0.66	0.30	0.48	-0.28	1.01	0.37	-0.10
10Y	1.08	0.76	0.61	0.54	0.45	0.03	-0.06	-0.24	0.59	0.14	-0.24
Tracking Error											
1Y	0.25	0.87	1.12	0.64	0.48	0.49	0.31	0.41	0.60	0.81	1.13
3Y	0.50	0.74	1.75	1.30	0.69	0.90	0.66	0.48	0.75	0.98	1.48
5Y	0.76	0.79	2.12	1.43	0.83	1.07	0.61	0.64	0.85	1.10	1.76
10Y	0.85	0.90	2.08	1.37	0.95	1.36	0.87	1.02	1.05	1.40	2.02
Info Ratio											
1Y	2.69	0.82	1.09	-1.02	0.77	1.45	0.17	1.21	1.11	0.36	-0.19
3Y	1.73	0.44	0.25	-0.52	-0.02	-0.29	0.46	-0.30	0.69	0.19	-0.36
5Y	1.78	0.53	-0.14	0.19	0.80	0.27	0.78	-0.43	0.77	0.32	-0.08
10Y	1.27	0.84	0.29	0.39	0.47	0.02	-0.07	-0.23	0.38	0.10	-0.15

Sources: Client, eVestment. As of September 30, 2025. Performance is presented gross of management fees.

On another hand, long-term performance among high yield managers has been underwhelming *in general*. Over the trailing 10-year period, the median manager has barely outperformed its benchmark (+14 bps). In addition, median IR was only 0.1—and this is gross of fees. Running this same analysis assuming 20–30 bps of fees would imply that well over half of the active manager universe did not outperform their benchmarks on a net-of-fee basis over the long run.

Lastly, performance consistency and persistence are fleeting, at best. Looking at rolling three-year excess returns by manager (Figure 3), we see that performance has been quite volatile. It's notable that (1) since 2015, the median manager has been able to eke out +50 bps of annualized net alpha over rolling three-year periods only starting in the past few years, and (2) there appears to be less differentiation in outcomes among these managers in the past 1.5 years, roughly, as spreads have continually narrowed to 25-year tights.

Figure 3: Performance consistency is a challenge among high yield managers



Sources: Client, eVestment. As of September 30, 2025.

2) Diversification

Another important factor is the degree to which a given manager's excess return profile is diversifying relative to the rest of the lineup. Figure 1 suggests that there is alpha differentiation among this set of managers.

Figure 4 confirms this quantitatively: three of the eight managers are truly diversifying with average pairwise correlations near zero, while the rest are less so, with average correlations generally above +0.2.

Figure 4: Some managers are more diversifying than others

	Manager 1	Manager 2	Manager 3	Manager 4	Manager 5	Manager 6	Manager 7	Manager 8
Manager 1	1.00							
Manager 2	0.04	1.00						
Manager 3	0.32	0.10	1.00					
Manager 4	-0.30	0.02	-0.05	1.00				
Manager 5	-0.02	-0.02	0.02	0.24	1.00			
Manager 6	-0.26	0.07	0.14	0.68	0.54	1.00		
Manager 7	-0.15	0.28	0.00	0.33	0.39	0.61	1.00	
Manager 8	0.04	-0.11	0.21	0.18	0.41	0.53	0.49	1.00
Mean:	-0.05	0.05	0.11	0.16	0.22	0.33	0.28	0.25

Source: State Street Investment Management. Correlation analysis is conducted on gross-of-fee excess returns vs. manager preferred benchmarks from September 2015–September 2025.

3) Fees

A key consideration for this client—like any other investor—is fees. As mentioned above, the long-term performance after fees was uneven and not satisfactory for the client. Many managers failed to deliver outperformance net of fees, which can be substantial in dollar terms.

Putting it all together

With the benefit of hindsight, Figure 5 illustrates how overall fees could have been reduced by substituting an index allocation for different combinations of managers who either underperformed, had less diversifying alpha profiles, or both. We then looked at the impact to net

performance of this index high yield substitution¹ for different combinations of long-term underperformers, with the results summarized below. Substituting out underperforming managers 6–8 and manager 3 due to its high tracking error would have resulted in substantial performance gains and fee savings.

Portfolio 5 (“P5”) would have resulted in the highest long-term alpha and IR of +22 bps and 0.5 respectively. In addition, P5’s weighted average fee of 21 bps would have saved the client 9 bps per year vs. their current allocation. This would translate to \$900k to \$9 million of annual savings for a \$1–10 billion portfolio.

Figure 5: Substituting an index high yield allocation for underperforming managers would have improved risk-adjusted alpha while lowering fees substantially

Portfolio allocations—substitute index HY for select managers

Manager	Current (%)	P1 (%)	P2 (%)	P3 (%)	P4 (%)	P5 (Best Alpha + Low Fee) (%)	P6 (%)
1	14.8	14.8	14.8	14.8	14.8	14.8	14.8
2	9.3	9.3	9.3	9.3	9.3	9.3	9.3
3	14.8	14.8	14.8	—	14.8	14.8	—
4	13.9	13.9	13.9	13.9	13.9	13.9	13.9
5	12.6	12.6	12.6	12.6	12.6	12.6	12.6
6	13.6	13.6	—	13.6	—	—	—
7	12.1	—	12.1	12.1	—	—	12.1
8	9.0	—	—	—	9.0	—	—
Index	0.0	21.1	22.6	23.8	25.6	34.7	37.4
Weighted Avg Fee	30.0	24.7	24.4	24.1	23.6	21.3	20.7

Net of fee performance, as of September 30, 2025

Excess Return

1Y	0.12	0.14	0.06	-0.02	0.10	0.09	-0.07
3Y	-0.20	-0.16	-0.09	-0.18	-0.12	-0.08	-0.11
5Y	0.05	0.09	0.12	0.19	0.05	0.10	0.20
10Y	0.08	0.17	0.18	0.08	0.17	0.22	0.13

Tracking Error

1Y	0.24	0.25	0.22	0.15	0.20	0.21	0.11
3Y	0.42	0.39	0.33	0.32	0.33	0.31	0.23
5Y	0.52	0.51	0.44	0.39	0.42	0.42	0.28
10Y	0.65	0.55	0.47	0.48	0.47	0.43	0.33

Information Ratio

1Y	0.51	0.55	0.26	-0.13	0.51	0.41	-0.61
3Y	-0.48	-0.41	-0.27	-0.57	-0.38	-0.27	-0.47
5Y	0.10	0.17	0.27	0.48	0.11	0.23	0.71
10Y	0.12	0.32	0.37	0.17	0.37	0.51	0.40

Sources: Client, eVestment. Performance analysis is net of the assumed management fees shown and conducted on excess returns vs. manager preferred benchmarks from September 2015–September 2025. For simplicity, the index high yield allocation is assumed to generate zero net alpha with zero tracking error over all time periods. Past performance is not a reliable indicator of future performance.

“Our analysis shows that adding an index allocation to an active high yield manager lineup can complement/improve performance, and provide meaningful fee savings.

The bottom line

As every basis point counts in today’s fixed income markets, we find that investors can benefit from taking advantage of the low-cost, liquid characteristics of high-yield index funds. However, combining index and active strategies may make sense because active credit management can help to mitigate default risk, and has historically performed better in periods of underperformance.

Endnote

- 1 For simplicity, in our analysis alpha and tracking error for the high yield index allocation are assumed to be zero. In reality, within our index high yield funds, we generate “implementation alpha” through structural value-add techniques such as innovative trading techniques, security selection, and new issue participation. For example, in the trailing 5-year period through 09/30/25, a representative account of our US High Yield Bond Index generated +27 bps of outperformance per annum net of fees with tracking error of 23 bps.

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A key caveat to this analysis is that we have the benefit of hindsight: obviously an allocator cannot know in advance which managers—active or indexed—will underperform or outperform over the next 10 years. Removing this uncertainty is, in our view, a reason to consider indexing alongside high conviction active managers.

In general, we think it can be helpful to see the performance and fee impact of allocating to index high yield in lieu of underperforming active managers. An index high yield allocation can serve as a compelling complement to an active manager lineup by improving risk-adjusted alpha, while also lowering fees substantively.

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