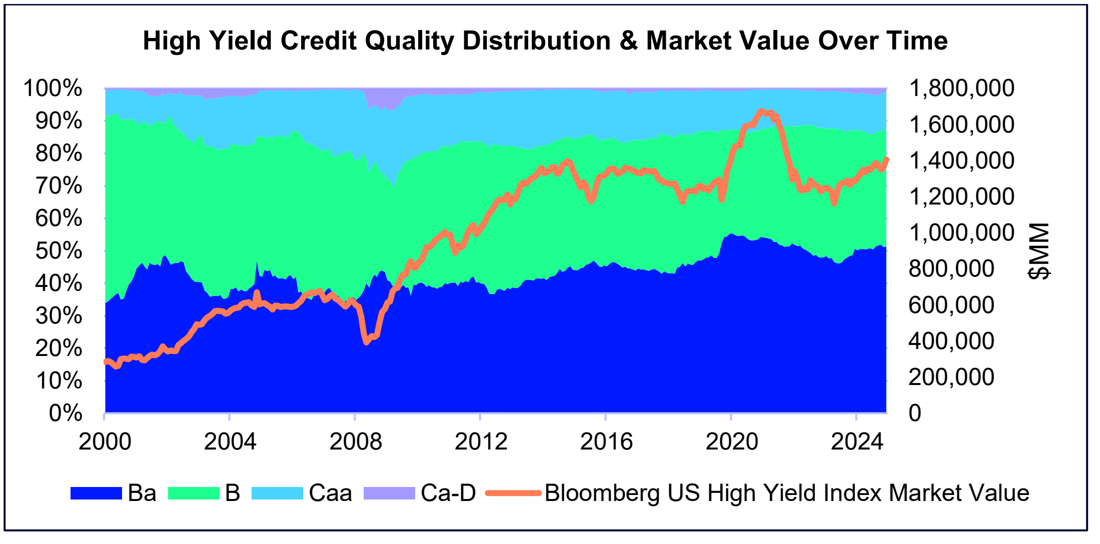
COMMENTARY
July 31, 2025

Mind on the Market

Chart of the Week



Source: Source: Bloomberg, Barclays. Data as of June 30, 2025.

Structural changes in the lending landscape post-the Global Financial Crisis (GFC) significantly reshaped the high yield (HY) bond market, particularly influencing HY credit quality composition. The rise of leveraged loans and private credit introduced new avenues for debt financing as well as new competition, resulting in favorable terms for lower quality borrowers. This dynamic has contributed to elevated overall credit quality within the high yield index. The influx of fallen angels during the COVID crisis further reinforced this trend, as investment-grade (IG) bonds were downgraded into the high yield universe. Collectively, these developments contributed to structurally tighter spreads across credit markets.

Contact

Arkady Ho, CFA
Fixed Income Client Portfolio Manager

Christine Norton, CFA
Investment Strategist

Weekly Highlights

Total Return YTD: Bloomberg US Treasury Index

3.34%

Data as of July 30, 2025

Total Return YTD: Bloomberg US IG Corporate Index

4.18%

Data as of July 30, 2025

Total Return YTD: Bloomberg US HY Corporate Index

5.01%

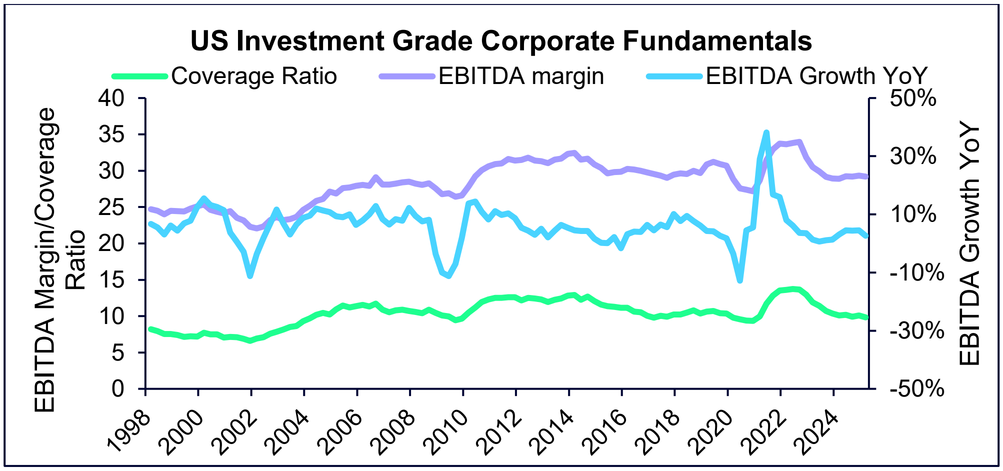
Data as of July 30, 2025

Where We Stand on Credit Markets

High yield and investment grade (IG) credit have outperformed Treasuries YTD as spreads tightened significantly after initially widening post liberation day. However, with spreads at historically tight levels, we are conservative on credit exposure, reflecting a tug of war between valuations and fundamentals. Valuations are a key reason behind our conservative stance on credit. The Bloomberg US Corporate HY index option-adjusted spread (OAS) currently sits at 278bps while US Corporate IG spreads are 76bps. This is tighter than 96% and 99% of daily spreads, respectively, over the last 20 years. In short, valuations are on the very rich side of fair value, leaving little room for further appreciation from spread compression.

From a fundamental perspective, corporate balance sheets and earnings overall remain healthy for both IG and HY issuers. However, we are starting to see some softening in this data. IG earnings growth has slowed, although notably it has avoided outright contraction, while margins and debt service capacity have showed some deterioration (figure 1). We continue to watch for softening in the labor market and have noted a recent increase in consumer delinquencies.

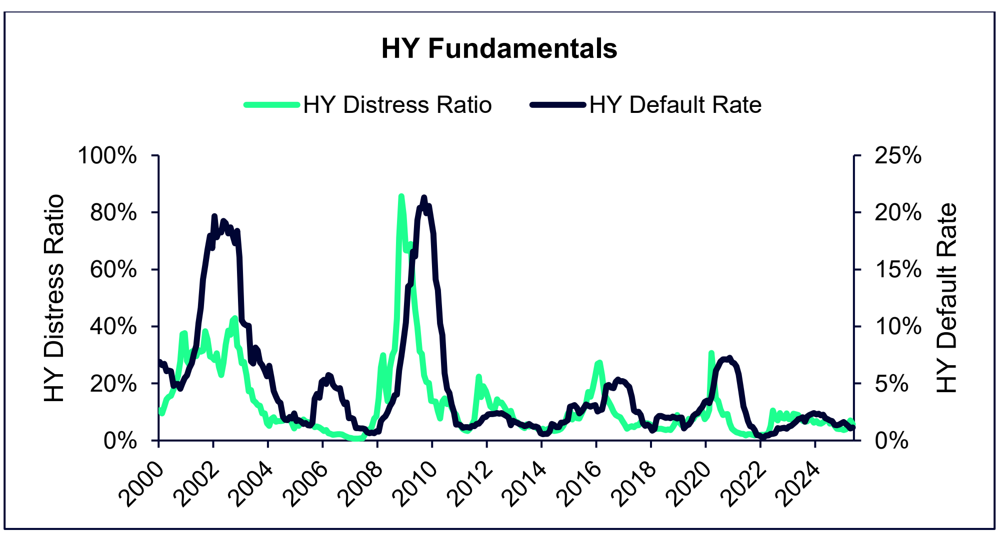
Figure 1



Source: Bank of America, ICE Indices. Data as of March 31, 2025.

High yield is a broadly similar story to IG: fundamentals continue to look healthy. Leverage ratios are well off their pandemic-era peaks, and interest coverage remains solid. Distress ratios and default rates tend to be good indicators of the overall health of issuers in the index. The latest data from BofA shows the HY index distress ratio (% of bonds trading at a spread of 1000+bps) is at 5.7% (figure 2), which is well below the 20Y average of 10.6%. Similarly, default rates remain near historic lows. This suggests there's little stress in the HY market.

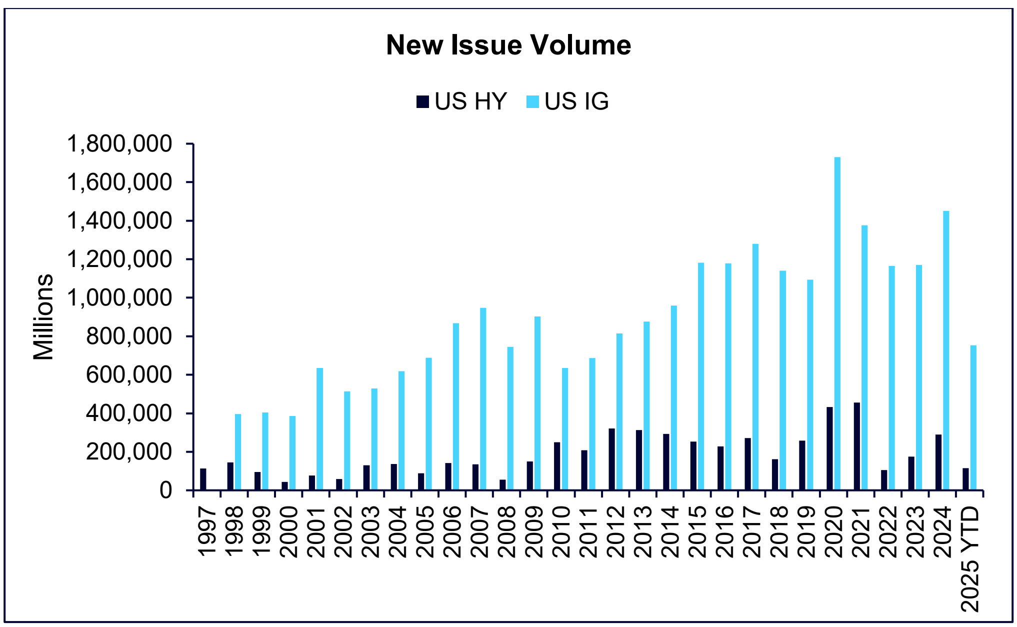
Figure 2



Source: BofA Global Research, ICE Data Indices. Data as of May 31, 2025.

From a market technicals perspective, both supply and demand for US corporate credit are robust across the board. The primary market has come roaring back in HY with almost $100bn in new issuance in Q2, and IG issuance is already outpacing 2024's total of almost $1.5 trillion. Despite the spread compression discussed previously, higher yields across the Treasury curve have kept all-in yields on US corporate bonds attractive. As a result demand remains healthy from pensions, insurance, retail, and overseas investors searching for yield.

Figure 3



Source: BofA Global Research, ICE Data Indices. 2025 data as of May 31, 2025.

The result of this tug of war is a delicate balance between relatively stable fundaments and strong technicals on one side and valuation on the other. An aggressive underweight would result in under-yielding the index over an extended period, while an overweight brings the risk of significant price weakness should conditions worsen materially. In our view, credit markets present asymmetric risk to the downside. At current valuations, the potential for price appreciation through further spread compression is limited, while the incremental compensation over Treasuries is not sufficient to offset the credit risk taken. We remain conservative on credit risk today.

Source: Bloomberg Financial L.P., Bank of America, ICE Data Indices, Barclays, State Street Investment Management. Past performance is not a reliable indicator of future performance.

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*This figure is presented as of March 31, 2025 and includes ETF AUM of $1,553.58 billion USD of which approximately $106.42 billion USD in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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Marketing Communication

Important Risk Discussion

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Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates raise, bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

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fluctuations than stocks, but provide lower potential long-term returns. U.S. Treasury Bills maintain a stable value if held to maturity, but returns are generally only slightly above the inflation rate.

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