HIGH YIELD COMMENTARY

U.S. equity markets posted positive returns in the third quarter despite persistent geopolitical and inflation concerns. The Federal Open Market Committee (FOMC) met twice during the quarter. In September, at Kevin Warsh's third meeting as Chair, the Committee raised the federal funds target range by 25 basis points to 3.75%–4.00%. The FOMC characterized economic activity as expanding at a solid pace, supported by resilient domestic spending, strong productivity growth, robust capital investment, steady job gains, and little change in unemployment, while noting that inflation remained elevated and uncertainty persisted. U.S. real gross domestic product (GDP) grew at a 2.2% annualized rate in the second quarter. Inflation, as measured by the Consumer Price Index (CPI), rose 3.4% over the 12 months ended in August, while core CPI, excluding food and energy, rose 2.4%. The Bureau of Labor Statistics reported that the unemployment rate held steady at 4.2% in September. The broader U-6 measure—which includes unemployed and underemployed workers as well as those marginally attached to the labor force—declined from the prior quarter to a seasonally adjusted 7.6%. Measures of consumer confidence weakened: the Conference Board Consumer Confidence Index fell to 81.9 in September, and the University of Michigan Consumer Sentiment Index registered a final reading of 48.1. Although below the prior-quarter level, the latter remained modestly above the record low of 44.8 set in May.

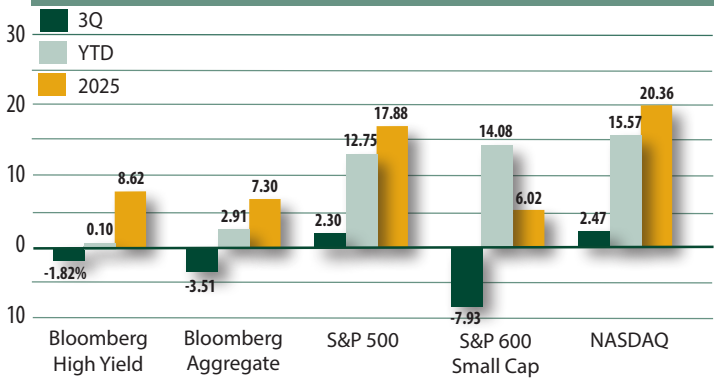
The S&P 500 extended the prior quarter's positive momentum, returning 2.30% in the third quarter, while the technology-heavy Nasdaq 100 returned 0.58%. Fixed-income markets weakened as interest rates rose sharply: the Bloomberg U.S. Aggregate Index returned -3.51%. The 2-year Treasury yield increased 71 basis points to 4.89%, while the 10-year Treasury yield rose 82 basis points to 5.29%, steepening the 2–10 yield curve by 11 basis points. U.S. Treasuries returned -3.04%. Other major investment-grade sectors also posted negative returns: investment-grade corporate bonds returned -3.94%; U.S. agency securities, -1.74%; mortgage-backed securities, -4.25%; commercial mortgage-backed securities, -1.81%; and asset-backed securities, -0.79%. The Bloomberg U.S. High Yield Corporate Index (Index) produced a -1.82% total return in the third quarter, but still remains in positive territory year-to-date with a 0.10 total return. By ratings category, BB-rated and B-rated bonds recorded returns of -1.95% and -1.18%, respectively, while the CCC-rated cohort underperformed all U.S. credit with a -3.44% third-quarter return. The Index option-adjusted spread (OAS) widened by 19 bps quarter-over-quarter to +311 bps, while the yield-to-worst (YTW) increased commensurately by 119 bps to 8.35%. BB-rated credits now trade at an OAS of +186 bps and offer a YTW of 7.11%, B-rated credits at an OAS of +301 bps and 8.30% YTW, and CCC-rated credits at an OAS of +1007 bps and 15.05% YTW. The Index's average dollar price declined to $93.82 in the third quarter. The trailing 12-month par-weighted U.S. high yield bond default/distressed exchange rate rose just 1 bp to 2.68%, and remains well below the 25-year average default rate of 3.4%. However, the trailing 12-month issuer-weighted U.S. High Yield bond default rate, including distressed exchanges, climbed by 13 bps QOQ to 3.28%, source: JP Morgan.

The PIA Investment Strategy Group (ISG) continues to view inflation as the greatest economic risk over the coming quarters. In our view, monetary policy remains below the equilibrium, or "neutral," rate and is therefore too accommodative to reduce inflation given current levels of economic growth and employment. We anticipate additional Federal Reserve rate increases in the fourth quarter of 2026 and the first half of 2027 as the Fed seeks to conclude a more than five-year period of above-target inflation and regain the confidence of bond investors. Although newly appointed Fed Chair Kevin Warsh stumbled initially, his Jackson Hole speech and September press conference may have earned him the benefit of the doubt from the bond market. Even so, monetary policy faces significant challenges, including some that originate within the broader policy framework. As the midterm elections approach, fiscal policies are increasingly adding to headline inflation pressures, particularly in food and energy. Related pressures from the wars in the Middle East and Ukraine may also create longer-term secondary inflation effects. In addition, Treasury Secretary Bessent's efforts at yield-curve control conflict with the Fed's intention to let the bond market guide financial conditions. Directly or indirectly, these forces add to the budget deficit and the growing national debt. We believe the bond market has focused disproportionately on headline inflation while deferring attention to structural inflation, although that pattern may now be changing.

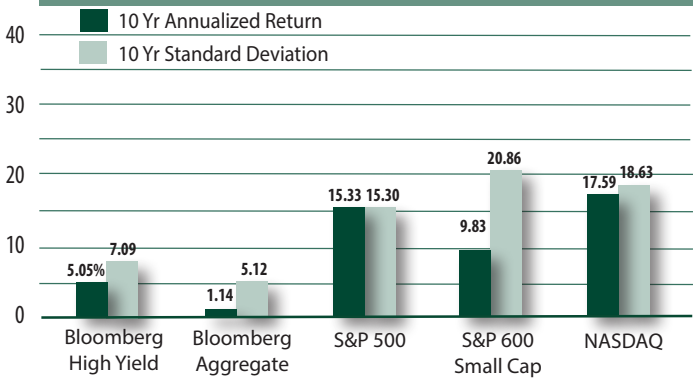
The current "low-hire, low-fire" labor market remains relatively healthy by most conventional measures. Job creation continues to exceed the estimated labor-replacement rate, although growth has been constrained by near-zero net immigration and limited migration. From the consumer's perspective, however, sentiment appears broadly pessimistic, reflecting widespread concern about job displacement related to artificial intelligence (AI). We believe the potential for productivity gains may ultimately outweigh the risk of job destruction. AI appears to be a transformational technological advance, potentially more consequential than the internet or the spreadsheet. Jevons paradox holds that when technological progress makes a resource more efficient to use, total consumption of that resource often rises rather than falls: lower relative costs stimulate demand and support additional growth. Over the medium term, AI could therefore contribute to growth that is either inflationary or disinflationary. In the near term, however, we are more concerned about the debt financing the AI build-out. We do not draw a direct parallel between AI and the internet boom of the late 1990s. Nevertheless, history suggests that widespread vendor financing, leveraged circular investment, and debt-funded purchases can increase systemic risk. The key question is whether AI-driven productivity gains will generate returns sufficient to justify the build-out and cover its financing costs. Against this backdrop, we expect U.S. debt term premiums to remain elevated amid uncertainty about U.S. policy and inflation, supporting an upward-sloping yield curve. We also expect credit-spread volatility to remain elevated in line with geopolitical tensions, even as spreads remain historically tight.

PIA Investment Strategy Group

INDEX **RETURNS**



HISTORICAL **PERFORMANCE**



Source: Bloomberg, Informais PSN
Past performance is not a guarantee of future results.

Source: Informais PSN; Annualized 10 Years
Past performance is not a guarantee of future results.

INDEX **RETURNS**	3Q	YTD	2025
BB	-1.95%	-0.01%	9.02%
B	-1.18	0.97	8.44
CCC	-3.44	-1.81	8.27
CC - D	-3.15	-12.25	-2.89
Basic Industry	-1.20	1.42	6.85
Capital Goods	-2.11	-1.33	7.63
Consumer Cyclical	-1.59	0.58	8.20
Consumer Non-Cyclical	-1.15	1.09	9.87
Energy	-0.62	3.54	7.31
Technology	-1.44	-0.25	7.15
Transportation	-2.72	-2.87	6.97
Communication	-3.65	-2.20	10.87
Other Industrials	-1.16	-0.13	9.18
Utility	-2.53	0.07	7.62
Financial	-1.88	-0.79	9.97

Index is Bloomberg U.S. High Yield Index. Source: Bloomberg

INDEX **SPREADS**	9/30/26	12/31/25	12/31/24
BB	207	191	203
B	329	294	309
CCC	1,009	631	582
CC - D	3,290	2,685	1,588
Basic Industry	311	316	284
Capital Goods	280	246	276
Consumer Cyclical	302	267	272
Consumer Non-Cyclical	287	269	331
Energy	201	304	288
Technology	417	344	294
Transportation	456	390	319
Communication	540	368	481
Other Industrials	177	294	246
Utility	213	176	219
Financial	317	252	269

Index is Bloomberg U.S. High Yield Index. Source: Bloomberg

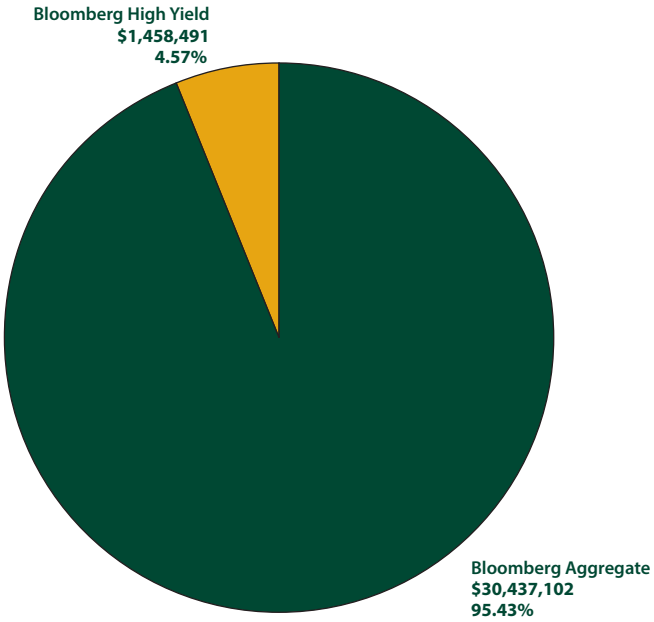
KEY **CHARACTERISTICS**	9/30/26	12/31/25
Duration	3.2	2.8
Yield To Maturity	8.5	7.1
Current Yield	7.2	6.7
Yield To Worst	8.4	6.5
Weighted Average Maturity	4.7	4.8
% $500mm and under	20.4	22.2
% $501mm and over	79.6	77.8

Index is Bloomberg U.S. High Yield Index. Source: Bloomberg, Yield Book

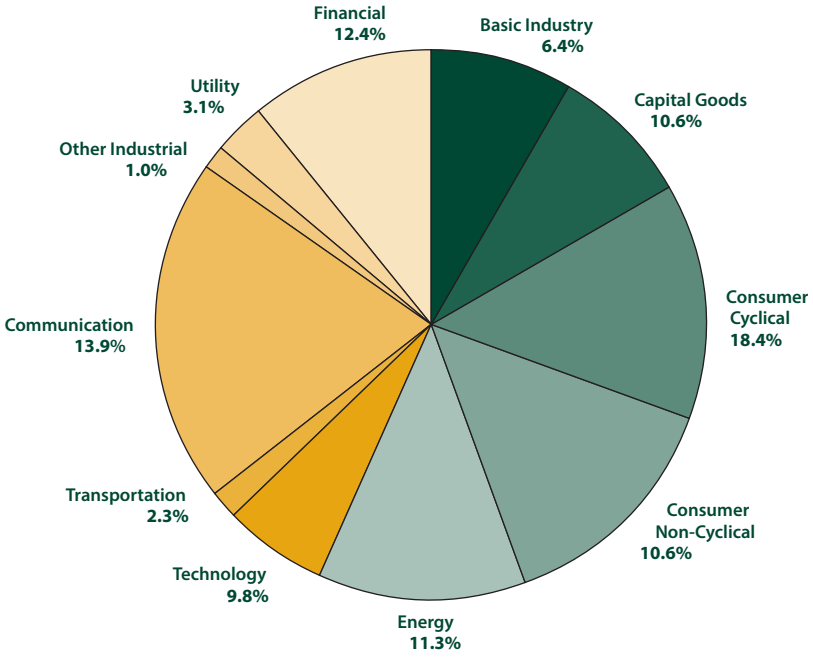
KEY **CHARACTERISTICS**	9/30/26	12/31/25
% BB or >	56.2	54.8
% B	34.8	33.2
% CCC	8.5	11.3
% CC and below	0.5	0.7
% Debt Maturing in < 3 Years	24.2	19.7
% Debt Maturing in 3 - 5 Years	37.7	40.1
% Debt Maturing in > 5 Years	38.1	40.2

Index is Bloomberg U.S. High Yield Index. Source: Bloomberg

US **DEBT MARKET ($MM)**



BLOOMBERG **HIGH YIELD**



Source: Bloomberg

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S&P SmallCap 600 covers approximately 3% of the domestic equities market. Measuring the small cap segment of the market that is typically renowned for poor trading liquidity and financial instability, the index is designed to be an efficient portfolio of companies that meet specific inclusion criteria to ensure that they are investable and financially viable.

Nasdaq Composite is a stock market index of the common stocks and similar securities (e.g. ADRs, tracking stocks, limited partnership interests) listed on the NASDAQ stock market, meaning that it has over 3,000 components. It is highly followed in the U.S. as an indicator of the performance of stocks of technology companies and growth companies. Since both U.S. and non-U.S. companies are listed on the NASDAQ stock market, the index is not exclusively a U.S. index.

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