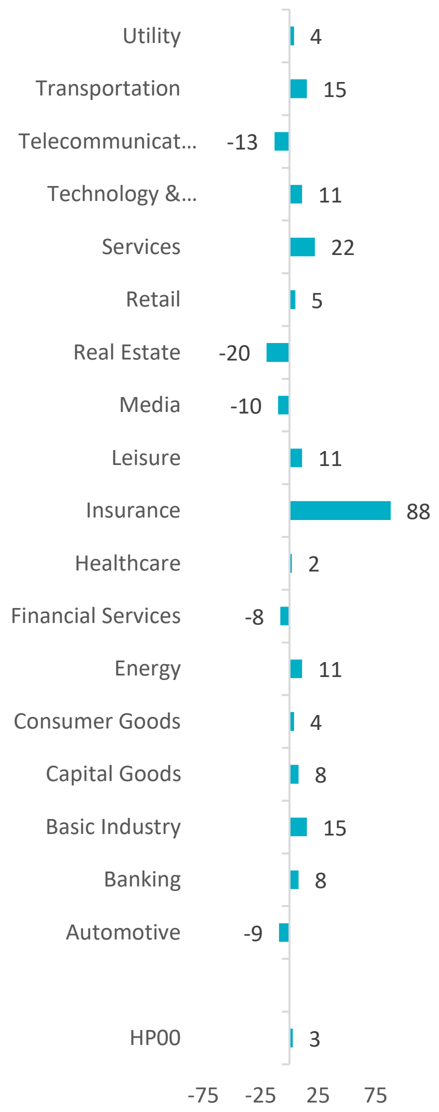
European High Yield

No signs of a Santa rally yet... but 2026 set to lift the spirits

What's happening?



Source: Asset Swap Spreads changes MTD, Bloomberg, BofA AXA IM, 30 November 2025. Shown for illustrative purposes only and should not be considered as an advice or a recommendation for an investment strategy.

- The performance of risky assets in November was largely dominated by repricing of a rate cut by the US Federal Reserve in December. The implied probability fell sharply from an initial 68% to, at one point mid-month, less than 25% - before rising again to 83%. The financial market uncertainty was higher than maybe seemed warranted, with the biggest fall for the S&P500 since the Liberation Day turmoil in April, and the VIX volatility index rising to its highest level since the same period. Ongoing fears about a possible AI-bubble maybe played a part though, in the end, the S&P500 did manage to eek out a positive return of +0.2% - marking a 7-month streak of consecutive gains for the first since 2021.
- With a more muted government bond market, the Eurostoxx600 outperformed. The +1.0% gain was also driven by hopeful headlines around the cessation of hostilities in Ukraine. The FTSE100 in the UK similarly rose +0.4%. The latest budget was received more warmly than had been expected by both debt and equity markets.
- European high yield ended the month just in positive territory – the total return rounded to +0.1%. BBs and Bs were both fractionally in the black (with BBs a touch weaker), though CCCs reversed some of their recent underperformance and gained +0.7%. Slightly higher European government bond yields, and very heavy supply volumes, meant that the investment grade index underperformed, falling -0.2%. Meanwhile, the ultimate repricing higher of the Fed rate-cut spurred US high yield to a stronger month. It rose +0.3% (EUR-hedged).
- As is to be expected at this late stage in the year, primary volumes began trailing off. Still, we remain on track for the biggest year of gross supply since 2021 [source: Deutsche Bank]. Issuers this month included Gatwick Airport (Transportation), David Lloyd (Leisure) and Vivion (Real Estate).

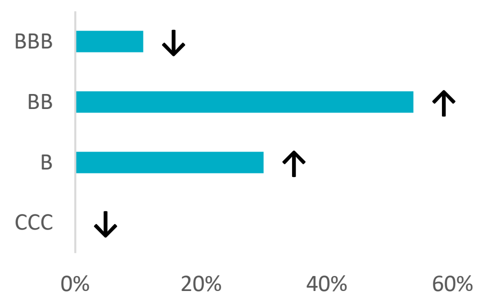
(All sources: Bloomberg)

Short duration strategy positioning and performance

Short duration strategy characteristics	
Yield	4.16%
Spread	197
Duration	1.46
Average rating	BB
ESG score	6.4

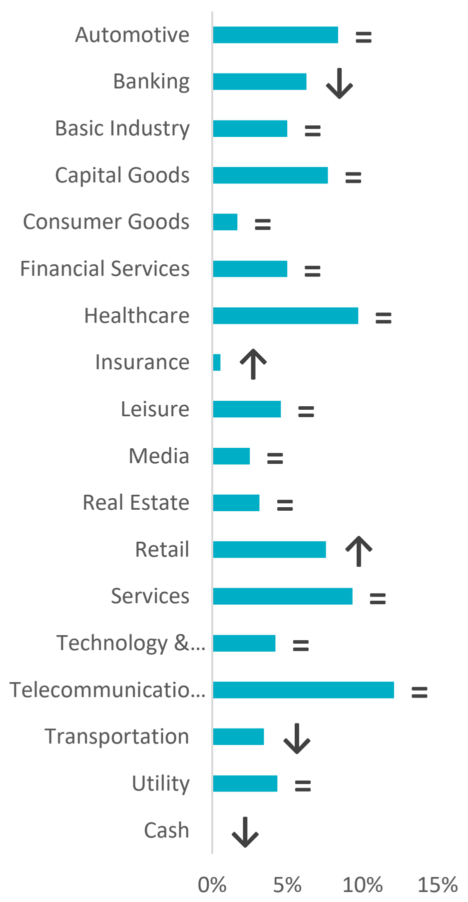
Source: AXA IM as of 30 November 2025

Our Rating Positioning



Source: AXA IM as of 30 November 2025

Our Sector Positioning



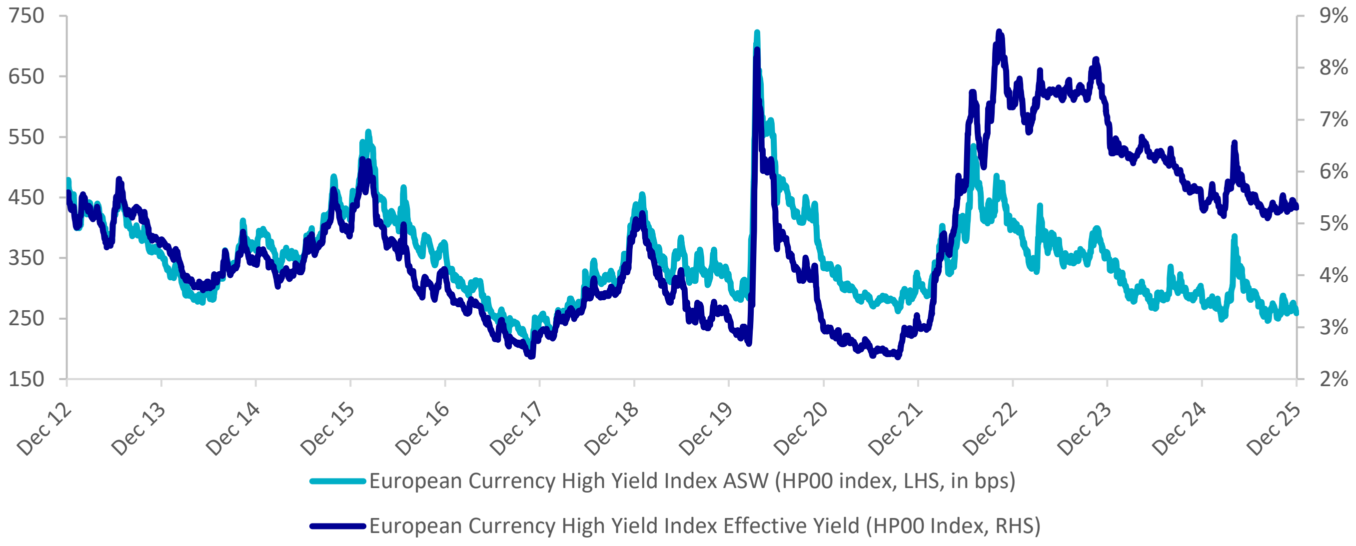
Source: AXA IM as of 30 November 2025

- Our strategy achieved a total return of +0.12% (A EUR Gross) in November. While slightly below recent monthly returns, we outperformed the broader market by 7bps and returns year-to-date stand at 4.24%, 4bps higher than the fund's YTW at the start of 2025. Our short duration stance helped mitigate the impact of Fed repricing through November but reducing CCC exposure and weakness in the Gaming, Tech, and Services sectors dragged on performance.
- The Gatwick deal mentioned above was accompanied by a call of our existing holdings – we thus rolled our exposure into the new paper. We also participated in the Vivion deal. Aside from maturities of bonds issued by Iron Mountain (Real Estate), Ocado (Services) and Picard (Retail), we reduced some of our exposure to CABB, a smaller issuer in the Chemicals sector. Whilst the company is generally well-run and is not overly indebted, the trends for the whole industry in Europe continue to be very weak. And with bonds still priced in the mid-90s, we felt that other, similar yielding names in sectors with fewer structural challenges represented a better place to wait for a Chemicals recovery

One theme we've been watching

- One of the weakest parts of the European high yield market this year has been the Chemicals subsector. Representing around 3.5% of the ICE BofA European High Yield Currency Index, it has fallen -3%.
- After a cyclical peak in the aftermath of the Covid pandemic in 2021, the start of the war in Ukraine in 2022 raised energy costs and subdued demand in Europe. The industry has been awaiting a recovery ever since
- This now looks likely to be pushed out even further, a somewhat unexpected consequence of the US trade war. High tariffs on Chinese goods, as well as government support for the sector, mean large quantities of chemicals are being dumped into the European market
- Struggling domestic producers have appealed to the European Commission (EC) for help but, in the absence of much action so far, continue to struggle with very low margins
- We prefer to retain a modest, highly selective exposure to the industry. We don't think it advisable to avoid it entirely - experience tells us that, when the cycle turns, companies can quickly become very profitable. A though not our base case for 2026, such a scenario could play out if both EC action and German fiscal stimulus come through quicker than expected
- But we prefer to concentrate our positions in the largest, most well-capitalised businesses. We believe the risk in some of these credits, which have large reserves of liquidity and ample experience in managing these cyclical troughs, is already more than adequately priced - even if patience looks likely to be needed

European High Yield Market Valuation



Source: AXA IM as of 30 November 2025

Outlook

After an October where European high yield fell 50bps in the first half of the month before unwinding it all in the second half, we had a November… which did exactly the same thing! Though this time the price action was driven less by credit-specific worries and more by general risk sentiment, as outlined above.

In a similar vein of repetition, and as our thoughts turn towards the outlook for 2026, it is very tempting to expect almost a rerun of the performance from the last two calendar years. That is, of a year with returns driven very much by carry and, therefore, broadly in-line with the current yield-to-worst (YTW) of 5.4%. This is what happened in 2024 (starting YTW of 6.6%; total return of +8.8%) and 2025 (starting YTW of 5.8%; projected total return of +5.2%). If realised, and when added to 2023's +12.4% return, this would be the longest sequence of annual returns greater than 5% since the four years between 2003 and 2006.

The reasons for this expectation are also rather similar to the ones we gave a year ago. Whilst the macro outlook for Europe is not stellar, low but positive growth is a perfectly decent environment for credit. Indeed, the very lack of overheating – and the animal spirits, in the form of elevated M&A and LBO activity, which that can bring – remains helpful for the technicals and fundamentals in our asset class. Clearly, valuations remain at the tighter end… though many people also said the same last year. But, now as then, this is matched by a high-quality (70% BBs), short duration (2.9 years) European high yield market, which limits downside risks and allows carry to dominate, this is doubly true for the fund which benefits from an investment-grade allocation above 10% and a duration of less than 1.5 years. And focussing back on that technical: as long as yields compare well to those on short-term government bonds, we would expect investor flows to more than match the current subdued growth in the size of our market.

As mentioned, the combination of low growth and low interest rates is also a helpful environment for fundamentals and, ultimately, default rates. As discussed a few times recently, there has been a clear increase in dispersion within European high yield. Companies with unsustainable balance sheets, overwhelmingly concentrated in the weak single-B and CCC ratings cohorts, have increasingly begun to see their bond prices reflecting as much. Still, these stories remain idiosyncratic. There are no indications that we are due a more broad-based increase in default rates in the next 12 months.

In fact, external risks are the main systemic threats that we envisage for European high yield in 2026. To name three: politics, AI and private credit. But as in 2025, we see most of these emanating from the US and, also as in 2025, we consider the risk to be small. Politics is noisy but corporates spent most of this year demonstrating their ability to carry-on despite worrying headlines. And, whilst AI and private credit remain topical and are worth monitoring, we believe the risks to our market are mainly as a part of the broader financial ecosystem – given it has no direct exposure to either.

Unsurprisingly, with an unchanged outlook our preferred positioning also remains the same. That is: a defensive core of BBs, to generate a steady income, supplemented with some strong conviction, returns-boosting picks from lower down the ratings spectrum. As mentioned above, the latter has shown increasing dispersion in recent months. This creates both opportunities – to buy cheaply, good credits showing some temporary operating weaknesses – but also risks. And in a year which, we believe, otherwise presents relatively few of the latter, we will remain particularly selective about adding to these.