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Four Reasons to Consider High Yield Bonds

INSIGHTS

Given the combination of equity-like return prospects with fixed income characteristics, high yield bonds may benefit investors.

From the potential for attractive returns to a large and dynamic opportunity set, there are a number of reasons why high yield bonds have become a key asset class for many investors today. In particular, we believe an allocation to high yield bonds can offer four principal benefits:

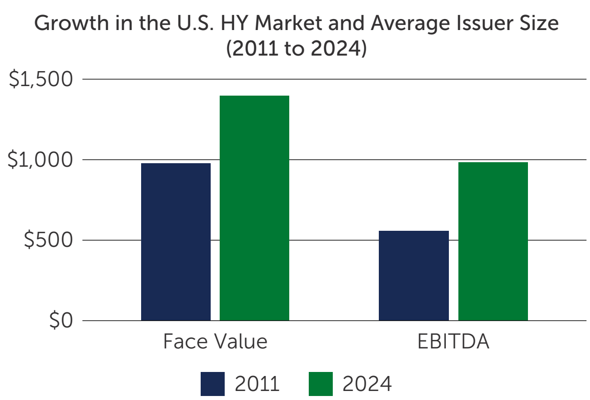
- The high yield bond market has evolved into a higher-quality, larger cap market with an expanded opportunity set.
- High yield bonds have achieved equity-like returns over time with less volatility, while also generating income for investors further along in their personal glidepath.
- Relatively lower correlations to both equities and investment grade corporate credit provide potential for portfolio-level diversification.
- While average returns over time have been similar to equities, the distribution of returns in high yield has been much narrower with smaller tails.

1. An Expanded Opportunity Set

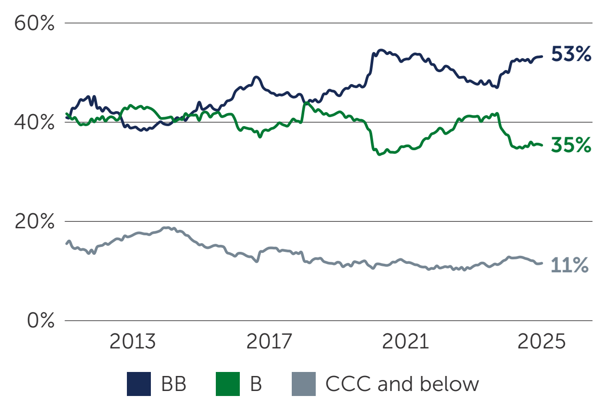
With over $1.4 trillion in outstanding bonds, the U.S. high yield bond market has more than tripled in size since the turn of the century and grown nearly 40% since 2011 **(Figure 1)**. The size and scale of the market provides investors with a robust opportunity set as well as improved liquidity throughout the cycle.

As the market has matured, so have the constituent companies. While the average EBITDA (earnings before interest, taxes, depreciation and amortization) of high yield issuers in the early 2010s was $550 million, average EBITDA is around $1 billion today—a near 70% increase **(Figure 1)**. Larger businesses with increased diversification and scale contribute to the increased credit quality of the market—this is reflected in the market's credit rating, with more than half of the market BB-rated today.[1]

Figure 1: U.S. High Yield: An Expansive and Higher Quality Market



Source: Bank of America Merrill Lynch. As of December 31, 2024. U.S. high yield market face value in $ billions. Average EBITDA in $ millions.



Source: ICE BofA U.S. Non-Financial High Yield constrained Index (HCNF). The ICE BofA U.S. Non-Financial High Yield Constrained Index measures the U.S. dollar-denominated, high yield corporate bond market, excluding financial sector issuers.). As of December 31, 2024.

1. Ratings by S&P, Moody's, or any other Nationally Recognized Security Rating Organization (NRSRO) are measured on a scale that generally ranges from AAA (highest) to D (lowest). Issues rated AAA, AA, A, and BBB are considered investment grade. Bonds, including government and government-related, not rated by a NRSRO are included in the Not Rated category. Higher-rated bonds generally provide lower returns and greater safety. Weighted average ratings methodology uses the highest of any NRSRO. Portfolio average credit quality is calculated on a dollar-weighted basis. Source: ICE BofA. As of December 31, 2024.

In addition to the higher-quality nature of issuers, the proportion of senior secured bonds has grown to comprise more than 35% of the U.S. high yield bond market, from as low as 8% at the beginning of the 2000s and 17% prior to the COVID pandemic.[2] Senior secured bonds are backed by collateral and are first in line to be repaid in the event of default, providing potential downside protection during periods of stress versus comparable unsecured bonds.

2. Differentiated Risk & Return Characteristics

Long-term investors with a focus on growth tend to allocate a significant portion of assets to equities—and subsequently accept additional levels of volatility in the pursuit of heightened returns. Analyzing high yield bonds through this lens, we find that the asset class has achieved competitive total returns over time while assuming materially lower levels of risk, resulting in a compelling allocation from a risk-return perspective **(Figure 2)**.

What has driven such returns in high yield bonds? While equity returns are driven by price appreciation, high yield bond returns over time are driven almost entirely by coupon income. In fact, current average coupon levels of 6.30% are nearly in line with long-term average annual returns dating back to 2000 **(Figure 2)**. This income component can also benefit investors further along the glidepath, where income considerations may outweigh capital appreciation.

Figure 2: U.S. High Yield Returns are Competitive with Equities, While Coupon Income Provides Lower Volatility

	U.S. High Yield	S&P 500	Russell 2000
Annualized Return	6.55%	7.60%	7.10%
Annualized Volatility	9.04%	15.30%	20.45%
Sharpe Ratio	0.52	0.38	0.26
Income	6.51%	1.37%	2.29%

Source: Bloomberg. U.S. High Yield represented by the Bloomberg Barclays U.S. High Yield Index. The Bloomberg U.S. Corporate High Yield Bond Index measures the U.S. dollar-denominated, high yield, fixed-rate corporate bond market. The S&P 500® is a gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization. Annualized data reflects the period from January 31, 2000 to December 31, 2024. Income is as of December 31, 2024 and reflects the weighted average coupon for U.S. High Yield and dividend yield for the S&P 500 and Russell 2000 indices. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

2. Source: ICE BofA. As of May 31, 2025.

3. Portfolio-Level Diversification

While exposure to high yield bonds may be warranted based on the compelling risk-adjusted return potential, the asset class can also benefit broader portfolios by providing diversification to a traditional stock/bond allocation.

This is largely because high yield maintains a relatively lower correlation of 60–70% with both equities and investment grade corporate bonds—which means high yield performance has typically been less aligned with these markets. The result is a potential diversification benefit, which is driven by several factors:

1. Contractual income provides a buffer to absorb widening credit spreads during adverse market environments.
2. Interest rate exposure can also offset adverse spread movement—albeit high yield is shorter duration than other fixed income asset classes.
3. Sector and issuer exposures differ from many of the large capitalization equity indices, with the Russell 2000 more representative than the S&P 500, which tends to receive the largest equity allocations in domestic portfolios.

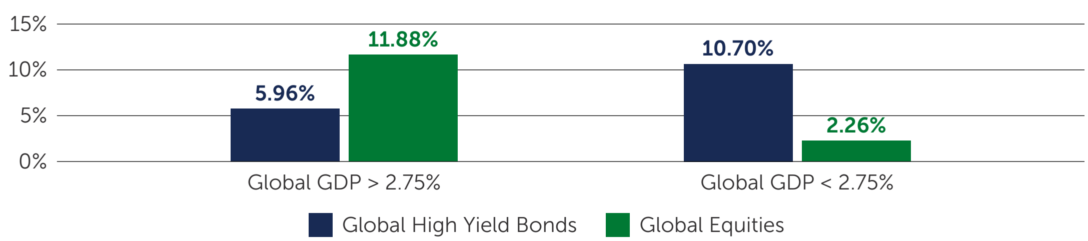
Figure 3: Modest Correlations to Both Equities and High-Quality Fixed Income Drive Portfolio-Level Diversification

Correlation	U.S. HY	SPX	R2000	UST	U.S. IG
U.S. High Yield	1.00				
S&P500	**0.68**	1.00			
Russell 2000	**0.68**	0.84	1.00		
U.S. Treasury	-0.05	-0.15	-0.18	1.00	
U.S. IG	**0.60**	0.36	0.32	0.65	1.00

Source: Bloomberg. As of December 31, 2024. Representative indices are U.S. HY: Bloomberg U.S. Corporate High Yield (LF98TRUU), UST: Bloomberg U.S. Treasury Index (LUATTRUU), US IG: Bloomberg U.S. Corporate Index (LUACTRUU). The Bloomberg U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. The Bloomberg U.S. Treasury Index measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury.. Correlation uses monthly data from January 2000 to December 31, 2024. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

As such, high yield tends to perform particularly well compared to equities in slower economic growth environments **(Figure 4)**. In particular, while companies are still growing revenue and generating positive free cash flow in this environment, which is credit-positive, longer-term growth prospects may decline, compressing equity multiples and valuations.

Figure 4: High Yield has Historically Outperformed Equities in Lower Growth Environments



Sources: Barings; MSCI; Bloomberg; ICE BofA. As of December 31, 2024.

4. Historically Consistent Returns

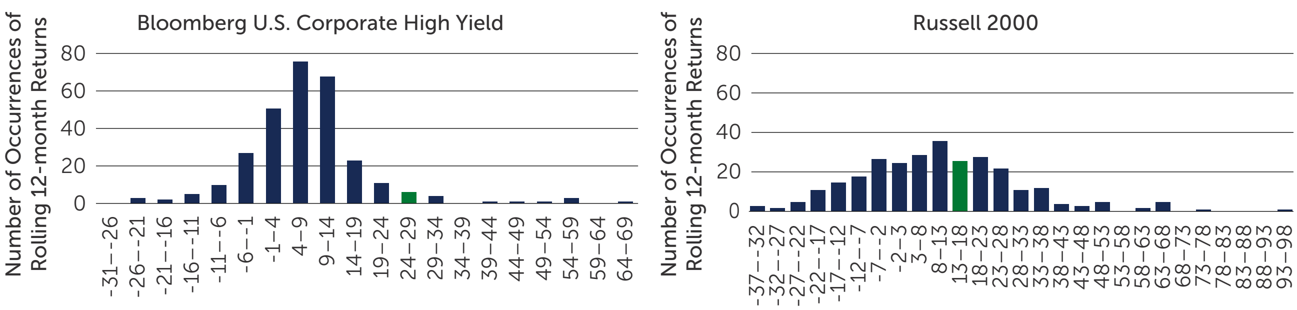
In addition to a strong risk and return profile as measured by the Sharpe ratio (a widely used method for measuring risk-adjusted returns across potential investment opportunities), history also reveals a more consistent pattern of returns in high yield. The histograms in **Figure 5** aggregate the number of occurrences of trailing 12-month total returns from 2000 to 2024. They suggest that while the mean annual total return in both U.S. high yield (left) and the Russell 2000 (right) fall within 5-10%, investors in high yield could potentially expect to generate this return with a higher frequency than through the equity index. Similarly, the dispersion of outcomes is much narrower with shorter tails, as only 21% of rolling 12-month high yield returns have been negative, compared to 33% for the Russell 2000.

Finally, when observing performance in adverse market environments, high yield again measures favorably versus the Russell 2000. **Figure 6** shows the average drawdown in the high yield market is half as severe in both magnitude and duration as compared to the comparable equity index.

Conclusion

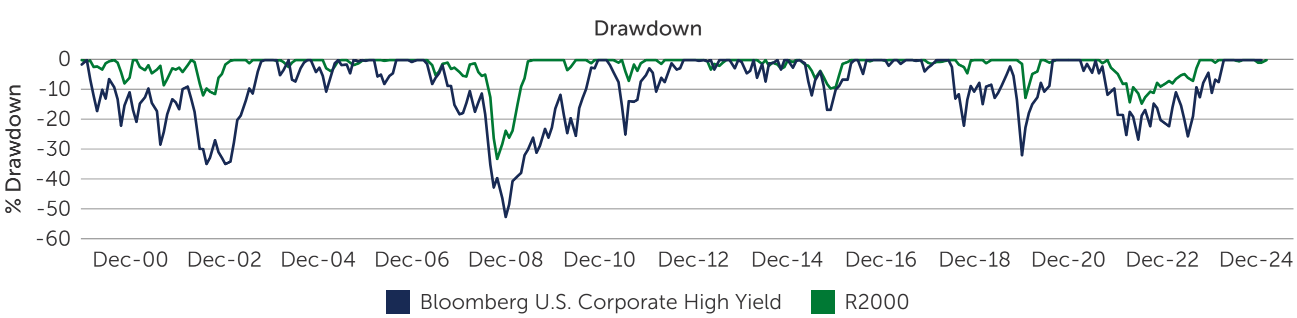
We believe the compelling risk-return potential high yield bonds offer, paired with meaningful diversification in a standard stock-bond portfolio, make the case for a strategic allocation to high yield in investors' portfolios. For defined contribution pension schemes—and investors across the risk and return spectrum more broadly—the asset class offers further unique benefits including potentially attractive long-term returns, consistent income generation and risk efficiency.

Figure 5: U.S. High Yield has Similar Average Annualized Returns as the Russell 2000, with Less Dispersion



Source: Bloomberg; Russell 2000. Histograms depicting the number of occurrences of rolling 12-month returns (%) by range bucket, from January 2000 to December 31, 2024. Green signifies the mean return. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

Figure 6: U.S. High Yield has Historically Declined Less and Recovered Faster In Down Markets vs. the Russell 2000



Source: Bloomberg. Drawdown measures the instances of negative monthly returns from the period of initial decline until the index recovers to prior levels, from January 2000 to December 31, 2024. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

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**As of March 31, 2025*

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MM202711-310849