European HY or US HY?

A recession in the US still seems relatively unlikely, supported by fiscal stimulus ahead of the midterms and massive investments in AI. If a recession were to occur, it would most likely be triggered by the sharp rise in oil prices.

In that scenario, US high yield would likely be far better positioned than European high yield. Europe remains heavily dependent on oil imports, while the US is largely energy self-sufficient. As a result, an oil-driven recession in Europe would likely be deeper and longer.

At the same time, the US high yield market has a significantly larger energy sector. So if concerns about turmoil in Iran and rising oil prices are driving recession fears, it may actually make sense to reduce exposure to European high yield and move into US high yield instead.

High Yield has shifted closer to Investment Grade

- Long-term returns between US and global high yield are broadly similar. However, US high yield offers a slightly better risk-return profile due to lower volatility. European high yield has a higher exposure to financials (around 20–25%), making it more exposed to AI disruption in that sector, while US high yield is more diversified.
- Many investors are currently waiting for spreads to widen, with significant capital on the sidelines ready to enter the market. However, absolute yields remain attractive, and even a modest widening in spreads is likely to trigger strong inflows. This makes a material widening of spreads less likely, absent a major market event. Historically, spreads can also remain tight for extended periods.
- In contrast, US senior loans, which have seen strong inflows and risk-taking over the past decade, are expected to face higher default rates. At the same time, credit quality in high yield is strong, with ratings at their highest levels in over 25 years.
- Traditional high yield sectors have also become more resilient. For example, the energy sector has significantly deleveraged, and many weaker issuers have already defaulted.
- Overall, high yield has shifted somewhat closer to investment grade in terms of quality. Meanwhile, parts of investment grade are becoming more exposed due to heavy capex from hyperscalers. In contrast, high yield remains focused on more traditional, real-economy businesses, which may offer more stability in the current environment.