

High yield bonds: better quality, lower leverage

Bottom line up top

Earnings: “I’m the captain now.” After the outbreak of war in Iran drove equity markets sharply lower in March, April has brought a sense of relative stability and renewed confidence. Ceasefire optimism and resilient corporate earnings have helped the S&P 500 Index and other U.S. equity benchmarks reach new all-time highs. Unlike some market rallies, this one is being driven not by valuations or even by geopolitical relief, but by earnings.

The equity risk premium (ERP), which measures the excess return investors expect to earn from equities over a risk-free rate (U.S. Treasuries), remains compressed, but stable, hovering near cycle lows (Figure 1). Importantly, the current level isn’t due to excessive equity exuberance, but rather to Treasury rates rising to meet equities. With the forward earnings yield on the S&P 500 roughly in line with the 10-year Treasury, stocks no longer look cheap relative to bonds — but they’re not outright expensive, either.

A generally supportive backdrop. Encouragingly, economic growth is holding up despite geopolitical friction, and consensus expectations for Q1 earnings season are for double-digit earnings per share (EPS) growth, led by continued strength in the information technology sector. In this sense, the market’s resilience is understandable — earnings are doing their job.

Last week’s retail sales release showed headline spending surged +1.7% in March. And while much of that increase resulted from higher gasoline prices, retail sales excluding auto fuel was a still-firm +0.6%. The retail sales control group, which excludes some volatile categories and feeds directly into GDP calculations, rose +0.7%, more than expected and higher than in February. Solid spending should bode well for continued earnings growth, but it also reduces the urgency for near-term Federal Reserve rate cuts. This will likely keep Treasury yields elevated and, in turn, limit any meaningful expansion in the equity risk premium.

Risks are evolving, not resolving. At the same time, risks haven’t disappeared. The energy supply shock tied to the on-again-off-again closing of the Strait of Hormuz introduces a potential stagflationary impulse, where each incremental

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*On behalf of
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As Nuveen’s Chief Investment Officer and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm’s most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she is a portfolio manager for several key investment strategies.

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move higher in crude prices trims growth forecasts while reaccelerating inflation expectations. Meanwhile, the artificial intelligence (AI) narrative is entering a more selective phase. The conversation is no longer just about who benefits, but also who gets disrupted — and the implications for business model viability and earnings durability across sectors and industries.

In this environment, with equity valuations tethered to higher-for-longer rates and the equity risk premium offering less cushion, investors seeking income and total return may want to diversify beyond equities into asset classes like corporate high yield bonds.

Figure 1

The equity risk premium has compressed, but remains stable

S&P 500 Index risk premium (%)



Data source: FactSet, April 2016 to April 2026. **Equity risk premium** reflects the S&P 500 Index 12-month forward earnings yield minus the "risk-free rate" offered by 10-year Treasuries. **Performance data shown represents past performance and does not predict or guarantee future results. Investing involves risk; principal loss is possible.**

Portfolio considerations

U.S. high yield corporate bonds have proved resilient in 2026 so far, despite escalating volatility from the Middle East conflict, AI-related risks for software businesses and concerns around private credit. Through 21 April, the high yield asset class is up +1.30% year to date, as measured by the Bloomberg U.S. Corporate High Yield Total Return Index, outperforming the broad Bloomberg U.S. Aggregate Bond Index by +82 basis points (bps).

High yield bonds have undergone a structural transformation since the 2007-2009 global financial crisis. Bonds rated BB (the top quality tier for high yield) now make up more than half (roughly 57%) of the overall high yield market, versus 38% before the crisis. Additionally, the market has shifted toward larger, more-established issuers with stronger credit profiles. The result is a higher-quality universe that features more public issuers, along with a default rate that

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Investors looking for a combination of income and total return should consider a closer look at corporate high yield bonds.

remains below long-term historical averages. High yield issuers also continue to post strong corporate earnings. At the same time, their net leverage ratios remain healthier than those in the private debt market (Figure 2). Interest coverage ratios, an important metric for evaluating whether companies can service their debt, are strong at 4.18x (source: JPMorgan).

Well-positioned for AI tailwinds. While AI-related risks have been a dominant theme for credit markets, the high yield space has minimal exposure (less than 5%) to software — an industry seen as particularly vulnerable to AI disruption. On the other hand, high yield stands out as the clearest beneficiary of potential AI disruption among credit markets, as its sector mix is meaningfully overweight AI enablers and beneficiaries — fiber, power, data centers, tech services and health care.

Given their combination of attractive yields, greatly improved (and improving) credit fundamentals and relative insulation from AI risks, high yield bonds have much to offer diversified investors looking to allocate to a below-investment grade credit market and expecting to be fairly compensated for doing so.

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Since the global financial crisis, high yield bond issuers have seen improvements in overall quality and rely on lower leverage levels.

Figure 2

Leverage levels for publicly issued loans have declined over time

Net leverage ratios



Data source: JPMorgan as of 31 Dec 2025.

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- macro and asset class views that gain consensus among our investors
- insights from thematic “deep dive” discussions by the GIC and guest experts (markets, risk, geopolitics, demographics, etc.)
- guidance on how to turn our insights into action via regular commentary and communications

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Endnotes

Sources

All market and economic data from Bloomberg, FactSet and Morningstar.

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