

MAY 2026

Quality within risk: strategic credit positioning in a resilient economy

Key takeaways

- A resilient macro backdrop – steady U.S. growth, moderating yet still elevated inflation and synchronized global expansion – supports selective credit positioning today.
- While conflict in the Middle East has increased the price of oil, fueling inflation and slowing growth, the overall expected economic impact is modest.
- The high yield market's structural quality improvement provides compelling value relative to default risk, and sufficient liquidity offers active managers additional return potential.
- Senior loans offer attractive yield potential, and wide price dispersion creates compelling total return opportunities for active managers over passive beta exposure.
- Preferred securities – 85% issued by regulated banks, insurers and utilities – could offer quality and tax-efficient income as a complement to high yield and loans.

In a world of compressed spreads and geopolitical crosscurrents, selectivity within below-investment-grade credit has never mattered more.

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

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A resilient economy: the case for taking risk

Before examining where to position within credit markets, we must first ask whether the economic backdrop warrants risk-taking. As of early 2026, we think the answer is a cautious yes.

The U.S. economy expanded at 2.2% in 2025, and we forecast a similar pace this year, with growth remaining solid if slightly more moderate. The labor market has stabilized — unemployment sits near 4.3%, wage growth remains solid but non-inflationary at 3.5%, and continuing jobless claims are hovering near multi-decade lows. Business investment, particularly in technology and AI infrastructure, continues to provide a substantial tailwind, and productivity growth is running at its strongest pace since the Global Financial Crisis.

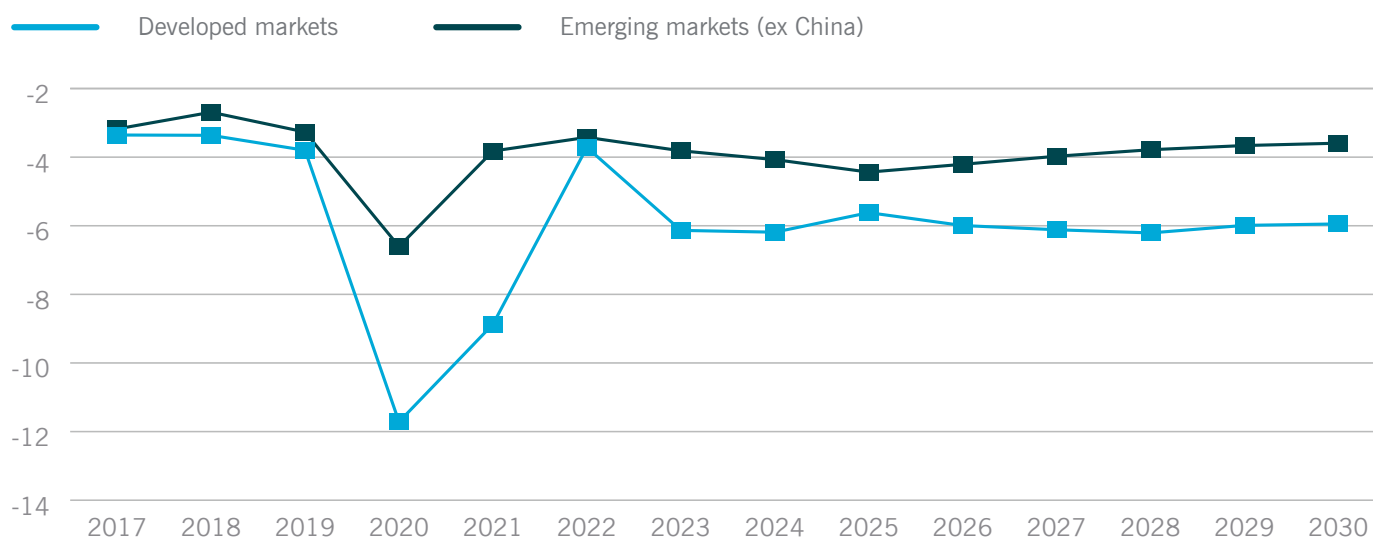
The constructive outlook extends beyond U.S. borders. A meaningful fiscal impulse is supporting European growth near 1.0% in 2026, with the UK, Japan and China also expanding. Developed market core inflation has declined to around 2.20% year-over-year, its lowest level since 2021. Global recession risk has fallen.

Geopolitical risks are real, but the U.S. is less exposed

Geopolitical risks — notably the ongoing conflict in the Middle East — introduce volatility that cannot be ignored. While oil near \$100 per barrel will push headline inflation modestly higher, the direct impact on the U.S. economy appears contained. Higher levels of domestic energy production partially offset the pressure, and U.S. consumers now allocate less than 4% of spending to energy (Figure 1).

We estimate the net effect will reduce U.S. GDP growth by approximately 0.2% this year — a modest drag that leaves the expansion firmly intact. Even with oil at \$120 per barrel, U.S. GDP growth should remain around 1.5% (Figure 2). Tariff uncertainty adds a separate layer of noise, but for active investors, the ability to respond to market dislocations may itself be a source of return.

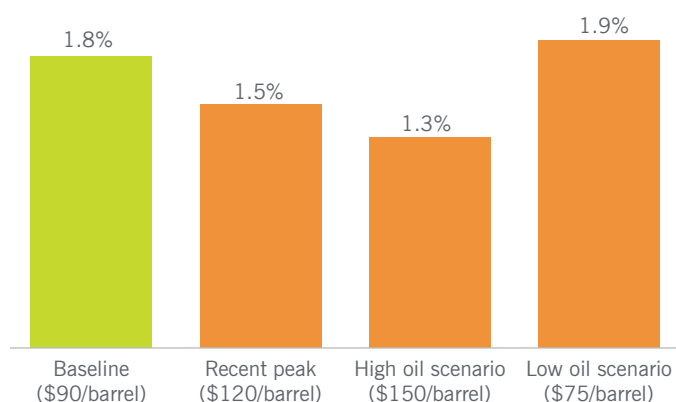
Figure 1: U.S. oil production is higher, while energy consumption is lower



Data source: Bloomberg, L.P., Department of Energy, Bureau of Economic Analysis, 31 Mar 1970 – 30 Sep 2025. Production/demand ratio data are available from September 1990.

Figure 2: Oil price volatility broadens the range of potential macro scenarios

U.S. real GDP growth at various oil price scenarios



Data source: Nuveen Macroeconomic Research, Bloomberg, L.P., 15 Apr 2026. Real economic growth represented by real gross domestic product (GDP).

High yield bonds: a market transformed

U.S. high yield bonds have undergone a profound structural transformation since the Global Financial Crisis. That shift is essential to interpreting today’s valuations.

Prior to 2008, the market was dominated by private equity-backed leveraged buyouts: smaller companies with aggressive capital structures, elevated leverage and limited transparency. BB rated bonds — the highest quality tier within high yield — comprised only about 38% of the market, while CCC rated bonds accounted for roughly 17% (Figure 3).

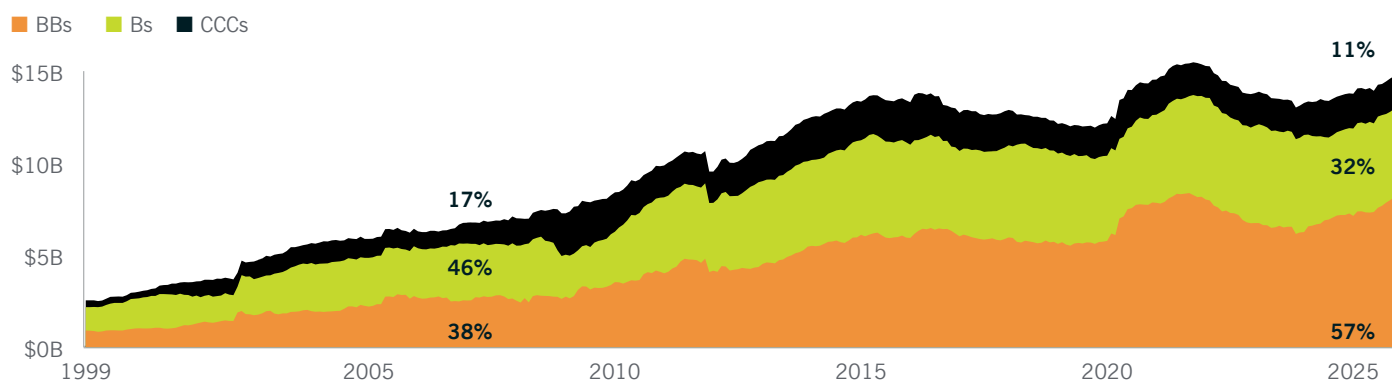
Post-crisis regulatory reform fundamentally changed the landscape. The 2013 Leveraged Lending Guidelines and Dodd-Frank imposed stricter underwriting standards on banks, redirecting the riskiest credit activity toward private credit and the lower-quality segments of the senior loan market. High yield moved upmarket.

Today, BB rated bonds constitute roughly 57% of the market, while CCC exposure has fallen to just 11%. Nearly two-thirds of high yield issuers — 65%, according to Bank of America research — are publicly traded companies subject to rigorous governance and disclosure requirements. These are established operating companies with stronger balance sheets, lower leverage multiples and healthier interest coverage ratios, accessing capital markets for general corporate purposes or strategic acquisitions — not financial engineering.

The result: a trailing twelve-month default rate of just 1.9%, well below the long-term average of 3.3%.

Figure 3: Quality shift has transformed the high yield landscape

U.S. high yield market (\$ billions)



Data source: BofA Global Research, 30 Apr 1999 – 31 Dec 2025. Data reflects credit quality dispersion of the ICE BofA U.S. High Yield Index. Performance data shown represents past performance and does not predict or guarantee future results.

What the quality shift means for high yield valuations

The structural transformation of the high yield market has an underappreciated implication for how investors should interpret current spread levels. Spreads reflect the underlying risk profile of the market — and when that risk profile improves materially, comparing today's spreads to historical averages becomes misleading.

Adjusting the historical spread benchmark to reflect high yield's current higher-quality composition, today's spreads of around 300 basis points (bps) could compress further — to roughly 220 bps — suggesting that while valuations appear tight, they remain attractive relative to actual default risk.

The risk profile for high yield has improved more than headline spreads reflect, and we believe any material spread widening would require macro deterioration rather than a weakening of underlying credit fundamentals. With \$10 billion in daily trading volume, high yield offers institutional-grade liquidity that enables effective risk management and the ability to act decisively during dislocations — an advantage buy-and-hold alternatives cannot replicate.

Senior loans: yield and dispersion in equal measure

Senior loans offer a distinctive set of portfolio benefits in 2026 — but capturing them requires active management.

Compelling yield with floating-rate protection. At a yield-to-three-year of over 8%, the broadly syndicated loan market offers significant income — among the highest of

any liquid fixed income asset classes. Because loans carry floating rates, that yield also serves as a natural hedge if rates remain elevated longer than markets expect. For income-oriented investors, that combination is difficult to replicate elsewhere.

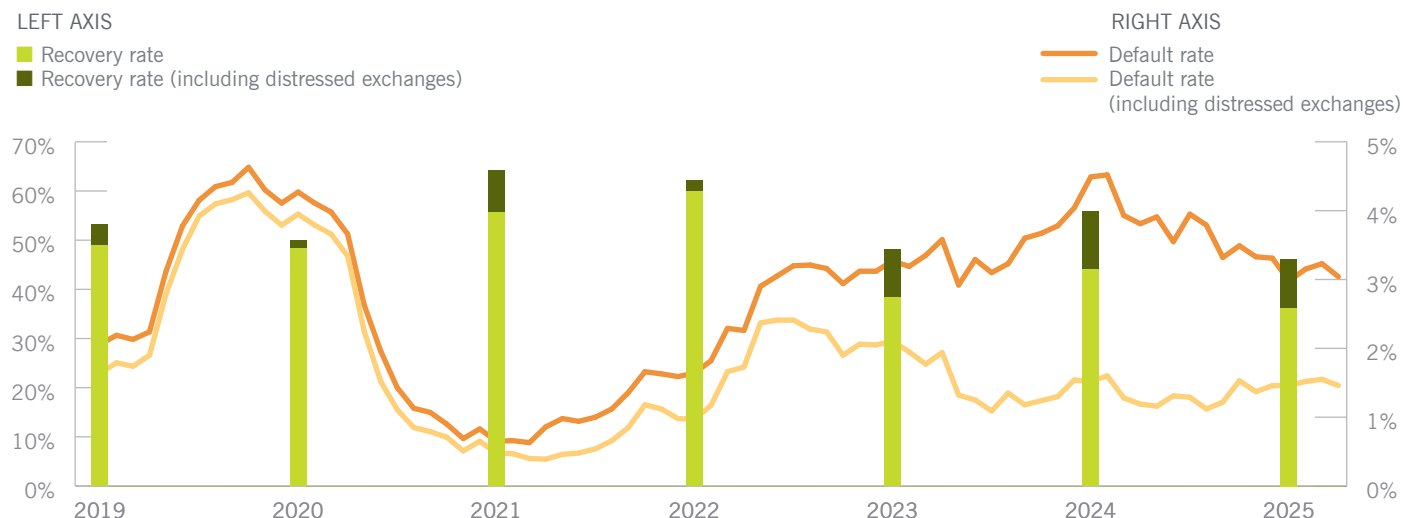
Dislocation as opportunity. Spread widening has been sharply uneven. BB rated loans have moved only 25 bps wider year-to-date, while CCC rated loans have widened 225 bps, with average CCC prices approaching Covid-era lows. Roughly 20% of the market now trades below \$95, the widest price dispersion outside of a major macro shock. For patient, selective investors, that bifurcation is precisely the environment where active management has historically added value.

A stable foundation beneath the noise. Away from software-related volatility, the underlying credit picture remains intact. The March default rate of 3.04% has fallen significantly from the 4.5% highs at the end of 2024, as several problem credits have worked their way through the system (Figure 4). Robust issuance of collateralized loan obligations (CLO) continues to drive institutional demand for senior loans, providing meaningful technical support.

The case for active management. Sector return dispersion exceeds 600 bps, and credit performance diverges sharply by rating tier and industry. Passive index-like exposure is poorly suited to this environment. This market requires managers with deep fundamental research capabilities that can separate temporarily stressed credits from genuinely impaired ones and position accordingly. Crucially, the market's liquidity, daily pricing and transparency enable skilled managers to identify mispricings, rotate out of deteriorating credits and capture value in real time.

High yield's \$10 billion daily volume enables decisive action during market dislocations.

Figure 4: Senior loan default rates have declined from 2024 peaks



Data source: PitchBook | LCD, 31 Dec 2019 – 31 Mar 2026. Performance data shown represents past performance and does not predict or guarantee future results. Representative index: Morningstar LSTA U.S. Leveraged Loan Index.

Preferred securities: quality, income and tax efficiency

Preferred securities round out a diversified credit allocation — offering a distinctive combination of yield, quality and tax efficiency that complements both high yield bonds and senior loans.

Quality rooted in regulated industries. Around 85% of the preferred universe is issued by banks, insurance companies and utilities — sectors with strong current fundamentals and rigorous regulatory oversight. Banks continue to pass Federal Reserve stress tests, have well-capitalized balance sheets and should benefit from the pickup in U.S. M&A activity. Insurance companies hold near-record surplus capital, supported by record annuity sales. Utilities benefit from surging power demand driven by AI data center buildout and the broader electrification of the economy.

While the average quality rating of the preferred universe is BBB, the average preferred security issuer is rated 3 to 5 notches higher, reflecting the subordinate position of preferred securities within the capital structure. Preferred

securities also offer meaningful diversification. Issuer overlap with high yield corporate bonds and senior loans is limited, since those markets have minimal exposure to banks and insurance companies.

Differentiation across market segments. Within the preferred market, we favor institutionally oriented \$1,000 par securities over the retail-dominated \$25 par segment. The \$1,000 par market is growing and offers a compelling combination of advantages: a duration of just 4.2 years compared to 9.0 years for \$25 par alternatives, wider option-adjusted spreads of 199 bps versus 144 bps, and greater liquidity with less volatility.

These structural advantages have translated into substantial outperformance. \$1,000 par securities returned 6.62% and 9.49% over one- and three-year periods, respectively, versus 3.12% and 4.61% for \$25 par alternatives as of 31 Mar 2026 (Figure 5).

Tax-efficient income. Many preferred securities pay qualified dividend income, taxed at lower capital gains rates rather than at ordinary income tax rates — a significant advantage for taxable investors focused on maximizing after-tax yield.

Figure 5: \$1,000 par securities have delivered superior returns

Total return (%)



Data source: Bloomberg, L.P., 31 Mar 2026. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: \$25 par: ICE BofA Core Plus Fixed Rate Preferred Index; \$1,000 par: ICE BofA U.S. Institutional Capital Securities Index.

Portfolio construction: quality as a north star

Within every risk segment, quality matters — and it matters more in today’s environment than at most points in the recent past.

The high yield market’s structural upgrade means that a blanket “avoid high yield” posture is no longer analytically defensible. But it also means that undifferentiated exposure to the lower tiers — CCC bonds, CCC loans, heavily leveraged private structures — carries risks that may not be fully compensated at current spread levels.

The three asset classes examined here are not simply parallel options — they function as a system.

- **High yield** provides core credit exposure with institutional liquidity and rate resilience.
- **Senior loans** add floating-rate income and opportunistic return potential in a market where active selection can exploit meaningful dislocation.

- **Preferred securities** contribute regulated-industry quality and tax-efficient income with low overlap to the high yield and senior loan sectors.

That system is built around a single organizing principle: a deliberate quality tilt. In practice, that means overweighting BB and upper B rated instruments where fundamentals are strong and liquidity is ample; maintaining selective exposure to lower-quality segments where price dislocation appears to have overshoot fundamental deterioration; and building in the liquidity necessary to respond dynamically as conditions evolve.

Selectivity as strategy

Economic resilience provides the macro foundation for this positioning. A growing economy, moderating inflation, gradually easing monetary policy and broadening global expansion all support corporate credit quality and limit systemic default risk across all three asset classes.

High yield benefits from stable fundamentals and continued spread normalization toward quality-adjusted fair value. Loans benefit from floating-rate income and the potential for meaningful price recovery in dislocated segments as sentiment stabilizes. Preferred securities benefit from the ongoing strength of regulated financial institutions and utilities — sector tailwinds that show no sign of fading.

But resilience is not immunity. Geopolitical volatility — from Middle East tensions to tariff uncertainty — creates the kind of episodic market disruption that active managers may translate into alpha. Liquidity, selectivity and the ability to act decisively during dislocations are not just risk management tools — they are return drivers in their own right.

The conclusion is not complex, but it demands conviction: within risk, quality is not a concession to conservatism. That quality tilt is a strategic choice — one that, in the current environment, may generate income, capital appreciation and portfolio resilience across multiple economic scenarios.

For more fixed income insights, please visit us at nuveen.com.

Endnotes

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