

Market Sense – High Yield Market Not Necessarily Signaling Doom for 2027

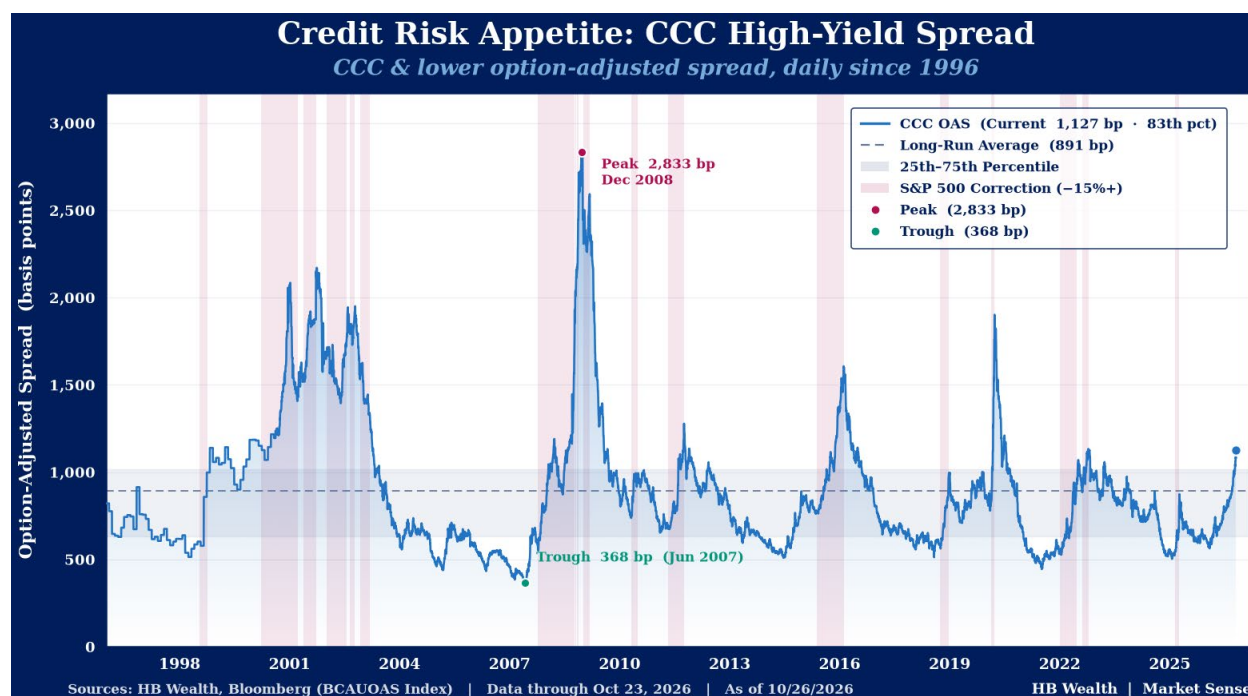
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Abstract:

- *CCC rated credit spreads have surged to beyond 1000 basis points for the first time since 2022, suggesting rising risk of default in this segment of the high yield market, and largely single-handedly driving widening in high yield benchmarks in recent weeks.*
- *Historically, CCC spreads at current levels were accompanied by significant strain across financial markets, but this time, markets are handling the spike in stride. This is because the rest of the high yield market remains remarkably stable, suggesting risks are concentrated in the lowest quality segment. As a result, the ratio of CCC to the high yield benchmark overall is at new record highs.*
- *Part of the reason CCC spreads to the rest of the market have moved so severely is structural - the top of the high-yield market has improved while private credit has drawn stronger borrowers away from the bottom.*
- *However, rates have moved against the most indebted borrowers, and more than a quarter of the CCC market now trades at distressed levels. Current CCC spreads break even at roughly a 15% default rate, and history suggests a coin flip between further widening and a rally.*
- *For now, the credit market stress is largely contained to CCC, suggesting a widespread credit default cycle is not likely imminent. We are actively monitoring various potential moves from here, such as whether stress moves up the credit ladder, downgrades into CCC, defaults, and sector breadth.*

While spreads remain near historic tightness across much of the credit spectrum, CCC rated credit spreads have surged almost 500 basis points over the last 12 months, to 1,127 basis points – a level currently

wider than 5 out of every 6 days since 1996. This is well beyond the long-term average spread, and a level that has historically only been reached during periods of significant strain for the financial markets. Yet, the widening in CCC spreads has occurred without a major risk off event emerging in stocks – an extremely rare event. In every other instance in which the CCC spread widened beyond long-term average over the last twenty years, the S&P 500 was nearing or already in the midst of a correction. This begs the question, is the bond market signaling more significant distress ahead?



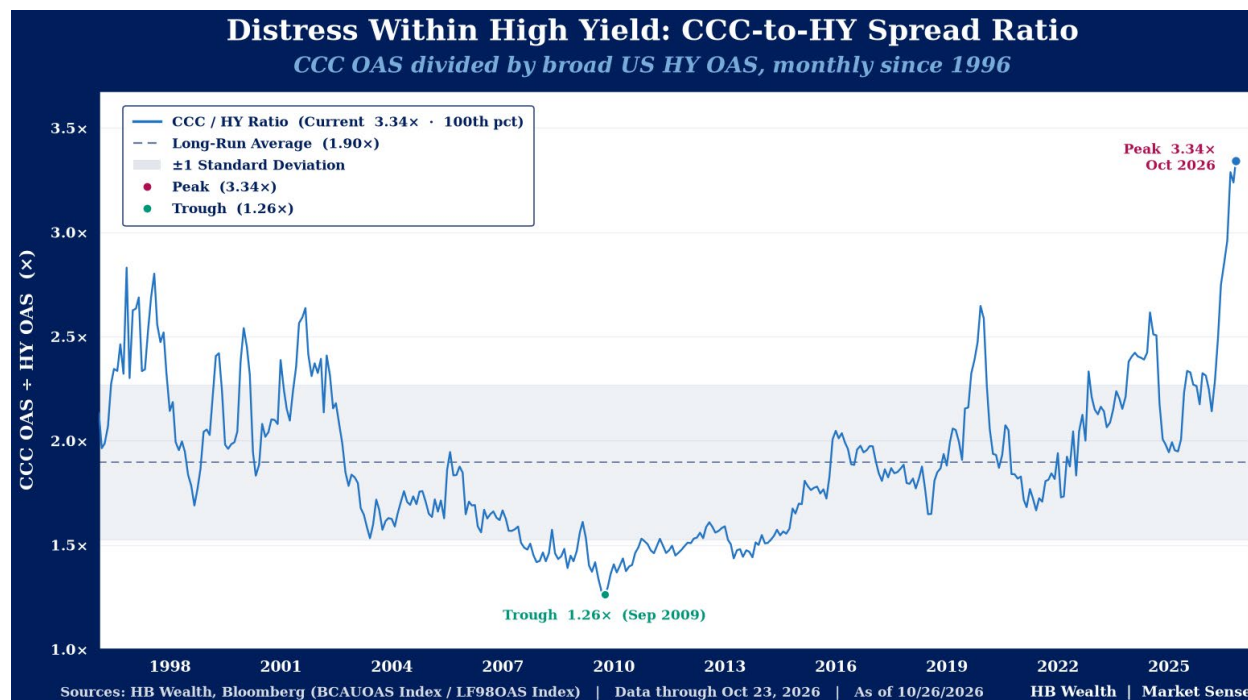
Why CCC Extremes are Not Worth Panicking About

While the historical track record is ominous, there are good reasons not to panic because CCC has widened beyond 1000 basis points this year. CCC risk may not be indicative of broader high yield market risk as it generally was in the past, for the high yield market has effectively split into haves and have-nots. In other periods of market strain, the high yield market as a whole was under stress, whereas this time CCC spreads are gapping wider during a time of relative calm in the broader High Yield market.

The bottom of the credit spectrum currently has extreme adverse selection issues. Many of the stronger lower-rated borrowers have moved to private credit, which has grown substantially over the past decade and a half. According to the Federal Reserve, roughly 85% of private credit borrowers have an estimated credit rating of single-B, so many issuers that could refinance privately often have. Those left in the public CCC market are thus more likely to be companies that could not refinance privately, or that are already restructuring.

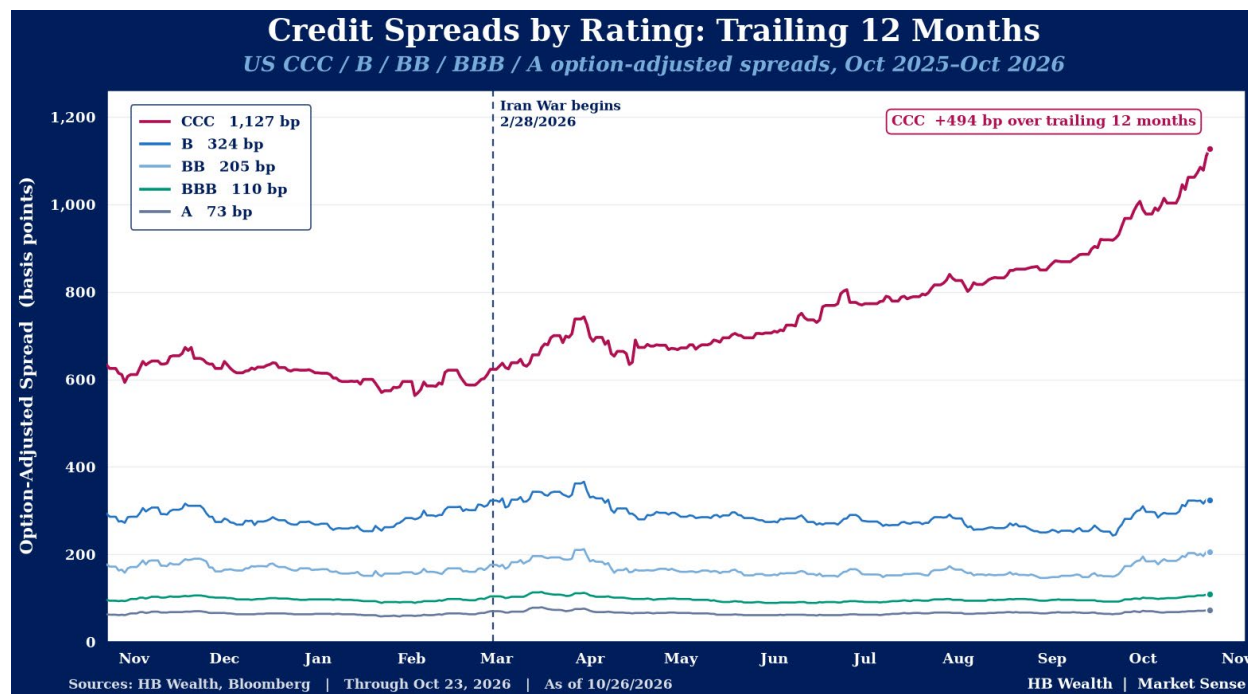
As the CCC cohort of the high yield market has struggled with adverse selection, the general credit quality at the top of the index has improved, and this higher quality segment of the bond market has simultaneously gotten bigger. While CCC spreads have widened 512 basis points year-to-date through 10/23/26, BB spreads have comparatively barely budged with their 56 basis points move. This not only widens the gap between CCC and the rest of the market, but it also diminishes the impact of the CCC cohort on the overall performance of high yield benchmarks. The weighting of the BB-rating cohort in the broad High Yield benchmark rose from 30% in 2010 to 54% in 2026, partly due to fallen angels downgraded from investment grade.

This combination of selection and weight explains why the broader High Yield index's spread is merely at its 16th percentile - even though CCC is pricing substantially more risk than others at its 83rd percentile, BB is at its 11th percentile. The lowest rated tier is pricing much more risk than the rest of the market, and that lower quality tier is just 8% of the index while BB is more than half. CCC spreads are now roughly 3.3x that of the broad HY index, compared to an average 1.9x since 1996, and currently the widest gap on record.



Those structural shifts help to explain the longer trend of a gap between CCC and the rest of the market, but the speed of recent widening in CCC is a separate and equally important issue to explore. The ratio between CCC spreads and those for the rest of the high yield market has moved from roughly 2x to above 3x in roughly a year and a half. Indeed, CCC spreads have widened nearly 400bps over the last twelve months, while B through A have barely moved. In addition to the long-term shift in market structure, the widening of the CCC spreads this year reflects deterioration at the bottom of the credit stack.

Meanwhile, rate expectations have swung from two cuts expected at the start of the year to now reflect the beginning of a hiking cycle. Many CCC issuers have interest coverage below 1x, so they stood to gain the most by rate cuts and get hurt the most by a higher-for-longer environment. This flows through to floating-rate loans right away, and at refinancing for fixed-rate bonds where elevated rates have already made recapitalizations harder for more distressed credits.



The volume of CCC trading at distressed levels has grown 10 percentage points this year to 27.7% as of September 2026. A few well-known names are driving much of that damage. The communications sector makes up roughly $\frac{1}{4}$ of the CCC index, with Altice/Optimum making up roughly 10% alone. CSC holdings accounted for nearly half of the index's YTD decline through the end of September, according to Bloomberg. Outside of CSC and energy, the pressure is more broad-based, including CCC-rated technology and capital goods issuers.

What Should We Do Now? Watch Those Spreads

History shows that there is no compelling reason to try to catch the falling knife in CCCs, as past spread spikes to 1000 basis points have been followed by further widening in 50% of instances, and EBITDA for the cohort remains extremely weak in an environment of rising rates. However, we can watch the rest of the high yield market for meaningful signals for the broader financial markets.

For now, the credit market stress is largely contained to CCC, suggesting a widespread credit default cycle is not likely imminent. The ratio between the lower tier and the market at large could remain wide given structural changes to the market and is not a signal in itself - the lowest spread between the market and CCCs on record came after spreads broadly blew out during the Great Financial Crisis, so a falling ratio isn't automatically good news.

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