Credit crossroads: Dispersion meets convergence

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Transcript

When we look across the credit market today, the big picture is pretty healthy. We've had a multi-year upgrade cycle, balance sheets are in good shape, earnings remain strong, profitability is at or near all-time highs, and we're seeing relatively limited stress through downgrades and defaults. But beneath the surface, we're starting to see more separation. AI is one area separating from the broad market spreads.

The historic amount of financing is creating an environment where issuers need to pay a premium to attract demand. And we're also seeing and also watching, companies with high leverage and limited growth prospects. Historically, lower yields could provide some relief for those businesses but given that we're in a structurally higher rate environment, that might be less of a cushion. The broad backdrop remains healthy, supporting the view to lean in, but as dispersion increases, selectivity becomes much more important.

We're optimistic about the long-term potential of AI, but the scale of investment is unlike anything we've seen before. A lot of that is spending is coming from high-quality hyperscalers with very strong balance sheets. But when you're investing at this kind of pace, there's always a risk that spending gets ahead of demand. It's too early to know if that's happening today, but it's something that we are watching very closely.

The financing needs are enormous. We're looking at roughly $3 trillion of capital needs through 2028, with a significant portion of that being funded through the credit markets. What's really interesting is also how this capital is being raised. Companies are increasingly looking across both public and private markets for flexibility and certainty of financing. And we think the scale of AI investment is only going to accelerate the convergence between both public and private.

So for investors, that creates opportunity, but also complexity. Many of these deals are highly customized, so you really need to understand the underlying risk. So while we are in the midst of a historic investment trend, the need for capital is not only creating opportunities, but also an environment where a flexible cross asset lens within both public and private creates a more clear picture to identifying potential value within this theme.

There are really three reasons why we think fixed income is so attractive today: income, total return, and the benefits of active management. It's been nearly two decades since we've consistently seen yields at these kinds of levels. And at the same time, we have an aging population with more moving into retirement and looking for reliable sources of income.

The second is the return opportunity. Equities have delivered very strong returns in recent years. But when you look over the long term, equity returns have historically been closer to high single digits. Today, we can build a high-quality investment-grade fixed-income allocation with a third of the historical equity volatility and potential yields between 7% and 8%.

And third, the opportunity for active management. We're in a market where the yield curve continues to move around and we're seeing greater differentiation across the credit markets. That volatility and dispersion creates opportunities for active managers who can be nimble around both the yield curve and also security selection.