The Quarterly Big MAC Letter

Multi Asset Credit Outlook

Overview

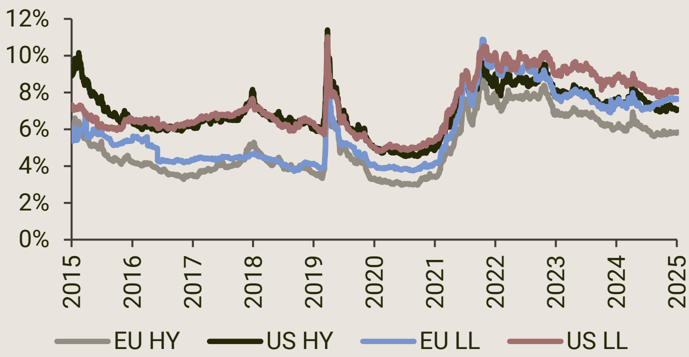
- **Macro picture broadly supportive for credit:** Growth remains positive and inflation continue to ease, supporting a benign default outlook. However, tighter spreads and elevated valuations imply reduced upside price convexity and a narrower margin for error, increasing sensitivity to volatility, policy shifts and idiosyncratic risk.
- **Return drivers shifting to dispersion:** With limited scope for further spread compression, expected returns are increasingly driven by carry, relative valuation and rating-level divergence, placing greater emphasis on security selection and capital structure positioning.
- **Relative value favours Europe:** European credit, particularly single-B high yield, leveraged loans and structured credit, continues to exhibit comparatively greater valuation headroom on a default-adjusted basis (DAS), while U.S. high yield spreads appear less attractive following pronounced DAS tightening.

Market Backdrop

The investment environment entering 2026 remains constructive from a macro perspective, with consensus growth of around 2% in the U.S. and 1.4% in Europe, supported by easing inflation, stable labour markets and an expected medium-term fiscal-driven growth acceleration in Germany driven by infrastructure and defence spending. These conditions underpin a benign default outlook and limit downside macro risk, but are increasingly reflected in market pricing amid elevated political and geopolitical uncertainty across Europe and the U.S.

In parallel, the emerging “Donroe Doctrine” (Monroe 2.0), marked by a more assertive U.S. posture across the Western Hemisphere and renewed strategic attention on Greenland, adds to global geopolitical uncertainty and has the potential to strain relations with EU-NATO allies.

Historic Yield Development

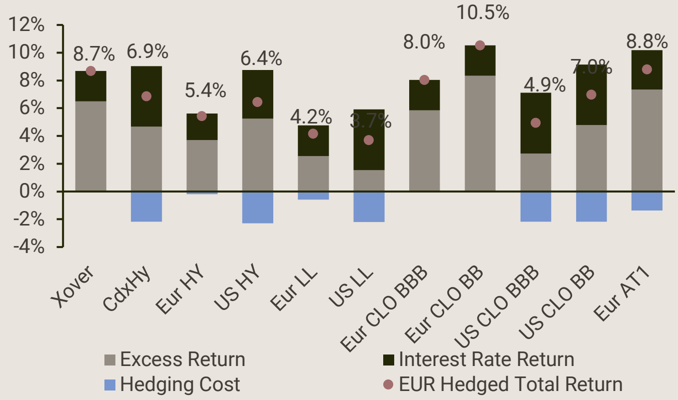


Source: ICE BofA Indices for High Yield bond data; S&P UBS Indices for Leveraged Loan data. Data as of 31 December 2025.

At the same time, financial markets signal higher sensitivity to tail risks: equity valuations, particularly in large-cap technology, appear rich by historical standards, implied volatility remains elevated relative to historical averages, and rising public-debt burdens in countries such as France, the U.S. and the UK warrant close monitoring.

Near-term U.S. rate expectations are increasingly shaped by uncertainty surrounding the appointment of a new Fed Chair and the perception of political influence, while long-term yields remain driven by inflation dynamics and term premia.

2025 Cross Assets Returns



Source: Capital Four calculations based on ICE BofA and S&P UBS indices. Returns shown are euro-hedged.

Credit Market Drivers

Credit Markets continue to consolidate within a technically supportive environment, underpinned by ample liquidity, easing inflation trends and a measured policy stance from central banks.

From a credit-market perspective, dispersion has increased meaningfully within leveraged loans, most visibly at the lower end of the rating spectrum, where CLO mechanics have driven forced selling of B- and CCC-rated exposures, weighing on secondary prices and contributing to par erosion in CLO portolios. By contrast, CLO demand for leveraged loans remains robust in the B1/B2 segment, supported by ongoing new CLO formation.

In parallel, pockets of stress are emerging within U.S. private credit, where BDCs continue to trade at discounts to NAV amid concerns around valuation transparency and over-leveraged capital structures, as highlighted by recent defaults such as First Brands and Tricolor. While this has weighed on sentiment toward lower-quality risk, relative value opportunities remain in select middle-market private credits with more conservative leverage, healthy equity cushions, and stronger documentation, particularly where issuers are too small to access the broadly syndicated loan market.

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Beyond structure- and flow-driven effects, dispersion is also evident at the fundamental level, most notably across cyclical industries, including chemicals, autos, packaging, and consumer-related sectors, where margin pressure and limited pricing power continue to weigh on credit performance.

In aggregate yield terms, leveraged loan yields remain elevated, with European and U.S. markets offering approximately 6.6% and 7.6%, respectively (c.6.4% on a euro-hedged basis).

Issuance conditions continue to support leveraged-finance issuance, with banks having underwritten approximately $65bn of LBO-related debt for 2026 and around €16.5bn of new-money supply across European loans and high yield. The European M&A pipeline is the strongest since 2021, with transactions expected to clear at tighter spreads than in 2025, underscoring resilient investor demand with issuance momentum already evident in early 2026.

After several years of contraction, the European high-yield and leveraged loan markets are again expanding, driven by a pickup in new issuance. Rating migration dynamics have turned more supportive, with rising stars outnumbering fallen angels in 2025, but new issue HY activity has contributed to net market growth. We expect this trend to persist into 2026, with continued issuance-led expansion, particularly in leveraged loans, where activity is expected to outpace high yield, consistent with recent primary-market trends.

Default Outlook

The Multi-Asset Credit (MAC) continues to signal a supportive backdrop for corporate credit, integrating default-loss projections, cross-asset valuation analysis, and a dynamic asset-allocation overlay to assess relative risk-adjusted return potential across credit markets.

Within the framework, realised macroeconomic inputs are translated into a derived macro signal, which is subsequently mapped into forward-looking default expectations. The current signal for both Europe and the U.S. under the base-case scenario, the model estimates annualised three-year-ahead default probabilities of approximately 1.6% for European high yield and 2.4% for U.S. high yield. Leveraged loans are screening higher at around 3.1% in Europe and 3.2% in the U.S. consistent with broadly stable underlying corporate fundamentals.

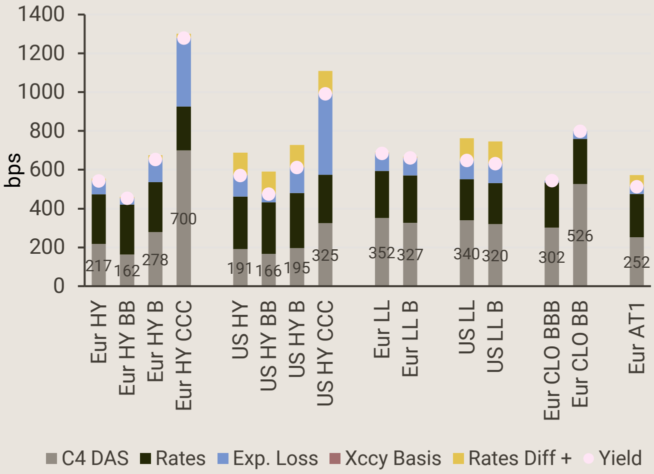
Relative Value and Strategic Allocation Outlook

These European credits continue to offer a favorable relative-value profile versus the U.S., particularly within single-B cohort, where spreads remain materially wider despite lower expected default risk.

Our asset-allocation framework, based on a constant-risk budget, continues to favor European leveraged loans and CLO tranches, alongside a selective allocation to European single-B high yield. This is complemented by a pronounced underweight in U.S. high yield, reflecting less attractive DAS following spread tightening into year-end and more limited remaining valuation upside. Select opportunities may arise within CCC-rated credits following underperformance in 2025; however, exposures remain highly selective given elevated idiosyncratic risk and asymmetric downside at this rating level.

Overall, we enter 2026 with a constructive but selective stance, emphasizing asset-class and rating-level positioning rather than broad beta exposure, as relative value and disciplined issuer and capital-structure selection are expected to be the primary drivers of credit returns.

Excess Spread Comparison



Source: Capital Four calculations based on ICE BofA High Yield and S&P UBS Leveraged Loan indices. Excess spread components reflect Capital Four's proprietary default-adjusted and euro-hedged methodology. As of December 2025.

C4 DAS: Capital Four Default Adjusted Spread

Source: Capital Four, ICE BofA, S&P UBS, JP Morgan. As of October 30, 2025. For illustration purposes only.

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High Yield	Leveraged Loans	Multi-Asset Credit	Structured Credit	Private Credit
Since 2001 €5.1bn AuM	Since 2013 €6.8bn AuM	Since 2010 €3.2bn AuM	Since 2019 €0.6bn AuM**	Since 2015 €8.0bn AuM

Notes

* As of September 2025.
** Includes structured credit assets under management in multi-asset credit funds and mandates

Disclaimers