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EYE ON THE MARKET
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Global High Yield: Strategies for a Shifting Market

Global high yield continues to be a credible source of income and diversification in today's environment—but broad market beta is unlikely to deliver outsized returns, making security selection and disciplined positioning paramount.

Global credit market investors are navigating a landscape defined by diverging growth paths, evolving policy stances and shifting investor sentiment. In the US, growth has moderated but continues to exceed forecasts, allowing the Federal Reserve (Fed) to begin easing monetary policy—though this "Goldilocks" mix introduces uncertainty regarding the pace and magnitude of future cuts. Risk appetite is improving as recession concerns fade, and markets seem comfortable that even with some moderation, tailwinds remain. In Europe, the recovery looks more uneven. While overall momentum is the strongest in years, certain regions and sectors—most notably German industrials—continue to face strong headwinds, and the European Central Bank (ECB) has signaled a pause in rate adjustments.

Amid these crosscurrents, global high yield bonds have held up well. Flows into global high yield bonds remain strong, particularly in the US, reflecting confidence in the asset class and persistent demand for yield. Importantly, yields are still attractive relative to history, reinforcing that this is very much a carry-driven environment where income continues to be a key source of return.

Figure 1: High Yield Has Outperformed More Rate-Sensitive Asset Classes

Sources: "Global High Yield": ICE BofA Non-Financial Developed Markets High Yield Constrained Index (HNDC); "Global Senior Secured Bonds": ICE BofA BB-B Global High Yield Secured Bond Index (HW4S); "Global Loans": Credit Suisse Global Leveraged Loan Index; "Global IG Corp": ICE BofA Global Corporate Index (G0BC); "EM Sov": JP Morgan EMBI Global Diversified Index; "Global Gov Bonds": ICE BofA Global Government Index (W0G1); "US Treasuries": Bloomberg US Treasury Index (LUATTRUU). As of September 30, 2025.

Improving Fundamentals with Pockets of Dispersion

Global high yield fundamentals continue to improve. Recent earnings trends show mid single-digit year-over-year growth in both revenue and EBITDA, signaling a steady climb out of the soft patch seen from late 2022 into early 2024. Capital spending has been measured, underscoring issuer discipline. Net leverage, too, is stable to improving, at roughly 3.6x in the US and 3.3x in Europe[1]. Reflecting the healthy fundamental picture, the market's credit quality is high—BBs now account for almost 60% of the global high yield bond market, compared to around 40% a decade ago[2]. This stable backdrop has kept the default outlook relatively benign, with bond defaults likely to remain below long-term averages in both the US and Europe[3].

That said, the picture is not completely uniform. In the US, the effects of the "two-speed" economy are increasingly evident. On one side are sectors that are holding up well, supported by strong demand and pricing power. Unlike equities, global high yield does not have large-cap tech companies whose AI driven capex dominates index performance. Still, the ripple effects of AI investment are visible in adjacent areas—such as certain utilities and tech/communications issuers—which is creating select opportunities. On the other side, deep cyclicals like chemicals and housing remain under pressure and will rely on lower financing costs to meaningfully unlock demand. Consumer dynamics add another layer of complexity. Signs of strain among lower-end consumers persist, while the top 10% now account for nearly half of US consumption[4]. For credit investors, this dispersion underscores the importance of distinguishing issuers exposed to discretionary, lower income demand from those serving more resilient, higher income or essential services segments.

In Europe, the story is slightly different, in that the market is heavily skewed toward non-cyclical companies with fairly predictable business models. While there are pockets of cyclicality—such as a small portion of automotive and health care names that are currently under pressure—these segments account for only a fraction of the overall market. As a result, periods of volatility or sector-specific stress tend to be contained, allowing investors to navigate the opportunity set with greater clarity and selectivity.

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Breaking Down the Opportunity

In the current environment, global high yield bonds look particularly attractive for their strong coupon-driven income and short duration (roughly 3 years). This combination provides significant downside buffers in a world where spreads are tight, and the direction of rates is favorable but not guaranteed—presenting an opportunity to achieve strong total returns over the next couple of years. In the US, single-B credits stand out as a segment where careful credit selection can add incremental value, supported by stable fundamentals and a deep, liquid opportunity set. Lower rated CCC bonds have rallied at points this year, but dispersion in that segment of the market makes selectivity and rigorous, bottom-up analysis essential.

Key Takeaway

High yield continues to be a credible source of income and diversification in today's environment. However, broad market beta is unlikely to deliver outsized returns, making security selection and disciplined positioning paramount. The most durable outcomes will come from identifying idiosyncratic catalysts, avoiding problem credits, and capitalizing on technical mispricings. With fundamentals improving at the margin, selective policy tailwinds in place, and technicals creating dispersion, active management is essential. Going forward, maintaining a balanced allocation across regions and markets will be key to preserving carry while keeping the flexibility to add risk during pullbacks.

Source:

1. CreditSights. Representing high yield bond markets. As of June 30, 2025.
2. ICE BofA; Barings. As of September 30, 2025.
3. ICE BofA; UBS. As of September 30, 2025.
4. Moody's; US Federal Reserve. As of June 30, 2025.

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Physical AI is about to reshape the world

Physical artificial intelligence (AI), the convergence of robotics and AI, is here. With autonomous vehicles and industrial automation moving into mainstream adoption, Matt Cioppa, Portfolio Manager and Research Analyst from Franklin Equity Group explains why this could represent a generational opportunity for long-term investors in the technology sector.

Physical AI isn't coming, it's here

Physical AI—the convergence of robotics and artificial intelligence—is no longer a theoretical concept. It's a rapidly scaling force reshaping how machines interact with the physical world. From autonomous vehicles and robotic surgery to smart factories and logistics, physical AI is unlocking new levels of precision, adaptability and efficiency.

Physical AI is seen as a foundational technology with the potential to transform multi-trilliondollar industries. Its impact will be measured not only in productivity gains, cost savings and margin expansion, but also by establishing a new paradigm for how technology becomes infused on the physical world.

What is physical AI?

Physical AI refers to intelligent systems that can perceive, reason and act in real-world environments. These systems combine advanced robotics with AI models, enabling machines to make decisions and execute tasks with speed and precision—often in milliseconds.

Unlike traditional AI, which operates in digital environments, physical AI translates code into real-world motion. These systems are equipped with sensors, actuators and edge computing capabilities that allow them to adapt dynamically to changing conditions. The result — machines that can operate autonomously in complex, unstructured settings.

Why it matters now?

Physical AI is moving from early-stage experimentation to real-world deployment, and it's already delivering measurable value. A few examples include:

- Mobility: Powering the shift toward autonomous transportation
- Manufacturing: Enhancing productivity and reducing waste
- Service economy: Addressing labor shortages and improving quality of life

As adoption accelerates, it's expected physical AI to become a core enabler of operational efficiency, safety and scalability across the global economy. Consider three industries already seeing meaningful value-generation driven by physical AI.

Mobility: autonomous vehicles drive multi-trillion-dollar shift

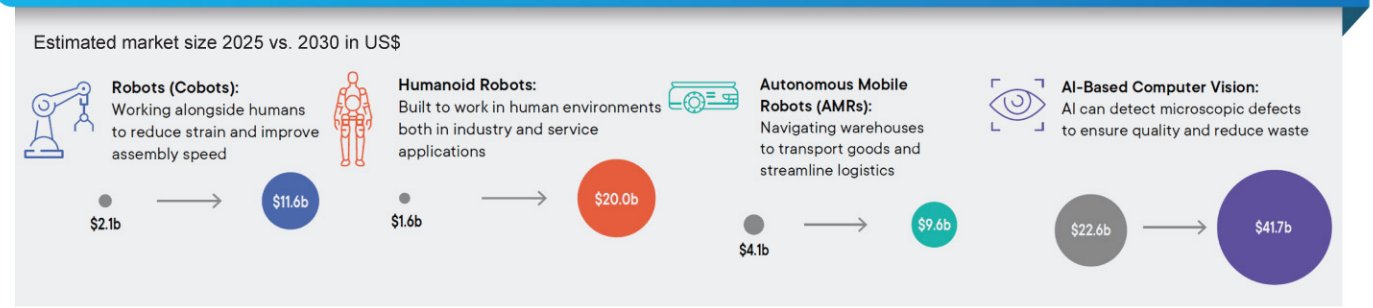
Autonomous driving is one of the most visible—and investable—applications of physical AI. In the United States, ride-hailing platforms have logged over 100 million fully driverless miles in cities like San Francisco, Phoenix and Austin. In China, over 14 million robotaxi rides have been completed across 16 cities.[1] In some markets, consumers have even shown a willingness to pay a premium for an autonomous ride versus a traditional rideshare with a driver, and high customer satisfaction scores imply a high likelihood of further adoption. Safety was long promised as a key element of the value proposition for autonomous vehicles, but there is now data to back it up; in one study, a leading service provider noted significantly lower crash rates relative to human drivers.

By 2030, Level 3 autonomous vehicles (AV) could account for 10% of global new car sales.[2] Under accelerated adoption scenarios, autonomous driving passenger revenues could be between US$300-US$400 billion by 2035.[3] This shift will also drive demand across the AV ecosystem—from semiconductors and edge computing to mapping, insurance analytics and software-defined vehicles.

Manufacturing: AI-driven efficiency as a competitive advantage

Physical AI is radically transforming manufacturing by embedding intelligence into every stage of production. Investors think four key areas of innovation stand out: humanoid robots, collaborative robots (Cobots), autonomous mobile robots (AMRs), and AI-based computer vision.

Figure 1: Market Growth Next Five Years



Source: Grand View Research. May 30, 2025. Collaborative Robot Market Size, Share & Trends Analysis by Payload Capacity (Up To 5kg, Up To 10kg, above 10kg), Autonomous Mobile Robots Market Size, Share & Trends Analysis and Machine Vision Market Size, Share & Trends Analysis Report. There is no assurance that any estimate, forecast or projection will be realized. Source for 2030 total addressable market for humanoid robots is Franklin Templeton analysis.

Humanoid robots, which are designed to mimic human appearance and behavior, represent a new and promising iteration of autonomous physical systems. While they're in the very early stages of adoption, humanoids are already being deployed in manufacturing facilities. The humanoid form factor is ideal for operating in complex environments that were built for human workers. Increasingly, they are powered by purpose-built AI models known as visionlanguage-action (VLA) models, which enable the robots to better understand their environment and have a more generalizable, rather than task-specific, skill set.

These new technologies will improve safety, profit margins, and factory yield. Potential beneficiaries span the value chain, from robotics and vision-system providers to semiconductor and AI software firms that are building the "brain" for robots.

The investment case for physical AI

It's believed physical AI will be a cornerstone of the next industrial era. It represents the convergence of automation, edge computing, AI and digital transformation, and we believe it will create a generational opportunity for long-term investors in the technology sector.

As adoption scales, it's expected to see:

- Recurring revenue models (e.g., per-mile and subscription AV services, robot hardware leases plus software and services)
- Cross-sector demand (health care, logistics, manufacturing, retail)
- Ecosystem growth (hardware, software, data infrastructure)

Physical AI is not just a technological evolution—it's a paradigm shift in how machines interact with the world. It's believed it can offer long-term investors durable growth and differentiated source of long-term alpha.

Source:

1. The Robot Report. July 18, 2025. Waymo reaches 100M fully autonomous miles across all deployments.
2. Goldman Sachs, August 19, 2024. Partially autonomous cars forecast to comprise 10% of new vehicle sales by 2030. There is no assurance that any estimate, forecast or projection will be realized.
3. McKinsey and Company. January 3, 2023. Autonomous driving's future: Convenient and connected. Level 3 autonomous vehicles (L3 AVs), as defined by the SAE International (J3016) automation scale, are "conditionally automated" driving systems. It can handle all aspects of the driving task in certain conditions but must be available to take over when requested by the vehicle. There is no assurance that any estimate, forecast or projection will be realized.

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