

Talking Heads podcast with Stef Abelli

Chris Iggo: Hello and welcome to the BNP Paribas Asset Management Talking Heads podcast. Every week, Talking Heads will bring you in-depth insights and analysis of the topics that really matter to investors. In this episode, we'll be discussing the state of play and the outlook for the high-yield market. I'm Chris Iggo, Chief Investment Officer, AXA IM Core, part of BNP Paribas Asset Management, and today I'm joined by Stef Abelli, who's a Portfolio Manager in the Euro high-yield credit team at BNP Paribas Asset Management. Welcome, Stef, and thanks for joining me today.

Stef Abelli: Pleasure to be here.

CI: Let's think about the outlook for high-yield in 2026. Investors are looking at spreads which are close to historic lows and therefore some may think that the extra return for taking risk has diminished. So, in your view, why should people still invest in high-yield short duration products today?

SA: Risk is lower for many reasons given the quality of the index and the short horizon as well as the ability to invest in the lower part of the capital structure of investment-grade companies. The index overweights double B rated bonds, so higher quality has a meaningful presence. Active management may increase significantly the carry, for instance, by including off-benchmark positions in financials.

Consider that the index's effective duration of 1-1/2 years acts as a shield from the vagaries of the market. While expectations flipflop on rates every week, this product will keep you insulated. This could be an important consideration for an investor that wants to diversify her portfolio with an allocation to this asset class.

Last but not least, this is a product that is inherently less volatile as we approach refinancing.

CI: Just to be clear, when we talk about short duration, what type of maturity bonds are we investing in?

SA: It's well below five years. With a duration of around two, two and a half years maximum, investors often worry about defaults in high-yield and defaults have been running at low levels.

CI: Is an increase in default rates a genuine concern for investors?

SA: Well, not really. We have seen defaults continuing to be quite subdued. The real risk is always the potential deterioration of a certain credit and the associated decline of the price of the bond. The key isn't avoiding risk, it's avoiding marginal credits with shaky fundamentals, which is what we do.

CI: There's been some disruption to the issues of software companies, particularly in the US high-yield market. How much is this affecting the European market?

SA: It's a really relevant question, Chris. Perhaps it would be helpful to know that in the European high-yield situation, the technology and electronic sector is a tiny amount, and of this, software is just a part. As such, it does not represent a significant concern. Clearly, there's been a certain amount of

overreaction in the market. I would say when the dust settles, it will be clear that there are simply winners and losers.

CI: Do you think there'll be more issuance from these types of companies in the year ahead?

SA: Absolutely. For sure, the winners will be able to reassess the market. Last year was a good year for the European high-yield market. The short duration side returns were well above 5%. We saw some decline in the overall level of yield and the tightening of spreads.

CI: What do you expect for 2026?

SA: I would expect noise just as in 2025, we'll likely see high volatility due to geopolitics, uncertain central bank moves and specific sector concerns. At the moment, it's AI and the software sector. I am, however, constructive on the European growth picture. Volatility would actually be welcome as it always allows us to capture opportunities and create more value for investors.

Credit quality, as I said, continues to be high; liquidity as well. Therefore, it's overall a quite protective bunch of metrics that we're looking at. Technicals remain incredibly strong with continuous inflows into the asset class. From a strategy perspective, given the tighter average spread and higher dispersion and expected volatility, this is a year for expert credit pickers rather than index trackers.

CI: Well, that all sounds very positive. When you look at the markets today, which sectors do you like and which sectors are you looking to avoid?

SA: This is always a really exciting question for me because it allows me to describe my conviction. My conviction list includes financials, real estate, healthcare, anything tied to defence and infrastructure budget tailwinds, think satellites, for instance.

When I talk about financials, European banking is viewed as being in a positive phase in which it will benefit from structural and macro factors and potentially even AI efficiency gains. I like to overweight European financials as they are high-quality plays with relatively higher coupons.

Real estate is enjoying a continued strong recovery. This sector is quite diversified across residential, logistics, retail and offices, with offices being obviously in the later stage of the recovery.

Healthcare benefits from supportive demographic and continues to be a pillar of the strategy while avoiding part of the sector that due to government budget constraints are more stretched.

We continue to be underweight consumer, both cyclical and even non-cyclical, as counterintuitively, non-cyclical consumer has a stronger link with the lower part of the economy and it has been more affected by the high inflation we have experienced. I'm also underweight utilities and industrial cyclicals.

CI: Obviously, interest rates are low, and we expect them to remain low for the foreseeable future, so high-yield is attractive. Do you expect to see continued strong demand from investors?

SA: Yes, I would say so. Investors are looking for yield wherever they can get it. And the asset class has matured enough to be more and more attractive to a wider range of investors.

CI: Well, with a good macro backdrop and an attractive yield, it should continue to be an attractive strategy. Thanks very much for joining me today.

SA: Pleasure.

CI: That's it for this week's Talking Heads. If you would like to learn more about our investment insights, please reach out to your BNP Paribas Asset Management contact or check out Viewpoint, our website for investment insights at viewpoint.bnpparibas-am.com. We recommend subscribing to Talking Heads on your favourite podcast channel such as YouTube or Spotify. You receive your podcast episodes every week. If you like Talking Heads, then please leave us a positive review and a nice rating. You've been listening to the BNP Paribas Asset Management Talking Heads podcast with me, Chris Iggo, and Stef Abelli from our European high-yield team. Please do join us again on Talking Heads next week. Until then, take care.