

Market View

by Sergio Grasso



Get sun in the summer and financial credit where it is due

As we approach the end of July, the European high-yield (HY) market has remained remarkably active over the past two months. A broad range of transactions—including refinancings, new money deals, taps, and add-ons done privately—have found a home with surprising ease. What stands out most is the aggressive pricing: many deals have priced well inside initial price talks (IPTs) and, more worryingly, well inside where the underlying credit fundamentals-or ratings- would reasonably suggest.

This continues to highlight a broader trend I've pointed out before: high yield risk premiums have compressed excessively (inside 300 in OAS and tighter than January), while the amount of risk being taken on across credit books appears to be rising. The result is a deeply distorted risk/return profile—where investors are being compensated less for taking on more risk.

While the precise origins of the mispricing are always complex, I believe—once again—that a key driver remains “the CLO bid”. The mechanical demand from CLOs, which need eligible paper to fill asset pools, is pushing spreads tighter regardless of credit merits. This creates a structural and technical force in the market that contributes to systematic underpricing of risk. Compounding this, conventional measures of risk (spread levels, volatility, distress ratios, or default rates,) are currently low, giving market participants a false sense of safety.



This has encouraged a broader sense of over-optimism, especially in HY credit, where this illusion of safety has caused many to overlook the underlying fragility. Investors are not being adequately compensated for the tail risks they're absorbing.

The CLO arbitrage is becoming the only hurdle to further asset prices tightening.

The consequence of this broadly shared misjudgment – fueled, also, by the inflows coming from US investors after several years of outflows from Europe during the controversial era of quantitative easing– is increasing systemic fragility, which only becomes visible ex-post. When defaults occur or sentiment turns, these mispriced risks become evident. We've already seen this play out across a number of weak credits that were bought at prices well above their ultimate recovery values. These positions have inflicted notable losses on portfolios and serve as cautionary examples. I won't name, obviously, specific credits, but Europe offers no shortage of high-profile busts and misjudged situations—cases where misplaced confidence in "cheap" securities has resulted in near-total capital loss. Many managers, even good ones, believed they were buying cheap assets with upside (example the SUNs), only to end up holding paper worth zero—or close to it. The market rarely delivers these lessons gently.

A mispriced market isn't inherently problematic if the majority of market participants are aware of it.

The rise of creditor-on-creditor violence, drop-downs, and up-tier transactions has made it increasingly difficult to position portfolios around stressed events or liability management exercises (LMEs), often resulting in outcomes that fall short of initial assumptions and recovery expectations. Private equities' willingness to negotiate with select creditor groups while excluding others has often led to transactions that leave sidelined investors dissatisfied and seeking recourse through litigation.

Creditors have entered into “cooperation agreements” for multiple reasons—chiefly to counteract pressure from aggressive shareholders and to position themselves alongside dominant players (based on size, not on knowledge) in the capital structure.

Let's pause it for now.

What are the critical considerations and evidentiary points that should be emphasized today?

Yield Demand Driving Strategic Duration Extension

The relentless search for yield continues to shape the issuance behavior, with corporates leveraging favorable market conditions to extend liability maturities. This trend, started in H2 2024, has intensified, particularly in the 5.5–7.5-year segment, now the most active part of the European curve. Issuance volumes in this cohort are up 20% year-on-year, underscoring investors' comfort with longer duration risk. Notably, the credit spread differential between short and medium maturities remains negligible in many sectors, supported by a stable rates environment and a mildly upward-sloping swap curve. In terms of overall activity, 2025 is increasingly comparable to 2021, a benchmark year for issuance and market depth. In the European high-yield space, the refinancing activity has effectively dismantled the previous “maturity wall”, eliminating what was once a structural risk. This shift has reduced refinancing pressure and speculation around default risk, contributing to tighter spreads across the curve.

The persistent yield-driven environment has led to a notable rise in dividend recapitalizations, as shareholders take advantage of strong market demand and favorable conditions to extract cash via leveraged structures — often opting for maturities with long tenors. Urbaser and TeamSystem provide timely examples of how this trend is playing out in the market.

Credit Segmentation Defines Market Access

Issuer behavior remains sharply segmented by credit quality. BB rated corporates maintain a clear preference for the bond market, capitalizing on attractive spreads and strong technical support to secure long-term funding. In contrast, lower-rated issuers are increasingly turning to the leveraged loan market, drawn by resilient CLO demand, tighter execution levels, and greater structural flexibility. Put differently, in bullish loan market conditions, credit spreads tend to compress, clustering even weaker credit names within a 50-75bps range of the highest-quality issuers (...we have B/B2 borrowers at E+325!!). Additionally, short non-call periods provide borrowers with the option to refinance opportunistically. These features make loans particularly appealing for lower-rated credits seeking to optimize their fragile capital structures without sacrificing optionality. By turning to the loan market, financially weaker and cash flow-negative companies were able to reduce financing costs by approximately 2% relative to the fixed-income bond market.

The new-issue premium for debut issuers (inaugural names or borrowers coming from banks or private credit loans) remains low by historical standards. The investors seeking bargains have, by and large, come away empty-handed or dissatisfied.

Despite the higher inherent risk, investor demand for unsecured debt remains notably active. After a subdued Q1, unsecured issuance saw a meaningful rebound in Q2 2025 — reflecting not only a sustained appetite for yield across the credit spectrum but, in some cases, a willingness to underwrite risk beyond what a purely constructive outlook would justify (in my point of view this warrants criticism and deserves open discussion).

Loan and Bond Markets See Pricing Convergence

A striking development over recent months has been the narrowing pricing differential between HY loans and bonds.



In many cases, the all-in yield of the two instruments has converged to within marginal basis points, prompting issuers to weigh structural considerations — such as covenant packages, liquidity, and investor base — more heavily than pricing alone. This convergence reflects the depth and competitiveness of both markets and suggests a “maturing cycle” where credit selection and relative positioning are relevant for credit books. Departing from the usual discretion around issuer names, the recent Froneri and Urbaser transactions are worth highlighting as clear examples of how the loan and bond markets increasingly interact — directly influencing each other's pricing dynamics. **This helps explain why many European buysiders struggle to fully understand the price formation of certain securities**, as cross-market interactions increasingly blur traditional valuation anchors. Yield disappointments for investors, in many cases, reflect not only a mispricing of risk, but rather a limited understanding of the forces at play driving the credit market. It can also be seen as an overreliance on outdated experience from a time when the European HY bond market was a third of its current size.

U.S. Issuers Increasingly Accessing European Capital Market

Another defining trend is the growing presence of U.S.-based borrowers in the European credit market. Drawn by persistent investor demand and favorable pricing dynamics, cross-border issuance has picked up meaningfully in recent months. For U.S. corporates, Europe continues to offer a deep, receptive investor base, particularly in the face of more expensive conditions in the domestic market.

Securitisation Regulation Revamp in Europe

Recent proposals and consultations from the European Commission introduce **important innovations in the regulatory treatment of asset-backed securities (ABS)**,

particularly concerning capital requirements for banks and insurers. These developments signal the potential for substantial reform. If enacted as outlined (and there is still ample room to go and to refine), the measures could markedly stimulate securitisation activity across Europe. The European securitisation market, which has remained significantly constrained since the 2008 Global Financial Crisis, could easily exceed €1,5 trillion in volume over the coming years. In the aftermath of the crisis the confidence of issuers, investors and regulators in ABS markets plummeted. This loss of trust triggered a sharp decline in issuance and investment in the Old Continent.

Now is the time to reassess the role of securitisation in capital markets—as a channel for funding, risk-sharing, and economic growth (see European Commission: “The future of European competitiveness Part B, in-depth analysis and recommendations”, document of September 2024). The objective should be to foster a more robust, transparent, and efficient securitisation framework that supports the issuers (banks account for the lion’s share of SRT volumes) and expands the investor base.

The SRT (Significant Risk Transfer) criteria and the STS (Simple, Transparent, and Standardised) framework have the potential to serve as pivotal levers for transformative change in the prudential treatment of securitisations. To fully realize their potential without compromising financial stability, it is essential that they be harmonized with broader regulatory components—examples could include the approaches to Risk-Weighted Asset (RWA) calculations (I can mention for instance the concept of risk-sensitive risk weight), the application of the “p-factor”, and the implementation of the output floor. **The regulation lies behind the growth of the market.**

Over two years ago, I argued that ABS products merited inclusion in diversified portfolios based on their risk-return profile that could be adapted to any strategy and risk appetite (the underlying assets span diverse types, qualities and cash flows).

That view remains valid and increasingly pressing for many credit managers and not only for global asset-based investors. The volumes have been rising steadily. Recent developments in the United Kingdom—particularly insurers' interest in transactions involving matching adjustment (MA)-compliant securitisation assets, such as the recent Middle Market CLO managed by Ares—may act as a catalyst for broader issuance of MA-compliant public securitisations across a range of asset classes.

European regulators would do well to follow the UK's lead, and, as I wrote, there is a lot that needs to be done on the bank side and on Solvency II.

Together with banks and insurers, investors should begin preparing their portfolios (and advising clients) accordingly, to seize the emerging opportunity set in this space. The evolution of structured products—once limited to institutional markets—is accelerating. Just as ETFs helped “democratize” access to the asset class previously reserved for large and professional players (I still do not know if this is 100% fine or demands scrutiny), structured products have the potential to deliver value for wise investors who can read the present and adapt to the future. **The asset-based finance market encompasses a range of products originated through various structures, many of which offer compelling features beyond those found in the increasingly commoditized and homogeneous CLO space.**

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