

Interconnections and Divergences

My core assumption is the persistence of excess liquidity in the system.

I have consistently emphasized that this backdrop sustains investors' risk appetite, encouraging continued capital deployment across sovereign bonds and credit markets and, as far as the latter is concerned, contributing to persistent divergences and risk-taking, particularly in lower-rated borrowers and more contentious issuers. In leveraged loans, another niche sector in capital markets, the dominance of CLOs as structural buyers, creates a persistent technical bid that distorts pricing away from underlying credit fundamentals.

Volatility is not simply rising or falling across the spectrum; it is becoming increasingly selective. On the surface, credit indices appear calm, spreads remain contained, risk premia compressed, and credit spread curves notably flat across both high yield market and ABS tranches in the capital structures. Yet beneath this apparent stability, dispersion is widening materially across sectors, issuers, and ABS papers. European private markets, for instance, have entered what I would define as a "second phase or 2.0," characterized by growing differentiation across investment platforms, alongside a steady flow of negative headlines and new surprises. This is not equilibrium—it is a masking effect.

Credit portfolio managers can no longer afford to remain "siloes" (I take this definition from the difficult situation of the UK bridge lender Market Financial Solutions, placed into administration since 25th of February).

Analyzing private credit as an example (but I could have started from a different asset class), the assumption that stress can remain contained is becoming increasingly fragile. Cross-market linkages between private funds, asset pools, bank portfolios, and public markets is deepening, raising the risk of contagion—particularly in a downturn (the ECB is looking at those matters very closely). "Disturbances" originating in a single, systemically relevant asset class rarely remain idiosyncratic. When the affected segment is of sufficient scale or interconnectedness (and where retail is involved), stress propagates through multiple transmission channels, refinancing dynamics, and credit segmentation. Moreover, disruption in one or two industries can quickly propagate across others—automotive into transportation and auto parts, or real estate into building materials—highlighting clear cross-sector spillovers. Framing the discussion in terms of AI is ultimately reductive.

The transmission mechanism itself is also evolving. High-beta credits still tend to move first, but second-round effects are faster and less discriminating. Investment grade is no longer insulated when liquidity tightens and markets reprice; entire industries can widen in tandem, with limited differentiation across issuers. These dynamics are clearly observable within the sub-investment-grade complex, particularly in the European BB-rated cohort. CCC-rated credits have outperformed single-Bs so far this year, with the latter emerging as the laggards within the high-yield universe.

Some of the loudest concerns remain for the moment overstated. Credit spreads are still tight and, in aggregate, do not signal systemic stress. That disconnect in my view, is precisely the issue. What is being underpriced is not near-term default risk (what matters is not only the magnitude of defaults, but the timing of their emergence and the way they are distributed through the credit cycle), but the path dependency of liquidity and the role of correlation in the tails, wherever capital has been allocated. The result is a market that no longer moves in sync. Credit is increasingly decoupled from interest rates, equities, and even corporate or macro news flow. Government bonds, equities, and credit are increasingly prone to diverging under identical shocks, eroding the reliability of traditional cross-asset signals and sentiment indicators.

Capital markets do price uncertainty—but often in an uneven way, with lags that are no longer just timing mismatches but, increasingly, structural distortions.

I do think differentiation, coupled with a rethinking of credit, has shifted from “optional to essential” as the sole durable driver of alpha in a managed portfolio.

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