

## Spread Carry or Price Convexity

Strong fund flows continue to provide a solid technical backdrop for credit markets, with spreads remaining tight by historical standards despite a challenging macroeconomic environment. Although some analysts interpret the data as holding steady—many of whom had previously forecast that the Federal Reserve would remain on hold until Q1 2026—I see it as reflecting underlying weakness and uncertainty.

In European Investment Grade (IG), it remains relatively easy to justify exposure at current option-adjusted spread (OAS) levels around 80 basis points. Similar dynamics apply in the U.S., where IG spreads have remained below 80 basis points since early July. In contrast, the backdrop for High Yield appears less supportive, with a disappointing earnings season and widespread downward revisions to EBITDA forecasts weighing on fundamentals.

I take a different stance from the prevailing narrative.

As I've often pointed out, attractive all-in yields continue to draw investors interest—not only in floating-rate notes and loans used in CLO asset pools, but also in fixed-rate bonds across various sectors. Positive market sentiment remains largely unaffected by isolated, idiosyncratic events such as the challenges faced by First Brands, one of the largest manufacturers of automotive aftermarket parts. That said, the credit story is striking at first glance—from investors behavior (CLOs, public and private lenders) to rating agencies actions—and warrants close attention.

The lack of forward guidance from major central banks, as noted last week, has not discouraged investors from allocating capital to credit markets in both the U.S. and Europe. This is evident in both long-maturity deals—such as Oracle's recent \$18 billion bond issuance—and in tighter-spread HY placements in Europe. While Oracle's issuance clearly benefited from the broader AI narrative, the aggressive pricing of recent European HY names is harder to rationalize. Issuers such as Intralot, Ineos, Evoke, and Solenis—just to name a few—have all priced bonds at levels I consider very tight. Despite a less constructive fundamental backdrop, investor demand remains robust, suggesting that technical factors are firmly in the driver's seat.

With credit spread curves relatively flat, issuers are increasingly extending maturities beyond five years. Ineos recently issued a 5.5-year bond, taking advantage of the narrow OAS differentials between 4- and 7-year tenors. Similarly, Solenis returned to the market with a dual-currency bond maturing in 2033. This is a notable contrast to 2023, when the company struggled to allocate a five-year euro tranche at 9.625% to finance the Diversey acquisition. (At the time, I was constructive on the deal, despite prevailing market skepticism. However, I'm approaching the new issuance with greater caution) The drop in coupon from 9.625% to 6.125% over two years is striking.

Intralot, the Greek lottery and gaming technology provider with solid EBITDA margins, also priced two new senior secured notes (SSNs) due 2031—one at 6.75% fixed, and the other at E+450 in floating-rate format. However, the fixed yield appears somewhat misaligned with fair value, particularly when compared to EVOKE's recent issuance, which has underperformed in yield-to-worst, as I anticipated. While some yield disparity is justified due to distinct quality of P&L and geographic concentration, the difference seems overly pronounced.

In the case of Ineos, the entire credit spread curve appears unusually compressed—likely driven by technical factors rather than improving fundamentals.



This is evident from the pricing of its recent 2031 senior secured notes at 7.25%. Its earlier euro-denominated bond, issued in January, carried a 5.625% coupon for a five-year maturity. However, credit metrics have deteriorated over the same period—an evolution that, in principle, should command higher compensation for increased risk and cyclicalitv.

All the bonds mentioned above are yielding more than the European ICE BofA Single-B Index (approximately 5.6%). However, certain valuations appear stretched, suggesting that investors should exercise caution. A large balance sheet or leading market position does not necessarily offer downside protection, as the First Brands case clearly illustrates.

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