Multi-Sector Credit: High Yields, Big Opportunities in 2026

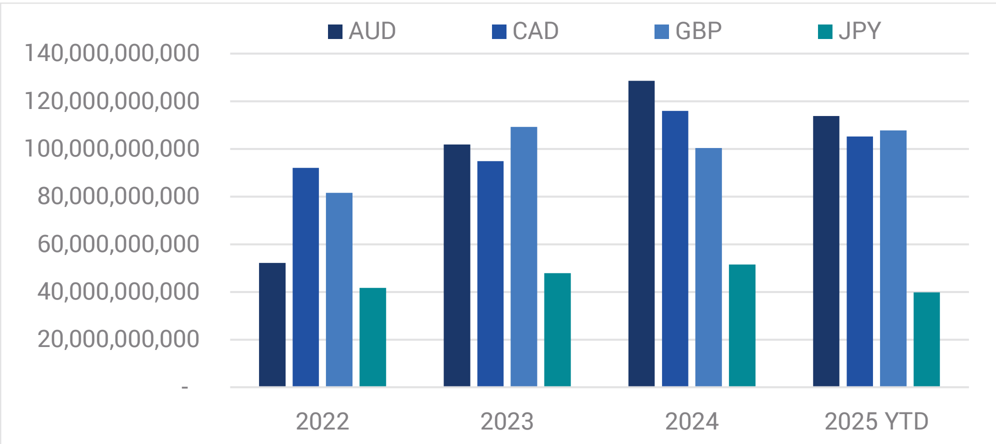
In 2026, investors can likely expect higher volatility associated with a maturing business cycle, especially in US equity markets. As that volatility nears the horizon, investors can benefit from a more optimal mix of active management focused on higher risk-adjusted returns.

By Phil Strano, Head of Australian Credit Research

Investors in our multi-sector credit portfolios have benefitted from de-dollarisation tailwinds through 2025, with the weakening of USD's reserve currency status driving greater allocations to $AUD fixed income which has meaningfully expanded what was already a large opportunity set.

In fact, the $AUD credit market has grown to now be the third largest primary issuance market in the world after the US and EUR; larger than the Canadian and UK credit markets (refer Chart 1). In particular, investors from the Asian region now represent a much larger share of the $AUD capital pool, comprising as much as 50% of bids in new primary bond issuance.

Chart 1. Primary Issuance – Credit ($AUD Equivalent)

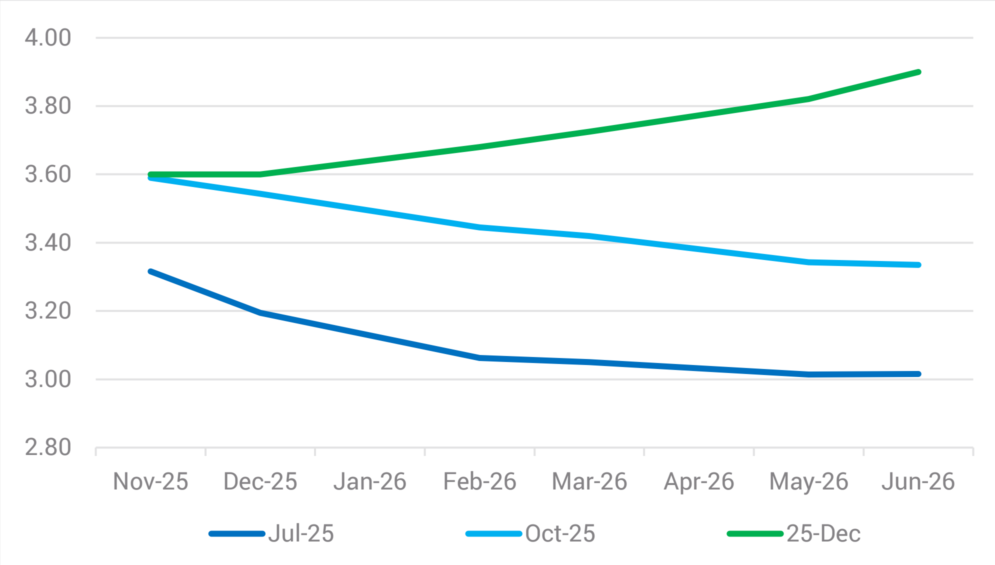


Source: YCM/Bloomberg – December 2025.

Sustainable higher running yields promotes attractive and defensive returns

As we approach 2026, the recent bond selloff bodes well for the maintenance of attractive running yields, with funding markets now expecting the RBA's next move will be to hike rates (refer Chart 2).

Chart 2. RBA Cash Rate Futures (%)



Source: Bloomberg – 31 October 2025.

Contrary to market consensus, we still expect modest easing in 2026, but with the RBA Cash Rate likely to remain at 3% or above through 2026. The corresponding running yield in our Yarra Higher Income Fund (HIF) should remain at ~6% and above. At those levels, we can expect HIF's running yield to provide a base for another year of attractive outperformance.

For many investors, it remains a case of *"choose your own adventure"*, with running yields not only underpinning attractive returns in 2026 but also continuing to provide a base for defensive income, with little likelihood of negative returns over the next 12 months.

For instance, on current portfolio settings, HIF could be expected to deliver positive returns in a recessionary environment and widening in credit spreads (refer Table 1).

Table 1. HIF – Scenario Analysis and Estimated Returns

	Severe recession	Mild recession	Soft landing	Trend growth
Projected 2026 running yield (avg)	6.20%	6.20%	6.20%	6.20%
Spread duration	3.40	3.40	3.40	3.40
Credit spreads	+1%	+0.5%	No Change	-0.30%
Interest rate duration	1.50	1.50	1.50	1.50
Interest rates	-1%	-0.5%	No Change	+0.30%
Estimated return	**4.30%**	**5.25%**	**6.20%**	**6.70%**

Source: YCM – December 2025.

While HIF is <u>not</u> an absolute return fund, it does exhibit some useful all-weather characteristics. As attested through the 'Liberation Day' risk-off event, HIF's strategic use of interest rate duration and credit default swaps protected the portfolio from losses, with a positive April 2025 performance of 65bps despite portfolio credit spreads widening by 22bps over the month. Given the preservation of high outright yields, applying similar tools to protect and enhance portfolio returns will remain a valid part of the approach in 2026.

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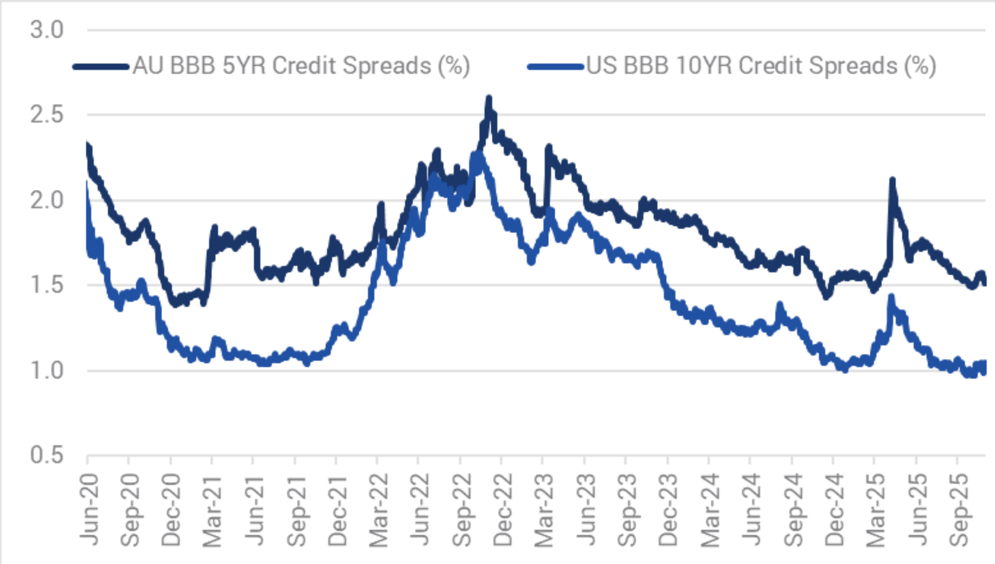
Australian market remains attractively priced

In terms of market pricing, current tight credit spreads are largely a US phenomenon, with credit spreads in Australia much better value than the US. Australian 5-year triple B corporate credit spreads still trade ~50bps wider of US 10-year triple Bs, with half the spread risk (refer Chart 3).

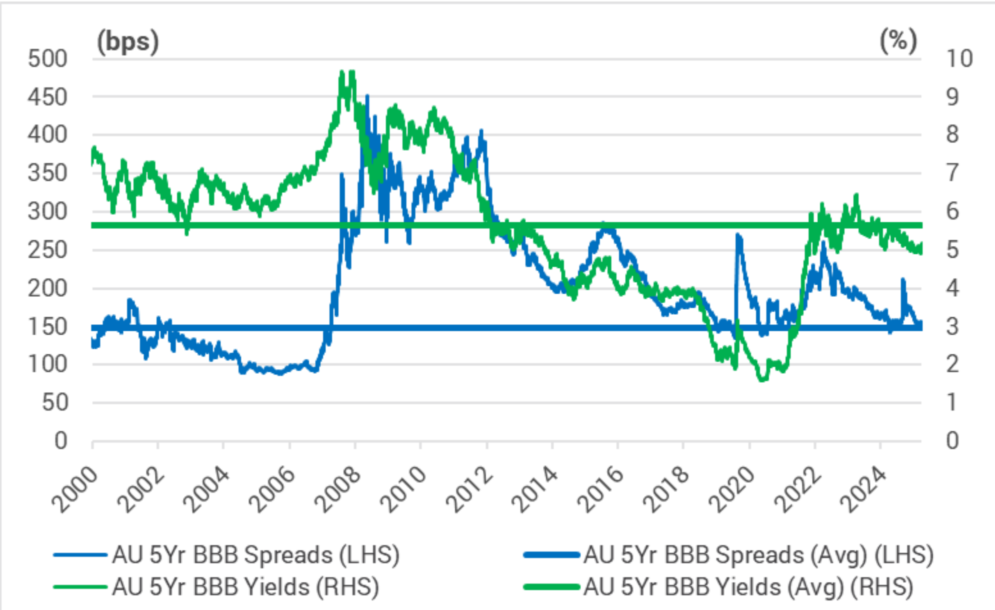
Chart 3. US/AU Credit Spreads to Bonds (%)



Source: YCM/Bloomberg – Dec 2025.

Moreover, in addition to representing better relative value, Australian credit is also trading at fair value in absolute terms, with both spreads and yields still at long term averages (refer Chart 4).

Chart 4. AU BBB Credit Spreads and Yields



Source: YCM/Bloomberg – Dec 2025.

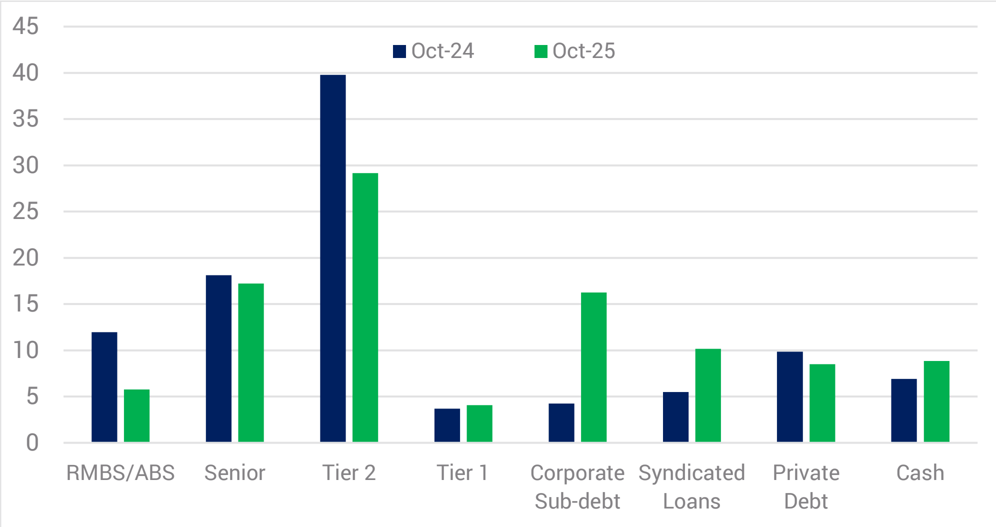
It is a similar story in parts of the private credit and leveraged (sub-investment grade) loan markets, with US loan spreads on equivalent BB and B-rated credits pricing 50-100bps tighter. While we elected not to participate, the recently completed Arnott's Group $US and $AUD TLB refinancing provided a directly comparable data point, with the $US TLB 7-year

(+300bps) pricing 50bps below the $AUD tranche (+350bps). Moreover, factoring in projected interest rate cuts in the US further increases the yield differential favoring $AUD markets.

Australia's relative value remains a standout

While Australian credit remains better value, there are segments of the market exhibiting superior relative value. For instance, with T2 credit spreads now having normalised, our weighting to the segment has fallen, while the decline in our RMBS/ABS weight represents significantly tighter spreads and an overwhelmed demand/supply market profile, particularly in the mezzanine tranches. By contrast, increased volume and superior relative value has driven our rotation into corporate sub-debt and syndicated loans (refer Chart 5).

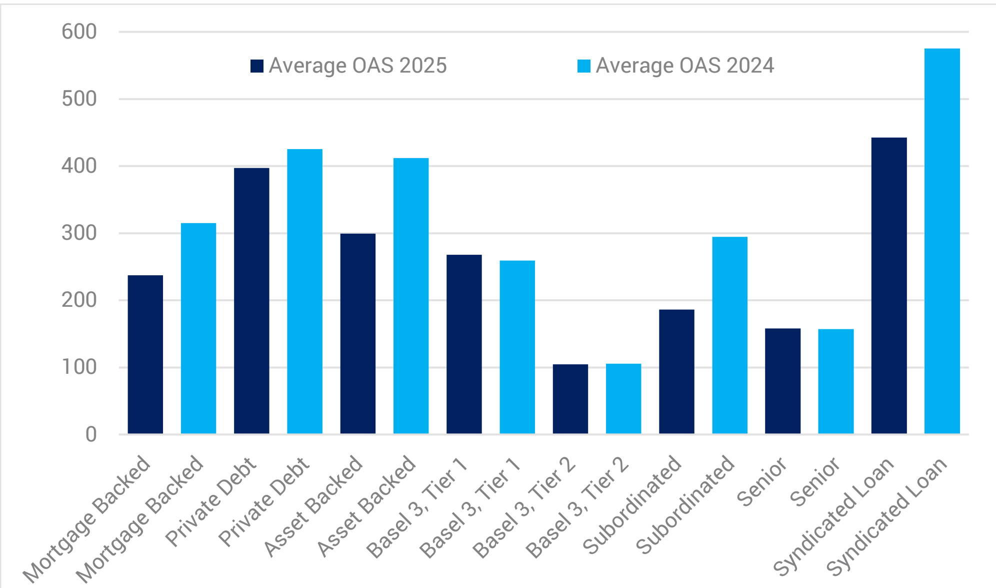
Chart 5. HIF Asset Allocation (%)



Source: YCM/Bloomberg – Dec 2025.

Despite there being little change in credit quality across the portfolio, credit spreads were generally lower across the board with relativities favouring the higher allocation to corporate sub-debt and syndicated loans. We also maintained our core private credit weighting at ~10% (capped at 20%).

Chart 6. HIF Credit Spreads by Segment (bps)



Source: YCM – Dec 2025.

All the fundamentals remain in place for another year of strong performance in 2026. While a year is a long time in markets, HIF is well positioned to benefit from high running yields and credit spreads remaining fairly valued. Moreover, as displayed in April 2025, our all-weather characteristics can again be relied upon to limit drawdowns in any risk-off and underpin future outperformance.

As global markets navigate a maturing cycle, Australian credit stands out for its combination of high-quality issuers, compelling yields and structural demand for income. Supported by fair valuations and robust liquidity, our multi-sector credit strategy (HIF) is well placed to deliver consistent returns—even through periods of uncertainty. For investors seeking resilience and opportunity, 2026 offers a compelling case to stay invested in Australian credit.

Contact us

If you require further information, please contact your relevant Business Development Manager.

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