

MAY 2025

ADVANTAGES OF HIGH YIELD BOND INVESTING



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As market uncertainty and changing interest-rate expectations are top of mind for many investors, fixed income should continue to play a vital role in well-diversified portfolios. Within the fixed income universe, high yield bonds can offer an attractive balance of income and capital appreciation opportunity — especially when backed by experienced and disciplined active management. Below, Portfolio Manager Brett Kozlowski answers key questions investors may have about high yield bonds and shares why they can be a smart addition to a portfolio.

KEY POINTS:

- High yield bonds offer an attractive income stream that is greater than traditional investment-grade bond sectors.
- High yield bonds have potential for capital appreciation from either improving company creditworthiness or improving economic scenarios.
- We find diversification in both company-specific return drivers and traditional investment preferences.

Q: Why is fixed income still an important part of a diversified investment portfolio?

Brett: Fixed income helps provide stability, income, and diversification — potentially even during periods of market volatility. Bonds, including high yield, can help smooth out overall portfolio returns. Corporate credit markets might feel some increased pressure from the uncertainty about inflation, tariffs, and falling consumer sentiment, but they are starting from a fundamentally solid position. Additionally, high yield bonds are senior to equity in the capital structure hierarchy, and their yield component helps cushion against fluctuating bond prices and sector risks.

ADVANTAGES OF HIGH YIELD BOND INVESTING *continued*

Q: What makes high yield bonds an appealing option right now?

Brett: Yields remain elevated compared to historical norms (**Figure 1**), offering attractive income potential. High yield bonds can also help diversify a bond portfolio (**Figure 2**). Having an allocation to high yield offers benefits over full business cycles, but is even more powerful now. With inflation cooling and the Fed potentially cutting rates, the backdrop is supportive for high yield bond performance.

“With inflation cooling and the Fed potentially cutting rates, the backdrop is supportive for high yield bond performance.”

FIGURE 1

High Yield Bonds Offer Attractive Income Potential

YIELD TO WORST

Bloomberg High Yield Index	7.90%
Bloomberg Investment Grade Corporate Index	5.14%
Bloomberg MBS Index	4.93%
Bloomberg Aggregate Index	4.51%
FTSE 3-Month Treasury Bill Index	4.29%
Bloomberg Treasury Index	3.94%
Russell 2000 Index	1.53%
S&P 500 Index	1.38%

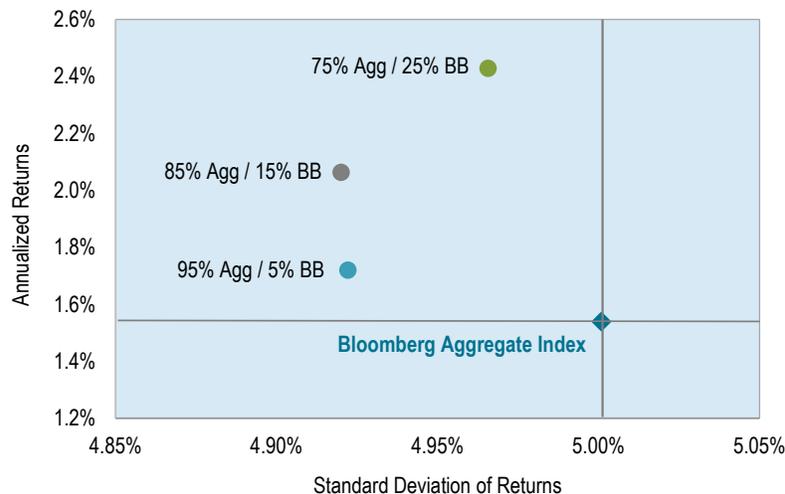
Data as of 4/30/25. Source: FactSet.

FIGURE 2

Can Deliver Diversification Benefits

RISK VS. RETURN

Annualized Returns: 10 Years Ending April 30, 2025



Source: FactSet.

“Adding a small allocation to high yield can enhance returns while creating less risk than the overall investment-grade market.”

ADVANTAGES OF HIGH YIELD BOND INVESTING *continued*

High yield bonds don't just offer income — they also have the potential for capital appreciation. When a company's financial health improves, its credit rating may be upgraded, which can lead to rising bond prices as the market begins to see the company as less risky. In a broader sense, when economic conditions strengthen — such as falling default rates, increased corporate earnings, or improving consumer demand — investor confidence in riskier assets often grows, which can boost demand for high yield bonds and lift their prices. This combination of steady income and potential price appreciation makes high yield bonds an appealing option for investors looking for more than just yield.

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Q: How risky of an investment are high yield bonds?

Brett: Certainly, high yield bonds face more default risk than investment-grade bonds, and their prices can be more volatile. However, many high yield bonds, especially in the upper tiers of the credit stack, are issued by companies with solid fundamentals and household names. Broadly, default rates remain low and today's high yield market is much more robust and diversified than in years past. The sector offers attractive returns compared to investment-grade bonds, without excessive volatility of returns. This is evidence that the additional income helps buffer against the added risk (**Figure 3**).

FIGURE 3

High Yield Bonds: Attractive Returns Without Excessive Volatility



Source: FactSet. Index returns do not reflect the deduction of fees, trading costs or other expenses. Investors may not make direct investments in an index. GW&K assumes no responsibility for the accuracy of data provided by outside sources. **Past performance is not indicative of future results.**

ADVANTAGES OF HIGH YIELD BOND INVESTING *continued*

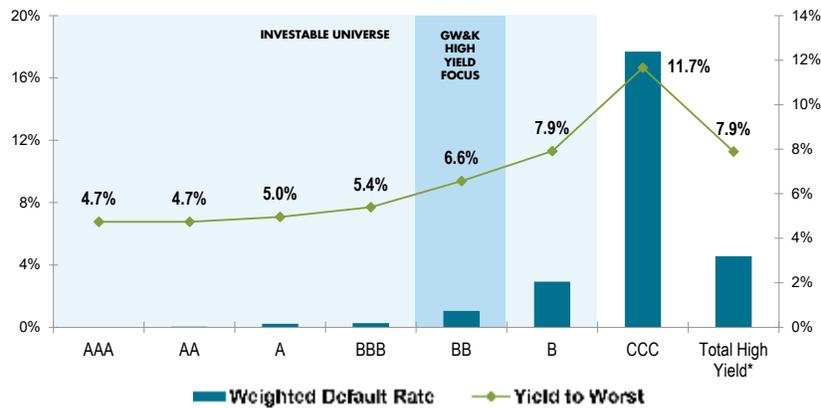
Q: Why is active management important in high yield investing?

Brett: Not all high yield bonds are created equal. Skilled active managers can manage risk and maximize opportunity by finding credits with strong balance sheets and growth potential while avoiding weaker credits. In our multisector strategies, we focus on investment-grade bonds, upper-credit-tier high yield names, and select securitized sectors, demonstrating how active management can steer sector rotation and security selection to create a better risk/return profile (**Figure 4**). Additionally, we account for the interest-rate movement risk (duration) that is inherent in bonds. This element of risk is driven by many macro forces and is difficult to reliably predict. Therefore, we prefer to manage our duration to be in line with our benchmarks to emphasize our security and sector selections. Through our continuous and robust active management process, we understand and control for both credit and interest-rate risks.

“Not all high yield bonds are created equal. Skilled active managers can manage risk and maximize opportunity by finding credits with strong balance sheets and growth potential while avoiding weaker credits.”

FIGURE 4
Best risk-adjusted returns

CORPORATE BOND YIELDS AND DEFAULT RATES



“BB rated securities have handily outperformed Treasuries and investment-grade credit consistently over every timeframe on a risk-adjusted basis.”

ANNUALIZED PERFORMANCE

Through April 30, 2025

	3 Years	5 Years	10 Years	20 Years
US Treasury	1.2%	-1.7%	1.1%	2.7%
Investment Grade	3.0%	0.5%	2.5%	4.1%
A	2.7%	-0.2%	2.2%	3.7%
BBB	3.6%	1.4%	2.9%	4.7%
High Yield	6.2%	6.3%	4.9%	6.6%
BB	5.9%	5.3%	4.9%	6.7%
B	5.8%	6.2%	4.5%	5.9%
CCC	7.2%	9.7%	5.0%	6.5%

ANNUALIZED SHARPE RATIO

Through April 30, 2025

	3 Years	5 Years	10 Years	20 Years
US Treasury	-0.5	-0.8	-0.2	0.2
Investment Grade	-0.2	-0.3	0.1	0.4
A	-0.2	-0.4	0.0	0.3
BBB	-0.1	-0.2	0.1	0.4
High Yield	0.2	0.5	0.4	0.5
BB	0.2	0.4	0.4	0.7
B	0.2	0.5	0.3	0.5
CCC	0.3	0.8	0.3	0.4

Average 1-year volume-weighted default rates 1994 – 2025. Yield to worst as of 4/30/25. *Represents the Bloomberg High Yield Bond Index. Sources: Bloomberg, Moody's. Performance represents corporate bond segments of the Bloomberg Aggregate Index. Index returns do not reflect the deduction of fees, trading costs or other expenses. Investors may not make direct investments into any index. Data is from what we believe to be reliable sources, but it cannot be guaranteed. The Sharpe Ratio is a risk-adjusted statistic that measures reward per unit of risk (higher is better). Calculated as excess return over a risk-free rate divided by the standard deviation of returns. Past performance not indicative of future results.

ADVANTAGES OF HIGH YIELD BOND INVESTING *continued*

Our focus on BB and B rated securities is due to their historical risk-adjusted return advantage. BB rated securities have handily outperformed Treasuries and investment-grade credit consistently over every timeframe on a risk-adjusted basis. Additionally, the higher risks of CCCs are not as attractive, and we do not purchase bonds in this credit tier.

Q: What should investors consider before adding high yield to their portfolio?

Brett: It's important to understand your risk tolerance and investment goals. High yield bonds can offer attractive returns, but selecting the right manager — one with deep credit research and a disciplined process — is key to making the most of the opportunity.

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