



Full Discretion Team

# Quarterly Credit Update

## Key Takeaways

In our view, the credit cycle remains firmly in a late-cycle phase, with economic growth likely to slow in the near term but with potential for re-acceleration later in the year. While geopolitical risks increased during the first quarter following the escalation of conflict involving Iran—contributing to higher energy prices and wider credit spreads—our base case continues to call for below-trend growth rather than a recession. Importantly, our estimated credit losses suggest that defaults and losses across both investment grade and high yield credit should remain below historical averages for this stage of the cycle, even as risk premiums adjusted higher in response to elevated uncertainty.

Investment grade credit conditions remain constructive, supported by strong demand and resilient corporate fundamentals, even as signs of normalization emerge. Heavy issuance continues to be absorbed, keeping spreads tight, though moderating flows and evolving macro and geopolitical dynamics suggest technicals may become less one-sided over time. While balance sheets remain broadly healthy, fundamentals are becoming more differentiated and selective risks are beginning to surface. In high yield, a supportive backdrop persists with disciplined issuance, improving credit quality, and strong fundamentals, including stable earnings and low default rates. As the market trends higher in quality, high yield remains well positioned as the cycle matures, even in a higher-rate environment.

Technology, specifically Services and Software, was a key focus in leveraged credit during the first quarter as artificial intelligence (AI)-related disruption concerns weighed on sentiment. Software exposure is more concentrated in loans than high yield, reflecting the loan market’s role in financing leveraged buy-out (LBO) activity, particularly post-COVID. As a result, weakness in the sector had a more pronounced impact on loans, highlighted by fewer credits trading above par. Overall, investors have grown more cautious, favoring higher-quality software issuers despite the sector’s continued importance in leveraged loans.



## About the Team

The Full Discretion Team brings decades of expertise and collaboration to create tailored solutions for their clients.

23

Investment Professionals

22+

Avg. Years of Industry Experience  
(Portfolio Management Team)

\$85.8

Team Assets Under Management  
(Billion USD)

## Team Philosophy

We have a legacy of independent thinking and leaning into the market when others may be pulling away. We take a deep-value, equity-like approach to credit selection across global fixed income markets. Our disciplined process helps gives us confidence in seeking to identify macro trends, formulate a clear view on market sectors, and invest throughout the credit cycle.

For more than 40 years, we have been applying our distinctive style of bond picking to deliver portfolios designed to provide excess yield potential and have low correlations to traditional benchmark-focused fixed income strategies.

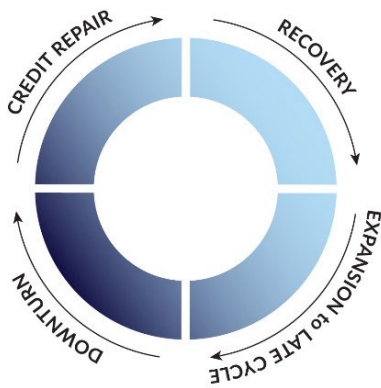
*Source: Loomis Sayles, as of 3/31/2026*

*Average years of expertise reflected at portfolio management level*

## Credit Cycles/Risk Premium

### Credit Cycle Remains in Late Cycle Stage

In our view, the credit cycle remains firmly in the late cycle stage, with the likelihood for slowing economic growth in the near-term and potential for re-acceleration later in the year. While geopolitical risks have risen meaningfully following the start of the Middle East conflict and the associated increase in energy prices, our base case calls for below-trend growth for the year rather than a recession.

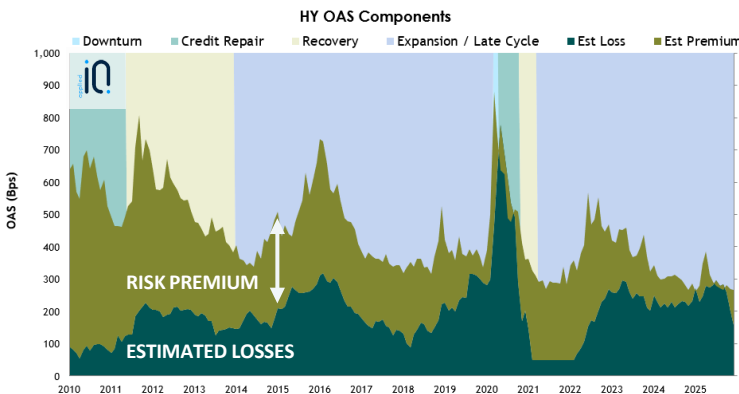


As of 3/31/2026. *Chart shown for illustrative purposes only.* This reflects the current opinions of Loomis Sayles Macro Strategies Team, and views are subject to change at any time without notice. Other industry analysts and investment personnel may have different views and opinions.

### Defaults and Losses Expected to Stay Below Historical Average

Our estimated credit losses continue to suggest that defaults and losses across both investment grade and high yield credit should remain at or below historical averages for this stage of the cycle.

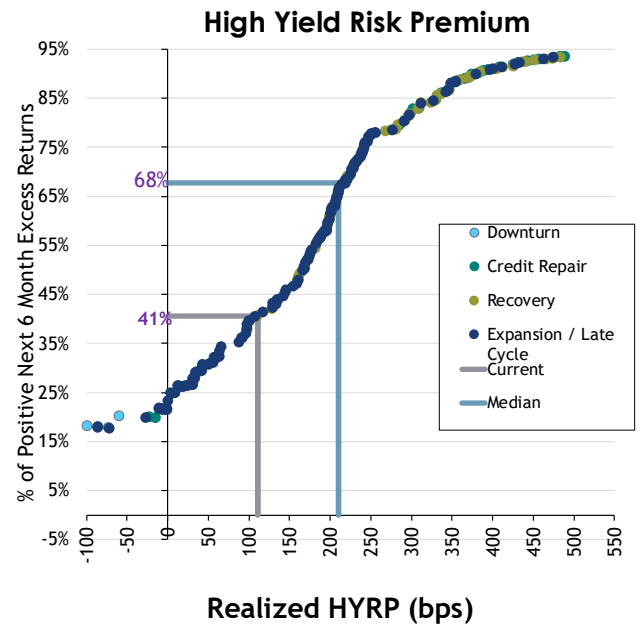
### Estimated High Yield Risk Premium Components Over Time



## Investment Grade (IG) and High Yield (HY) Risk Premiums Rise Following Geopolitical Developments

During the first quarter, credit spreads and risk premiums widened in response to heightened geopolitical uncertainty following the outbreak of conflict involving Iran.

### Median High Yield Risk Premium & Probability of Positive Excess Return



Source: Loomis Sayles, Bloomberg and Moody's, as of 3/31/2026. OAS is based on the Bloomberg US Corporate High Yield Index.

*The charts presented are shown for illustrative purposes only. Some, or all, of the information on these charts may be dated, and, therefore, should not be the basis to purchase or sell any securities. The information is not intended to represent any actual portfolio managed by Loomis Sayles.*

*This analysis is based on historical data and does not predict future results. Therefore, the use of this type of information to make investment decisions has inherent limitations. Markets may behave very differently than history suggests, it is not possible for any methodology to accurately identify and interpret all relevant market events.*

*Any investment that has the possibility for profits also has the possibility of losses, including the loss of principal. Please see the Risk Premium Disclosure Statement for additional important information.*

*Past performance is no guarantee of future results.*

## IG Outlook

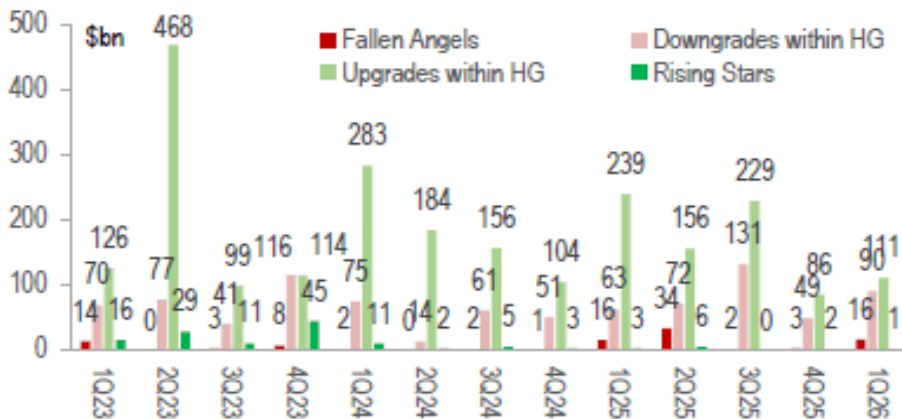
### Resilient Fundamentals with Emerging Pockets of Risk

Investment grade fundamentals remain broadly resilient, though pockets of risk are beginning to emerge. Corporate balance sheets continue to support credit performance, but fundamentals are becoming increasingly bifurcated across investment grade rating bands. Bottom-up indicators point to selective vulnerabilities, including areas exposed to datacenter investment cycles, AI related disruption, and business development company (BDC) linked issuers, even as overall corporate fundamentals remain solid. Following a multi year upgrade cycle, downgrade activity has begun to pick up. While upgrades still outpace downgrades, the margin has narrowed, signaling a more balanced, though still constructive, credit environment, in our view.

### Strong Technical Backdrop Persists, Though Early Cracks Emerge Beneath the Surface

Investment grade technicals remain strong this quarter, even as early signs of fatigue begin to surface. Supply continues at record levels in 2026, driven by a supportive regulatory environment for mergers and acquisitions (M&A) and sustained AI-related funding needs, yet demand has continued to absorb issuance with ease. New issue concessions remain modest and order books are consistently oversubscribed, helping keep spreads tight despite the heavy calendar. That said, cracks are beginning to emerge, with fund flows moderating in March 2026 amid a challenging geopolitical backdrop and a rapidly shifting global yield environment, suggesting technical support may be less one sided as the year progresses, in our view.

### Upgrades and Downgrades – 1Q26 Marked by most Fallen Angels since 2Q25



Source: J.P. Morgan, as of 3/31/2026

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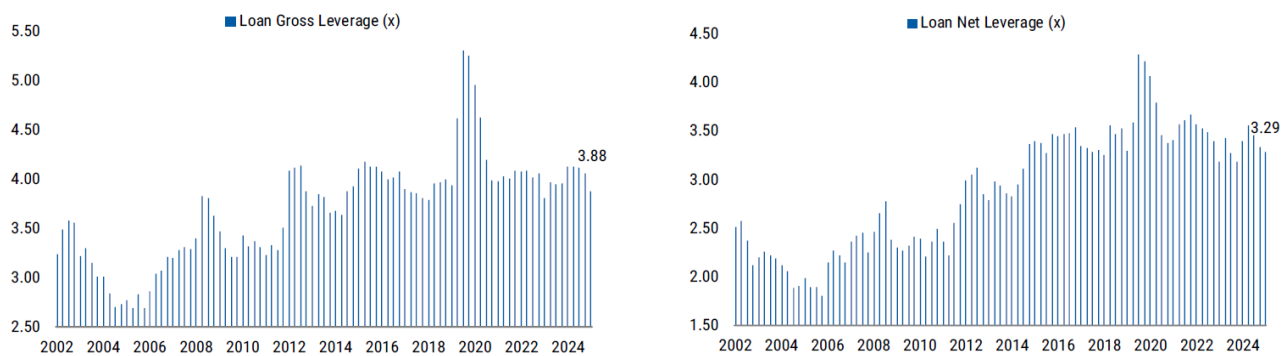
**Past performance is no guarantee of future results.**

# High Yield Outlook

## Positive Fundamentals Reinforced by Low Defaults and Improving Quality

High yield fundamentals remain positive, underpinned by manageable leverage metrics and a default environment that remains well below long term stress levels. Issuers continue to benefit from stable earnings and prudent liability management, helping limit balance sheet pressure despite a higher-rate backdrop. Importantly, the high yield market continues to trend up in quality, with a greater share of BB-rated issuers, reinforcing the fundamental case for the asset class as the cycle matures.

### Historical HY Gross Leverage and Interest Coverage



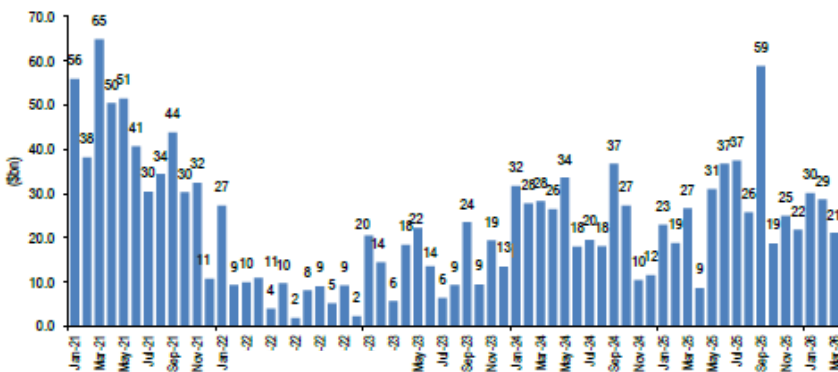
Source: Morgan Stanley Research, as of 3/31/2026.

The chart presented above is shown for illustrative purposes only.

## Healthy HY Technicals Supported by Disciplined Issuance

High yield technicals remain healthy, supported by a manageable supply backdrop and disciplined issuer behavior. Refinancing continues to dominate issuance activity, with limited evidence of aggressive balance sheet leveraging or widespread LBO-driven supply, though select large transactions—most notably the recent Electronic Arts deal—have garnered attention. Private credit outflows, particularly from BDCs, have been a key area of market focus, yet there has been little to no contagion, the technical environment remains constructive and supportive of secondary market performance.

### Monthly High Yield New Issue Volume



Source: J.P.Morgan, as of 3/31/2026.

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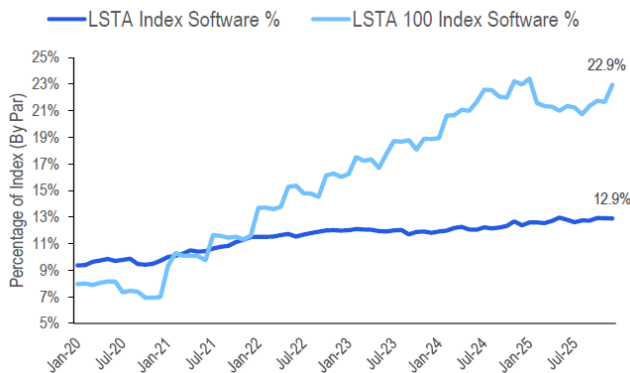
# Security Selection

## Software Trends in Leveraged Credit Amid AI Developments

Technology—specifically Services and Software—was a key focus in leveraged credit during the first quarter, amid heightened concern over AI-driven disruption. Recent advances in AI have raised significant questions about the long-term viability of many companies, as new AI products increasingly overlap with—and may disrupt or render obsolete—existing products and services. Across public leveraged finance markets, software exposure is more concentrated in loans (approximately 13%) than in high yield (3%). This higher exposure reflects the leveraged loan market’s historical role as the preferred avenue for sponsor-led Leveraged Buyout (LBO) financing, given the more flexible call structures in the Broadly Syndicated Loan (BSL) market compared to high yield bonds.

During the low-rate, post-COVID period, LBO activity accelerated, further increasing software exposure in the loan market. As a result, while the software sector weighed on returns across both loans and high yield, its larger presence in loans had a more pronounced impact on that market. This dynamic was evident in the sharp decline in the share of loans trading above par, which fell from 65% to as low as 19% in early February. Overall, heightened caution has led investors to underweight the sector and favor higher-quality, lower-yielding software issuers, despite the sector’s structural importance within the leveraged loan market.

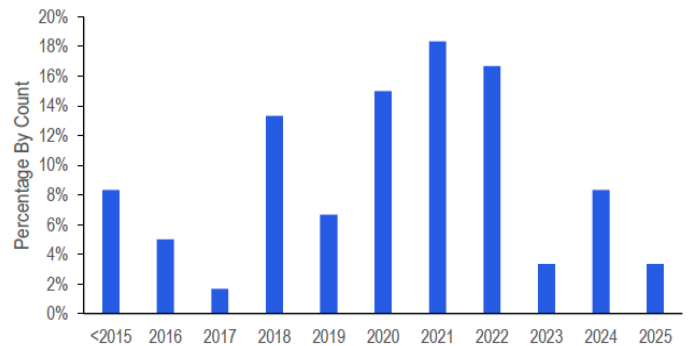
**Software Grew During the Early 2020s**



Source: Citi Research, as of 3/31/2026

**Supported By Numerous Buyouts**

**Original Vintage Year of Software LBO Deals**



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## Meet the Team

**MATT EAGAN, CFA**

Head of Full Discretion, Portfolio Manager

**BRIAN KENNEDY**

Portfolio Manager

**PETER SHEEHAN**

Portfolio Manager, Credit Strategist

**ERIC WILLIAMS**

Portfolio Manager

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Portfolio Manager, Associate Portfolio Manager, Investment Grade Corporate Strategist

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Investment Director

**CHERYL STOBER**

Investment Director

**KRISTEN DOYLE**

Associate Investment Director

**MATTHEW GREEN**

Associate Investment Director

## Important Disclosures

### CREDIT CYCLE REGIME PERIODS

#### **EXPANSION/LATE CYCLE:**

4/1/1997- 8/31/2000; 3/1/2006-12/31/2007; 1/1/2014- 2/28/2020;  
4/1/2021 - 3/31/2026 (PRESENT)

#### **DOWNTURN:**

9/1/2000 - 11/30/2001; 1/1/2008 - 6/30/2009; 3/1/2020 -  
4/30/2020

#### **CREDIT REPAIR:**

12/1/2001 - 5/30/2003; 7/1/2009 - 5/31/2011; 5/1/2020-  
10/31/2020

#### **RECOVERY:**

6/1/2003 - 2/28/2006; 6/1/2011-12/31/2013; 11/1/2020 -  
3/31/2021

As of 3/31/2026

Regime periods are determined by Loomis Sayles Macro Strategies Team based on a variety of subjective and objective factors, including past economic and asset performance metrics. Views and opinions expressed reflect the current opinions of the team, and are subject to change at any time without notice. Other industry analysts and investment personnel may have different views and opinions.

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Unless otherwise specified, all analysis covers the period from 6/30/1996 to 3/31/2026

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### ADDITIONAL IMPORTANT DISCLOSURE

**Principal Investment Risks:** Investments in bonds can lose their value. When interest rates rise, bond prices usually fall and vice versa. High yield securities are subject to a high degree of market and credit risk, including risk of default. In addition, the secondary market for these securities may lack liquidity which, in turn, may adversely affect the value of these securities and that of the portfolio. Foreign investments involve special risks including greater economic, political and currency fluctuation risks, which may be even greater in emerging markets. Currency exchange rates between the US dollar and foreign currencies may cause the value of the investments to decline. Commodity-related investments, including derivatives, may be affected by a number of factors including commodity prices, world events, import controls and economic conditions and therefore may involve substantial risk of loss. Equity securities are volatile and can decline significantly in response to broad market and economic conditions.

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Indices are unmanaged and do not incur fees. It is not possible to invest directly in an index.

This is not an offer of, or a solicitation of an offer for, any investment strategy or product.

Market conditions are extremely fluid and change frequently.

**Any investment that has the possibility for profits also has the possibility of losses, including the loss of principal.**

**Past market experience is no guarantee of future results.**