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Building unexpected bridges in high yield



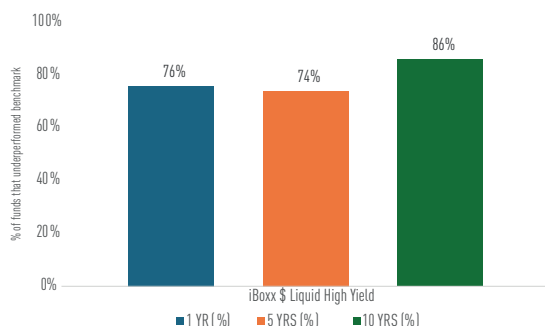
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The active-passive debate has long been framed as a contest between competing investment philosophies. In equities, the distinction is familiar: passive delivers low-cost market exposure, while active promises the possibility of outperformance through stock selection. Yet few asset classes expose the limitations of this binary as clearly as high yield credit.

Passive investing has solved a genuine problem in credit markets. Historically, high yield investing required trading infrastructure, credit research capacity and tolerance for idiosyncratic risk. By June 2026, global assets in passive fixed income ETFs had approached USD 3 trillion, underscoring the extent to which investors have embraced the model. The logic is straightforward. High yield returns are inherently asymmetric: a single default can materially impair returns, whereas the upside of one successful issuer is capped. Broad diversification therefore matters. From a portfolio construction perspective, exposure across hundreds of issuers can absorb isolated credit events far more effectively than a concentrated portfolio of 40 or 50 bonds, at times even where the latter is supported by extensive bottom-up research.

In fact, performance evidence helps explain why passive high yield should not be dismissed too quickly. According to the latest SPIVA scorecard, a majority of active US high yield managers underperformed the iBoxx US High Yield benchmark across multiple time horizons (Figure 1). While active management undoubtedly creates winners, consistently outperforming broad high yield benchmarks remains challenging.

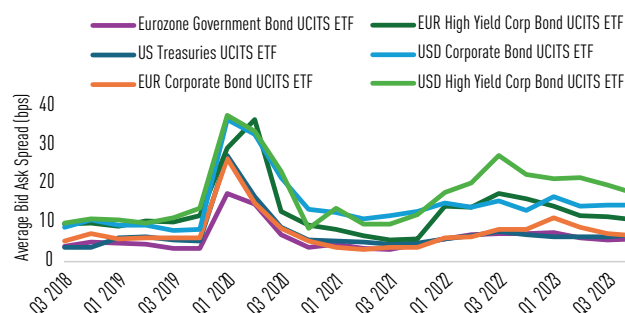
Figure 1: Outperforming High Yield benchmarks remains a challenge for active managers



Source: S&P Dow Jones Indices LLC, CRSP, Bloomberg LLC. Data as of Dec. 31, 2025. Past performance is not indicative of future returns. Table is provided for illustrative purposes.

The liquidity argument is equally important. Fixed income ETFs have not simply created a lower-cost wrapper around existing bond exposures; they have significantly influenced how many investors access, price and trade fixed income markets. Today, it is widely recognised that the inclusion of bonds in ETF creation and redemption baskets can enhance liquidity in both high yield and investment-grade markets, with the benefits persisting across both calm and more volatile market environments.

Figure 2: ETF spreads in volatile times



Source: DWS International GmbH, Big XYT, as of December 2023, ETF selection for illustrative purposes only.

This matters in a market where corporate bonds trade far less continuously and where dealer balance sheets have remained constrained since the financial crisis. Against this backdrop, the ETF secondary market provides an additional layer of price discovery and liquidity. Institutional investors, including open-ended funds managing inflows and outflows, have long utilised ETFs to adjust exposures and manage liquidity without immediately transacting in every underlying bond. As a result, the ETF wrapper can serve simultaneously as a liquidity sleeve, a tactical allocation tool and an effective bridge between portfolio-level flows and the execution challenges of the underlying bond market.

The resilience of this structure was tested during the COVID-19 market dislocation, arguably the most significant stress event in the history of fixed income ETFs. At a time when trading activity in large parts of the underlying bond market became impaired, investors were still able to buy and sell ETF shares. ETF prices frequently traded at discounts to reported net asset values, but these discounts largely reflected the reality that underlying bond valuations had become stale due to the lack of trading activity. More importantly, from a market structure perspective, ETFs create different incentives than traditional bond mutual funds. In an ETF, the costs of liquidity are primarily borne by the investor choosing to exit, who sells at the prevailing market price. In a traditional bond fund,

the burden is often transferred to remaining investors, as managers may be forced to sell more liquid holdings to meet redemptions. For long-term investors, this characteristic is often underappreciated.

Why Active Judgement Still Matters

Yet the increasing efficiency of passive high yield does not imply that passive exposure can answer every credit question. Credit indices are ultimately shaped by issuance patterns, liquidity screens and amounts outstanding. A mechanically constructed benchmark naturally allocates more capital to larger debt issuers, not necessarily to those with the strongest balance sheets.

This is where active credit judgement retains an important role, particularly as the credit cycle matures. High yield has once again become a carry-driven market. With yields of around 6% in Europe and roughly 7% in the US, investors can no longer rely on broad spread compression alone to drive returns. Instead, income has re-emerged as a key contributor to performance, providing a meaningful cushion in times of short-term market volatility.

As a result, the market has also become increasingly sensitive to issuer-specific outcomes. While default rates remain relatively moderate, investors are placing greater emphasis on differentiation across issuers, sectors and capital structures. In this environment, the quality of credit selection matters more. Ultimately, realised losses are often determined less by the number of defaults than by recovery values and an investor's position within the capital structure. Here active credit analysis can become an increasingly valuable tool in a market where selectivity matters more.

The recent rise of active fixed income ETFs should be viewed against this backdrop. As interest rates normalised and fixed income re-emerged as a meaningful source of income, investor demand for actively managed bond ETFs accelerated sharply. While active ETFs have enjoyed strong growth across Europe, it is the fixed income segment that has recorded strong growth rates, highlighting investors' increasing appetite for strategies that combine efficient implementation with active credit expertise.

The most compelling version of this model might be benchmark-aware rather than unconstrained. In many ways, it provides a more practical answer to the active-passive debate. High yield typically plays a specific role within an institutional portfolio, providing income, access to credit risk premia and diversification. Investors do not necessarily want that allocation fundamentally transformed. Much as enhanced active strategies have gained traction in equities, investors increasingly recognise the value of creating targeted opportunities for outperformance while maintaining the core characteristics of the asset class. Established benchmarks can provide a robust risk framework within which active decisions are implemented. Tools such as issuer and sector limits, controls on foreign-currency exposure, restrictions on bond types and calibrated allocations to lower-rated CCC issuers can all help maintain a predictable risk profile and keep long-term ex-post tracking error within a defined range. Ultimately, this risk-controlled approach to alpha generation may offer an attractive path forward. Benchmark-aware active ETFs combine the diversification, liquidity and implementation benefits of passive investing with the selectivity and credit judgement that active management can provide.

¹Source: Bloomberg, as of 25/06/2026

²SPIVA U.S. Scorecard Year-End 2025. SPIVA (S&P Indices Versus Active) is a semi-annual research report published by S&P Dow Jones Indices that objectively evaluates the performance of actively managed mutual funds against their relevant passive benchmark indices.

³Source: Barclays Credit Research Corporate Bond Liquidity: The Rise of Institutional Investors in Bond ETFs,

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