IMPAX Asset Management

Why value can never go out of style in high yield

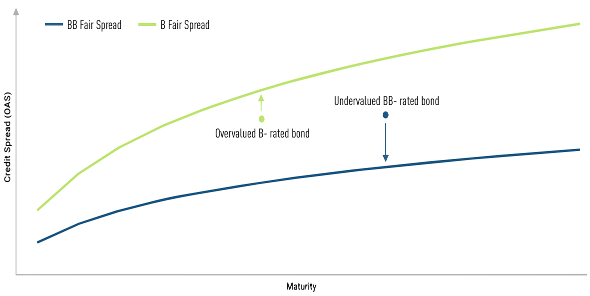
Klaus Blaabjerg, Senior Portfolio Manager
Peter Dabros, Senior Portfolio Manager
Liam Moore, Head of Fixed Income Portfolio Specialists

There is an unappealing paradox at the heart of investing in line with a bond index: the more indebted an issuer, the larger its place in the benchmark. The largest 20% of issuers account for close to 60% of the ICE BofA Global High Yield Index, for instance.[1]

Allocating to borrowers based on quantity, not quality, of debt – dubbed by some as the "bums problem" – does not seem to us the optimal starting point for building a credit portfolio. This approach also ignores valuations.

In our view, a more logical starting point may be to focus on relative value – where bond prices are higher than their modelled fair value. The fragmented and under-researched global high yield market, where pricing inefficiencies are persistent, creates structural opportunities for active investors to identify mispriced bonds.

Relative spreads can point to value in high yield
Illustrative comparison of two issuers' fair-value curves



Source: Impax, June 2026. For illustrative purposes.

Market complexity creates pockets of value

Each company typically issues one type of common stock, but may have a dozen of bonds outstanding, each with different seniority, duration and covenants, and each priced slightly differently. Many high yield issuers are also unlisted, with patchy or hard-to-obtain financials.

For active credit managers, these nuances provide the raw materials for judging whether any given bond's spread is generous relative to the issuer's underlying risk.

For any rating and maturity, the market demands a certain spread. Mapping those points across the investable universe can create a fair-value curve for any given issuer (see illustrative example opposite). A bond trading wider than its curve is offering a higher spread than its fundamental risk warrants and is, in that relative sense, undervalued; the inverse is true too, of course.

This is a relative judgement, not an absolute one. For example, a solid 'BB'-rated bond whose spread has overshot can offer better value than a higher-spread 'CCC' trading tight to fundamentals that do not justify it.

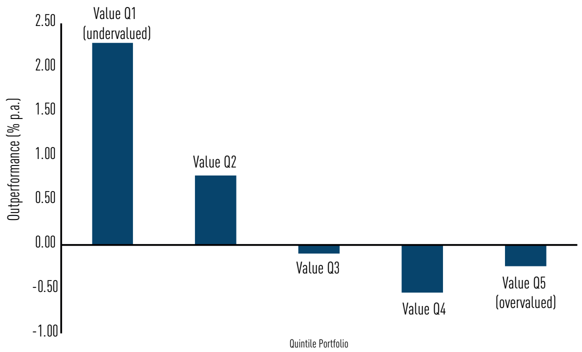
Value has been a persistent source of excess return in high yield over time. Our analysis of global high yield markets finds the most undervalued quintile of the index has outperformed by 2.3 percentage points annually since 1999, against 0.8 percentage points for the second quintile. Third, fourth and fifth quintiles all underperformed (see chart on next page).[1]

Looking beyond familiar markets and issuers

The high yield universe is geographically wider than many approaches allow. While some managers treat "global" as little more than the US and Europe, we think it is important to include emerging markets. For instance, the dynamics for telecoms issuers in developing markets, where demand is rising, contrast with saturated developed markets where incumbents increasingly need to consolidate.

Past performance is not indicative of future returns and outcomes may vary.

The historic correlation between value and outperformance
Relative performance of bonds by value quintile, annualised, January 1999 to May 2026



Source: Impax analysis of ICE BofA Global High Yield Index data, as at 31 May 2026. Excess returns versus benchmark of long-only value factor portfolios from January 1999 to May 2026. Quintile (Q1) represents the top 20% undervalued bonds; Q5 the bottom 20% overvalued bonds. The results are annualised. No transaction costs.

Relative value opportunities tend to arise among under-researched and out-of-favour issues. Smaller issues often drop into that category. These are less frequently quoted by dealers and routinely marked down by agencies for their size, even where leverage is lower and fundamentals stronger than larger peers. Thinner coverage amplifies the potential for longer and more persistent mispricing – an illiquidity premium that the patient investor is paid to harvest. Meanwhile small, well-run issuers also carry takeover optionality, where change-of-control terms can hand bondholders an equity-like payoff in some instances. One recent example was the takeover of healthcare company Organon by Sun Pharmaceutical, which lifted the former's bonds from around 85 cents on the dollar to above par.

Crucially, this is terrain that passive and benchmark-aware investors are poorly placed to work. An investor tethered to the biggest debtors structurally omits the corners of the market where mispricing is most reliable. Scale compounds the problem: the largest managers cannot take meaningful positions in small issuers without owning an unwieldy share of the bond. Low tracking error mandates face the same tension: low index weights and off-benchmark names where value often concentrate are precisely those that widen deviation from the index.

Simple in principle, but risks need managing
Value approaches to investing in equities have had a hard time in recent years, as certain share prices have demonstrated their ability to trade independently from company fundamentals.

The deadlines intrinsic to bond markets mean credit is a different picture. Cash flows are contractual (unlike dividends) and investors' principal is repaid on maturity at the latest, provided the issuer does not default; in the meantime, spreads that have overshot tend to revert toward fair value. Put simply, investors who identify mispricing have a built-in deadline to be proven right or wrong.

Consistently realising opportunities based on fair value takes fundamental research to underwrite each issuer and weed out the credits likely to default. Systematic approaches may be tempting – buying the cheapest bond against fair-value curves and holding to reversion or maturity – but spreads can be wide because the market consensus is ultimately correct.

The relative-value approach does carry risks – namely higher tracking error and a higher beta than the market through bias towards wider-spread credits. Spreads may also widen before they tighten. These risks must be managed through effective credit selection, sector rotation and hedging as the macroeconomic backdrop shifts, cash to redeploy as and when valuations reset, and judgements about quality buckets across the credit cycle.

The goal of this approach to high yield is simple: buy bonds for less than they are worth, do the fundamental work to avoid defaults, and manage risk through the cycle. While no easy task, it is our conviction that an actively-managed, relative value-based approach has structural advantages that enable the pursuit of improved risk-adjusted returns, relative to strategies anchored to a debt-weighted benchmark.

Past performance is not indicative of future returns and outcomes may vary.

[1]Impax analysis of ICE BofA Global High Yield Index data, as at 31 May 2026