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Credit investing in a low spread environment

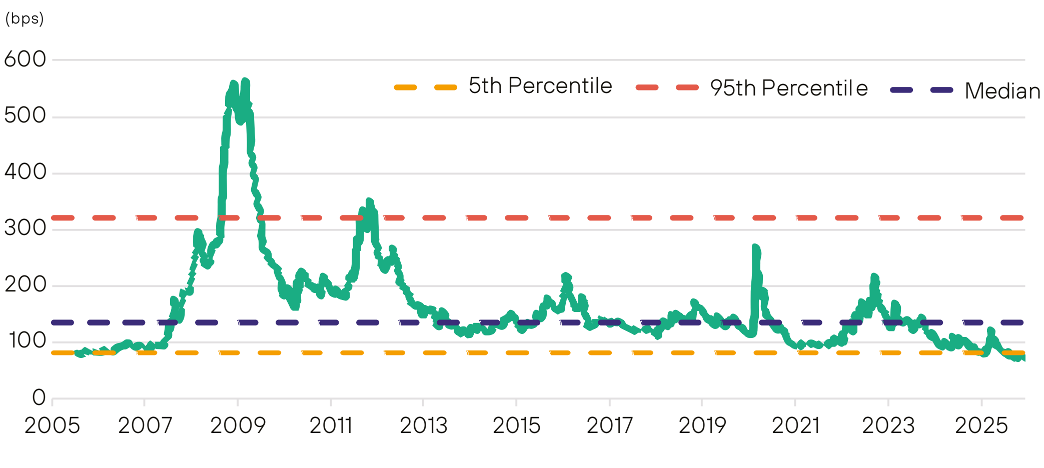
isio.

How schemes can boost yield, stay opportunistic, and understand risk in a low-spread environment

Background

Credit markets remain expensive (see chart), so finding good opportunities in a low-spread environment will mean moving away from the mainstream to enhance ongoing yield, or preparing to deploy opportunistically should conditions change. Schemes with credit-heavy portfolios should dig deeper to understand credit risks.

A-rated Corporate Bond Spreads



Source: iBoxx £ Corporates A-rated Option Adjusted Spread, 31 December 2025

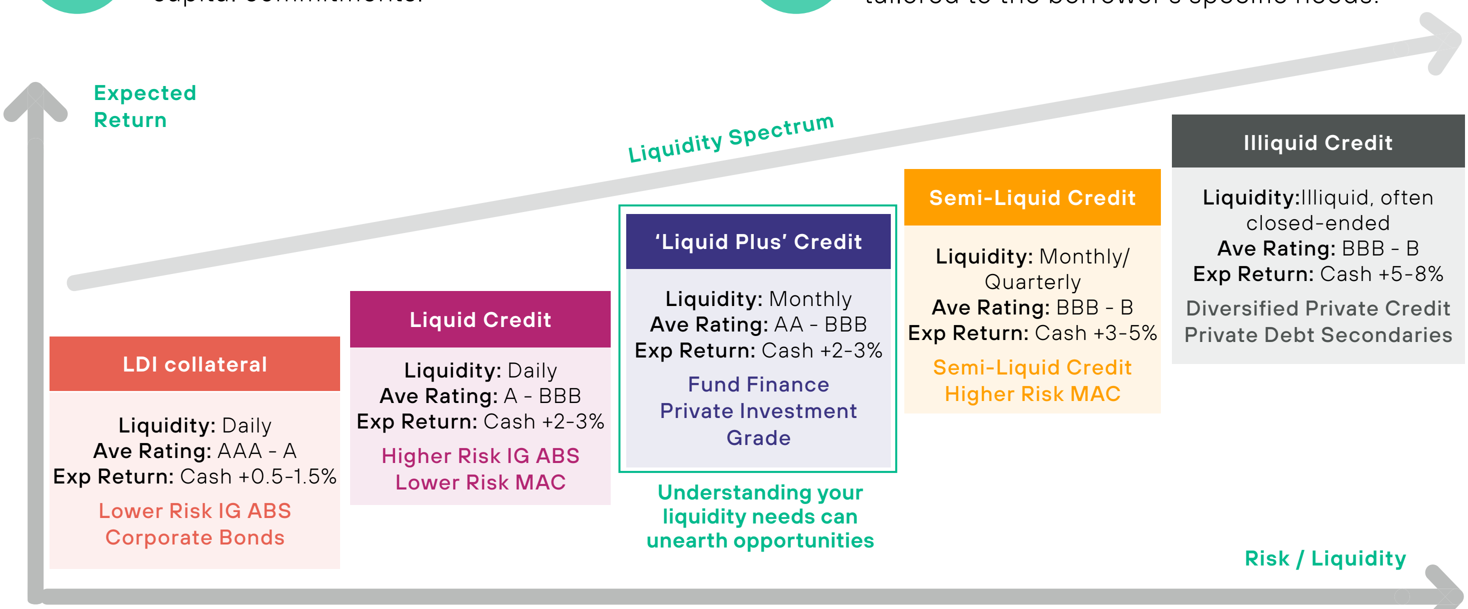
> **"Schemes should use their competitive advantage to seek the best credit available. Currently that isn't traditional IG credit"**
>
> Tom Wilson, Head of Credit Research

Yield enhancement – where value still exists

Corporate bond spreads are close to historic lows offering little spread pick up and risk of losses from spread widening. Many schemes have started to diversify their investment grade holdings into shorter dated or securitised credit and we continue to advocate moving away from the mainstream to enhance ongoing yield with two investment grade-rated asset classes we have previously written about here [Fund Finance and Private IG Credit - Isio](#)

Fund Finance: Short-term loans to private market funds secured against uncalled capital commitments.

Private IG: Lending negotiated directly with investment grade-rated issuers, with terms tailored to the borrower's specific needs.

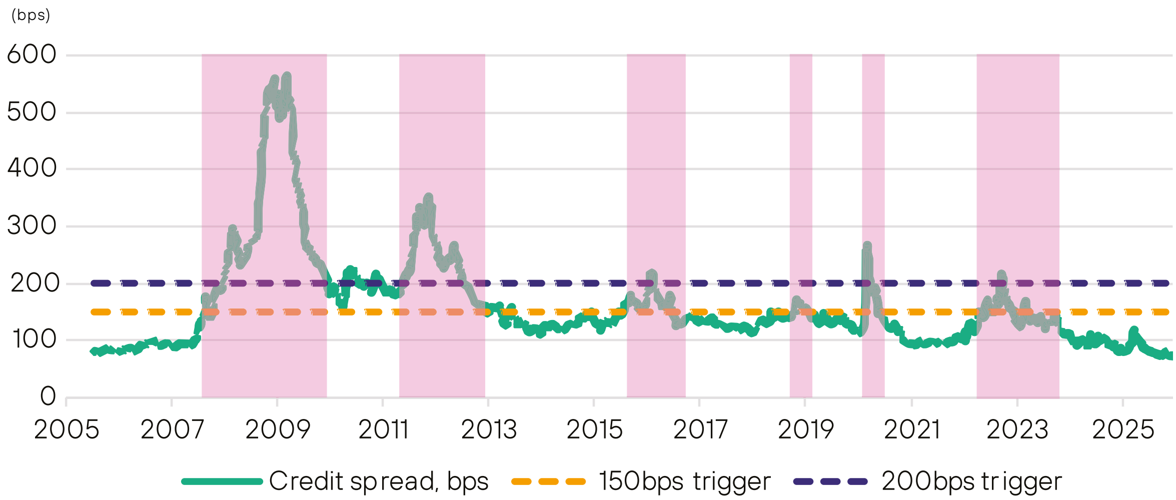


Opportunistic approaches

Schemes may prefer to bide their time for better opportunities to deploy capital. We have worked on two implementation routes:

Corporate Bond Framework: Corporate Bonds should be an attractive asset class for pension schemes. They currently offer poor value, but market conditions can shift quickly and buying opportunities are episodic (see chart). To prepare for this, we recommend setting triggers, considering relative value with the assets used to fund it (cash, LDI, ABS) and a focus on integrating implementation with LDI managers. Read more here: **iBoxx Clever: How to re-enter the ring with corporate bonds**

A-rated Corporate Bond Spreads



Source: iBoxx £ Corporates A-rated Option Adjusted Spread, 31 December 2025

Dislocation strategies: These funds focus on higher yield credit, as well as idiosyncratic opportunities. Operating as closed-ended or evergreen vehicles they focus on the fact that volatility creates opportunities if markets operate inefficiently. The funds present a solution designed to capitalise on these market inefficiencies, but dry powder (e.g. excess ABS) needed to supply capital.

Credit risk analysis

Schemes with credit-heavy portfolios should dig deeper to understand default risks.

Credit risk is exponential: While credit ratings go up in linear steps, the increase in default risk is exponential. A way to quantify this is Weighted Average Rating Factor WARF (see table). Analysis of the credit spread vs. WARF offered by an asset is a good way to assess portfolio efficiency.

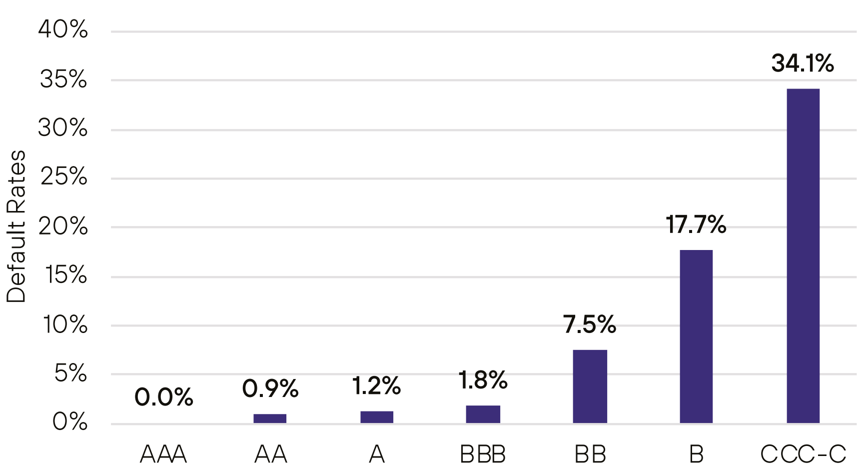
Credit Rating	WARF
AAA	1
AA+	10
AA	20
AA-	40
A+	70
A	120
A-	180
BBB+	260
BBB	360
BBB-	610
BB+	940
BB	1,350
BB-	1,780

"WARF is a better representation of credit risk and should be used to compare approaches"

Barry Jones, CIO

Scenario analysis: Using actual portfolios and historic default and recovery rate data, for example following the GFC from 2008-10, Schemes can assess their exposure to default risks in a downside scenario. This could be more appropriate than VaR which is good for measuring volatility but struggles with tail risks.

Moody's 3-year Cumulative Default Rates (Global Financial Crisis: 2008-10)



Diversification and recovery rates: Not all assets have the same recovery in event of default. High quality securitised assets would expect to have stronger collateral backing than corporate bonds and therefore higher recovery rates. They also tend to have more underlying diversification of lender.

IG vs Securitised Sector Exposure

Key takeaways for trustees

Credit markets remain expensive so schemes must look beyond mainstream assets to boost returns or stay ready to act when conditions shift.

- Yield enhancement options include fund finance, and private investment-grade lending.
- Schemes can prepare for opportunities through corporate bond frameworks or dislocation strategies that exploit market inefficiencies during volatility.
- For credit-heavy portfolios, deeper analysis of default risk is essential—use metrics like WARF and scenario testing to ensure resilience and efficiency.

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