Sparinvest

High Yield hit by Geopolitical Turbulence

Performance reverses amid geopolitical unrest

Credit spreads weakened by 61 basis points in the High Yield (HY) market in Q1. The largest negative contributor to benchmark return was the widened of bond spreads, which the bonds' accrued interest wasn't able to fully offset. This resulted in a benchmark return of -0.73% in Q1, resulting in a year-to-date return of -0.73%.

The credit market experienced a challenging start to the first quarter of 2026, as developments in Iran weighed on investor sentiment. January and February initially began on a positive note supported by strong economic data that provided tailwinds for risk assets, including high-yield bonds. Credit spreads widened minimally during this period, and investor demand for carry remained solid. However, sentiment shifted toward the end of February, when military strikes led to a sharp increase in oil prices and a rise in geopolitical uncertainty. This triggered a risk-off environment across financial markets.

High-yield bonds, which had performed well earlier in the quarter, came under pressure as spreads widened particularly in more cyclical sectors and lower-rated segments. Performance within high yield was notably uneven. The energy sector was a clear outperformer, benefiting from the surge in oil prices, while other sectors especially industrials and consumer-related credits lagged. At the same time, dispersion between regions became more pronounced. US high-yield generally held up better than its European counterpart, supported by a stronger macro backdrop and greater exposure to energy issuers. Liquidity conditions also became more fragile toward the end of the quarter, amplifying price movements. Overall, Q1 2026 highlighted the sensitivity of high-yield markets to geopolitical shocks, with a clear shift from a carry-driven environment to one increasingly dominated by macro and risk sentiment factors.

Positive relative return

The portfolio delivered a negative gross return of -0.55% in Q1 which was 0.18 percentage points more than the benchmark. Thus, year-to-date the portfolio has returned a gross return of -0.55%.

At the onset of the Iran conflict, the portfolio initially outperformed its benchmark, primarily due to its more defensive positioning in credit spreads. However, as the optimism towards a more peaceful resolution set in, the relative return was affected by the following:

Regional dispersion between European and US high-yield markets generally influenced performance with the portfolio's US underweight acting as a drag. This was however partly offset by an overweight in Northern European high-yield bonds.

From a ratings perspective, the portfolio's non-rated bonds contributed positively to relative returns, whereas its allocation to **BB-rated bonds detracted**.

Sector allocation also played a role. **An underweight to the energy sector** driven by ethical investment restrictions—proved detrimental, particularly as the sector delivered strong performance toward the end of the quarter. Similarly, an **overweight to financials** negatively impacted returns.

Furthermore, the portfolio's **overweight in European industrials** relative to the benchmark's larger allocation to US industrials detracted from performance.

Finally, a **distressed holding** within the aviation logistics sector entered restructuring during the period, resulting in a material negative contribution to the relative return. However **totally, the gross excess return was positive.**

Strategy

Ethical High Yield Value Bonds invests in global corporate bonds, cf. the fund's prospectus. Bond selection is based on the value approach, meaning that the team focuses on bonds issued by companies with healthy long-term earnings power and strong balance sheets as well as an expected ability to service outstanding debt. The portfolio is diversified across sectors, regions and credit ratings. At least 2/3 of the portfolio are invested in High Yield bonds. Up to 15% may be invested in corporate bonds issued by companies operating in Emerging Markets.