

Overview

High Yield Market Has Strong 2025 Finish

The US High Yield bond market provided solid returns again in the fourth quarter, as better-than-expected economic growth and an accommodative Fed helped drive returns. This macro backdrop allowed spreads and yields to retest recent tights as we ended the year, helping propel another year of high-single-digit gains for the market, according to JP Morgan data. As we enter 2026, there is limited room for much further spread compression. Most economic indicators are healthy, and corporate earnings growth remains strong. We believe this suggests that balance sheets should improve in 2026. This sets the stage for continued ratings improvement and a benign default environment that could potentially keep spreads at current low levels for the foreseeable future. This backdrop could see another year of coupon-plus returns, as returns benefit from stable spreads and the expected decline in US Treasury yields from Fed rate cuts.

Solid 4Q Returns End Year On A High Note

The US High-Yield bond market gained 1.52% in the fourth quarter of 2025, as slight spread tightening helped drive what is now the 13th consecutive quarter of positive returns for High-Yield bonds, according to JP Morgan data. At quarter's end, spreads fell 5 bps as a dovish monetary backdrop and positive growth data helped fuel investor optimism. Spreads tightened to 314 basis points, helping drive the Yield to Worse to 6.78% at Year End, just off the 2025 low of 6.75%. Given fourth-quarter gains, the High-Yield market produced an 8.97% annual return, a strong showing given robust 8.63% returns in '24 and 13.51% returns in '23. As we start 2026, spread levels remain near long-term lows versus the 20-yr median of 498 basis points. This environment suggests that the US High-Yield market is pricing in below-average defaults, and the rating agencies agree, with a strong underlying credit rating for market issuers.

By rating, higher-quality BB companies were the top-performing High Yield bonds in 4Q25, dethroning last quarter's top performers, CCC credits. BB returns hit +1.76% in the quarter, while riskier CCC credits returned only 0.24%. This strong 4Q performance helped cement BB bonds as the best-performing credits by rating for the year in 2025, with returns of 9.44%, handily beating returns from single-B bonds (8.56%) and CCC credits (+7.13%). By sector, Broadcasting captured the top spot for the fourth quarter, with returns of +3.57%, besting the second-best performer, Telecom, at +2.74%. At the other end of the spectrum, Retail

was the worst performing sector, with losses of 0.75%. These results were slightly worse than the Media sector, which posted losses of 0.67% during the quarter. For the full year 2025, Broadcasting captured the title of best sector performer, with returns of 16.3%, while Paper & Packaging ended the year as the index's worst sector performer, with anemic gains of only 3.74%.

Market credit quality, as measured by ratings, continued to improve in the fourth quarter, with the dollar-weighted Upgrade/Downgrade ratio reaching 1.6x. This indicates that the pace of credit upgrades has exceeded that of downgrades over the past three months. For the full year, the Upgrade/Downgrade ratio measured 1.3x, suggesting that market credit quality improved nicely over the course of the year. The US HY default rate also remains benign at 1.88% as of the end of 4Q25. This default level remains well below the historical average default rate of ~3.3%. Low defaults and strong credit quality provide justification for the tight spread environment exiting 2025.

Capital Market Indicators

The US High Yield primary market had its smallest issuance calendar of the year in the fourth quarter of 2025, according to JP Morgan, as only ~\$65bn of gross volume was placed. Refinancing activity remained the main driver of issuance, representing ~62% of new volume. By rating, issuance remained focused on higher-rated BB credits. In total, BB and Split BB-rated deals represented ~71% of the new bonds issued during the quarter. Low-quality CCC issuance crept up to ~4% of new volume in 4Q 2025 but remains subdued compared with recent levels. For the full year 2025, the US High Yield market recorded \$332 billion of gross issuance. This issuance level is significantly higher than in 2024, which reached only \$289 billion. Refinancings were the main driver of issuance for the full year, accounting for 70% of issuance volume, down from 76% in 2024. By rating, full-year 2025 issuance remained high-quality focused, with BB and split-BB credits representing ~60% of new issuance. This high-quality tilt to issuance has helped keep the majority of US High Yield market value at BB rating levels.

Defensive Short Duration High Income

The Defensive Short Duration High Income strategy, which holds mainly BB/B-rated bonds with an average portfolio maturity of 3 years or less, outperformed the ICE BofA 1-3 Year BB/B Rated US Cash Pay HY Index on a gross basis in 2025. The best-performing sector was Capital Goods, driven by smaller industrial companies, Wabash National, and Park-Ohio. The Media sector outperformed as we favored

broadcast affiliates over basic cable networks. The Basic Industry sector lagged, with paper companies Mercer International and Clearwater Paper underperforming. The Utility sector underperformed due to an underweight position, as the sector moderately outperformed the index during the year.

Defensive High Yield

The Defensive High Yield strategy slightly underperformed the ICE BofA BB-B US Non-Distressed HY on a gross basis in 2025. The Capital Goods sector outperformed during the year, led by O-I Glass, which successfully navigated a period of low demand in 2025. Consumer Goods were driven by food, Rise Baking, and distribution through KeHe Distributors, which passed rising inflation on to customers. The Financial Services industry saw strength from consumer payments company Bread Financial and Diebold Nixdorf. Telecom lagged as Cable One saw weak subscriber trends while preparing to acquire an affiliate. Additionally, Echostar (not owned) threatened bankruptcy and ultimately sold its spectrum assets to repay its debt. Within Healthcare, Fortrea experienced weak sales conversion as it completed its spin-out from Labcorp.

Opportunistic High Yield

The Opportunistic HY strategy outperformed the ICE BofA US HY Constrained Index in 2025. The Retail sector was the best performer, avoiding Saks Global while seeing the Foot Locker acquisition. In Media, Gray Media successfully termed out its capital structure and reduced its debt load during the year. The Healthcare sector lagged as Modivcare faced financial stress amid ambulance clients shifting from risk contracts to a cost-plus model. The Telecommunications sector lagged, with Cable One's weak results, as European telecom companies outperformed in an area not owned.

Outlook

High-Yield Market Continues to Have Solid Fundamentals

The High Yield market exhibited continued positive momentum through year-end, recovering from tariff fears on April 2, 2025, amid tightening credit spreads. The interest rate environment appears more constructive as the Federal Reserve resumed rate cuts in September. The High Yield market is at its highest credit quality in asset-class history, with slightly over 50% of bonds rated BB- or better. Most companies have termed their maturities out to the 2028-2030 period and have ample liquidity. Most issuer balance sheets are strong today and would require a prolonged downturn to pose a challenge to repayment. At this time, we believe the High Yield market is well positioned to manage any headwinds and seek to achieve solid returns in this backdrop.

Penn Capital Products	QTD	YTD	1 YR	3 YR	5 YR	10 YR	Since Inc.	Inc. Date
Net Performance (%) – as of Dec 31, 2025								
Small to Mid Cap Equity	-0.67	13.64	13.64	10.85	5.18	8.67	9.24	Dec-02
<i>Bloomberg 2500 Index</i>	1.84	10.84	10.84	13.48	7.11	10.27	11.17	
Small Cap Equity	-1.17	14.85	14.85	12.62	8.83	10.40	11.87	Dec-93
<i>Bloomberg 2000 Index</i>	2.41	11.06	11.06	13.32	6.64	10.00	10.31	
Smaller Company Equity	0.28	14.69	14.69	14.82	11.91	17.00	16.23	Dec-11
<i>Bloomberg 2000 Index</i>	2.41	11.06	11.06	13.32	6.64	10.00	11.10	
Micro Cap Equity	-3.72	8.66	8.66	3.06	0.12	6.32	7.46	Aug-06
<i>Bloomberg Microcap Index</i>	1.01	12.73	12.73	9.45	3.39	8.40	7.27	
Defensive Short Duration High Income	1.76	7.88	7.88	7.85	4.91	4.48	4.08	Jan-13
<i>ICE BofA 1-3 Year BB US Cash Pay High Yield Index TR</i>	1.58	7.22	7.22	7.58	4.50	4.98	4.47	
Defensive High Yield	1.63	8.35	8.35	9.24	4.08	5.19	6.39	Dec-93
<i>ICE BofA BB-B US Non-Distressed High Yield Index TR USD</i>	1.62	9.00	9.00	9.29	4.12	5.87	-	
Opportunistic High Yield	1.86	8.59	8.59	9.80	4.22	6.05	6.88	Dec-93
<i>ICE BofA US HY Constrained Index</i>	1.35	8.50	8.50	10.02	4.50	6.43	-	

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At Penn Capital, we believe that understanding a company's entire capital structure is the best way to identify investment opportunities with the most value. In fact, we've found that managing bond portfolios makes us better equity managers, and vice versa.

Employing a fully integrated credit and equity research process, we focus on non-investment grade companies in the micro to mid-capitalization range, where we can take advantage of inefficient security pricing.

We are a boutique investment management firm based in Philadelphia, PA. We forge our own ideas, we respect hard work, and we are committed to our clients, our staff and our community.

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A copy of Penn Capital's current written disclosure statement discussing our advisory services and fees is available upon request.