

Overview

High Yield Market Sees a Strong Rebound in Q2 2026

The US High Yield bond market posted a solid rebound in Q2 after a negative Q1 2026 as investors dealt with a highly uncertain conflict in the Middle East, rapidly rising rates, and the largest retail withdrawals since Liberation Day. High-yield bond yields and spreads fell as Treasuries remained stubbornly higher due to lingering inflation concerns. The default environment remains manageable with the par-weighted HY bond default rate at 2.67%, below the 25-year average of 3.2%. If macro concerns recede then the US High Yield bond market should return to fundamentals and coupon returns.

Strong Q2 Returns as Market Sees Past Geopolitics

The US High Yield bond market posted a 1.89% gain in Q2 2026. Spreads tightened by 53 basis points during the quarter to 275 basis points while the Yield to Worst fell 29 bps to 7.15% as rates rose. For reference, HY spreads touched a post-GFC low of 295 bps on January 22nd before widening to as high as 373bp on March 30th. High Yield spreads neared the January tights in June before widening as Treasuries outperformed High Yield existing the quarter. The Q2 2026 index return of 2.46% was the best return since Q2 2025 when the market recovered from the Liberation Day tariff selloff.

By rating, CCC bonds outperformed in 2Q26 with a return of 3.40% compared to Single-B bonds at 2.76% and BB credits at 2.24%. By sector, Financial Services (3.57%) was the strongest performer in 2Q26 followed by Leisure (+3.26%) and Automotive (+3.20%). At the other end of the spectrum, Insurance (0.74%) was the worst performing sector in the quarter followed by Media at 0.91%.

In 2Q26, there were three payment defaults totaling \$12.4bn and three distressed transactions totaling \$1.6bn. Including distressed exchanges, the par-weighted US high-yield bond stands at 2.67% compared to the 25-year average HY default rate of 3.2%. JP Morgan's forecasted 2026 high-yield bond remains at 1.75% with a forecast to rise to 2.25% in 2027, well below the long-term average. The current lending market continues to be constructive though default forecasts can change quickly based on market and geopolitical events.

Capital Market Indicators

Capital markets for high-yield bonds produced higher activity in 1Q26 with bond issuance totaling \$91.9bn (\$43.6bn ex-refi) and Year to Date Gross New Issuance volume of \$171B vs \$122B and Net New Issuance volume of \$76B vs 32B. Net new issuance volume has increased to \$76B Year to Date vs \$32B over the same period last year. AI financing is a growing area of the High Yield market but is less than 5% of total issuance. Most AI related deals are 5-year maturity that fund data center construction where the borrower has a 15-year lease with an IG rated hyperscaler as the counterparty.

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 during Q2 2026. The best performing sector was Retail driven by Bloomin' Brands as management executes a turnaround at Outback Steakhouse. The Basic Industry sector had solid performance from homebuilders despite higher interest rates. In Leisure, Penn Gaming improved cash flow by focusing on their regional gaming properties. On the downside, the Capital Goods sector saw weakness in a trucking supplier due to slow current ordering patterns despite a firming pricing outlook for customers. The Automotive sector performance lagged due to conservative positioning as the sector outperformed during the quarter.

Defensive High Yield

The Defensive High Yield strategy slightly outperformed the ICE BofA BB-B US Non-Distressed HY on a gross basis during Q2 2026. Transportation sector outperformed as trucking freight rates improved for RXO, a logistics company, due to a tightening supply of qualified drivers. The Basic Industry area saw broad strength as cyclical companies gave improving outlooks as geopolitical concerns ebbed and customer confidence rose. In Consumer Goods, staples companies saw slowing input cost inflation improving product margins. Healthcare struggled as Emecta lost market share at a large drug store, reducing 2026 cash flow guidance. Capital Goods saw weakness in suppliers to the recreational vehicle market as consumer demand was soft due to geopolitical concerns. Underweighting Automotive lead to index outperformance as Nissan Motors provided a positive financial update.

Opportunistic High Yield

The Opportunistic HY strategy outperformed the ICE BofA US HY Constrained Index on a gross basis during Q2 2026. The Media sector outperformed as Snap recovered and the strategy avoided Altice, a weak cable and Internet provider. In Transportation, VistaJet continues to see improving subscription trends as customers purchase more flight hours as they extended bond maturities. In Consumer Goods, Herbalife saw solid margin improvement as they expanded their distributor base. The Basic Industry sector lagged as Mercer International saw headwinds from weak pricing and higher input costs in a shifting tariff landscape. The Healthcare sector saw weakness in the Hospital sector due to weaker admissions and payor trends. Underweighted the Automotive sector which outperformed during the quarter driven by parts suppliers.

Outlook

High Yield Market Outlook Should Get Back to Fundamentals

If geopolitical concerns recede, the US High Yield market can return to underlying fundamentals. The High Yield market has its highest credit quality in asset class history with over 50% of bonds rated BB- or better. Most companies have termed their maturities out to the 2028-2030 period and have ample liquidity. We believe strong underlying credit fundamentals and 2H 2026 earnings constructiveness should help support the market to return to coupon returns.

Penn Capital Products		QTD	YTD	1 YR	3 YR	5 YR	10 YR	Since Inc.	Inc. Date
Net Performance (%) – as of June 30, 2026									
Small to Mid Cap Equity		22.98	22.01	30.80	15.54	6.32	10.77	9.96	Dec-02
<i>Bloomberg 2500 Index</i>		16.64	19.06	32.39	17.07	7.39	11.73	11.75	
Small Cap Equity		24.56	27.87	41.05	19.03	8.26	13.17	12.53	Dec-93
<i>Bloomberg 2000 Index</i>		20.97	23.03	40.92	18.49	7.11	11.96	10.85	
Smaller Company Equity		29.76	31.01	47.96	22.27	10.36	20.04	17.81	Dec-11
<i>Bloomberg 2000 Index</i>		20.97	23.03	40.92	18.49	7.11	11.96	12.29	
Micro Cap Equity		18.85	14.18	20.25	6.35	-3.68	7.67	7.99	Aug-06
<i>Bloomberg Microcap Index</i>		18.44	16.39	39.21	14.37	-0.54	10.25	7.91	
Defensive Short Duration High Income		1.97	2.10	5.70	7.29	4.82	4.39	4.08	Jan-13
<i>ICE BofA 1-3 Year BB US Cash Pay High Yield Index TR</i>		1.76	1.95	5.18	7.02	4.42	4.67	4.46	
Defensive High Yield		2.39	1.82	5.53	8.14	3.86	4.90	6.35	Dec-93
<i>ICE BofA BB-B US Non-Distressed High Yield Index TR USD</i>		2.44	2.04	6.09	8.38	3.96	5.45	-	
Opportunistic High Yield		2.60	1.82	5.91	8.60	3.66	5.65	6.83	Dec-93
<i>ICE BofA US HY Constrained Index</i>		2.45	1.89	5.74	8.78	4.13	5.69	-	

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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.