

Credit Spreads

Dancing on Glass

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Preamble

Corporate bond yield spreads vs. Treasuries are currently at the tightest (lowest) level in 20 years. The last time spreads were at this level was the period preceding the Great Financial Crisis (GFC) in 2008.

When spreads trade at record tights, it is the direct result of market complacency and an overreach for yield.

The validity of signals originating from the fixed income markets cannot be overstated. There is no greater incorruptible prognostication that the 3 year rally in global risk assets is its final stages.

The Basics

Quick review of concepts covered in this report.



Credit Spread

['kre-dit 'spred]

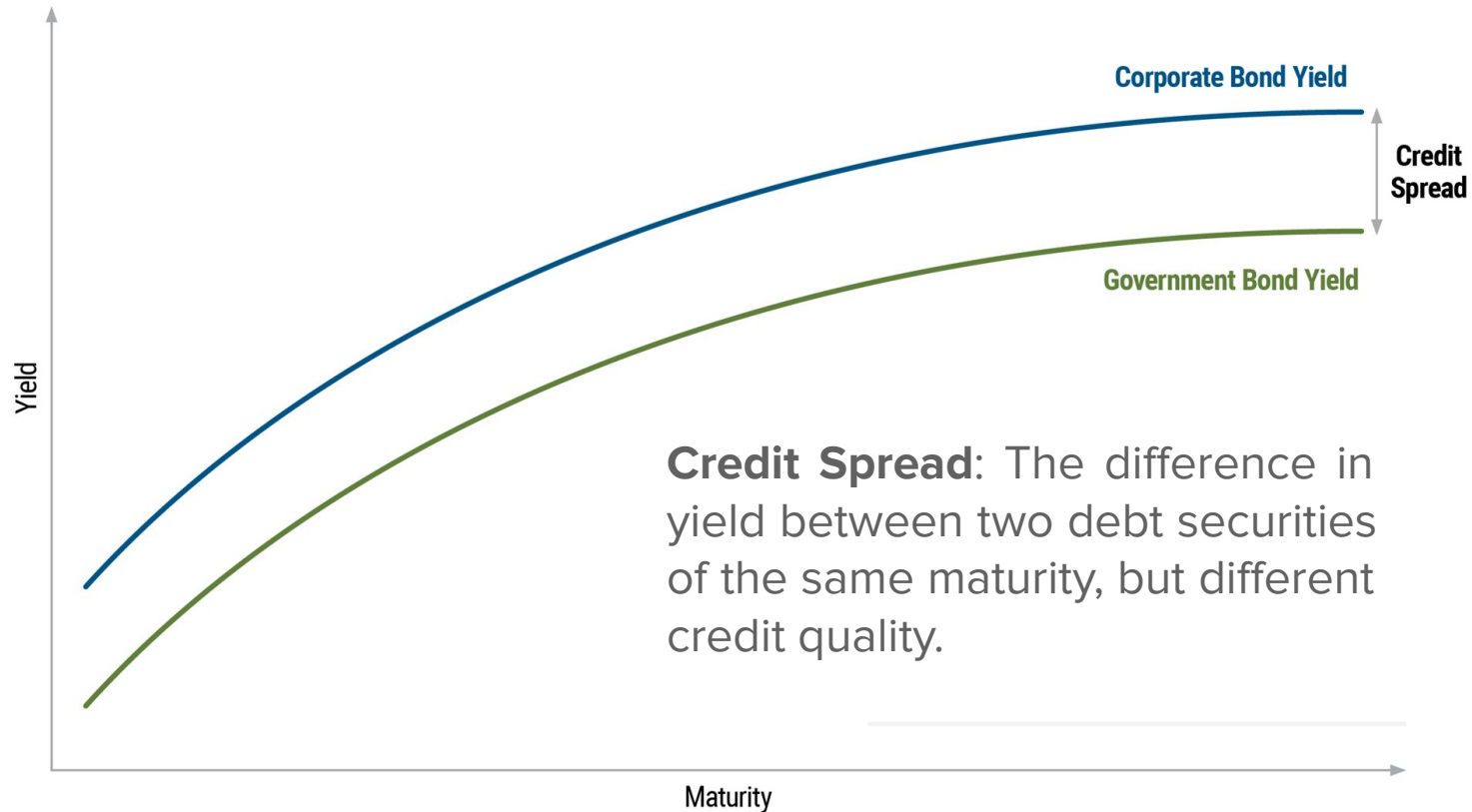
The difference in yield between two debt securities of the same maturity but different credit quality.

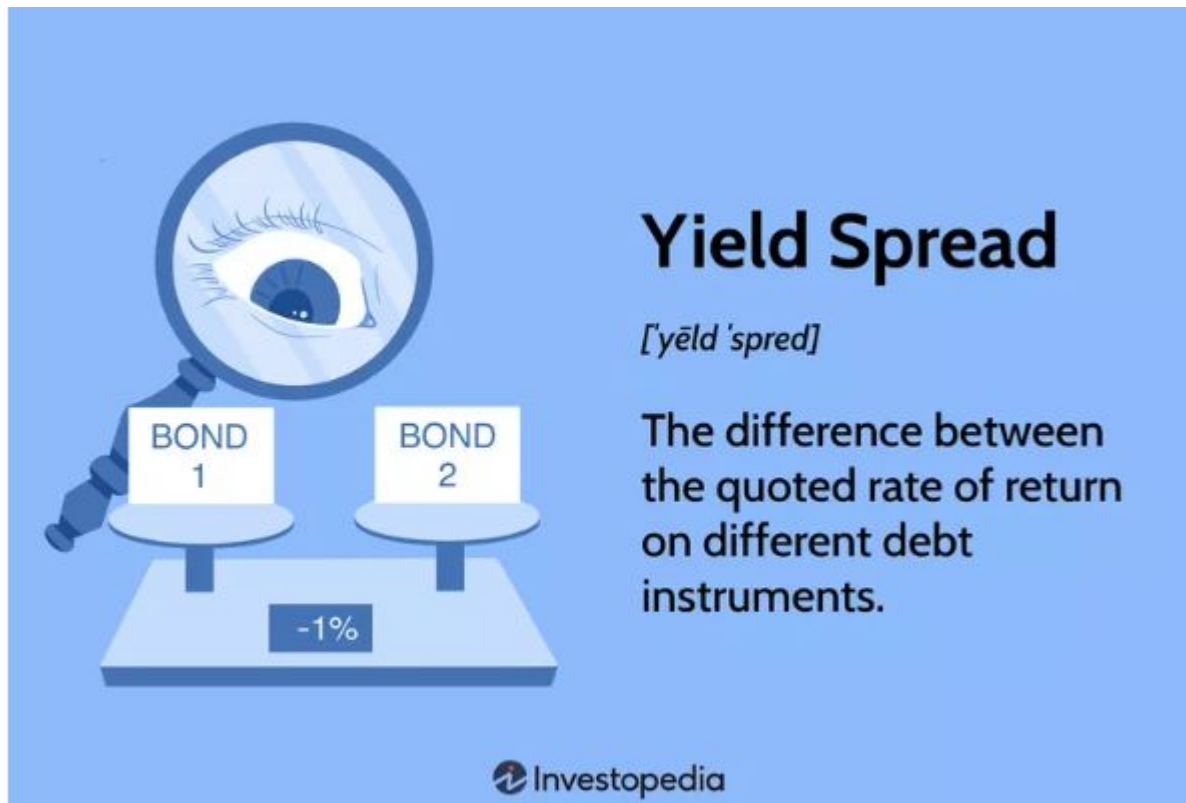
 Investopedia

- A credit spread is the difference between the quoted rate of return on two different debt instruments

Non-Treasury bonds are generally evaluated based on the [difference between their yield and that of a Treasury bond](#) of comparable maturity.

Credit Spread | Example





- A yield spread is the difference between the quoted rate of return on two different debt instruments
- The spread is calculated by subtracting the yield on one security from that of the other security.
- Yield spreads are often quoted in terms of a yield versus U.S. Treasuries; or alternatively, versus AAA-rated corporate bonds.
- Spreads are expressed in a percentage or basis points.

Non-Treasury bonds are generally evaluated based on the [difference between their yield and that of a Treasury bond](#) of comparable maturity.

The Basics | Yield Spreads

A bond yield spread is the difference in interest rates between two different bonds, usually of similar maturity but varying credit quality or issuer type. It measures the extra return investors demand for taking on additional risk. Spreads are typically quoted in basis points (bps), where 100 bps = 1%.

Importance of Yield Spreads:

Yield spreads act as a key indicator of economic health and market sentiment. The yield of every bond is comprised of 2 components:

1. **Benchmark Rate**: The "risk-free" rate, represented by a U.S. Treasury bond of equal maturity length.
2. **Spread**: The risk premium added to compensate for default risk, inflation, or liquidity concerns.

The Basics | Yield Spreads

Types of Yield Spreads:

- **Credit Spread** (Option-Adjusted Spread / OAS): Compares the yield of a corporate bond to a government bond of the same maturity. It indicates the financial stability of the issuer.
- **Yield Curve Spread**: Compares bonds from the same issuer (like U.S. Treasuries) but with different maturity dates. This measures the economic outlook, such as the gap between the 2-year and 10-year Treasury yields.

The Basics | Credit Spreads

- **Narrowing** (Tightening): Spreads shrink when market confidence is high. Investors are willing to buy riskier corporate bonds because they trust the economy, causing corporate bond prices to rise and their yields to drop relative to Treasuries.
- **Widening**: Spreads grow when the economy struggles or uncertainty rises. Investors execute a "flight to safety," selling off riskier corporate bonds (pushing their yields up) and buying safe Treasuries (pushing their yields down).

For more, see [FINRA Bond Spread Guide](#) or [Investopedia's Yield Spread Overview](#) for more details.

The Basics | Yield Spreads

- **Steepening**: Short-term yields are much lower than long-term yields. This usually signals expectations of economic growth and higher inflation.
- **Flattening/ Inverting**: Short-term yields are equal to or higher than long-term yields. An inverted curve is closely watched, as it historically signals impending economic slowdowns or recessions. In an efficient market, only treasuries can display an inverted yield curve; corporates cannot because of the non-zero probability of default.

See [FINRA Bond Guide](#) or [Investopedia's Yield Spread Overview](#).

IG Credit Spreads

Corporate Investment Grade (IG) spreads vs. Treasuries are currently at the tightest level in 20 years. The last time spreads were at this level was the period preceding the GFC in 2006

Spreads Signal Equity Market Transitions

Bond markets are heavily institutionalized; as such, credit spreads most often react to systemic threats and economic declines ahead of equity markets.

Because the broad benchmark spread sits at an exceptionally tight 0.73% (73 basis points), the relationship between bond spreads and stock market risk requires specific context to interpret accurately.

Credit spreads represent the "fear premium" in the corporate world. When equity investors are overly optimistic, bond investors are often already pricing in the following structural realities:

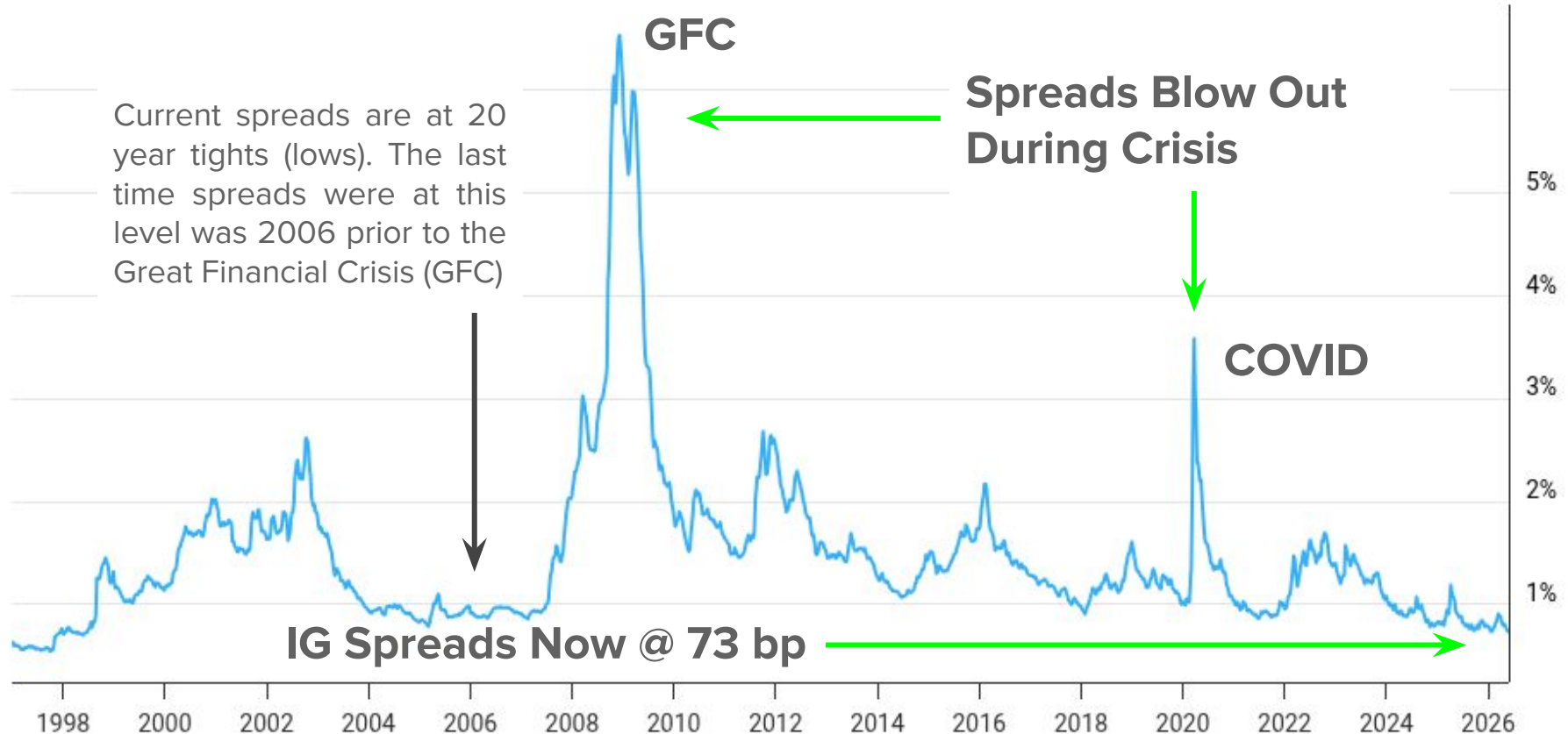
Spreads Signal Equity Market Transitions

- **The Leading Indicator Effect**: When an economy slows down, a corporation's cash flow shrinks, making its debt riskier *before* its stock price reflects a full earnings recession. This causes bond investors to immediately demand higher yields, widening the spread.
- **Capital Structure Priority**: Bondholders are paid before stockholders. If investment-grade spreads widen, it means institutional investors are worried about the safety of top-tier debt. It stands to reason everything below senior debt in the capital stack is fundamentally much more vulnerable.
- **Liquidity Inversion**: Stock markets can remain irrational and highly valued on momentum. The bond market relies entirely on math & balance sheets to calculate debt-service capabilities.

Historically Tight IG Spreads Signal Danger

- **Asymmetric Risk Profile**: At 73 basis points, spreads are statistically $< -3\sigma$ (statistically, - 3 std deviations). Risk-reward relationship is heavily skewed toward widening. Any macroeconomic shock will cause spreads to snap wider violently.
- **No Safety Cushion**: According to [Morningstar's market analysis](#), the *long-term historical average for IG spreads is 132 basis points*. Today's narrow spread leaves equity markets with virtually zero margin for error regarding unexpected inflation spikes, geopolitical shocks, or corporate earnings misses.

IG Corporate Spreads - TODAY

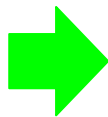


ICE BofA US Corporate Option-Adjusted Spread

Historical Long-term Average: **1.3%**



Historically Tight IG Spreads Signal Danger



Current Spread: 73 bps → [High Complacency/ Richly Priced]

Historical Avg: 132 bps → [Fair Value/ Symmetric Risk]

Recession Peak: 300+ bps → [Equity Panic/ Market Capitulation]

The current spread of 73 bps indicates extreme market complacency.

High Yield Credit Spreads

Spread compression caused by the overreach for yield in the high yield “junk” bond space is even more severe than in corporate IG credits.

The long-term historical average yield spread of junk bonds (high-yield corporate debt) over U.S. Treasuries is between 4.5% and 5.2% (450 to 520 basis points).

The exact long-term benchmark baseline varies slightly depending on the specific time horizon tracked: [1]

- 25-Year Average (1997–2026): 5.21% based on the [ICE BofA U.S. High Yield Master II Index](#).
- 20-Year Average (2000–2026): ~5.00% (500 bps).
- 15-Year Average (2010–2025): 4.50% via the Bloomberg U.S. High Yield Index. [1, 2, 3, 4]

Key Historical Spreads by Economic Environment

High-yield spreads fluctuate wildly because they represent the "risk premium" investors demand to hold debt that has a higher likelihood of defaulting.

Current Valuation Standings (June 2026)

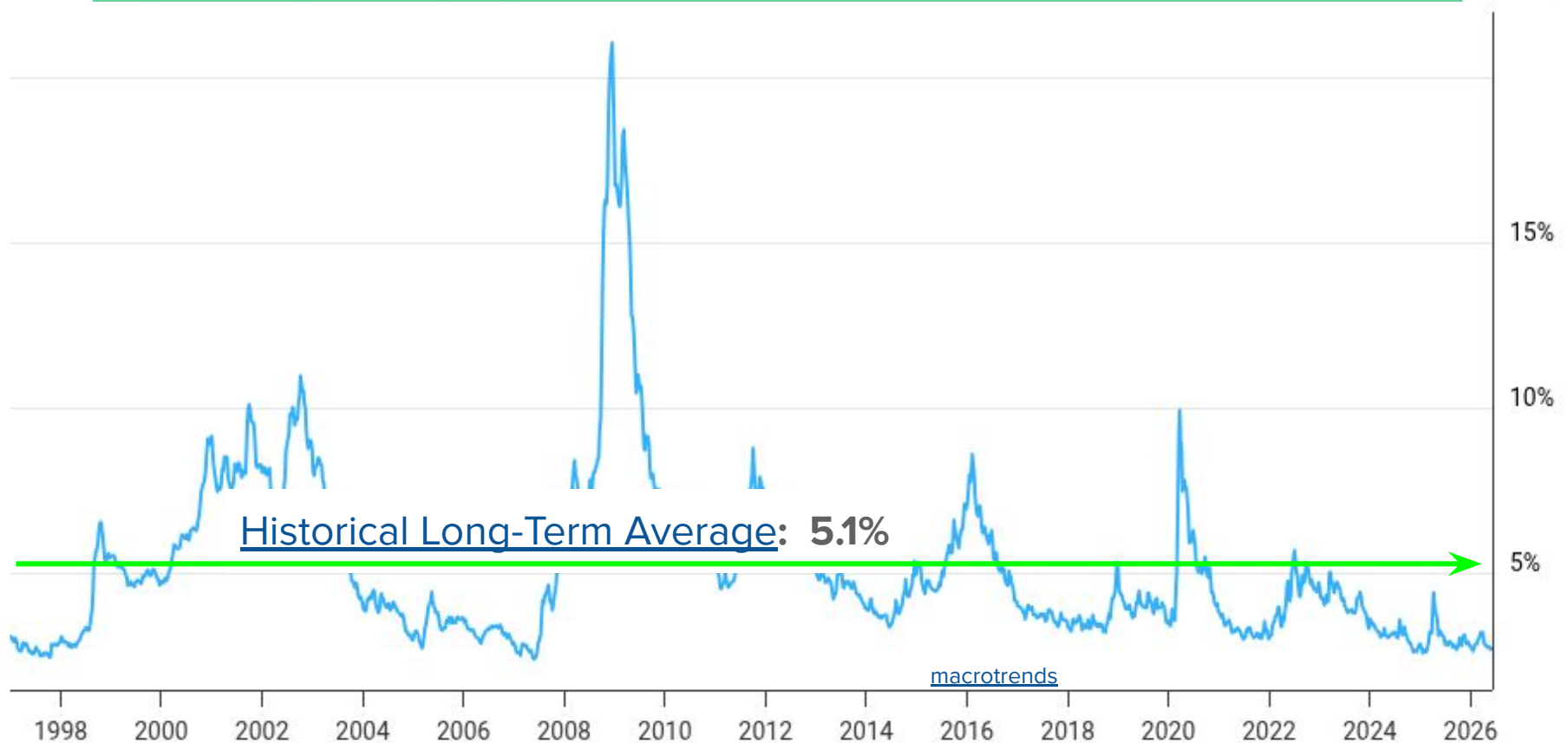
As of June 2026, the high-yield bond spread is sitting at 2.78% (278 basis points). This indicates a highly aggressive market environment: [1, 2]

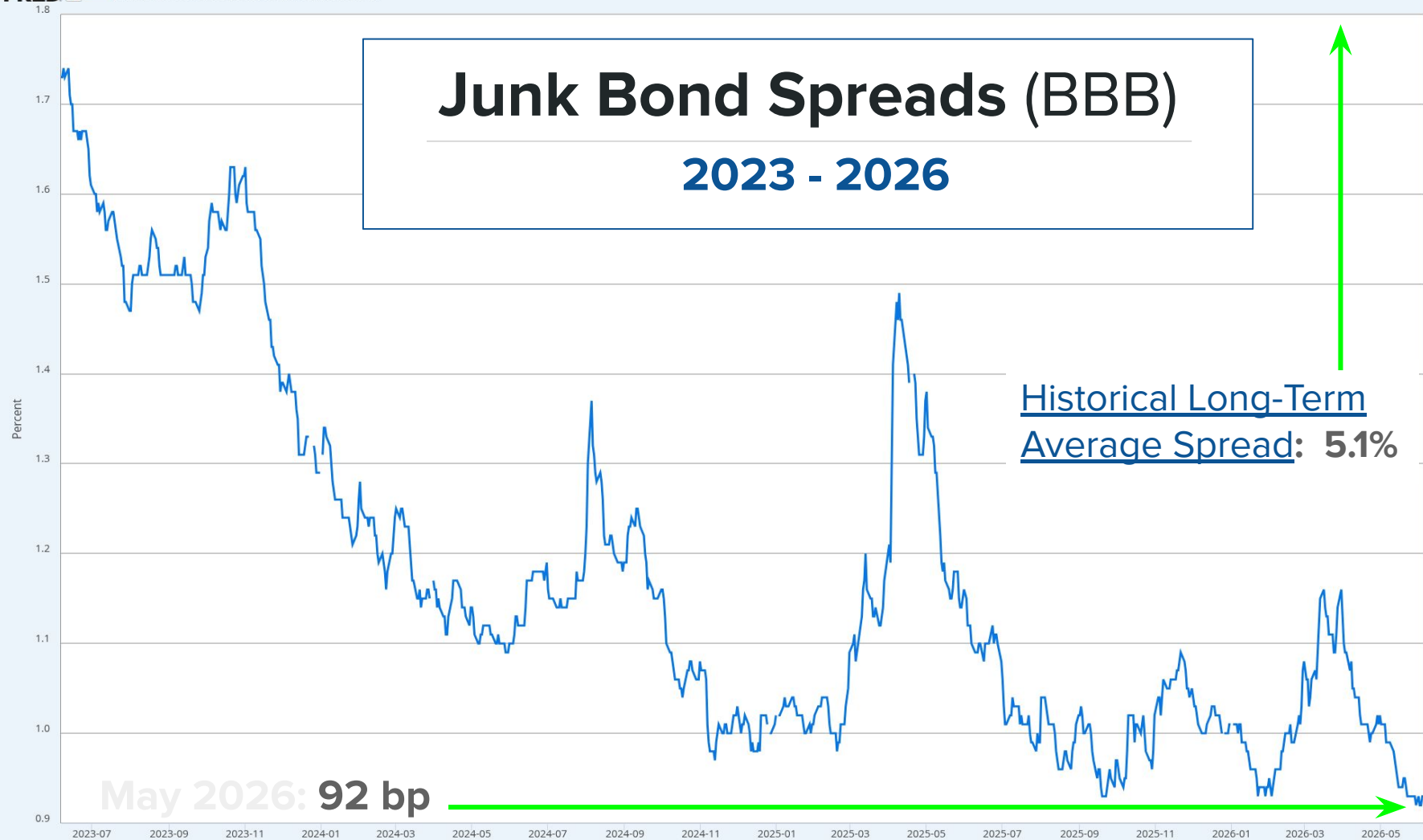
- Extreme Compression: The current spread is significantly below the long-term historical norm of 5.18%. [1]
- Risk Appetite: Spreads near or below 3.0% signal immense investor optimism, economic confidence, and highly favorable financing conditions for corporations. [1]
- Asymmetric Risk: According to analysts tracking [Charles Schwab's market data](#), when spreads fall below the standard 4.0% threshold, the potential rewards rarely justify taking on high-yield default risks.

See Excellent Article/ Graphs: <https://www.currentmarketvaluation.com/models/junk-bond-spreads.php>

Market Condition	Average Spread Range	Historic Context Examples
Recession / Crisis Peaks	> 10.0% (>1,000 bps)	2008 Global Financial Crisis (~21.8%) 2001 Dot-Com Crash (~11.5%) 2020 Pandemic Shock (~11.0%)
Historical Baseline	4.5% – 5.2% (450-520 bps)	Long-term macroeconomic norm
Economic Expansion Lows	< 3.5% (<350 bps)	Late 1990s Boom Late 2007 pre-GFC Current Era (June 2026)

Junk Bond Spreads (1998-2026)





Hi-Yield (Junk) Bond Valuation Thresholds:

- **Extreme Compression**: The current spread is significantly below the long-term historical norm of 5.18%.
- **Risk Appetite**: Spreads near or below 3.0% signal immense investor optimism, economic confidence, and highly favorable financing conditions for corporations.
- **Asymmetric Risk**: According to analysts tracking [Charles Schwab's market data](#), *when spreads fall below the 4.0% threshold, the potential rewards rarely justify taking on high-yield default risks.*

Criticality of Junk Spreads @ 92 bps

- Treasuries are the “risk-free” investment; ie, return of principal is guaranteed by the U.S. Government.
- Junk credits are bonds issued by companies with questionable credit histories and/ or weak financials.
- Junk bonds are typically uncollateralised debt unsecured by any physical assets in the event of default.
- Using housing as a metaphor, at a spread of 92 bps, one receives less than 1% per year of additional return for lending to a “*subprime*” borrower vs. a risk free borrower.
- The following table illustrates the end result when there is an over reach for yield compressing spreads:

Spreads: Infallible Precursor/ Coincident Indicator

Macroeconomic Event	S&P 500 Drawdown	IG Spread Before	Peak IG Spread (Panic)	Lead/ Lag/ Coincident
Dot-Com Crash (2000–2002)	-49.10%	1.15% (1999)	2.76% (2002)	Led
Great Financial Crisis (2007–2009)	-56.80%	0.85% (2007)	6.56% (2008)	Led/Coincided
Eurozone Debt Crisis (2011)	-19.40%	1.20% (2011)	2.34% (2011)	Coincident
Recession/ Oil Crash (2015–2016)	-14.20%	1.10% (2014)	2.21% (2016)	Led
Fed Rate Hike Cycle (Q4 2018)	-19.80%	0.92% (2018)	1.59% (2019)	Coincident
COVID-19 Crash (March 2020)	-33.90%	0.94% (2020)	4.01% (2020)	Slight Lag
Inflation / Rate Shock (2022)	-25.40%	0.90% (2021)	1.65% (2022)	Coincident

Historically Tight Spreads Signal Danger

- **Asymmetric Risk Profile**: At 73 basis points, spreads are statistically $< -3\sigma$. Risk-reward relationship is heavily skewed toward widening. Any macroeconomic shock will cause spreads to snap wider violently.
- **No Safety Cushion**: According to [Morningstar's market analysis](#), the long-term historical average for IG spreads is 132 basis points. Narrow spreads leave equity markets with zero margin for error regarding unexpected inflation spikes, geopolitical shocks, or corporate earnings misses.

Historically Tight Spreads Signal Danger

- **Current Spread.** The ICE BofA US Corporate Index Option-Adjusted Spread (OAS), the primary benchmark chart for US investment-grade corporate bonds, is 0.73% (73 basis points).
- **Spreads Trading Near Multi-decade Tights,** well below the long-term historical average of 132 basis points. This indicates that investors are demanding very little extra premium over risk-free US Treasuries to hold corporate debt in a “over reach for yield”.

Current Spreads vs. Historical Comparison

Credit Quality Rating Tier	Current Spread Level (Basis Points)	Historical Long-Term Average
AAA	52 bps (0.52%)	~60–80 bps
AA	48 bps (0.48%)	92 bps
A	65 bps (0.65%)	~110 bps
BBB	93 bps (0.93%)	189 bps

Spreads have tightened consistently over the past year, compressed by resilient corporate earnings and strong economic growth.

Risk Thresholds to Monitor

1. **The 100 Basis Point Line**: Analysts consider a sustained break above 100 bps on the core ICE BofA index to be the initial warning sign of credit market deterioration.
2. **The 130 Basis Point Line**: Moving past 130 bps signals a structural turn in the credit cycle, historical reversion, and potential price declines for broad corporate bond funds.

Risk Thresholds to Monitor

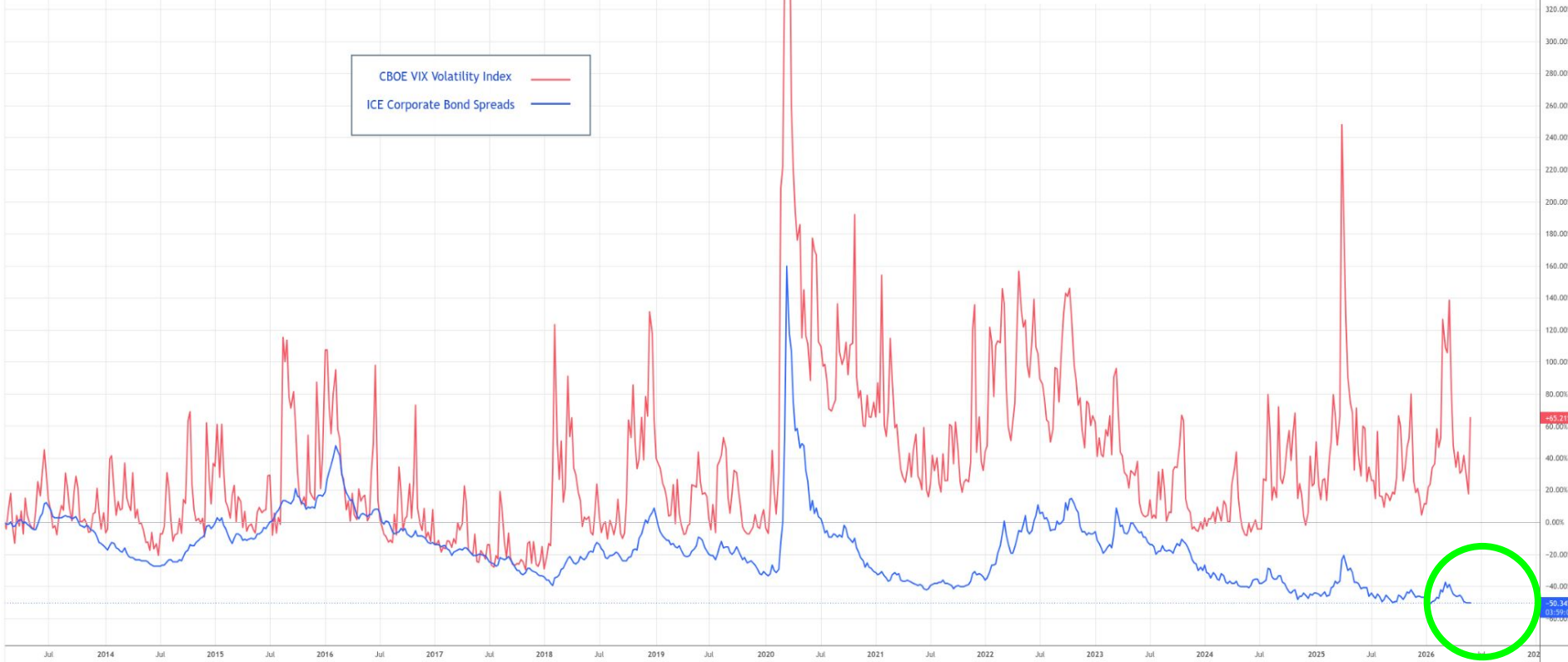
3. **Near Future, New Supply**: Gross investment-grade corporate bond issuance is projected to exceed \$2 trillion in 2027, which could pressure spreads to widen later in the year as the market absorbs new debt supply. Investment-grade issuance above the annual $+2\sigma$ level (2 standard deviations) indicates an excessive supply of new bonds that must be absorbed by the current corporate bond market.

ICE BofA US Corporate Index Option-Adjusted Spread - 1W - ICE -50.34%
VIX - CBOE 65.21%

VIX Volatility Index

VS.

Corporate Bond Spreads



Conclusions

Important Takeaways and Actions to Consider

00 Index - 1M - SPCFD 07,582.29 H7,620.90 L7,237.85 C7,394.31 (-2.45%)
55, close) 1,253.41
200, close) 1,063.39

S&P500 Index



APPENDIX

Additional Information

References

Reference 3: The long-term historical average yield spread of junk bonds (high-yield corporate debt) over U.S. Treasuries is between 4.5% and 5.2% (450 to 520 basis points).

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(CONTINUED)

References: 1Y Interest Rates **vs.** Inflation



