

Leveraged Finance Asset Allocation Insights

Navigating the AI Credit Divide

- The leveraged finance market is confronting an “AI faultline” whereby the early promise of operational efficiency is giving way to clear fractures in legacy business profiles in certain issuer segments.
- Our outlook remains split along a stark credit dichotomy: technology hardware and utility power providers continue to rally on data center expansion, while enterprise software and tech-enabled business services face structural revenue erosion and margin pressure.
- While we remain fundamentally constructive on both high yield bonds and leveraged loans due to their attractive all-in yields, we currently favor high yield bonds given headwinds facing the leveraged loan market.
- Leveraged loans carry a heavy, concentrated exposure to technology and software credits, a cohort that is uniquely vulnerable to AI workflow disruption and near-term rating migration penalties. The loan market displays an intensifying fundamental divergence, where opportunistic top-tier repricings coexist with bottom-tier restructurings.
- CLO managers are executing aggressive credit de-risking strategies, underweighting software exposures to mitigate downgrade risk. Strong institutional technicals and rising retail ETF inflows support secondary spreads, but structural return alpha will heavily favor active managers who insulate their portfolios from lower-tier technology defaults.

During the past several weeks, the leveraged credit markets have arrived at a highly complex macroeconomic crossroads. Sticky inflation data – underscored by a hot year-over-year consumer price index (CPI) print – collided with volatile geopolitical headlines that briefly pushed crude oil prices near multi-year highs. This hardening macro backdrop completely upended the rates backdrop. Treasury investors switched from anticipating near-term Federal Reserve policy cuts to pricing in explicit interest rate hike risks, with forward markets placing an overwhelmingly high probability on a final interest rate increase by the winter voting session. This sudden upward trend in Treasury rates brought back a tactical bid for floating-rate asset classes. Leveraged loans briefly overtook high yield bonds in total return performance year-to-date, supported by the carry component, given the healthy yield premium over fixed-rate corporate debt. Concurrently, strong demand allowed issuers to run a massive refinancing wave, expanding the repriceable share of the institutional loan index to its highest level of the year.

However, we view this floating-rate outperformance as a near-term phenomenon. A rising percentage of lower-quality loan issuers face a maturity wall over the next two years. With policy rates staying higher for longer, these lower-rated issuers face compressed interest coverage ratios. When combining these upcoming maturity considerations with secular AI workflow disruption, the credit baseline shifts in favor of high yield over loans. High yield bonds are more insulated from these near-term maturity walls and exhibit minimal software concentration risk. Accordingly, our view has shifted away from broad floating-rate loan beta and toward fixed-rate high yield bonds, which offer the opportunity to lock in attractive all-in yields, and we believe the Treasury market may provide an attractive entry point for longer-term investors.

This material must be read in conjunction with the disclosure statement.

21 May
2026

About This Report

This is a quarterly publication which encapsulates insights of the Leveraged Finance Team at PineBridge Investments, a MetLife Investment Management company. Our global team of investment professionals convenes in a live forum to evaluate, debate, and establish top-down guidance for the leveraged finance investment universe. Using our independent analysis and research, driven by our Fundamentals, Valuations, and Technicals framework, we assess the pulse of high yield, leveraged loans, and CLOs.

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Key Data

		Spread (bps)				Yield (%)			
		Current	3-year median	5-year median	10-year median	Current	3-year median	5-year median	10-year median
High yield	Index	267	302	312	359	7.15	7.47	7.46	6.57
	BB	159	183	205	230	6.06	6.28	6.22	5.20
	B	289	289	322	361	7.39	7.40	7.43	6.54
	CCC	700	700	714	727	11.41	11.21	11.27	10.38
Leveraged loans	Index	430	427	429	422	8.13	9.05	8.52	6.56
	BB	248	274	302	298	6.15	7.36	6.96	5.01
	B	431	433	436	438	8.1	9.13	8.63	6.81
	CCC	1959	1305	1264	1188	24.78	19.05	18.63	14.38
CLOs	Index	230	231	255	245	6.25	6.26	6.10	4.63
	AAA	114	127	130	128	5.03	5.22	5.12	3.71
	AA	147	171	178	181	5.37	5.66	5.60	4.30
	A	193	218	232	240	5.88	6.03	6.01	4.85
	BBB	337	355	362	363	7.42	7.30	7.30	6.07
	BB	729	766	769	731	11.46	11.55	11.54	9.85
	B	1112	1197	1197	1114	15.48	16.15	16.07	14.11

Source: Bloomberg as of 21 May 2026. High yield represented by the Bloomberg US Corporate High Yield Index; spread is OAS and yield is yield-to-worst. Leveraged loans represented by the Morningstar LSTA Leveraged Loan Index; spread is spread-to-maturity and yield is yield-to-maturity. CLOs represented by the JPM Post-Crisis CLOIE; spread is discount margin to worst and yield is yield-to-worst. Methodologies used differ between asset classes to account for differences in characteristics, including, but not limited to, call protection, reference rate, cash flows, coupon rates, and embedded options.

High Yield Bonds

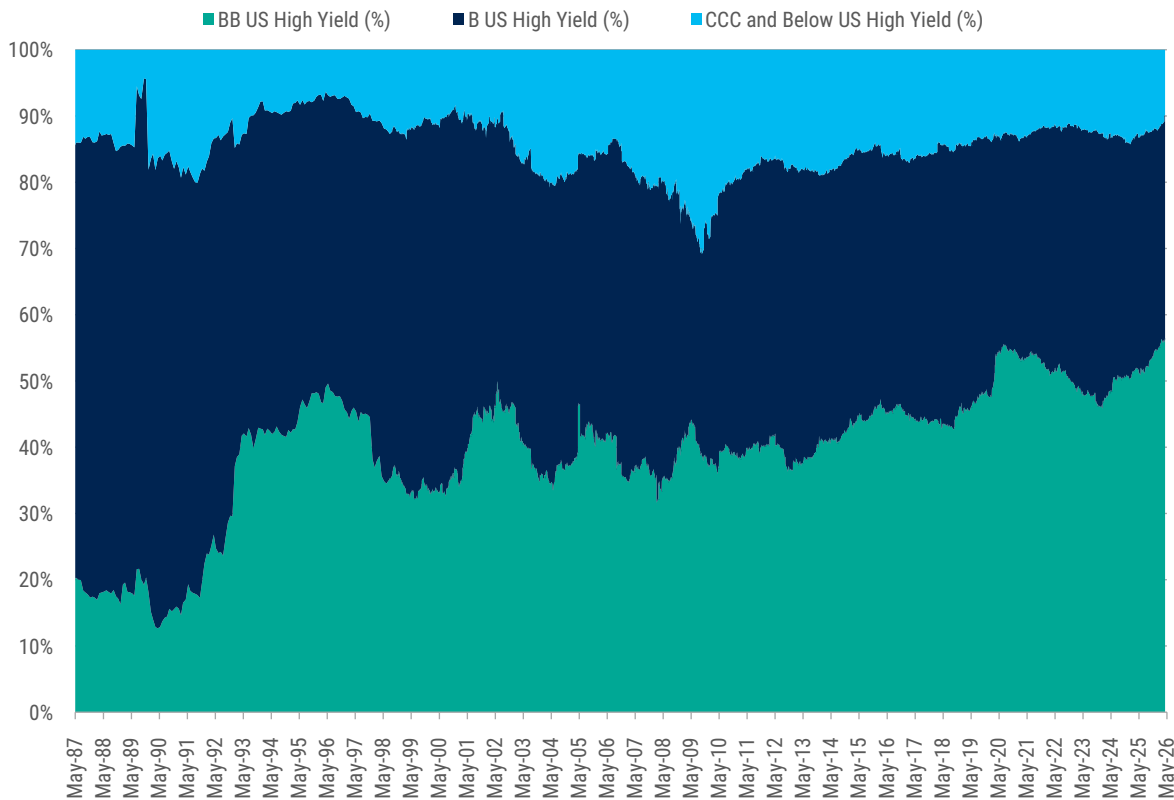
Overall, we continue to expect positive, carry-based total returns for high yield bonds. While spreads remain relatively tight, we view relative valuations as reasonable given the lower concentration of AI-vulnerable issuers in the high yield market.

Throughout the past three to four months, credit markets have focused intensely on the intermediate- to long-term threat of generative AI to legacy business models, keeping software and business services issuer spreads wider than those for the broader market. While we believe AI will fundamentally affect a range of companies, we also believe the breadth of related sectorwide selling pressure has created attractive total return opportunities in certain instances. Fundamental credit health remains firm; par-weighted default rates ticked up only marginally, staying at a very manageable level relative to long-term historical averages. Ratings activity has trended positively, insulating the benchmark from immediate downgrade stress. Primary issuance has slowed recently, although year-to-date gross volume appears to easily outpace last year's level. We expect this will be heavily front-loaded, implying more balanced technical conditions for the remainder of the year.

That being said, valuations are tight. The Bloomberg US Corporate High Yield Index spread-to-worst is at 299 (BB 188, B 325, CCC 729), 7 basis points wider year-to-date (as of 21 May), while the yield to worst (YTW) is considerably higher at 7.15%, or 62 basis points higher year-to-date. We see limited scope for a meaningful bull-case spread tightening from these compressed bands; conversely, the primary bear-case catalyst remains a pronounced macroeconomic slowdown or inflationary pressures that accelerate and force the Federal Reserve to begin hiking rates again. However, all-in yields adequately compensate investors for current risks amid low-to-moderate default expectations. We continue to view the belly of the high yield market – low-BB to mid-B rated bonds – as a sweet spot for investors: this area avoids the tight spreads in the highest-quality rating tiers along with the default tail risks emerging in the lowest credit segments.

Higher Credit Quality in the High Yield vs. Leveraged Loan Market

The portion of the high yield market rated BB- or higher is at the highest level since the index's 1987 inception



Source: Bloomberg as of 21 May 2026.

Leveraged Loans

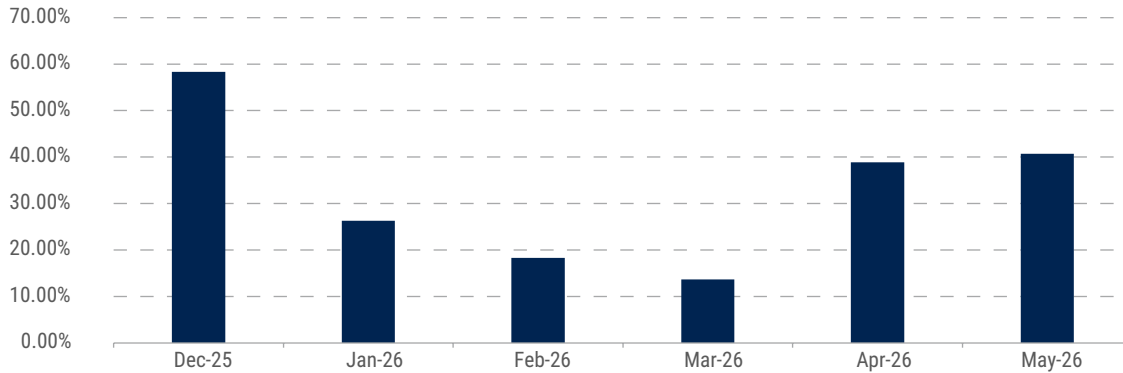
Looking ahead, conditions in the leveraged loan market should remain broadly constructive, but the opportunity set is likely to become more selective as investors balance still-resilient issuer fundamentals against a less certain macro backdrop. As a result, alpha is likely to depend more on disciplined credit selection and downside avoidance than on broad market beta.

Over the coming months, the market's direction will likely hinge on whether energy-related inflation remains contained and whether labor market conditions begin to soften more meaningfully. If the current Middle East stalemate persists and commodity price pressure builds, risk appetite could weaken as higher input costs weigh on margins and consumer demand. Even so, the outlook for performing issuers remains relatively stable for now, supported by several quarters of steady revenue and EBITDA growth and by continued access to capital markets, which should help many companies further reduce interest burdens and extend maturities. AI related capex and government spending should continue to support the economy, absent significant shifts in either driver.

Broadly syndicated loans have higher software exposure, but any AI-related dislocation is likely to emerge gradually and remain concentrated in weaker issuers with near-term maturities that are viewed as lacking AI-resilient business models. More broadly, we do not expect the recent shift in short-term rate expectations to materially change the distress backdrop, as fundamentals remain broadly sound, and performing credits continue to access capital markets to lower borrowing costs and manage maturities, limiting the risk of a sharp rise in distress.

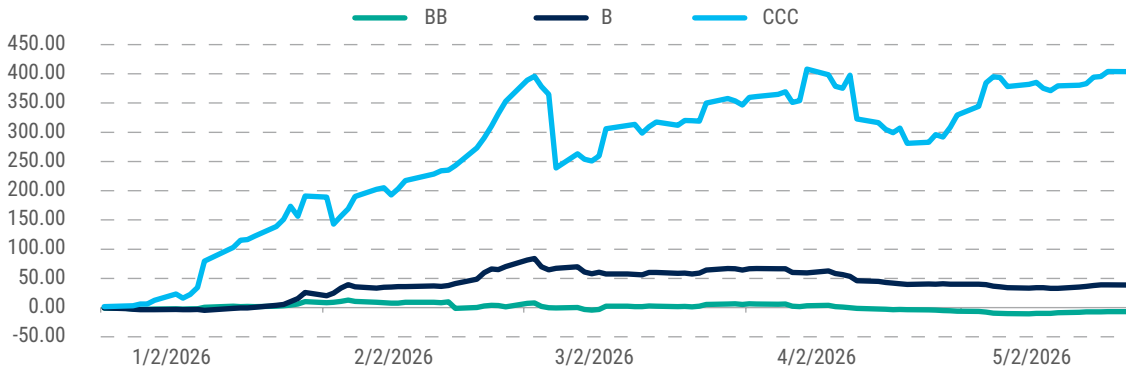
Technicals should remain supportive but are likely to become more balanced from here. A smaller share of the market trading above par should limit repricing activity, while macro uncertainty and rate volatility may keep M&A and LBO issuance subdued. CLO formation should improve further if AAA spreads remain contained, although challenging arbitrage economics for third-party equity could temper the pace of issuance growth. Retail demand is likely to remain tied to headline-driven shifts in sentiment. Higher-quality spreads have remained relatively stable since the beginning of the conflict, while spreads for loans rated CCC have widened amid more pronounced idiosyncratic factors. With near-term rate-cut expectations having receded, all-in yields should remain elevated and provide ongoing support for floating-rate demand, particularly if duration-sensitive assets face renewed pressure.

Percentage of Morningstar Leveraged Loan Index Trading Above Par



Source: Pitchbook LCD, month-to-date through 26 May 2026.

YTD Change in STM



Source: Pitchbook LCD, month-to-date through 26 May 2026. STM: spread to maturity.

CLOs

CLO spreads have tightened back to expensive levels, but demand remains strong due to high all-in yields. However, elevated geopolitical risks, persistent inflation, and structural challenges like AI-driven disruption are increasing left-tail risks and driving greater dispersion across managers.

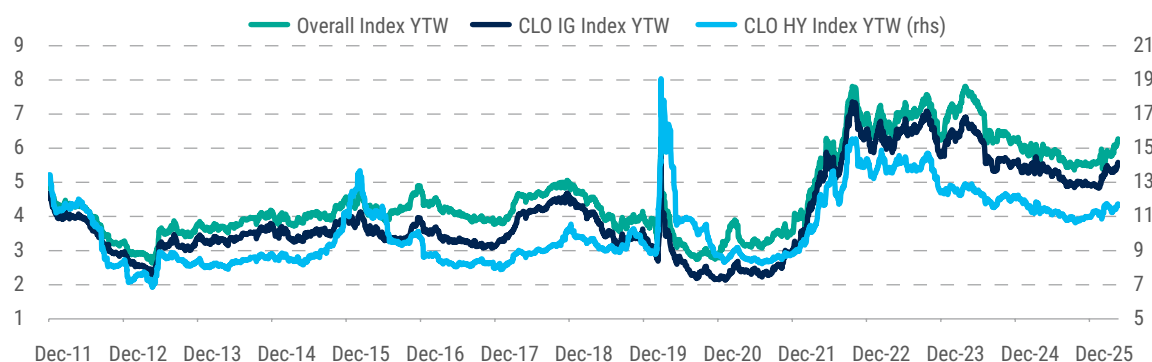
Alongside many credit assets, CLO spreads retraced the widening from the end of the first quarter and now appear expensive overall. Despite tight valuations, we anticipate strong demand for CLOs to continue for the rest of the year, particularly for investment grade tranches. Following three hawkish dissents at the Fed's April meeting and hotter-than-expected inflation that is expected to remain elevated given the ongoing conflicts in the Middle East and Ukraine, markets now see a higher likelihood of rate hikes than cuts over the next 12 months. This is a dramatic shift from year-end, when more than two cuts were priced in. As a result, base rates will remain higher for longer, a boon for floating-rate investors, as all-in yields will remain at attractive

levels. Against this backdrop, institutional investors have continued to allocate to CLOs, and retail demand has remained robust, with \$7 billion of inflows into CLO ETFs year-to-date, bringing total ETF assets under management to more than \$46 billion.¹ In addition, greater clarity on various regulatory regimes – notably, the Basel III Endgame and the NAIC risk-based capital regime – is expected to result in additional demand at the top of the capital stack from banks and insurance companies.

While demand is expected to remain strong, left-tail risk continues to be elevated in CLO portfolios. At a macro level, market valuations appear to be pricing in a near riskless path forward, but the resolution of the conflict in Iran remains elusive, and we anticipate that the impact of the energy price spike should start to filter through into the economy in the months ahead. In addition, while AI fears have taken a backseat following the continuation of the war in Iran, the outcome is likely to have a bigger impact on long-term performance for loan issuers. As a result of AI disintermediation, we continue to see a repricing of risk premia in the form of wider spreads, higher yields, and lower prices in software and other AI-impacted credits. In addition, while the chemicals sector has rallied off the lows, long-term systematic pressures remain unresolved. We have seen this play out more acutely in the private credit market, given the asset class’s high exposure to software. While risks in the private credit market are notable, we don’t believe they pose a systemic threat and don’t expect a broader market contagion.

As we have observed increasing tail risks in portfolios throughout 2025 and 2026, we continue to prefer tranche purchases higher in the capital stack. However, select shorter spread-duration assets for lower-rated credits are presenting more opportunistic entry points amid elevated geopolitical tensions and signs of a K-shaped economy. Despite viewing spreads as tight, we are finding value in AAA, A, and junior BBB tranches in the primary market and select equity tranches in the secondary market. We anticipate additional bouts of volatility in the coming months and would like to maintain the ability to shift further into lower-rated tranches during periods of market weakness.

All-In Yields for CLOs Remain Attractive



YTW	Overall Index	CLO IG Index	CLO HY Index
Current	6.25	5.55	11.64
25th percentile	3.76	3.24	8.56
Median	4.17	3.59	9.52
75th percentile	5.57	5.01	11.60

Source: J.P. Morgan CLOIE Index as of 21 May 2026.

¹ Source: BofA Global Research, Bloomberg, “CLO Factbook,” as of 15 May 2026.

Disclosure

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