



Credit Markets Overview, by Jim Simpson & Kyle Lambert

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Market Positioning

At times like this it is very hard for investors to keep their balance with headlines that skew towards the extreme outcomes. The tariff salvos from Washington, a geopolitical order that continues to fragment, and an oil price that has become as much a political instrument as an economic signal — all of this makes it tempting to reach for certainty where none exists. On the other hand, the markets have actually had a reasonably muted reaction with the S&P 500 down around 4% from recent highs and 10-year yields stuck in their range. So how to approach credit from here?

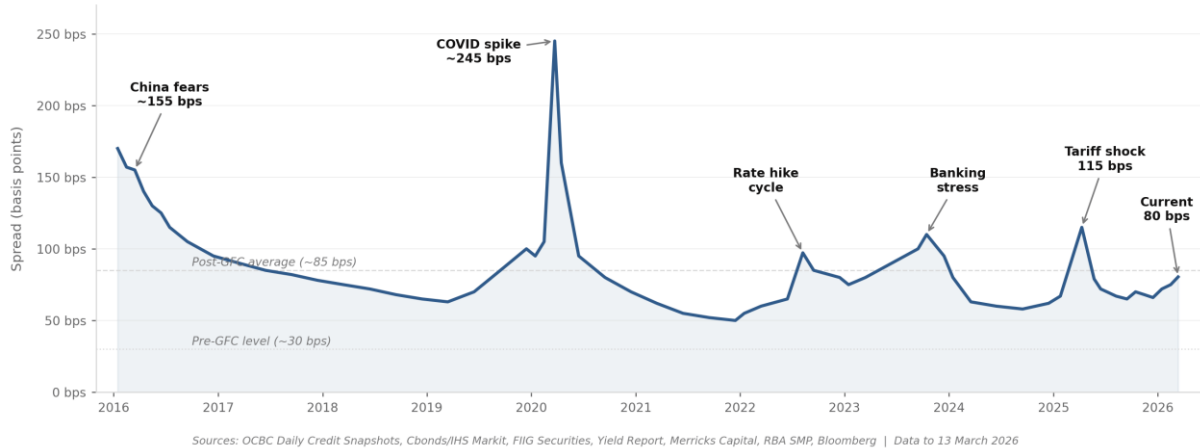
The answer requires stepping back through the recent history of credit. Following the COVID shock in 2020, central banks flooded markets with liquidity and drove the cash rate to the zero bound. The consequence was predictable: investors starved of income chased yield with extraordinary aggression, compressing credit spreads to historically narrow levels. By late 2021, iTraxx Australia 5-year CDS spreads had collapsed to near 50 basis points — a level that priced in near-perfection across the corporate credit universe. Then came the inflation shock of 2022. As the RBA and the Fed tightened aggressively, base rates surged, spreads widened sharply, and total credit yields moved materially higher.

Today's environment presents a subtler challenge. Headline credit spreads are nominally wider than the tightest levels seen during the 2021 liquidity bubble, and on an absolute basis this appears comforting. But this framing obscures a critical dynamic: **credit spreads, expressed as a proportion of total yield, are now lower than they were during the most compressed periods of the post-COVID cycle.** Consider a stylised example: in early 2022, a BBB-rated corporate bond might have offered a total yield of 3.5%, comprising a risk-free rate of 1.5% and a credit spread of 200 basis points — meaning the spread represented approximately 57% of the total yield. Today, with risk-free rates having settled in the 4.0–4.5% range and spreads at perhaps 150 basis points, the total yield might appear more attractive at 5.5–6.0%. Yet the spread component now represents only 25–30% of total yield. The investor is being paid less, in relative terms, for taking credit risk.

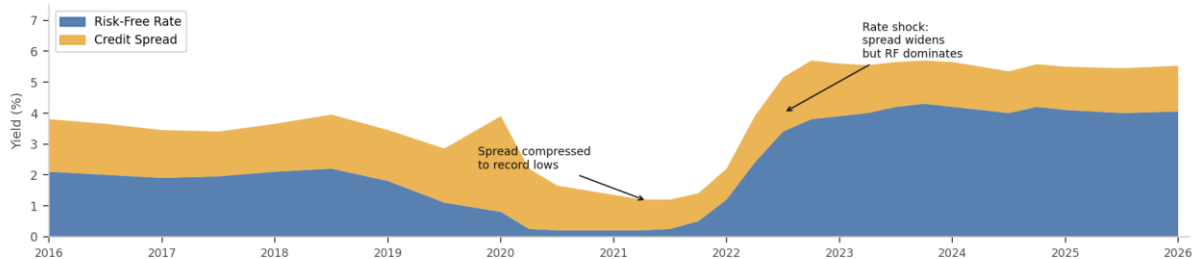
This matters enormously in the current macro context. The elevated base rate is not manna from heaven — it reflects a monetary policy environment that remains genuinely restrictive, and one where central bank optionality is constrained by sticky services inflation and fiscally-driven supply pressures. Simultaneously, the tariff escalation emanating from Washington is not a benign tax on consumers; it is a structural shock to global supply chains that will manifest in corporate margins, particularly for issuers with complex international input costs. In this setting, a credit investor holding spreads at historically thin relative levels is, in effect, being paid less to absorb an expanding set of macro risks than at any point in the recent cycle.

We think the best approach is therefore to favour short-term floating rate securities that benefit from the uptick in implied policy rates, while avoiding the temptation to reach for yield by extending into lower-quality or longer-duration credit at spreads that do not adequately compensate. The chart below of iTraxx Australia 5-year CDS spreads illustrates the point: while spreads have recovered from their post-COVID lows, the market remains broadly optimistic — arguably too optimistic given the macro headwinds now assembling. Duration is looking structurally more attractive, particularly in the government range where the risk-free rate itself is the source of return, but it is probably not quite at the level that compels a decisive move. Hence the strategy is to harvest short-term yields as they rise, while preserving the optionality to extend duration if and when risk-off sentiment reprices the long end.

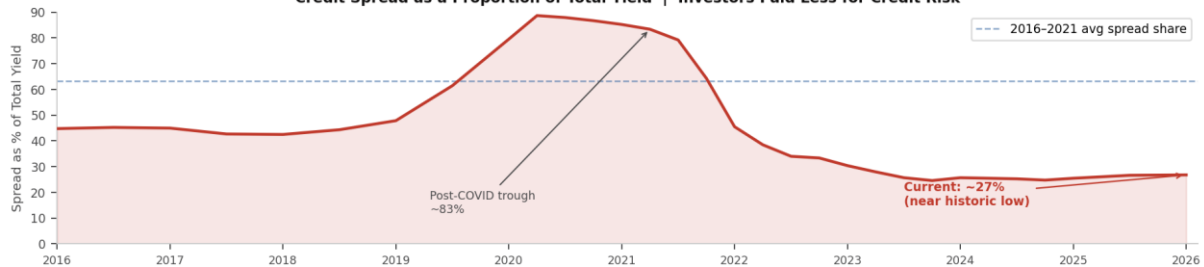
iTraxx Australia 5Y – Credit Default Swap Spread (2016-2026)



Indicative IG Credit Yield Composition | Risk-Free Rate vs Credit Spread



Credit Spread as a Proportion of Total Yield | Investors Paid Less for Credit Risk



Note: Yield composition is indicative, based on approximate 3-year AGB yields and investment-grade CDS spreads. For illustrative purposes only.

Listed Income Funds and Private Credit

Lots of negative noise is emanating from this “hot” sector of the market. The chase to buy high-yielding assets and package them into a product for the investment masses has been in a real bull market with many snouts in the trough. The structural backdrop has been accommodating: a decade of yield suppression conditioned investors to accept opacity in exchange for income, and the listed private credit vehicle became the distribution mechanism of choice. But the environment is changing. Rising base rates have altered the return calculus, and the macro uncertainty introduced by trade disruption and geopolitical fragmentation raises real questions about the credit quality lurking inside portfolios that few managers can actually interrogate with independent rigour. From our recent perusal of new listings on the ASX, we can make the following observations:

- Generally, fees are high (1.5–2.0% of NAV) and we question whether there could be hidden fees, as many of these structures are feeder funds into other funds. The layering effect — management fee at the listed vehicle level sitting atop management fees at the underlying fund level — can erode net returns in ways that are not immediately apparent from product disclosure statements. At a time when the gross yield differential between

public and private credit is narrowing, fee drag is no longer a rounding error; it materially undermines the investment case.

- Investment quality is often stated as low investment grade, but it's hard to know what is being owned as mostly they do not publish their holdings, and so the shadow credit rating is internally generated. This is not a trivial concern. When a manager assigns its own internal rating to a private loan, there is an inherent conflict of interest — the rating that keeps capital deployed is also the rating that validates the manager's own performance fee. Independent rating agencies exist precisely to resolve this conflict; their absence in the private credit ecosystem is a structural weakness that is rarely scrutinised by retail and even semi-professional investors reaching for yield.
- Given the fund structure, there is a real risk at times of stress that the funds trade at a material discount — indeed, some funds already trade at discounts in the high teens. The irony is acute: investors were sold these vehicles partly on the promise of listed liquidity, yet the moment that liquidity is most required — in a risk-off environment where underlying private loans cannot be rapidly unwound — the market mechanism delivers a discount that itself imposes a capital loss. This is the fundamental misalignment between a liquid wrapper and an illiquid asset pool, and it is a risk that does not diminish simply because rates are higher.

In summary, the targeted 7.5–8.0% net returns on offer do not seem to pay for the potential risk involved.

IAM Managed Discretionary Accounts

In contrast to the listed structure pushed by many brokers (largely driven by fee rebates), we believe in direct ownership of the underlying securities through a managed discretionary account. This allows you to receive the benefits of active oversight and management without giving up high fees, opacity, and liquidity. We believe a return in the 7–8% range can be delivered on a portfolio of 20 securities that the investor can actually see, where each security has been assessed either by independent credit rating companies or large international bank syndicates.

The current macro environment makes the case for this approach more compelling, not less. In a world where tariff-driven supply chain dislocation is beginning to compress corporate margins, where geopolitical fragmentation is fragmenting the counterparty universe, and where central banks are navigating between residual inflation and softening growth, credit selection has rarely been more consequential. Owning 20 securities that have been stress-tested by external rating agencies or large bank credit desks — institutions whose own balance sheets are on the line — provides a fundamentally different risk anchor than a pooled vehicle with internally generated ratings and opaque underlying exposures.

Critically, the managed discretionary structure also preserves liquidity and eliminates the discount-to-NAV risk that plagues listed vehicles in stressed markets. An investor who needs to exit holds individual securities that can be sold at market prices — they are not dependent on a thin secondary market for fund units where the bid deteriorates precisely when it is needed most. Typically, liquidity in the investment grade bond portion of the MDA is intra-day whilst the syndicated loan portion of the portfolio may have a slightly longer lead time to achieve the desired liquidity. And because holdings are fully visible at all times, the investor retains the ability to monitor, question, and engage with the credit thesis behind every position. In the current environment, that transparency is not a luxury — it is a prerequisite for informed risk management.

About the Author

Jim Simpson is a Non-Executive Director of IAM, the Chair of the Income MDA's Investment Committee and the major shareholder of IAM. He was a Co-Founder of Platinum Asset Management and is a significant investor in Financial Markets broadly and Credit Markets in particular.

Kyle Lambert is Co-Head of Capital Markets at IAM and brings a wealth of fixed income and financial markets experience.