LOOMIS | SAYLES

FULL DISCRETION TEAM

Extra Credit

Can't Help Falling for You: The Market for Fallen Angels in Late Cycle

Many investors react to short-term news. Others may emphasize beta, want to replicate a benchmark or have inflexible guidelines, so they may take a less discriminating approach to portfolio holdings. On the Full Discretion team, we utilize a top-down credit cycle framework to analyze changing credit conditions, which provides a common language and boundaries for credit cycle phases. At its core, our credit cycle framework measures the ebb and flow of credit and creates a familiar pattern of "boom-and-bust" asset price cycles.

Because we invest over the long term and consider where we are in the credit cycle, we also maintain security selection disciplines that can create entry points for us. Through fundamental research and active management, we seek to capture risk premiums that other investors may be unable or unwilling to access. We consistently use six security selection strategies to help identify and capitalize on mispricings throughout market cycles, and fallen angels are a prevalent strategy in the expansion to late cycle environment, which is where we are currently.

In late cycle, corporate profits are increasingly under pressure, which can result in balance sheet deterioration. When firms struggle to generate profits, shareholder-friendly activities take precedence to boost earnings per share. In this environment, credit ratings become vulnerable, making downgrades across the ratings spectrum more likely. This dynamic creates opportunities for fallen angels, which is exactly what we've seen year-to-date.

Key Takeaways

- The Full Discretion team utilizes a top-down credit cycle framework to analyze changing credit conditions, which provides a common language and boundaries for credit cycle phases.
- Fallen angels are companies that have their credit ratings downgraded from investment grade to below investment grade, or high yield.
- We believe the opportunity set for fallen angels is expanding in the late stage of the credit cycle.

What is a Fallen Angel?

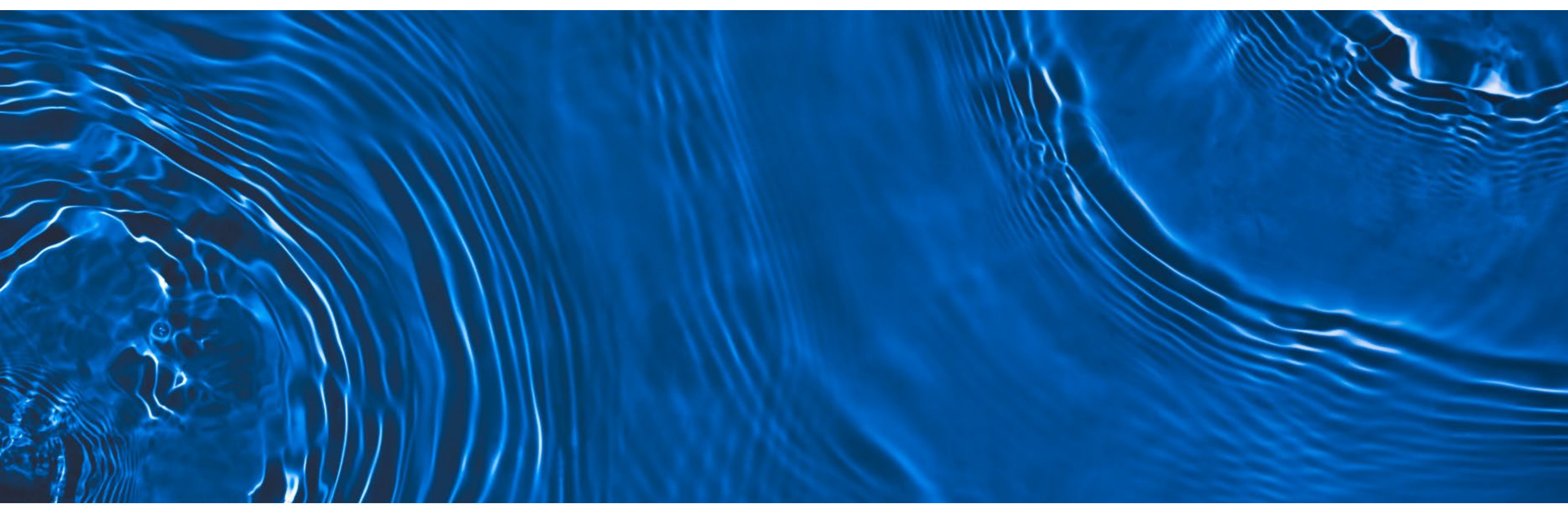
Fallen angels are companies that have their credit ratings downgraded from investment grade to below investment grade, or high yield. Many investors must sell downgraded bonds when they fall out of investment grade indices. This reflex can push bonds below fair value and inflate their yield. It has also helped fallen angels' return profile over time. Over the past 15 years or so, fallen angels have outpaced high yield and crossover credits on a total return basis and bested high yield for return per unit of risk. Their return per unit of risk is roughly in line with that of crossover credits but with higher total return potential and volatility.

Fallen angels are often considered to be a higher-risk segment of the market, and we believe fundamental research and valuation analysis are crucial for investing in this space. Research demonstrates the importance of identifying potential fallen angels more than six months before downgrade while simultaneously having the guideline flexibility to purchase them in advance of or once they are downgraded to high yield.

Year-to-date, fallen angel volume is pacing at a five-year high at nearly \$60B.[1] For example, Warner Bros. Discovery (WBD) became one of the largest fallen angels into the high yield market earlier this summer after electing to split into two distinct businesses. Legacy media companies are adjusting to an "on-demand" world and WBD is no exception, with WBD separating into a Networks business and a Studios and Streaming company. We believe fallen angels, in this example, are an opportunity worth consideration. While WBD's fundamental credit story is challenged, and questions remain about the optimal capital structure, there is still large issuance across a variety of maturity levels.

Where is the Potential Opportunity?

Looking ahead, as investors continue to confront questions related to the health of the economy and the dynamic scope for fallen angel candidates, they should keep a close eye on this attractive segment of the market in relation to the phases of the credit cycle. Investors who can unlock the credit cycle while understanding the interaction between spreads and asset prices have the potential to generate attractive risk adjusted returns.



[1]Source: J.P. Morgan, as of 7/31/2025

Meet the Team

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Investment Director

KRISTEN DOYLE
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About the Team

The Full Discretion team brings decades of expertise and collaboration to create tailored solutions for their clients.

27 Investment Professionals

23+ Years of Industry Experience (Portfolio Management Team)

$80.3 Team Assets Under Management (Billion USD)

Team Philosophy

We have a legacy of independent thinking and leaning into the market when others may be pulling away. We take a deep-value, equity-like approach to credit selection across global fixed income markets. Our disciplined process helps gives us confidence in seeking to identify macro trends, formulate a clear view on market sectors, and invest throughout the credit cycle.

For more than 40 years, we have been applying our distinctive style of bond picking to deliver portfolios designed to provide excess yield potential and have low correlations to traditional benchmark-focused fixed income strategies.

Source: Loomis Sayles, as of 6/30/2025
Average years of expertise reflected at portfolio management level

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