

2026
3Q

Credit Quarterly

New normal?

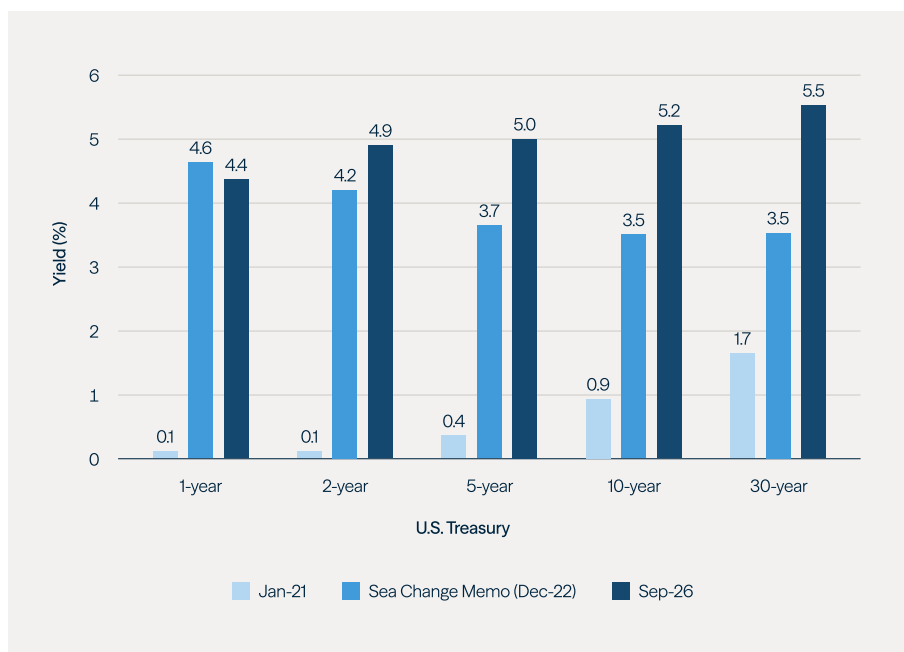
Four years after the sea change in interest rates began, the tide hasn't reversed. The rate hikes of 2022 weren't just a blip in a multidecade yield compression trend—they initiated a fundamental repricing of capital.

Expected rate cuts have not materialized and government bond yields are well above 2022 levels, with the U.S. 10-year Treasury yield recently crossing the symbolic 5% threshold.

Elevated rates therefore continue to shape the market environment, creating a richer opportunity set for credit investors but also a heavier burden for borrowers. The latter is manifesting in clear dispersion in the fates of weaker and stronger borrowers.

It appears this is the “new normal” for interest rates, but what does it mean for credit investors?

Figure 1: The zero-rate era is (still) over



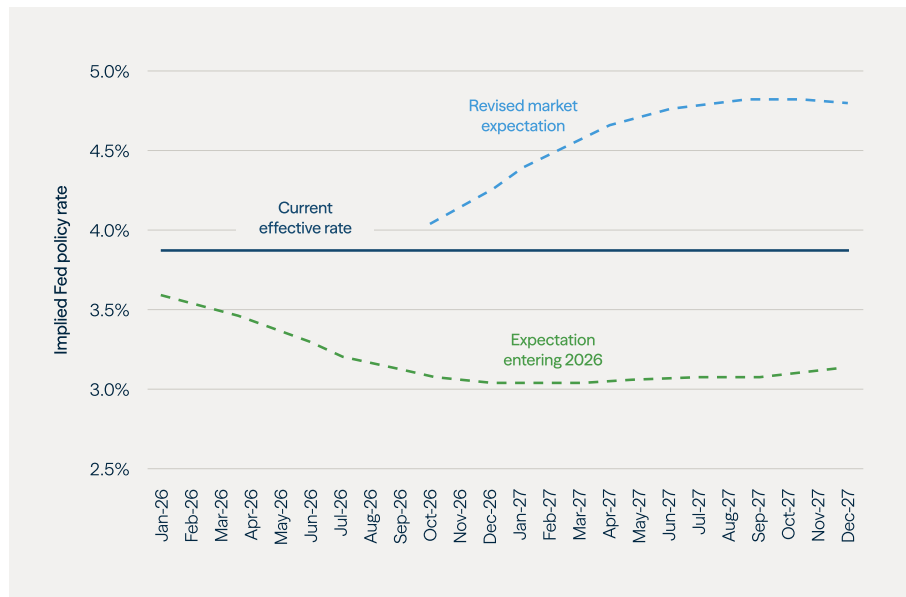
Federal Reserve Economic Data, as of September 24, 2026.

False dawns

The market has been overly bullish on rate cuts over the last few years. When the federal funds rate peaked at 5.3% in 2023, expectations were for a cooling economy—maybe even a small recession—and then rapid interest rate cuts. But the U.S. economy was remarkably resilient, supported by spending from high-income consumers and substantial AI investment, and inflation remained stubborn. The recession—and the Fed's rationale for taking rates back down to the floor—never came.

This pattern has repeated this year. Entering 2026, the market expected around 60 basis points of cuts to the federal funds rate.¹ Heading into the fourth quarter, with economic activity strong and inflation still elevated, we have had one hike and no cuts. As market participants reassess the trajectory of interest rates, they are demanding additional yield for holding government bonds.

Figure 2: Rate cuts haven't materialized



Bloomberg, as of September 28, 2026.

The long and short of it

Long-dated bonds have dominated the headlines this year but yields have increased across the curve.

The shorter end of the yield curve is most sensitive to expected moves in policy rates. This is reflected by the 140-basis-point rise in the two-year Treasury yield so far in 2026.² Investors, considering persistent inflation and a strong economy, have flipped their expectations for Fed policy from cuts to hikes. A higher average policy rate over the next few years means investors expect extra yield from their bonds.

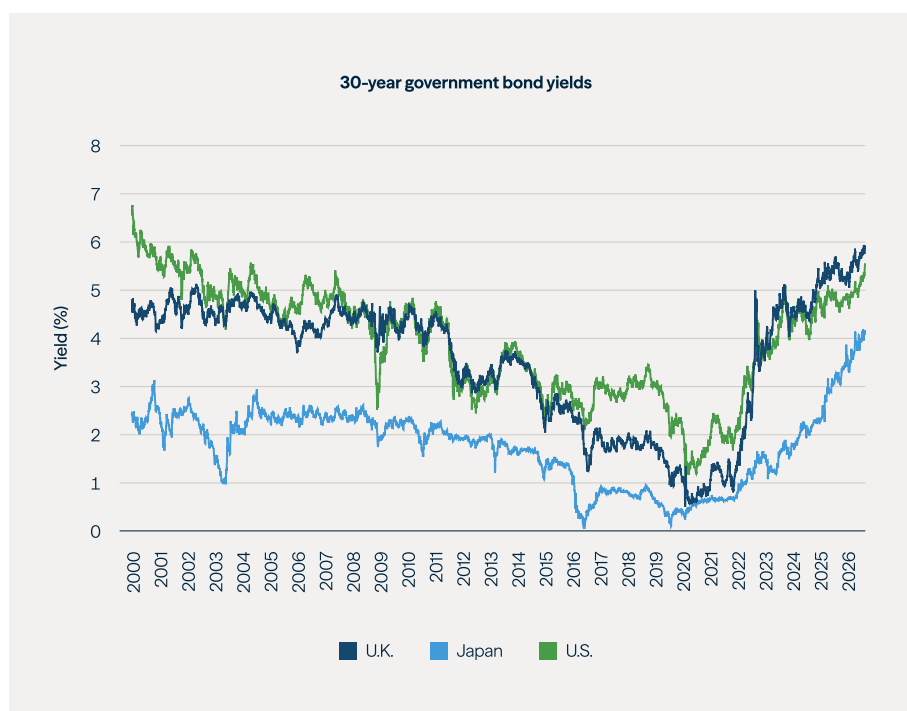
The story at the longer end of the curve is perhaps more complex. Fed policy repricing plays a role, but the movement in 10-year and 30-year bond yields is also variously attributed to longer-term factors including:

- **Robust growth expectations**, which push real yields higher as investors expect faster long-term economic growth and productivity gains.

- **Fiscal uncertainty**, with persistent budget deficits contributing to a U.S. national debt of \$40 trillion, while various European governments are also struggling to deliver fiscal tightening.³
- **High supply** across long-dated government and corporate debt, including unprecedented debt issuance to fund the artificial intelligence buildout. This dynamic is likely to be sustained, given the estimated \$5.5 trillion of AI capex needs by 2030.⁴

Importantly, elevated bond yields aren't limited to the U.S., indicating a global repricing of capital. In the U.K., 30-year government bonds are at their highest yield this century at nearly 6%, while even “safe haven” German bond yields have spiked.⁵ Meanwhile, Japanese government bond yields—compressed for decades through a policy of yield curve control—are also at their highest in 30 years.⁶ It appears this phenomenon isn't unique to one nation: Investors have broadly decided they want more compensation for holding government debt.

Figure 3: A global phenomenon



Source: Bloomberg, as of September 28, 2026.

High rates = high yields

Higher rates make for attractive credit yields even as average spreads are historically tight. At a time when public equity valuations are stretched, this elevated contractual credit income can be additive for portfolios.

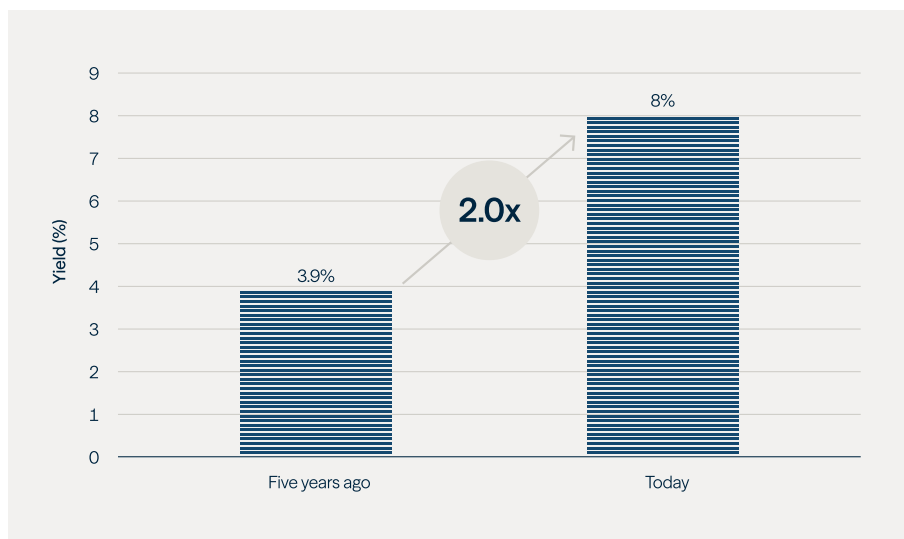
For example:

- **High yield bonds** offer a yield of 8%, even as spreads are only around 300 basis points.⁷ Five years ago, the equivalent yield was below 4%.⁸ Importantly, the fixed-rate nature of high yield bonds allows investors to “lock in” prevailing yields, regardless of the future direction of rates.

- **Floating-rate assets** benefit from three-year SOFR above 4.5%, supporting a yield of over 9% on broadly syndicated loans.⁹ The coupons on these assets reset based on changes to the base rate, insulating against price volatility resulting from interest rate moves.

Importantly, these assets achieve this yield pickup without the high duration that has been punishing longer-dated credit. The long end of the curve offers more yield than the front end but also brings significant interest rate volatility.

Figure 4: High yield bonds merit the name again



Source: ICE US High Yield Index, as of September 25, 2026.

The borrower's burden

High yields are a boon for income-seeking credit investors but present a challenge to highly leveraged borrowers.

Elevated interest rates have a severe impact on corporate cash flows, exacerbating an existing theme of dispersion between weaker and stronger borrowers. For weaker borrowers, cash flow is already under pressure, with around 10% of senior loans now having cash flow coverage below 1x.¹⁰ The problem may be particularly acute in debt dating back to 2021–2022 LBOs, which were conducted at extremely low interest rates and often very high multiples.

The “organic” solution to an overleveraged balance sheet is either declining debt costs or growing earnings. Many companies relied on the former, but rate cuts have not arrived—and it appears they won’t anytime soon—and this could be amplified by rising spreads as the market reprices credit risk. That leaves the option of growing revenue, which is itself often constrained by cash flows being directed to servicing debt rather than business enhancement, and potentially also by lower spending from consumers with reduced disposal income.

Therefore, as interest expense continues to erode cash flow, many weaker borrowers will need some kind of rescue loan or capital solution. The mainstream credit markets will not meet this need, leaving borrowers to seek customized private capital that can be delivered with speed and certainty.

Figure 5: Indicative impact of rates on corporate cash flows



For illustrative purposes.

Navigating a new rates backdrop

Upon understanding all this, how can investors position themselves to navigate an environment of high rates and high dispersion?

- Take advantage of elevated yields to achieve high absolute income via credit.
- Protect that income via prudent risk management, avoiding losing credits in a more dispersed market environment.
- Watch out for duration, given a decent yield is available without pushing far out along the curve.
- Augment income-focused strategies with those that can pursue disruption caused by prolonged interest expense burdens. We anticipate elevated coupon payment will continue to pressure weaker borrowers, increasing the opportunity to provide rescue financing and purchase discounted liquid credits.

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Robert O'Leary is Co-Chief Executive Officer of Brookfield's Credit Group. In this role, he is responsible for investments, operations and the expansion of the Credit business. Mr. O'Leary is also Portfolio Manager for Oaktree's global opportunities strategy, contributing to the analysis, portfolio construction and management of both the global opportunities and value opportunities strategies.

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Endnotes

1. Bloomberg World Interest Rate Probability
2. As of September 24, 2026
3. Congressional Budget Office, U.S. Treasury Department
4. J.P. Morgan, AI Capex 2.0, June 17, 2026
5. As of September 25, 2026
6. As of September 25, 2026
7. As of September 25, 2026, ICE US High Yield Index
8. ICE US High Yield Index
9. As of September 25, 2026, UBS Leveraged Loan Index
10. Pitchbook, 2Q2026

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