SAHYCF Commentary: Hopping along

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With $25bn of issuance in August, markets are feeling saturated with stock but deals remain oversubscribed.

What a month! Annual corporate issuance has now exceeded 2025's record year, with 4 months of the year still remaining; soggy spread performance as the market comes to terms with bumper deals; our first AUD Hyperscaler issue; corporate reporting season; and the unravelling of more than a decade of poor lending and investment practices in Australian private debt. There is no shortage of things to discuss with you this month. So, hang on to your hats, here we go…

Heavy supply in August led to soggy spread performance. While the Bloomberg Ausbond Credit 0+ Index was only 2 basis points (bps) wider by month's end, broker axes have felt heavy and bids are wider than marked, indicating considerable indigestion.

Part of the reason for this was the $5.5bn of issuance from our first Hyperscaler deal in Australia, Alphabet. While the bond has outperformed by circa 6bps since issuance, we saw long-dated Tier 2 underperformance led by the switching from longer dated major bank paper trading around 131bps (at the time) versus the new Google 20 year issued at 180bps with a credit rating differential of A- for major bank sub-debt versus AA- for Google. While the switch made sense, it flooded the market with long-end T2 supply triggering underperformance at the back end of the curve. This led to some broader contagion across the credit landscape with Canberra Data Centres also pricing 10bps wider.

Beyond Google was a quick burst of Tier 2 bonds from domestic banks ($3.5b), a swathe of other financial senior debt ($9.5b), and a healthy dose of corporates. NextEra paid a return visit, the [very] large US electricity utility issued A$1.3b of subordinated debt and printed 20bps wide of where we saw fair value. We also had a debut A$ print from United Kingdom utility company SSE ($1b), a revisit from Coles ($500m), and finally Newcastle Coal Infrastructure Group chipped in for a modestly sized A$ debut ($200m), which had an initial spread of 160bps, tightening to 142bps as the deal was 9x oversubscribed. Following Port of Newcastle's Inaugural AMTN in 2025 and Whitehaven Coal's 144a issue this year, previously unloved coal and coal-related assets now appear to be “en vogue”.

The book statistics always make for interesting reading. As expected, we saw a strong Asian bid (30-40% of the book) for Newcastle Coal Infrastructure and SSE. More surprisingly, Coles also drew 40% of overall demand from the same buyer-base. This is a little off-piste as Asian demand is typically lured by the punchier spread issuers in our market. This could signal a shift in approach, with investors now more willing to participate in lower-beta, lower-spread issuance. The outlier was the subordinated NextEra offering, with a surprisingly low sub-10% Asian bid – which was unexpected given NextEra's global issuer status, an attractive new issue concession, and a coupon above 7%, typically three green lights for foreign buyers.

A solid report card for Australian companies

Australia's reporting season was respectable in aggregate; however, the multi-speed economy was on display. Companies exposed to Resources, Infrastructure and the investment cycle around Data Centres were broadly positive and Banks and Consumer staples relatively neutral, while companies reliant on discretionary consumer spending or those a little more sensitive to interest rates were more cautious in their outlooks. Trading updates to start FY27 were certainly softer but did not point to a complete collapse in activity brought on by the housing market.

Among the bigger surprises were Stockland and Mirvac, whose results belied concerns that the weakness in residential housing could cause an FY27 earnings headache. For the banks, the picture looks strong in the rear-view mirror but somewhat cloudier through the windscreen. We are not forecasting a rapid deterioration in asset quality or a significant earnings decline, but credit growth is tipped to slow to low-single digits, with increasing evidence that mortgage holders are tightening their belts, even as net-saver households (those with no debt) continue spending freely. CBA mentioned that they are now operating within their capital target range (not above) and shareholders should expect the dividend payout ratio to temper. Tax changes around negative gearing and capital gains have put a handbrake on big bank lending in the housing investment sector for the foreseeable future.

From a credit investor perspective, a low-growth environment is not a terrible scenario. With steady employment and credit growth slowing to low-to-mid single digits, credit spreads can conceivably enjoy a lower-volatility setting. It's worth noting that around half the issuers in the index are privately owned, so earnings updates will continue to flow right through September. There is also an increasing cohort of Kangaroo issuers from the US, Europe and Asia.

• US earnings season was 'strong' rather than merely 'respectable', with a very high proportion of companies beating expectations in both IG and HY markets. While AI-related investment remains the dominant theme, earnings strength also extended to financials, industrials, materials and energy.

• Europe surprised positively. While energy remained a major contributor, earnings growth extended to financials, technology and industrials. STOXX 600 earnings growth expectations improved as the reporting season progressed, suggesting analysts had underestimated corporate resilience.

• Across Asia, the tech-heavy sectors (Taiwan/Korea) led performance, along with North Asia exporters, while the still-sluggish Chinese domestic economy dragged elsewhere. Asian-domiciled companies issuing into the Australian Credit market are primarily the systemically-important banks across the region and their earnings were rock solid on this front.

Private debt problems continue to play out as we expected

The reason we wanted to feature private debt in our commentary this month is not only to raise awareness of the issues the asset class faces, but also to highlight that while some peers in the higher-income universe invest in private loans and structured credit to support their performance and volatility metrics, the Schroders High Yielding Credit Fund does not invest in these assets.

You'd have to be living under a rock to miss the recent developments in parts of the private credit market that have attracted significant media and regulatory attention. The collapse of Sydney-based developer, Bathla Group, has highlighted some of the risks associated with certain private credit exposures. The rapid growth of the asset class over the past decade, together with concerns regarding transparency, governance and risk management practices, has led to a number of issues that are now coming into sharper focus. Where such practices have taken hold, they highlight the risk of insufficient safeguards for retail investor capital.

In Q4 2025 ASIC produced a report highlighting concerns within the Australian private credit market, including poor disclosure and transparency, inappropriate marketing, fees, governance, valuation practices, liquidity and credit-risk management. Consequently, several stop orders were issued as well as a broader industry-wide call to action. Since then, a number of some funds have restricted redemptions or suspended distributions, further increasing investor focus on the sector.

Some Funds have suggested that withdrawal restrictions are intended to “protect” their existing investors. In our view, the most effective risk mitigation for investor capital occurs upfront – in the underwriting, credit research, valuation and pricing stages - not at the point when loan quality is rapidly deteriorating. In our view, these events may may prove to be an early sign rather than an isolated one and our concern from here on in, is the contagion effect across investor portfolios, particularly for those who have limited understanding of the risks that can sit within this part of the market.

Public credit, in contrast to Private credit, operates within a more transparent and regulated market structure, is highly regulated with independent daily market pricing, full transparency and daily liquidity and rather than being concentrated in property linked lending. back by questionable commercial real estate assets, we invest in high-quality corporates and infrastructure issuers like Melbourne Airport, Ausnet and APA. Furthermore, with base rate rises over the past 4 years, the delta between returns on private versus public credit have narrowed significantly, and we believe investors should carefully assess whether the incremental return available from private credit justifies the trade-offs in liquidity, quality and transparency.

Market Outlook

We aren't expecting a significant rally in spreads, given the continued pipeline of new issuance, including ElectraNet, Aurizon, ARTC, Lotteries Corporation, and potentially Amazon in September. Overall, we expect more of the same: spreads range-bound but delivering high-quality carry. Separately, over A$2 billion of Australian retail bank hybrids mature over the next two months. Investors with exposure should be reviewing reallocation now, as pricing on these securities reverts to par and liquidity is likely to deteriorate.

We flag this because our year-end conviction trade remains Australian major bank Tier 2, which has underperformed this month against the supersized Alphabet issuance. However, the hybrid investor base, outside of direct retail investors, is largely passive and coupled with active funds mandated to buy subordinated Australian major bank paper, is delivering a structural demand pool for Tier 2 securities. With little to no further Tier 2 issuance expected for the year, we anticipate this demand base absorbing the remaining available stock.

Portfolio update

With so many deals on offer, you might be thinking that we are spoilt for choice, however new issuance concessions on deals vary considerably and valuation discipline remains critical. At an index level, valuations have improved as over-supply this month shifted spreads wider. With talk of an Amazon deal in the pipeline, our expectation is that spreads will continue to underperform at least until we get a pause in supply and the market has a chance to absorb issuance.

One of our preferred sectors is utilities given the solid fundamentals, cash flow predictability and regulatory environment for these assets. However, with the NextEra deal coming with a generous new issuance premium, names like Transgrid have underperformed, which has unfortunately impacted our performance. That said, we have high conviction on the name and will consider adding to our position at the wider spread level. With no clear pipeline of higher yielding deals to follow, non-financial corporate subordinated paper looks well positioned to rally as NextEra’s issuance is absorbed.

The portfolio remains well diversified across 41 different Issuers and 79 individual securities. We continue to believe that with the enhanced level of geopolitical and market risk that is embedded in the system today, portfolios with concentrated positions in a small number of issuers are at risk of underperformance.

Learn more about investing in the Schroder Australian High Yielding Credit Fund or the Schroder Australian High Yielding Credit Fund - Active ETF.

Source: https://www.schroders.com/en-au/au/individual/insights/sahycf-commentary-stuffed-to-the-gills/