



THEMES & OPPORTUNITIES IN 2026

February 2026

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Note: Unless otherwise stated the source for all levels and other financial information in this report is Bloomberg

FOREWORD – CALM SURFACE, POWERFUL UNDERCURRENTS

The outlook for 2026 is one of the most complex in recent memory. Credit spreads are extremely tight across investment grade and high yield, in both Europe and the US. On the surface, this reflects a supportive macro backdrop: growth momentum appears to be very strong in the US while the tailwind from defence spending will mean a return to trend-like growth in [Europe](#).

What these headline valuations obscure is how non-linear credit markets have become. Tight spreads are co-existing with a prolonged default cycle that, after years of financial repression, is now generating real [dispersion](#) across the investable universe. Outcomes are increasingly idiosyncratic, shaped by capital structure, documentation and access to liquidity rather than incremental changes in growth.

There are numerous important thematic shifts too. The AI cycle is the most obvious. Not only is AI itself a disruptor, but the amount of capex which needs to be spent on AI is itself a disruptor, creating beneficiaries in some industries, but also crowding out funding for less topical industries. It will also test investor tolerance for much higher net supply.

We believe this non-linear environment will persist through 2026, but with that, we also see a broad opportunity set ahead. Dislocations can emerge quickly and navigating these markets will require a relentless focus on credit underwriting. At the same time, the deployment of capital must be increasingly dynamic, overlapping, and flexible across strategies. And trading strategies must be dynamic.

Outstanding notional debt of public and private credit markets should exceed \$18tn in 2026¹

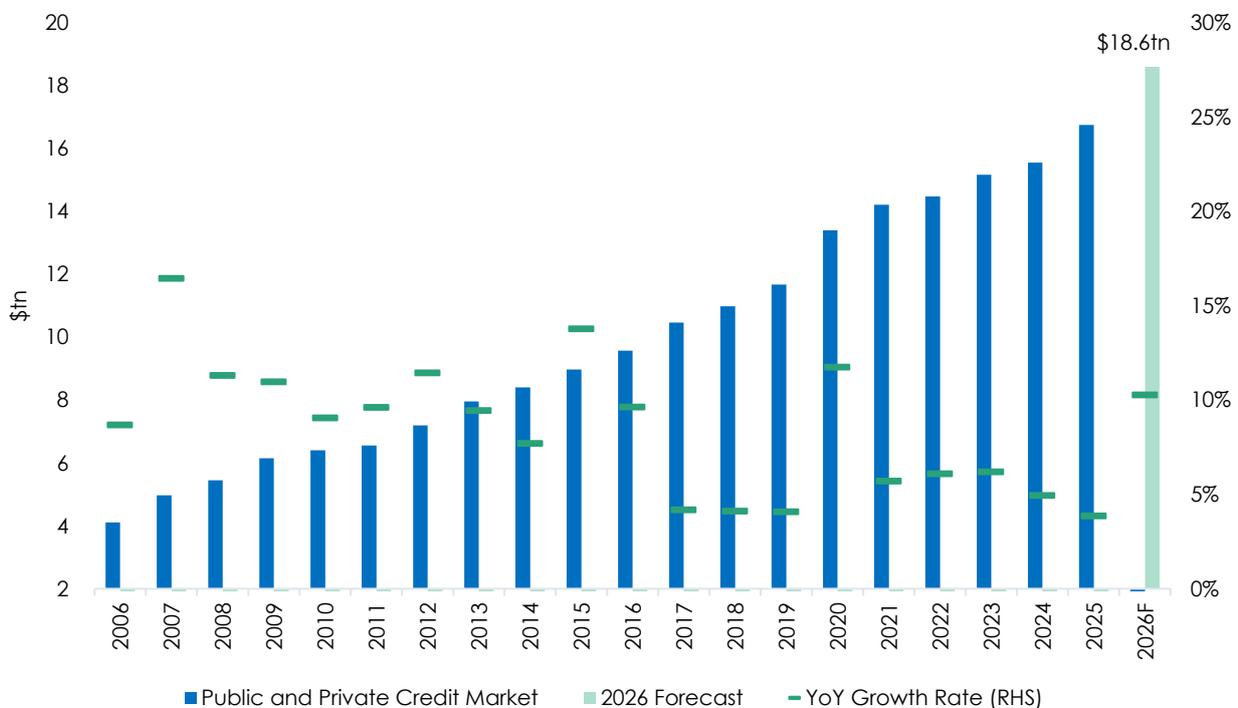


Figure 1: Size of Global Public and Private Credit Markets

Source: Preqin, Sona analysis of investment bank consensus

¹ Public market forecast for 2026 is the median of all investment banks net supply forecasts. Private market forecast based on a 5y CAGR

2025: RESILIENT BUT DEFINED BY DISPERSION

While the purpose of this paper is to look forward, it is worth briefly reflecting on how we ended 2025. On the surface, it was a good year for markets, with returns ranging from reasonable to impressive. In Europe, investment grade (IG) and high yield (HY) delivered total returns of +3.0% and +4.9%, respectively. Those numbers were higher in the US, helped by the rate environment, with +7.8% for IG and +8.6% for HY. Equity markets did even better, posting double-digit returns almost everywhere, with convertibles up +22.4%.

In credit, returns almost perfectly matched their start-of-year yields. This alignment is surprisingly rare and, at first glance, suggests a benign outcome. There were extended periods of calm, particularly over the summer. But 2025 will also be remembered for sharp episodes of uncertainty and volatility. Relations between the US and the rest of the world were tested in ways we have not seen in our careers. The US government shut down for the longest period on record. Central bank independence was openly questioned. Government deficits spiralled. And the AI cycle - the most significant technological advancement of our generation - entered a new, more capital-intensive phase.

Against this extraordinary backdrop, the resilience of both the economy and markets was striking. That stability, however, concealed growing stress beneath the surface, particularly within credit markets and most acutely in leveraged finance. In the €-HY market, for example, 14% of bonds finished the year either up or down by at least 10%. Within leveraged loans, distress levels in both Europe and the US were the highest in several years. Similar dispersion patterns were evident beyond public credit: in securitised markets, CLO equity frequently generated negative returns amid loan market pressure, while SRT funds commonly delivered double-digit returns.

Resilience defined 2025 - but it was also a year of great dispersion. This combination creates a fascinating and demanding setup as we enter 2026. Generic beta spreads sit at exceptionally compressed levels, marking the narrowest entry point of the post-GFC period. Subsequently, spread breakevens are very low – inside 60bp for BBs for example – leaving little room for adverse developments. Yields continue to offer better value, albeit are the lowest since 2022.

Generic liquid beta credit is very, very tight

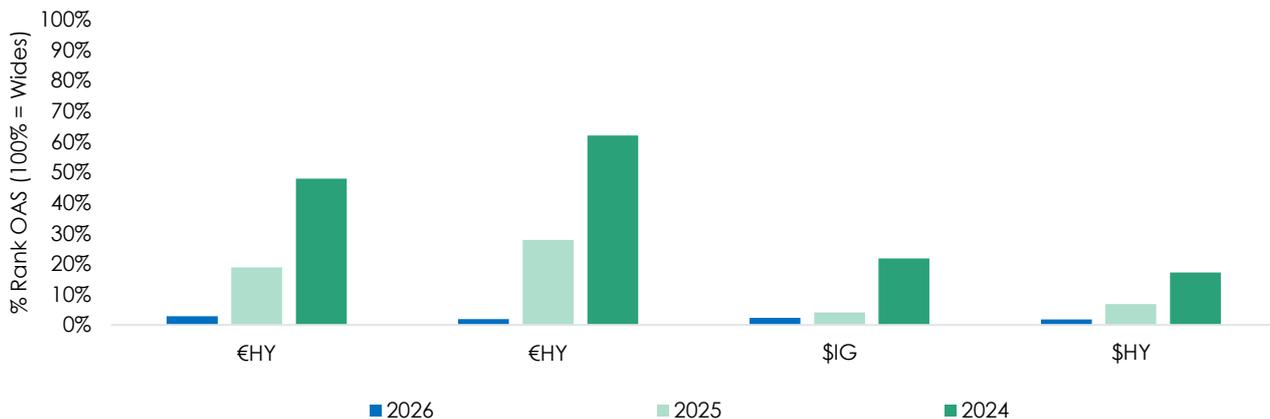


Figure 2: Percentile Rank of Spreads

Source: Bloomberg

MACRO: STRONG MOMENTUM, FRAGILE BALANCE

Across market cycles, risk assets ultimately take their cue from the macroeconomic backdrop. We have been investing in credit for long enough to expect the unexpected, but our job is to assess the current environment at face value and consider where stresses and risks may emerge. Growth ultimately matters most, and we see many reasons to be optimistic. Momentum is clear in the US, and Europe is finally showing signs of traction. More importantly, there are credible reasons to believe this momentum can carry through at least the first half of the year.

The surface looks supportive. The undercurrents will shape outcomes.

US: RUNNING HOT

US growth dynamics have continued to surprise meaningfully to the upside. Real GDP expanded at an annualized rate of 4.4% in Q3, exceeding economists' expectations by more than 100bp, following an upside surprise also in Q2. For Q4, the Atlanta Fed is forecasting a striking 5.4%. This would imply the US economy is growing as much as 8% in nominal terms.

Growth at these levels is unlikely to persist indefinitely. Even so, the US enters 2026 with substantial momentum, making it difficult to construct a credible scenario in which growth slows enough to meet the current 2.4% consensus forecast² - particularly when set against the material tailwinds outlined below.

The US economy has tremendous momentum going into 2026

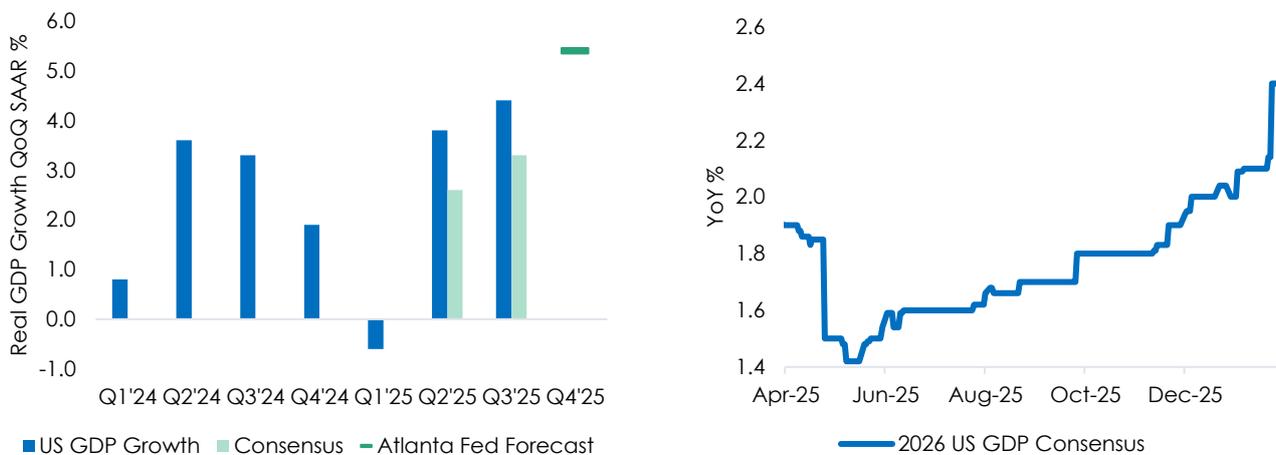


Figure 3: US Quarterly GDP Growth vs. 2026 US GDP Growth Consensus

Source: Bloomberg

EUROZONE GROWTH: TURNING POINT

It's not controversial to predict that Europe will fail to match US growth - but nor does it need to. If there is one word that has defined the European economy, especially given the magnitude of macro headwinds it has faced in recent years, it is resilience. What is new, however, is that we are now seeing the emergence of momentum.

Activity indicators have begun to turn. The composite PMI reached a two-and-a-half-year high in the fourth quarter. In Germany, the construction PMI moved above 50 for the first time in four years, while industrial and manufacturing output have started to recover. While European growth is never without risk, the current backdrop is incrementally

² Source: Bloomberg, Jan-26

more supportive: peripheral economies continue to perform well, tariff-related headwinds are easing, and the early stages of a cyclical rebound are becoming visible.

FISCAL POLICY: ALL EYES ON GERMANY

In the US, the impact of tax cuts from last summer's reconciliation bill (OBDDA), will be felt most clearly in the first half of 2026. Higher tax refunds should act as a tailwind for consumer spending, with JP Morgan estimating a fiscal boost of up to 0.5% of GDP. The trade-off, unsurprisingly, is a wider fiscal deficit, likely rising from around 6.0% to 6.5% of GDP, depending on US growth outcomes.

For developed markets, the most consequential fiscal easing will take place in Germany. Increased government spending on defence and infrastructure is expected to contribute 0.5% to growth in the euro area this year³, lifting real GDP growth to 1.5% by the end of 2026. Importantly, Germany enters this phase with fiscal headroom to spend, given its debt-to-GDP ratio of 62%. If executed as planned, federal debt in Germany will rise by c.€850bn, or 20% of GDP. It is fair to say that the ramp-up to date has been slow owing to the timing of the federal budget, but this should gain significant momentum from the start of this year. Nevertheless, the emphasis is clearly on Germany delivering its fiscal plans, with sustained European growth dependent on their execution.

Germany's planned spending will positively impact growth from 2026

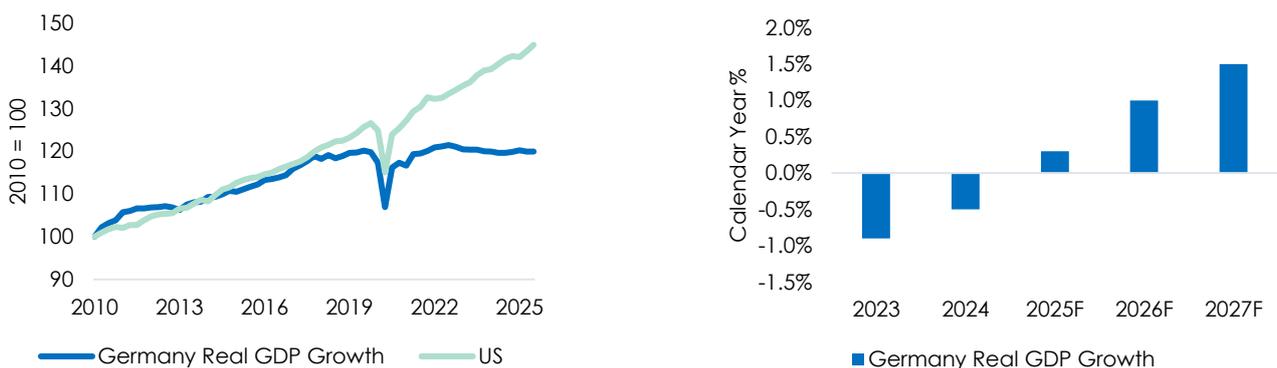


Figure 4: Germany and US GDP Growth Rebased to 2010 vs. Germany GDP Growth Including 2026 & 2027 Consensus
Source: Bloomberg

MONETARY POLICY: A STORY FOR THE SECOND HALF

Powell's term as Fed Chair concludes in May. While there has been much speculation, in recent days news outlets have reported that the Fed is likely to appoint Kevin Warsh as the next Chair.

In the interim period until he is appointed, markets are pricing in a low probability that the Fed cuts rates. In the second half of the year, roughly two cuts are priced in. Warsh is predominantly seen as having a dovish view on policy rates, albeit the extent to which front-end rates can be lowered much further will be contingent on inflation tracking lower and the economy not running too hot. Warsh has also been critical about the Fed's usage of the balance sheet in the past. This would perhaps suggest that the Treasury will take greater responsibility.

In general, with the ECB likely to hold rates this year, monetary policy will arguably matter less versus fiscal, at least in the first half of this year. The extent to which US inflation falls back toward 2% will determine how much the Fed comes into play in the second half.

³ Source: Deutsche Bank, Dec-25

MID-TERMS: POLITICS MEETS POLICY

Barely a day passed in 2025 without reference to the “K-shaped” US economy - and for good reason. Much of the year was defined by the contrast between weak sentiment surveys and resilient spending data, alongside significant differences across upper-, middle-, and lower-income households.

That backdrop is now colliding head-on with political incentives. With the mid-term elections less than ten months away, affordability has clearly moved to the top of the policy agenda. In recent weeks, President Trump has taken aim directly at household cost pressures, calling for a 10% cap on credit card interest rates, pledging \$2 gasoline prices, banning institutional purchases of single-family homes, and directing Fannie Mae and Freddie Mac to purchase up to \$200bn of agency MBS in an effort to compress mortgage rates.

Even if some of these measures prove to be more symbolic than impactful, we see no reason why this shouldn't be viewed as a form of QE. At the very least, they signal a clear willingness to lean on policy to support the lower end of the consumer spectrum.

NOT WITHOUT RISK – AI: TOO BIG TO IGNORE

All of this sounds broadly positive - but it is not without risk. In our view, the single most important factor is the AI cycle.

AI reached a clear inflection point in 2025. Its influence on equity markets was already obvious, but the degree of concentration risk has been striking. The market cap of a common AI-equity basket is close to 50% of the S&P 500 today, doubling over the last couple years. As funding needs have grown, debt capital markets have increasingly been called upon to bridge the gap - sometimes contentiously. Oracle, in particular, has become emblematic of investor scepticism around excessive borrowing.

What also became increasingly evident in 2025 is AI's very real economic impact. Estimates suggest it contributed around a quarter of all US GDP growth through the third quarter⁴, and that figure is likely understated once second-order effects from wealth creation are taken into account. Its impact also extends to the labour market. US college graduate unemployment rate⁵ is now at a four-year high of 9.5%. It is clear that AI is playing at least some role in this shift.

AI is one-quarter of US growth and one-half of US equities



Figure 5: AI-Related Contribution to US GDP Growth vs. AI Equity Stocks Market Cap as % of S&P 500

Source: Barclays, Bloomberg, Goldman Sachs

⁴ Source: JP Morgan, Jan-25

⁵ Source: BLS, Dec-25. Based on 20–24-year-olds.

Unsurprisingly, infrastructure spending has attracted the most attention. Hyperscaler capex reached around \$400bn in 2025, up more than 70% versus 2024. While the run-rate is expected to moderate, consensus still points to \$540bn in 2026 and \$630bn in 2027 - increases of 38% and 16%, respectively⁶. McKinsey estimated that AI-related capital outlays could reach as much as \$7tn by 2030. Morgan Stanley last year estimated a \$1.5tn funding gap through 2028, with as much as \$1.3tn of that expected to be financed through public, private and securitised credit markets.

Credit markets will be needed to fill a \$1.3tn AI funding gap through 2028

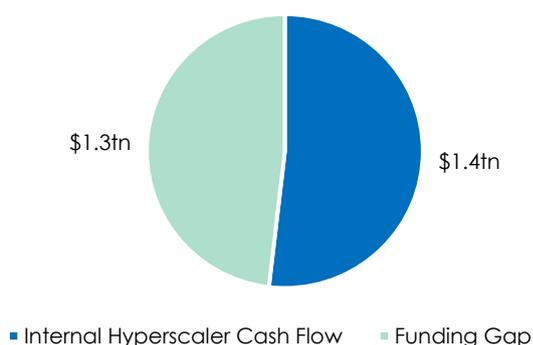


Figure 6: Hyperscaler Capex Needs Through 2028
Source: Morgan Stanley

For both markets and the economy, we have little doubt that AI represents the most significant structural narrative over all time horizons. That said, we are especially cognisant that the risks are not just one-way. The upside scenario is a continuation of the status quo: ongoing productivity gains drive stronger economic growth, while risk assets benefit from improved growth expectations and sustained earnings expansion. However, the sheer scale and centrality of AI investment mean that downside risks have also grown materially. Valuation corrections or a slowdown in planned capex would clearly matter, but ultimately it is the earnings outlook that carries the greatest weight.

We think an earnings pullback is unlikely. Comparisons to the TMT bubble are all too frequent, but for many reasons not the right yardstick - primarily because the bottom-line impacts are already being felt. Demand for both compute and inference power remains clear and has shown no signs of slowing. Driven by Big Tech, return on equity for the S&P 500 now stands at 19%, the highest level outside 2022 in the past 25 years. And while P/E ratios are undoubtedly elevated, big tech companies today operate with high margins of ~30%, in stark contrast to many previous bubbles, including the TMT giants of the 1990s, which functioned in a far more utility-like environment.

That said, the technology is also evolving. There are growing arguments that AI compute may shift from being training-led towards inference-led. While investment needs will remain substantial for the foreseeable future, infrastructure requirements will continue to change. For example, it's impossible to predict whether the current reliance on GPUs - central to the LLM journey so far - will persist, particularly if the next phase of development involves robotics. Similarly, total compute demand may continue to rise, but perhaps in different configurations. This leaves open questions around the future trajectory of data centre demand.

There is clearly a great deal of speculation here, and understandably we have more questions than answers. However, in a cycle as large, economically significant and transformative as AI, this uncertainty is precisely the point. The evolution of the cycle, and the financing needs it creates, keep incentives for capital allocation firmly in place - particularly while animal spirits dominate. As the cycle advances, however, the risk of casualties rises, whether from being left behind or from underwriting the wrong kind of risk.

⁶ Source: Various Investment Banks, Dec-25

Much like last year, 2026 will bring another period of significant AI build-out, with a continued and meaningful impact on the economy. AI is the first domino in a long chain - if it falls, most things will fall with it.

FAULT LINES BEYOND AI

AI is not the only source of risk as we enter 2026. A return of the bond vigilantes, as ballooning government deficits spiral towards levels markets deem unsustainable, is another risk to the macro-outlook. This is not a theoretical concern. Recent years have already provided multiple examples of markets pushing back against fiscal excess, with outcomes differing by jurisdiction - the UK's LDI crisis being the most acute illustration.

Japan is a clear point of focus today. At the 30y point, JGB yields have climbed c.130bp in the last twelve months to levels not seen since the 1990s. Japan has one of the highest debt-to-GDP ratios in the world, and beyond the fiscal sustainability of Japan, there are worries that weakness in the JGB market could trigger contagion globally. In recent days, reports⁷ suggest that the US and Japan have co-ordinated to intervene in the currency to stem some of these contagion worries. This rare example of bilateral intervention helped to calm markets, but it remains to be seen if it's a sustainable long-term strategy (which also has broader implications).

In Europe, France continues to be a source of worry. An uncomfortably wide deficit is compounded by fragmented politics and limited policy cohesion, making budget negotiations increasingly fraught. With local elections later this quarter and the next Presidential election looming in 2027, political uncertainty looks set to persist. This is unhelpful and while the risks may continue to be isolated - largely confined to OATs - we cannot rule out a left-tail risk scenario where things could deteriorate very quickly.

Fiscal sustainability and geopolitics are obvious risks to the macro-outlook

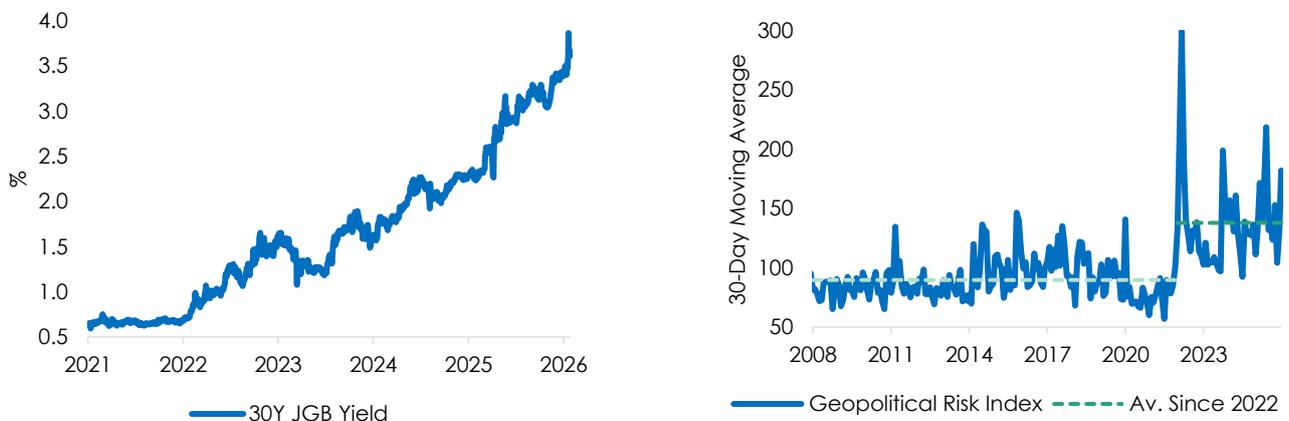


Figure 7: JGB 30y Yield vs. Geopolitical Risk Index
Source: Bloomberg, Caldara Iacoveillo

Beyond this, there are additional warning signs. US private payroll growth averaged just 43k per month in the second half of last year - levels typically seen only outside recessions. The US unemployment rate has risen by around 100bp over the past 18 months. Across Europe, incumbent governments continue to fall by the wayside. And geopolitical risk remains widespread: Iran, Venezuela, Ukraine/Russia, Israel and even Greenland all feature prominently.

There are significant reasons for optimism surrounding the macro-outlook in 2026 - but we are equally mindful of the risks that sit beneath the surface.

⁷ Source: Bloomberg, Jan-26

THE CREDIT MARKET IS ITS OWN ECOSYSTEM

Macro conditions matter. As we have explained above, we believe the AI cycle trajectory will be the single most important influence on risk assets - and potentially the broader economy - in 2026. However, in an environment of very strong growth in the US and improving momentum in Europe, it feels counterintuitive to expect generic beta spreads to reprice materially wider, all else being equal. History would largely support that view.

The starting point clearly matters and with spreads already tight, the scope for further compression is limited. A more realistic outcome is a continuation of the status quo: a period where spreads remain tight on the surface, until the limits of monetary or fiscal support are reached, or growth momentum begins to fade.

That said, the credit market has its own ecosystem and spreads rarely move in straight lines, and calm headline pricing often masks very different dynamics underneath. Several powerful themes are already influencing pricing and behaviour, and we expect them to do so to varying degrees through 2026. Some may pass quietly; others may introduce pockets of sharp volatility. Our clearest takeaway is that the conditions are firmly in place for continued dispersion - across ratings, sectors and within capital structures.

SUPPLY IS NOW THE DOMINANT FACTOR

As a function of the funding cost environment, the last few years have been defined by massive demand for credit outpacing supply. We think we have now hit an inflexion point where supply is to become the dominant factor. Consensus forecasts point to just over \$1.5tn of net supply across public credit markets in 2026⁸. The bulk of this issuance is expected to come from the US IG market, where net supply is estimated at between \$700bn and \$1tn - around 50% higher than in 2025. Unsurprisingly, much of this increase reflects hyperscaler capex requirements.

Hyperscaler capex in 2026 will be equivalent to the entirety of 2020-2023

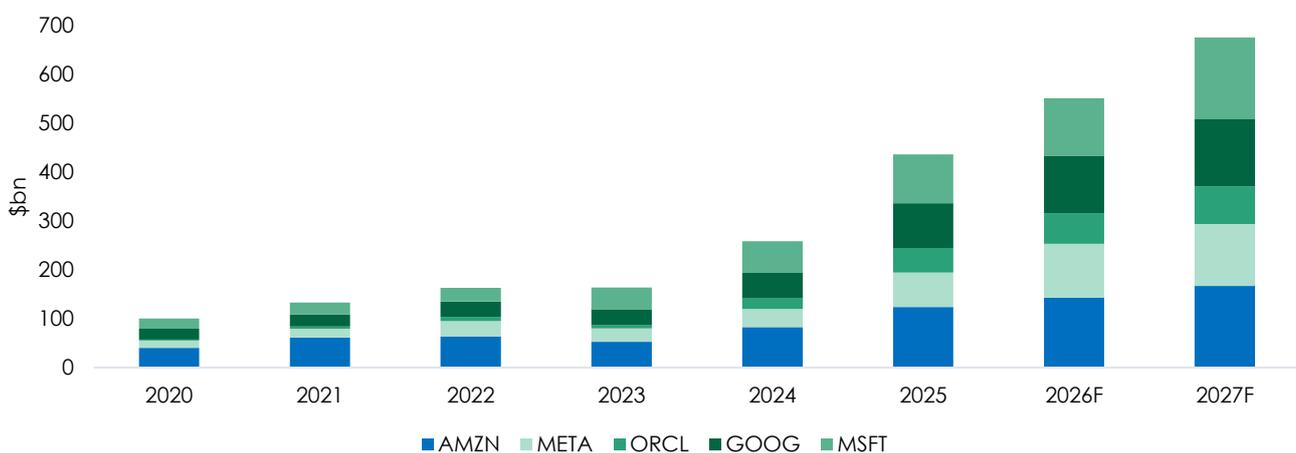


Figure 8: Annual Hyperscaler Capex with Forecasts

Source: Bloomberg, Company Reports

⁸ Source: Various Investment Banks, Dec-25

The hyperscaler supply surge is also changing the composition of the US IG market: moving away from banks being the largest issuers of debt, to the likes of META, ORCL and GOOGL. A lot of hyperscaler funding also tends to be longer dated, which increases the risk of the overall market duration extending. Given the large quantum of debt being issued by a small number of credits, concentration risk is also rising, both on a single-name basis and at a sector level.

Hyperscaler funding is changing the structure of the US IG market

<i>Size of Issuer in US IG Market</i>			
Current		After Funding 20% AI Capex	
JPM	1	JPM	1
BAC	2	AMZN	2
MS	3	BAC	3
C	4	MS	4
WFC	5	META	5
GS	6	C	6
HSBC	7	WFC	7
T	8	MSFT	8
CMCSA	9	ORCL	9
UNH	10	GS	10
ORCL	11	GOOGL	11
AMZN	28	HSBC	12
MSFT	64	T	13
META	72	CMCSA	14
GOOGL	212	UNH	15

Figure 9: Size of Largest US IG Issuers
Source: Bloomberg, Apollo

From a pricing perspective, a big reason why US IG spreads are tight today is due to the net demand imbalance of the past few years. Therefore, to the extent that this reverses, the floor for US IG spreads should also re-rack wider. While it is true that the underlying yield environment remains decent, spreads in US IG are back to trading at 30-year lows. Specifically, for the hyperscaler capex financing to come, we are particularly cognisant of the risks stemming from the sheer abundance of capital available for debt underwriting relative to the spreads on offer. We would go as far as to say that this dynamic could define the cycle for many credit managers in the years ahead. And where US IG trades, the rest of credit will follow.

US IG net supply is increasing significantly at a time when spreads are at the tightest level in 30-years

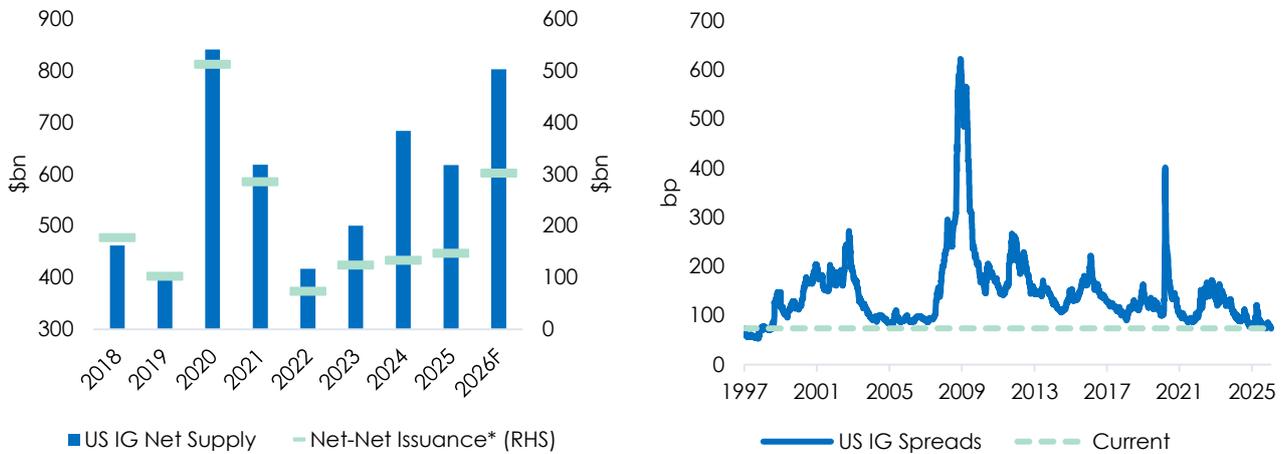


Figure 10: US IG Net Supply (*After Coupons) vs. US IG Spreads Since 1997
Source: JP Morgan, Bloomberg

Beyond the implications of hyperscaler capex supply, there is a strong case for more M&A and LBO activity which feeds into the broader higher supply narrative. Arguably this is already in motion given the uptick that we saw in M&A volumes at the end of last year. And there are numerous reasons for why this is the case: debt funding costs have fallen, equity valuations outside the highly concentrated tech sector remain manageable, the broader macro backdrop is supportive, and animal spirits appear alive and well. While attention is rightly focused on US IG, sell-side forecasts suggest the US HY market could also grow by around 10% this year. This should not be underestimated.

In conjunction with the expected supply surge from hyperscaler funding, we are in an environment where there is simply greater need for capital. But with that, as the pendulum shifts from investors being price takers to price makers, the premium that is demand will have to rise alongside.

REFINANCING CLIFF EDGE

We estimate that €146bn of debt will mature in 2028 across the European high yield and leveraged loan markets. While it is true that maturities in 2026 and 2027 are relatively modest at just €60bn, the amount coming due in three years' time is around 250% of the total maturing over the next two years combined. In the leveraged loan market in particular, this represents the steepest maturity wall we have ever seen.

The concept of a maturity wall is clearly not new - but its steepness worries us. Admittedly, a significant portion of this debt will refinance without difficulty, particularly in the high yield bond market where most issuers sit in the BB category. Even so, we believe a sizeable subset will struggle to refinance on acceptable terms and will ultimately require some form of restructuring. The leveraged loan market looks especially exposed. Of the €79bn of loans maturing in 2028, €44bn - more than half - are rated B3 or lower. Nearly 20% of these loans trade below 90, signalling some credit stress.

We have seen this situation before. Similar concerns were raised around the maturity wall in 2022, and those fears were ultimately borne out, with four of the five largest defaults in European leveraged finance occurring between 2023 and 2025. We see little reason to think this next phase will be any different, and we expect further casualties - alongside a growing need for creative and bespoke solutions.

Nearly €150bn of debt is due to mature in European leveraged finance markets in 2028, 2.5x versus 2026 & 2027

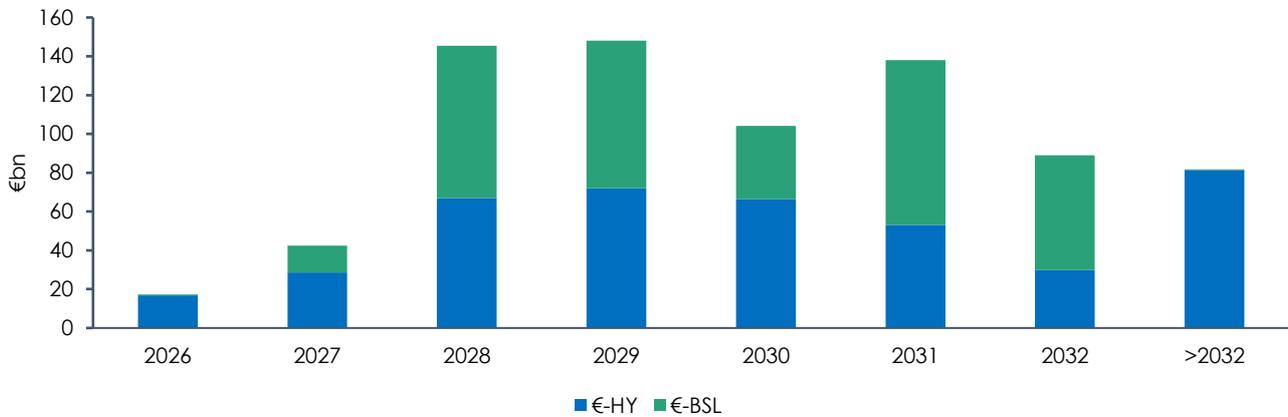


Figure 11: European Leveraged Finance Maturity Wall
Source: Bloomberg

PUBLIC AND PRIVATE CONVERGENCE

At the heart of this dynamic sits an accelerating convergence between public and private credit. Today, the private credit market, high yield bond market and broadly syndicated loan market in Europe are comparable in size. This is a dynamic that has shifted meaningfully over the last decade, when the high yield market was comfortably the largest.

We think this convergence will persist and that the Venn diagram of public and private markets will increasingly overlap. Central to this is a need for solutions, not only in the public market but also in the private world.

Private and public markets have converged in Europe

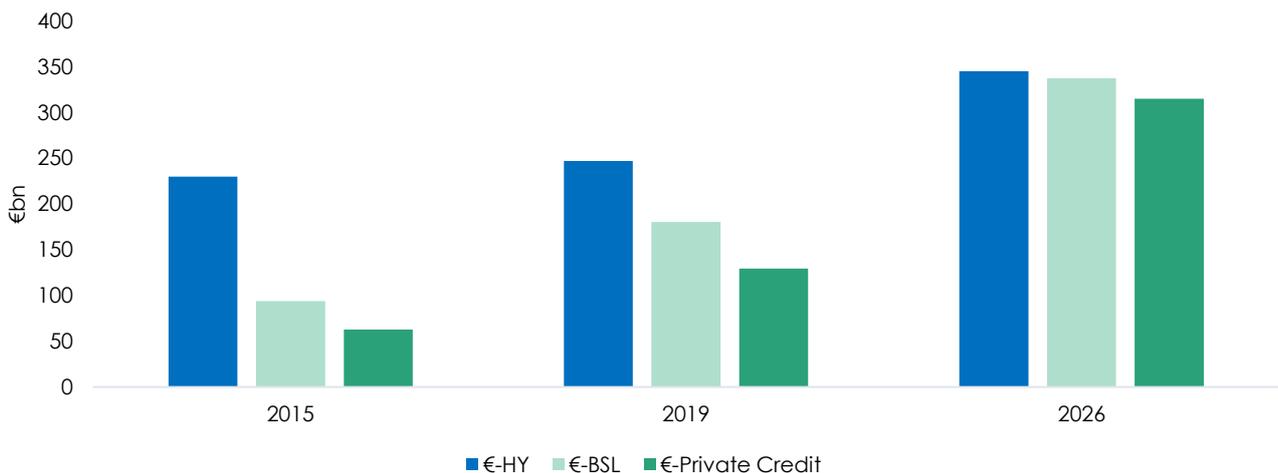


Figure 12: Split of the European Leveraged Finance Market
Source: Bloomberg, Preqin. Private credit data as of Q1 '25 and based on unrealized values only

In Europe, the BSL market, for example, suffers from numerous structural inefficiencies. Chief among them is the growing market share of CLOs, which now account for roughly 70% of the European BSL market⁹. This structure becomes especially problematic in the context of par-loss restructurings. CLOs are, by design, highly default-averse and constrained by structural features that limit flexibility precisely when flexibility matters most. These include the need to protect equity tranches, rigid portfolio tests such as CCC buckets, limited ability to participate in new-money financings, and, in some cases, outright prohibitions on doing so. The requirement to mark equity to zero only compounds the issue, particularly when compared with traditional credit funds.

A significant portion of the loan market - particularly within the 2028 maturity bucket - is low-rated, and almost half of that debt originated in the 2021 underwriting vintage. That year marked a record for leveraged finance issuance, fuelled by abundant liquidity and aggressive risk-taking. We believe that, somewhat inevitably, this environment led to weaker documentation and underwriting standards, and we expect this to translate into a higher incidence of restructurings over time.

Given structural constraints around CLOs, some of these solutions will need to be solved for in the private market. But there are reasons to think that the private market will require solutions of its own. Compressed spreads and risk appetite returning to banks argues for a greater competitive process around new deals. But more central to private credit, we see worries related to its significant exposure to a problematic sector (software) and also heavy dependence on subordinated instruments (PIKs).

Using BDCs as a proxy, software now represents approximately 22%¹⁰ of portfolios – materially higher than the equivalent share in the \$-BSL market, which sits closer to 12%. We think there will inevitably be issues in the sector given the clear disruption from AI, with the worry being that isolated problems begin to reinforce one another, eventually feeding through into a broader negative dynamic for private credit.

Seniority is another pressure point to consider. For BDCs, PIK usage rose further last year. According to Barclays, PIK income accounted for around 8% of interest and dividend income as of Q2 last year - nearly double the level seen in 2018. What was evident in public credit markets last year was how stress manifests first in subordinated parts of the capital structure. For example, by the end of 2025, the senior-sub pricing differential had widened to around 14pt, double where it stood 12 and 24 months earlier. That move reflected genuine strain, particularly in structures where even senior instruments were already pricing in distress.

There is considerable decompression within capital structures in public credit markets

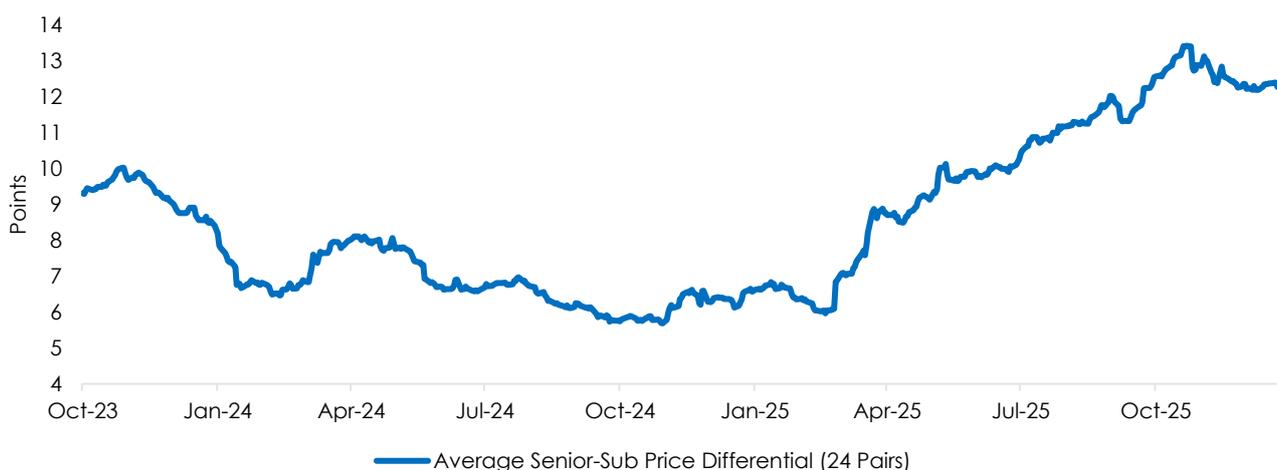


Figure 13: Senior-Sub Price Differential in €-HY
Source: Bloomberg. Based on 24 tickers in €-HY with a senior-sub pair

⁹ Source: Barclays, Nov-25

¹⁰ Source: Deutsche Bank, Nov-25

We think the implications for many private subordinated deals could be very negative, and in many cases, they sit in structurally and contractually weaker positions than their public market equivalents. Cram-downs are easier, sponsors can retain control, and recovery outcomes are often less predictable. While it is somewhat speculative, we would not be surprised to see meaningful losses emerge where marks are mispriced - which we suspect may be the case in several instances.

Last but by no means least, there is duration. An emerging issue in private credit - and one we expect to persist - is the amount of risk embedded in fixed-duration vehicles. Put simply, the longer the duration of an instrument, the greater the exposure to left-tail outcomes at either the company or industry level. When that risk is combined with loose documentation and long-dated subordinated PIK structures, where upside is capped and downside is not, problems tend to arise.

There are issues central to both public and private markets, and there is a need for solutions. Those that can offer solutions, in a flexible way, stand to benefit most. And we think this will all lead to further public-private convergence in the long-term.

CREDITOR-ON-CREDITOR REALITY

Liability management exercises (LMEs) have evolved over recent years. In the past, there have been numerous examples of both good and bad behaviour, which has subsequently led to different degrees of outcome success for creditors depending on the specific situation.

More recently, however, we think the tone has shifted toward a poorer outcome for creditors, in general. The inclusion of third-party new money - used to influence pricing of the existing structure and capture discounts - has pushed the market back towards a far more hostile environment. Asset layering, or creditors losing access to assets from which they previously could have extracted value, is becoming increasingly common. Put simply, today's environment around LMEs is intense, with competition among borrowers, sponsors, holdouts, third parties, and ad-hoc groups. In our view, creditors who lack the size and scale to exert significant influence in a process risk being left at a significant disadvantage.

The attractiveness of co-op membership is an open question in this phase, and, in our view, being outside of a co-op is close to un-investable. We also believe creditors who were once happy to participate in LMEs are now less willing to do so, preferring to exit positions earlier - further contributing to volatile and gappy price action. We are certain that creditor-on-creditor violence is here to stay, and 2026 is likely bring further legal creativity as sponsors and subsets of creditors take advantage of permissive documentation.

THE RECOVERY GAP

In the US BSL market, recovery rates have trended lower recently at an aggregate level. While the average first-lien recovery rate of 58% over the past twelve months appears reasonable, that figure falls to around 40% when looking at the most recent three-month period¹¹. Aggregate data in Europe are harder to source, but anecdotally we have seen several recent situations with low, or potentially low, recoveries, including ETC and Accell in the loan market and Amara in the bond market.

What is clear is the high degree of dispersion in recoveries. It's fair to say that some distressed exchanges have delivered acceptable recoveries for creditors. But even within the same capital structure, recoveries can differ materially depending on whether a creditor is part of a co-op or not.

We are concerned that this downward trend may persist. The aggressiveness of recent LMEs is one factor, but bankruptcies - particularly in the loan market - are also likely to involve structures underwritten during the 2021 LBO boom. The abundance of capital and weak documentation, from a protection standpoint, has produced numerous

¹¹ Source: BofA, Jan-26

problematic credits, which will inevitably see defaults. Rising legal costs have also weighed on outcomes. Over the past five years, legal fees as a proportion of liabilities have roughly doubled, from around 1.5% to 3.0% now¹².

Lower recoveries carry meaningful implications, particularly for CLOs, where equity underwriting often assumes recoveries of around 60%. As a result, we expect dispersion in CLO equity performance to persist, reflecting the wide range of potential loss outcomes.

OPPORTUNITY SET IN 2026

Given everything that has been discussed to this point, we see strong reasons to believe that the opportunity set in 2026 is both substantial and broad. Thematically, we think it can be broken down into three areas: (1) Old World Survival; (2) New World Disruption; (3) Regulation, Policy and Geopolitical. We discuss some of the relevant sub-themes within each of these below.

OLD WORLD SURVIVAL

EUROPEAN CYCLICALS

While broad in totality, we view chemicals, building materials and autos as the most relevant in this theme for 2026.

Today, chemicals is the widest trading sector in HY. Fundamentally, the sector has many challenges: persistent oversupply from China, elevated gas prices and weak end-market demand. As a result, utilisation rates across the sector have fallen to record lows. That said, while many of these headwinds remain in place, we see grounds for cautious optimism. Valuations have reset meaningfully and now offer a material spread premium relative to the wider credit universe. Importantly, the sector's challenges are now well understood and more fully reflected in pricing, which was not necessarily the case twelve months ago. There are also tentative positives on the macro front. China's "anti-involution" policy may provide some relief, even if it's unlikely to be a panacea. In addition, there is a non-trivial possibility of some form of coordinated policy response from European policymakers, reflecting the sector's strategic importance to parts of the regional economy. Measures such as anti-dumping actions are one potential avenue; even if their direct impact proves limited, the signalling effect alone could be enough to influence market pricing.

For building materials, much rests on Europe's cyclical recovery. And against a backdrop of improving growth momentum, the construction sector is showing signs of recovery, particularly in Germany. The construction PMI moved above 50 for the first time in four years in December, while building permits for new dwellings – after nearly three years of decline - turned positive on a year-on-year basis late last year. Admittedly, some caution is still needed. Much of the improvement in Germany has been driven by civil engineering, with new orders remaining subdued. Housing activity is still below 50, and construction growth outside Germany remains weak. That said, if the European cyclical recovery proves durable, the sheer scale of German fiscal spending this year should create opportunities to deploy capital. We see this as a sector with the potential for genuine funding needs to emerge.

As for autos, for obvious reasons, tariffs dominated the autos narrative in 2025. While still important, particularly for Europe, intense competition from China especially in the EV market, strikes us as being the clearest threat for the sector in 2026 and beyond. At the expense of the US, China has dramatically increased exports into Europe, with the most recent data showing shipments to the EU up 15% YoY. The implications are clearest for German auto manufacturers. Chinese-made vehicles are substantially cheaper and continue gaining market share. Chinese brands now account for 20% of the European hybrid market and 11% of all EV sales¹³. By contrast, German brands' share of the Chinese market has fallen to 17%, down from a peak of 27% in 2020. This competitive dynamic is likely to remain a defining theme through 2026.

¹² Source: Barclays, Nov-25

¹³ Source: The Economist, Nov-25

TELECOMS

The sheer size of the telecoms sector – 19% of European high yield and 10% of the US market – makes it difficult to ignore. Several important themes are likely to shape the sector in 2026 and beyond. In Europe, sector-wide cash flow trends are improving, but the economics of fibre-to-the-home are shifting. Build-out is slowing, network sharing is increasing, and many AltNets are running out of cash. Idiosyncratic risk is rising, consolidation feels likely, and dispersion should increase.

The greatest focus has arguably been in the US. Sector M&A was active in 2025, including Charter's acquisition of Cox, Lumen's sale of its FTTH business to AT&T, and EchoStar's sale of wireless spectrum. Fixed wireless access continues to pressure cable operators, a trend we expect to persist through 2026. Valuation multiples have compressed to around 5.0x–5.5x, which may encourage further consolidation. With the sector facing numerous fundamental challenges, dispersion should also remain elevated - creating an interesting opportunity set.

NON-BANK FINANCIALS

While financials have traditionally been dominated by banks, we see an increasingly attractive opportunity set emerging within non-bank financials in the leveraged finance universe. Debt collection is one example - a sector fundamentally driven by cost of capital. While this has always been the case, the dynamic has shifted materially as several Nordic players have become deposit-taking institutions, allowing them to acquire non-performing loan portfolios at returns as low as c.6% IRRs.

In insurance brokerage, M&A activity has remained strong, supported by both sponsor-to-sponsor transactions and the continued roll-up of regional and local players. We see opportunities skewed towards larger brokers, where scale benefits and operational leverage are most evident.

Finally, accountancy groups have returned to focus. As firms reassess partnership structures, seek to monetise embedded equity and pursue greater consolidation across global networks of member firms, we expect financing opportunities to emerge - particularly among mid-tier platforms.

DISTRESSED/RESTRUCTURING

Despite historically tight levels in generic beta credit, there remains a material amount of distressed debt outstanding across both Europe and the US. We estimate around €35bn of distressed debt currently within the European leveraged finance market, with a further ~\$140bn in the equivalent US market. What is noticeable is the difference in sectoral composition of the distressed companies between the two regions. In the US, distress is heavily concentrated in TMT, accounting for roughly 40% of the total. In Europe, by contrast, TMT represents closer to 20% of the distressed universe, with a much broader spread across sectors overall.

We expect the trend of public market restructurings transitioning into the private credit market to continue. This is particularly relevant within the BSL market, where heavy CLO ownership poses problems for restructurings and may ultimately necessitate more creative private solutions – an area that may present opportunity. However, we have some material doubts about the current distressed market. It has undoubtedly been a difficult place to invest in in recent years, and even harder to generate consistent returns. One clear illustration is the growing number of credits restructuring more than once within a short period – S&P noted recently that 48 defaults, globally, in 2025 were repeat issuers.

This reflects a combination of structurally challenged industries and the economics of recent restructurings, particularly the aggressiveness of LMEs. In many cases, these processes have resulted in poor recoveries - even at the secured level - and capital structures that remain unsustainable over the medium term.

NEW WORLD DISRUPTION

ROBOTICS AND AUTOMATION

Robotics and automation are themes that are still in their infancy, but have the potential to be hugely impactful across multiple sectors for years, if not decades, to come. While the clearest trading opportunities are likely to sit outside of traditional credit markets for now, future financing needs will ultimately determine where capital is required.

As with the broader AI theme, we have little doubt that humanoids in particular represent a generational industrial shift. Research from Barclays suggest that while the humanoid robot market is just \$2-3bn today, it could be as big as a \$200bn market by 2035 in the most optimistic scenario. Adoption in households is likely to be slower, but demand is expected to be led by commercial and industrial applications. That implies wide-ranging sectoral implications, including for areas that were less exposed to the first wave of AI, such as autos and industrials. Defence is another sector already at the forefront of this technology. Europe, with its car-making DNA at its core, is arguably in a starting position of strength to lead.

Underpinning much of this trend is the reliance on critical minerals and rare earths, a large proportion of which are sourced from China. That dependency creates a second-order opportunity set as the push for more diversified supply chains intensifies, alongside the need to build mine-to-device ecosystems. Mining companies could be clear beneficiaries as a result.

AI DISRUPTION OF SOFTWARE/MEDIA

As far as AI disruption is concerned, media companies are among some of the most exposed. We believe that generative AI will reshape the media sector permanently. That raises the likelihood of consolidation, both horizontally and vertically, across production and distribution, as firms seek to counter rising competition and an increasingly fragmented buyer base.

One emerging battleground is sports rights, where digital platforms continue to outbid traditional media players. Streaming channels are playing a massive role in this, accelerating the shift away from linear media. That transition carries meaningful implications for a number of credits.

GLP-1

Over one billion people live with obesity worldwide and more than half of all adults are expected to be overweight or obese by 2035¹⁴. Research from Morgan Stanley suggests injectable GLP-1 medications can help people lose as much as 25% of their body weight through reduced appetite. Weight loss drugs, including GLP-1, are already disrupting certain industries, and we expect this theme to only gain traction.

While this has arguably been years in the making, some of the implications are only becoming better understood now as GLP-1 usage ramps up. What makes this theme particularly relevant is the broad-based implications across sectors. Traditional consumer sectors such as food & beverage, pubs and restaurants are arguably the most exposed. However, there are implications for sectors like packaging also assuming lower future demand for products. This is particularly notable given the sector's prior perceived recession-proof status – a concept that we think is no longer valid. At the same time, assuming a shift in consumer behaviour toward a healthier lifestyle, gyms would be a perceived beneficiary as this advancement.

¹⁴ Source: Morgan Stanley, Jan-26

REGULATION, POLICY AND GEOPOLITICAL

ENERGY

With oil prices having risen 6-8% so far this year, current spot prices are comfortably higher than year-end forecasts. The median Brent forecast points to a decline of \$6/bbl from current levels¹⁵, reflecting expectations of an oversupplied market - by an estimated 1-4mbpd - this year. Longer term, the outlook is more constructive, with demand forecasts pointing to higher prices over the next five years. In the near term, however, this remains a challenging backdrop, compounded by persistent geopolitical risk, with Venezuela being the most recent example.

In this environment, it would not be a surprise to see an increase in distressed assets, even if the current number remains limited. That risk sits most clearly in E&P, given its higher beta to oil prices, where we see scope for increasing opportunities - particularly on the short side. By contrast, services providers appear better positioned, with many having repaired balance sheets post-Covid. We continue to see decent value in a number of high-quality names with strong contract coverage and robust cash flow generating models.

US HOUSING

While US mortgage rates have eased from recent peaks, they remain above 6%, around 300bp higher than pre-2022 lows. Housing supply has been broadly stable, but demand has remained subdued, reflecting high borrowing costs, elevated house prices and slower population growth driven by lower immigration.

That said, we believe the housing market may be entering the early stages of a cyclical recovery. Data through October suggest single-family housing starts may be nearing a floor. More importantly, housing affordability has emerged as a central policy priority for President Trump. His directive for Fannie Mae and Freddie Mac to purchase up to \$200bn of MBS - while arguably more symbolic than immediately impactful - signals a clear intent to push mortgage rates lower. Proposals to restrict institutional ownership of single-family homes are similarly aimed at easing house price inflation.

With affordability positioned as a priority issue ahead of the mid-term elections, housing policy is likely to remain front and centre. Given the breadth of second-order effects linked to the housing market, we see this as a potentially significant opportunity set through 2026.

DE-BANKING

Banks continue to de-risk their balance sheets, creating a growing role for non-bank capital. There are two areas which stand out as an opportunity set from this trend: Significant Risk Transfers (SRTs) and Asset Backed Finance (ABF). We firmly believe that both already represent meaningful and attractive opportunities for credit firms to deploy capital over the next decade and beyond.

In 2025, SRT issuance averaged around €30bn per quarter through Q3¹⁶. We have built a meaningful SRT platform to capitalise effectively on this trend. Looking ahead, further success will increasingly depend on understanding the data and identifying the trends that differentiate between platforms. As banks make greater use of SRTs to achieve outcomes similar to partnering with, or selling assets to, credit managers, this creates access for firms like ours to assets that would otherwise be difficult to source - such as RCFs (revolving credit facilities) and other bank-originated relationship loans.

GEOPOLITICAL TENSIONS

¹⁵ Source: Bloomberg, Jan-26

¹⁶ Source: AFME, Dec-25

There has been no shortage of geopolitical themes - not only in 2025, but even in the first weeks of 2026. Alongside Russia-Ukraine, tensions in the Middle East and ongoing competitive friction between the US and China, recent weeks have added Venezuela, Greenland and Iran to the list. This comes on top of more localised flashpoints, such as last year's political upheaval in Argentina.

With the exception of Russia-Ukraine, these developments have so far been largely immaterial for broad risk assets. That said, they remain highly idiosyncratic situations and continue to add to the opportunity set in front of us. Our expertise - particularly in emerging markets - positions us well to capitalise on pricing dislocations as they arise.

There are also potential longer-term implications tied to several of these pressure points. Should the US, for example, exert greater control over the flow of Venezuelan oil, we believe this would fuel a deployment of capital into the region.

CONCLUSION

While it would be easy to be discouraged by starting valuations as we enter 2026, we see far more reasons to be excited about the upcoming opportunity set. Beneath a calm surface, multiple powerful forces are reshaping credit markets - from the generational AI cycle to a range of concurrent, less visible dynamics unfolding across regions, sectors and capital structures. Together, they create an opportunity set that is not just large, but unusually deep and wide.

Credit markets themselves are also changing. Structural shifts are accelerating, most notably the continued convergence of public and private markets. These changes are forcing investors to rethink how capital is deployed and how risk is managed. We firmly believe that the ability to operate across strategies, instruments and markets - and to allow genuine cross-pollination between them - is becoming increasingly important in navigating what lies beneath the surface.

This is a highly compelling environment for active credit investing. Capital is needed, complexity is rising, and creative solutions matter more than ever. We are confident that we have built a platform with the scale, flexibility and expertise to identify where the undercurrents are strongest and to act decisively as opportunities emerge.

We thank our investors for their continued trust and support, and we look forward to navigating what promises to be a rewarding - and dynamic - year ahead. We hope that this paper has left you with a shared sense of optimism in the opportunities we see as a credit manager as we look forward to 2026.

ABOUT SONA

Sona Asset Management is a London-based credit platform that aims to extract alpha, through the cycle, primarily from the European credit markets. Sona has been investing in Europe since its inception in 2016, with a total AUM of over \$16bn.

The team is large, diverse, and experienced. With 154 team members,¹⁷ including over 80 dedicated investment professionals, Sona's reach covers public and private markets, corporate credit, structured credit, and equities.

¹⁷ Source: Sona, Dec-25

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