



GCC High-Yield Bonds: A Compelling Alternative to Emerging Market High Yield

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- **Global Context**

Global Spreads have compressed with expectations of lower rates

The global shift from "risk aversion" (2023) to "credit normalization" (2025).



1 year forward rate and crossover CDS moves broadly together — as rate expectations fall, credit spreads tighten, suggesting that the carry environment is improving : cheaper funding, lower risk premium and stronger market sentiment.

Investment Implication:
With both funding costs and systemic risk declining, GCC HY offers premium yield with defensive credit characteristics.

Bond volatility and S&P HY US bond Index



As volatility falls, credit spreads tighten — confirming that investors demand less risk premium when rate stability returns.

Lower volatility enhances carry-to-risk efficiency — even with spread compression, HY continues to deliver superior carry in a low-volatility environment.

Investment Implication: As the Fed approaches an easing bias, volatility is likely to remain subdued. **Tight spreads are sustainable when supported by soft-landing growth and improving liquidity.** This provides a constructive entry point into high yield, especially for GCC HY with a stronger sovereign cushion.

As global rate volatility declines, risk assets re-rate



Volatility is Easing, Carry Is Compelling: GCC HY, backed by strong sovereign anchors and low default risk, becomes a prime destination for steady carry as global volatility fades.

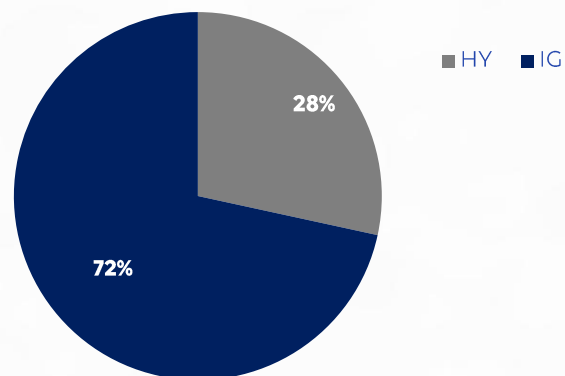
• **Low Beta, High Sharpe Exposure: Historically, GCC HY's correlation to the MOVE index is weaker than global HY — meaning less drawdown when volatility spikes. As volatility normalizes, GCC HY captures the upside without the same tail risk as EM HY.**

• **Regional HY market is effectively transitioning from “opportunistic yield” to “structural quality carry.**



- **The GCC Credit Structure**

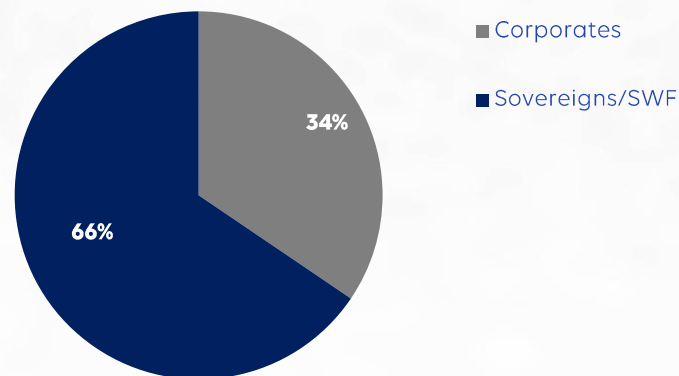
GCC Credit Market: Predominantly Investment Grade



Roughly two-thirds (66%) of the GCC bond market is issued by sovereigns and sovereign-linked entities, reflecting the region's strong government balance sheets and deep fiscal capacity. The remaining 34% represents corporates, many of which are financials, strategically important sectors such as energy, utilities, and infrastructure.

This structure provides a unique blend of stability and predictable cash flows, reinforcing the GCC's reputation as one of the most defensive and high-quality segments within emerging market fixed income.

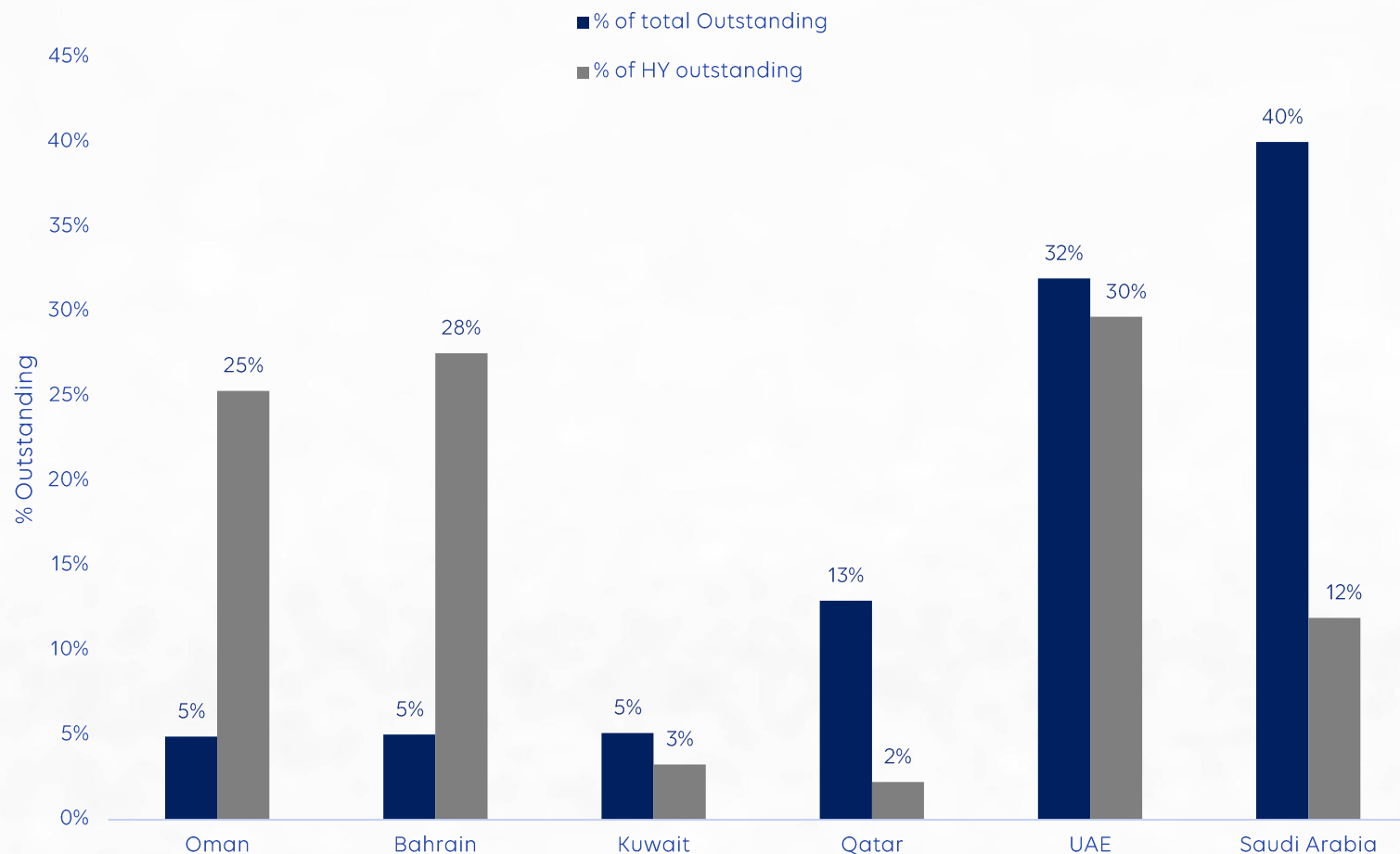
GCC's Credit Profile Remains High-Quality



The GCC credit market is predominantly investment grade, with roughly 72% of outstanding bonds rated IG and only 28% classified as HY. This composition underscores the region's strong sovereign anchors, prudent fiscal management, and improving corporate credit profiles.

High-yield exposure, though smaller, remains supported by low levered Real estate and utility-linked issuers, offering enhanced carry without the typical EM credit risk. Overall, GCC credit provides investors with a high-quality, USD-denominated, and structurally resilient opportunity within the broader emerging market spectrum.

Saudi and UAE Drive 70% of GCC Credit Market



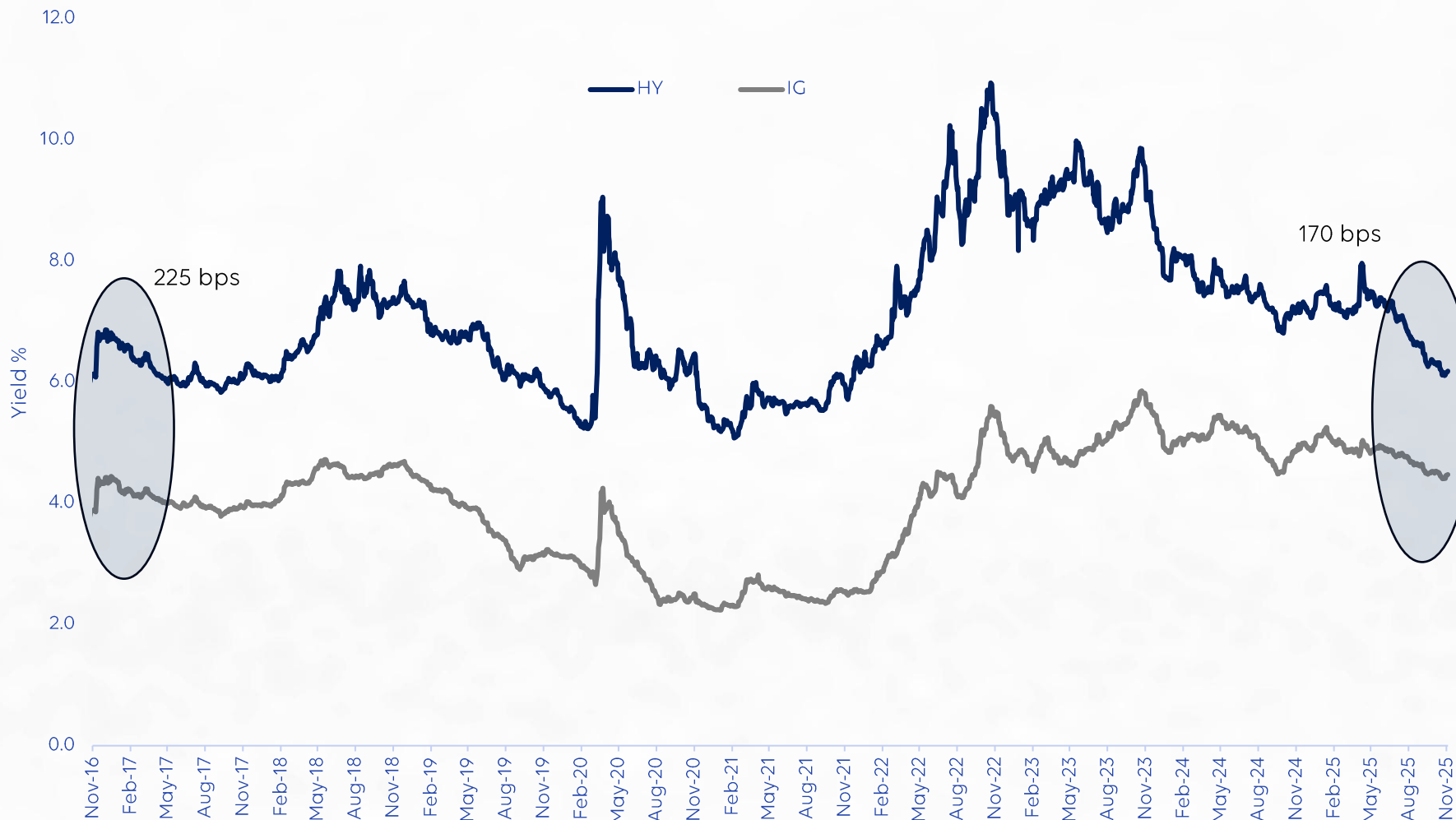
Saudi Arabia and the UAE together account for over 70% of outstanding GCC bonds, reflecting their scale, market depth, and credit evolution. Both markets have led the structural expansion of GCC credit, supported by government-related entities (GREs), quasi-sovereign borrowers, and diversification programs linked to Vision 2030 and Beyond 2020 initiatives.

Within the High Yield (HY) segment, however, the distribution shifts — the UAE now accounts for nearly 30% of HY issuance, reflecting a growing base of financials perps, quasi-sov, real estate-linked credits with strong fundamentals but higher spreads. Saudi Arabia’s HY share stands at 12%, while Bahrain and Oman continue to represent 25–28%, consistent with their lower sovereign ratings and frequent recourse to capital markets.



• **GCC Credit Convergence — The Maturing Story**

HY Returns, IG Discipline — The GCC Credit Advantage

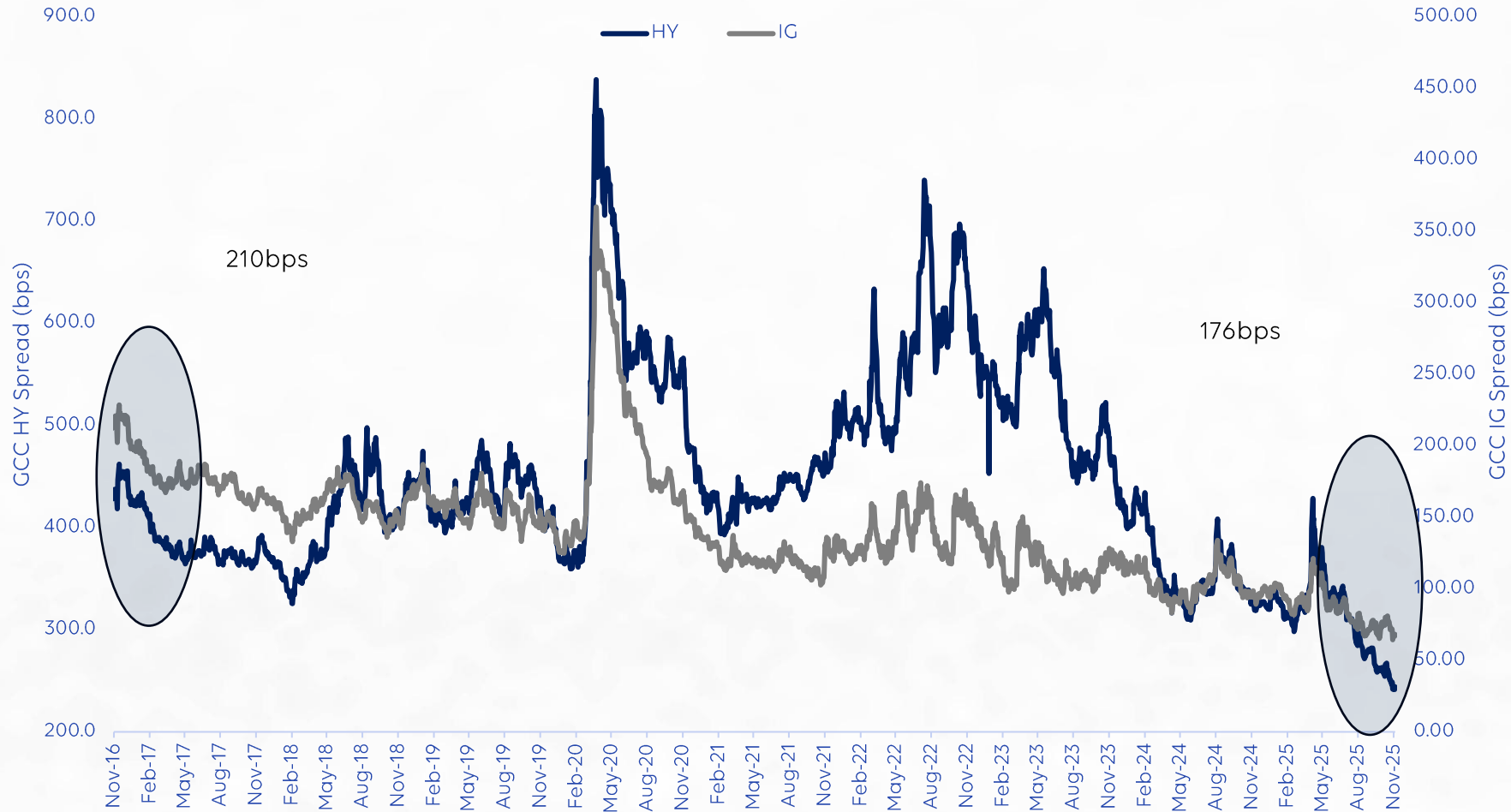


The yield gap between GCC High Yield (HY) and Investment Grade (IG) has compressed steadily from over 230 bps in 2016 to about 180 bps in 2025, underscoring the market’s growing confidence in regional issuers.

This convergence mirrors regional investor recognition that GCC HY is no longer “risk premium” territory — it is evolving into a crossover-quality asset class with improving liquidity and governance standards.

For investors seeking income in a low-rate or normalizing rate world, this becomes a compelling allocation — where HY offers upside, IG offers stability, and their convergence enhances portfolio efficiency

HY Spread Compression Reflects Market Re-Rating



2016–2019: HY spreads traded about 200 bps wider than IG, consistent with an early-stage, shallow bond market still building

Post-2022: While both markets have tightened meaningfully, the current HY–IG differential of ~175 bps reflects residual value rather than distress — a premium investors are still paid for liquidity and depth, not for credit risk.

As GCC debt markets deepen and issuance broadens, this differential is likely to compress further, offering potential total-return upside even in a lower-rate world.

From Fragile to Fundable: Bahrain's Spread Compression Tells the GCC Story

Bahrain-KSA spread has compressed by ~130 bps reflecting a decisive re-rating of weaker GCC credits.



The spread convergence signals market confidence in Bahrain's fiscal reforms and the credibility of regional sovereign backstops (notably KSA and UAE).

Regional HY names — particularly Oman, and GREs — are now trading closer to investment-grade benchmarks, not traditional EM HY levels.

The decline in 1-year forward rates (from ~5% → ~3.3%) supported tightening, as liquidity improved and funding costs eased.

Regional HY spreads now behave like "quasi-IG" credits — offering EM-style yields with investment-grade stability.

As Rates Fall, GCC HY Corp Risk Premium Reprices Up the Quality Curve



As the forward rate has steadily declined since early 2023, GCC HY Corporate spreads (blue line) have compressed — moving from around 350–400 bps to near 250–280 bps. The pockets of inverse relationship is primarily driven by sharp repricing on the short-term interest rate futures, whose impact typically filters into the GCC Corporate credit market with a time lag

Investors are reassessing risk premium in the GCC — moving from a “liquidity discount” to a “quality premium.”

This shift reflects a broader market normalization where some of the GCC HY issuers are treated closer to Quasi-IG credit in relative risk-adjusted terms.

- **The Regional Advantage**

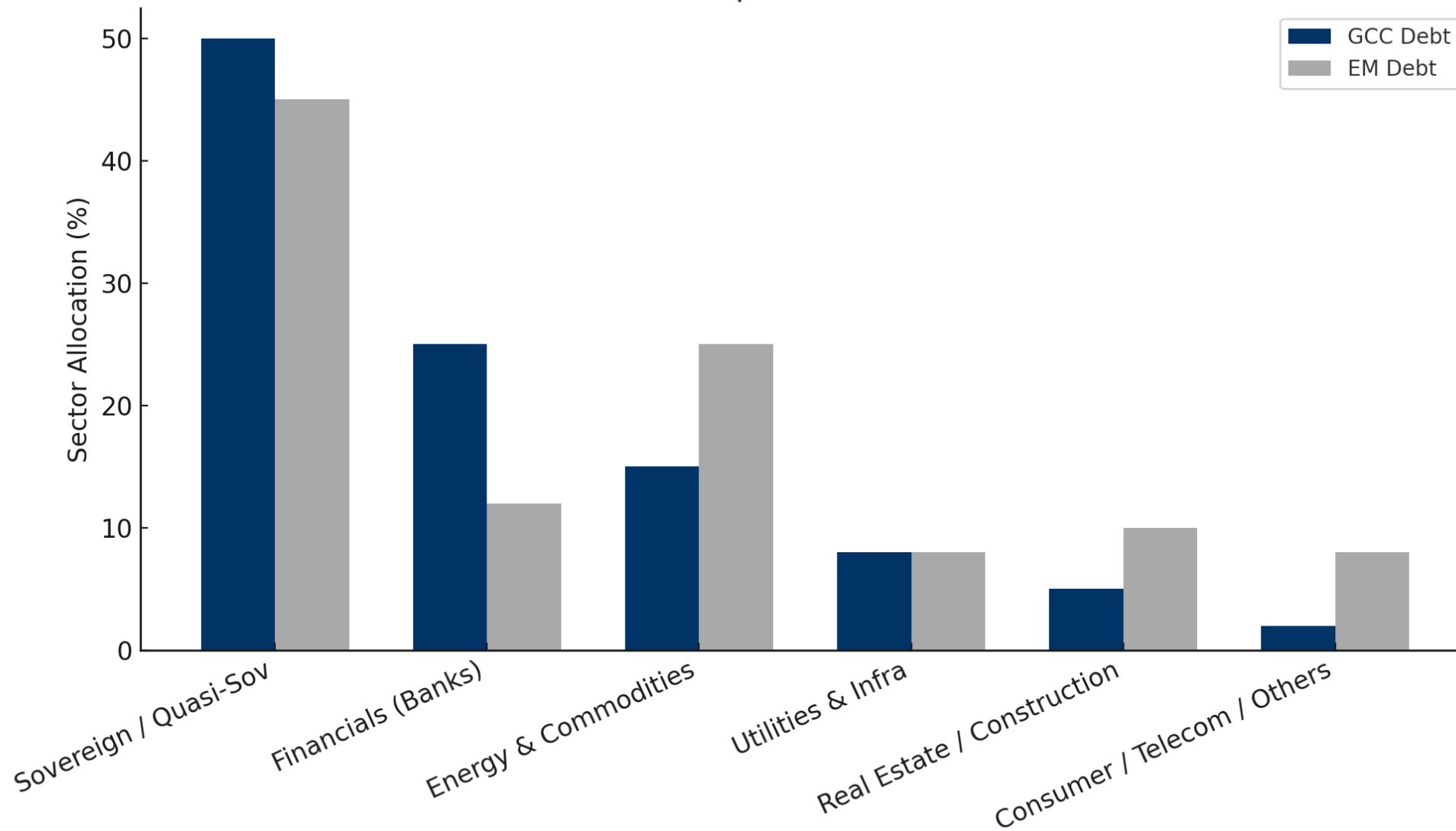
Merits of GCC HY Bonds space

Strong Sovereign Anchor	<ul style="list-style-type: none">• GCC governments have very high reserves and fiscal buffers.• Implicit support provides a “floor” under corporate distress scenarios.
Lower Default Volatility	<ul style="list-style-type: none">• Even during stress periods (e.g., COVID-19, oil price crash), defaults were minimal.
Attractive Risk-Reward Profile	<ul style="list-style-type: none">• Superior risk-adjusted returns given their lower volatility and lower default history
USD Denomination & Stable Currencies	<ul style="list-style-type: none">• Peg to USD eliminates one of EM’s biggest risks — FX depreciation.
Structural Reforms & Market Growth	<ul style="list-style-type: none">• Debt capital markets in GCC are expanding, supported by Vision 2030, diversification programs, and new issuance pipelines.
Diversification Benefits	<ul style="list-style-type: none">• Low correlation with global HY and EM risk factors (oil-linked, regional demand-driven).

GCC High Yield Bonds — Strength, Stability, and Strategic Diversification

Aspect	GCC High Yield	EM High Yield
Yield (YTW/YTM)	~5.7%	~7.1%
Duration	~3.8 yrs	~5.0 yrs
Spread (OAS)	~170-200 bps*	~317 bps
Default (2024 realized)	~0.2%	~3.4%
Default Outlook (2025)	Resilient / Stable	~1.7% forecast (CEMBI HY)
Currency	USD-pegged (low FX risk)	Multi-currency (higher FX risk)
Sector Exposure	GREs, Real Estate, Utilities, Energy Transition	Energy (20-25%; Metals 10-15%, Real Estate (10%-20%), Infra and industries (10%), consumer/retail (10%)
Market Liquidity	Expanding, strong primary issuance	Deep and globally diversified

Sector Allocation Comparison: GCC Debt vs EM Debt



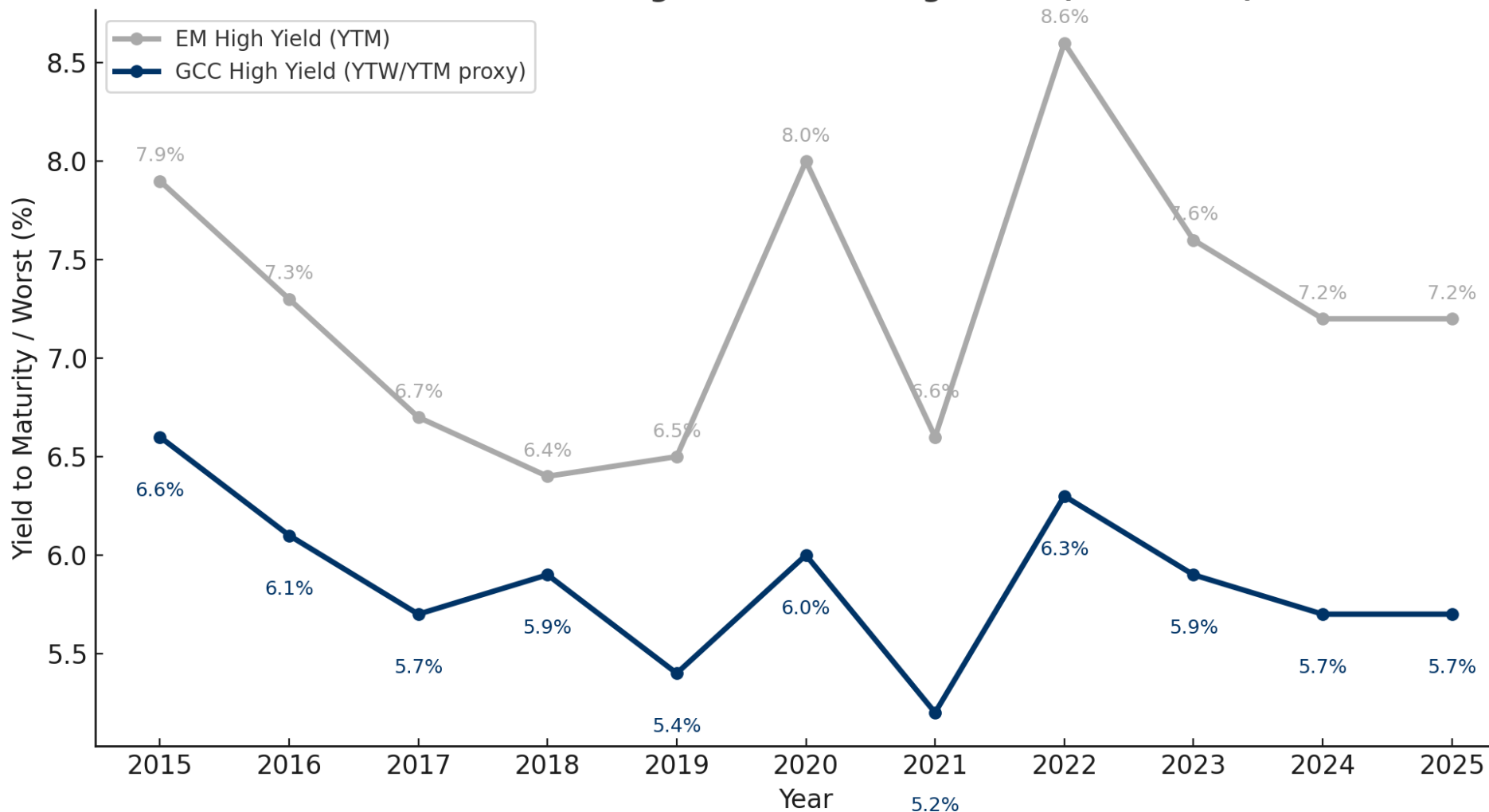
GCC Debt: quasi-sovereign heavy, stable, lower volatility, shorter duration — acts as an EM stabilizer.

EM Debt: higher yield and beta exposure, broader diversification — drives carry but adds volatility.

A blended EM–GCC allocation improves diversification and risk-adjusted returns.

GCC HY is a quality-carry trade, not a yield-chasing one

YTM Trend: GCC High Yield vs EM High Yield (2015-2025)



Data reflects indicative yield trends from ICE BofA EM HY and GCC HY/Sukuk indices.

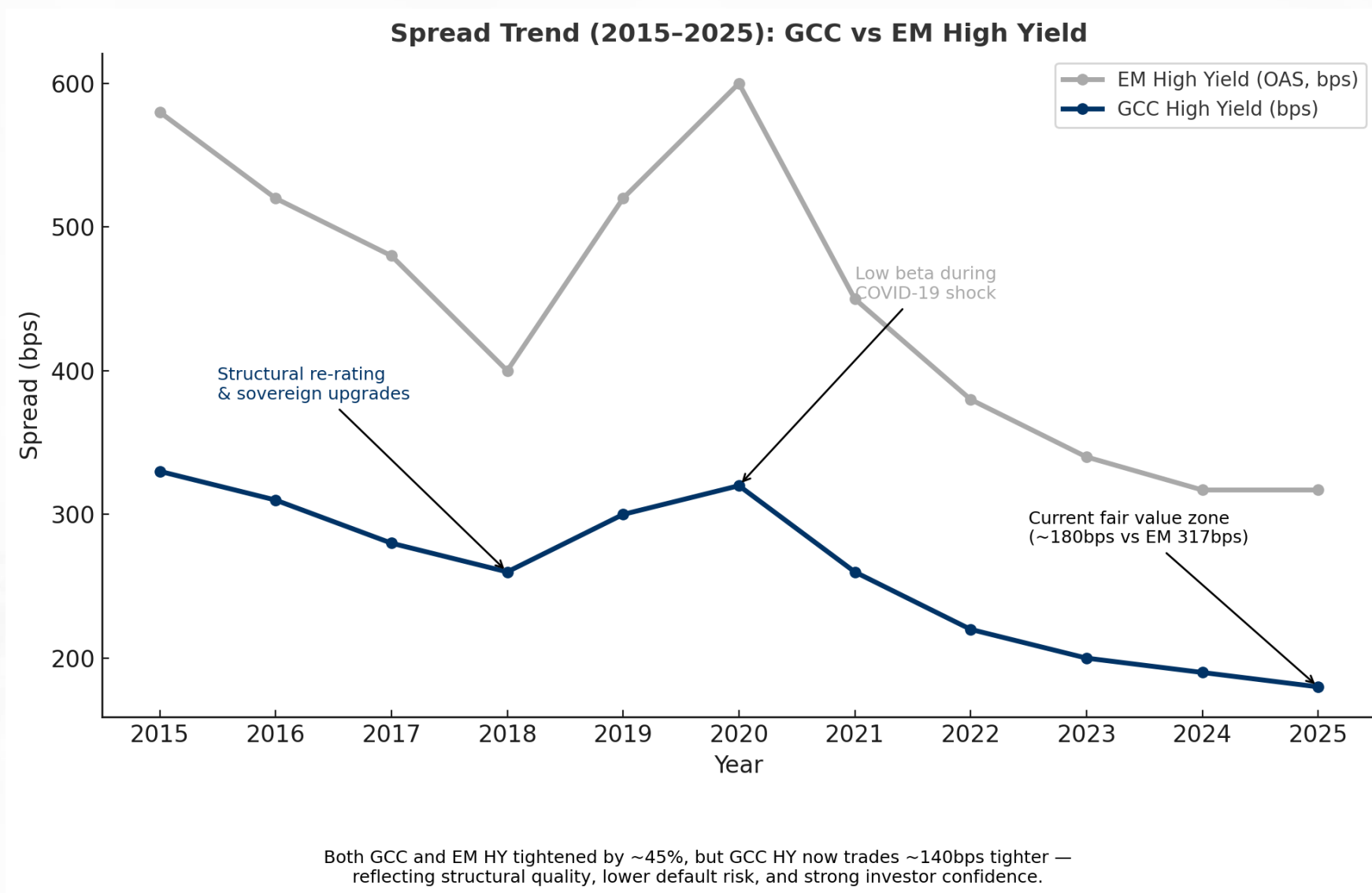
GCC HY's yield ($\approx 5.7\%$) is below EM HY's ($\approx 7.1\%$), the risk-adjusted yield per unit of volatility and default risk is superior.

Low beta: GCC HY trades more like BB/BBB sovereigns than CCC cyclicals.

Most HY issuers are related to government (implicit support), utilities, or infrastructure — not highly leveraged private borrowers

Policy stability: USD-pegged regimes anchor inflation and rate expectations.

Spread Convergence: GCC High Yield Strengthens Against Broader EM Markets



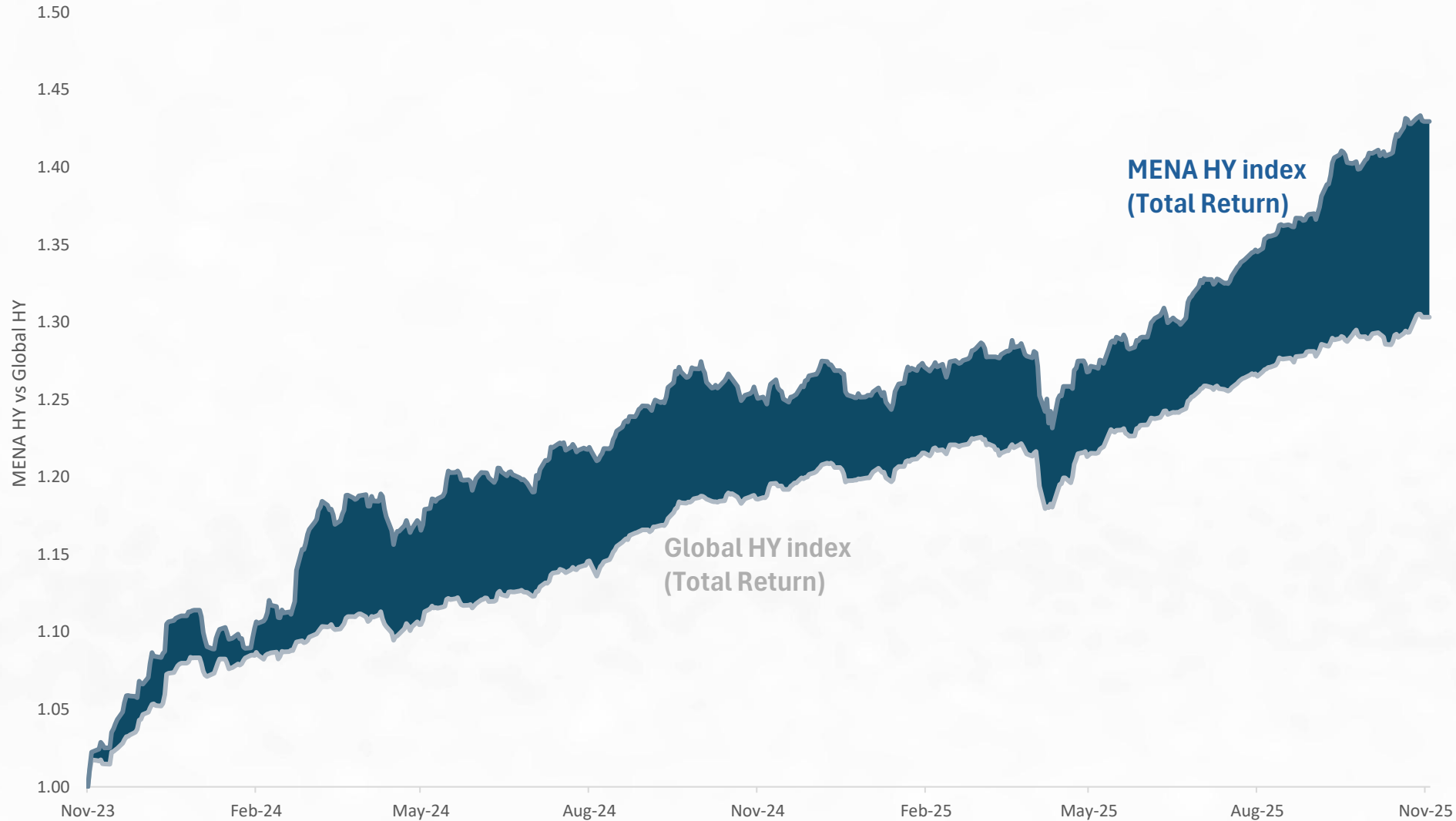
GCC HY spreads have compressed structurally, converging towards IG level (such as Oman)

GCC spreads now move at less than 0.4x EM HY volatility. Hence, despite tighter spreads, GCC HY offers superior risk-adjusted carry.

Strategic allocation: Add GCC HY to lower EM HY portfolio volatility and improve Sharpe ratios

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- **Regional Outperformance**

Regional HY, a structural source of alpha in lower-rate world.



~12% higher total return vs Global HY over the past two years : Consistent outperformance driven by strong carry, sovereign support, and a high-quality issuer base.

Low volatility, strong fundamentals: USD-pegged currencies, near-zero default history, and quasi-sovereign backing position MENA HY as a stable income generator rather than a high-beta play.

Structural re-rating of GCC credit: Regional HY offers better risk-adjusted returns as global investors recognise its resilience and depth in both sukuk and conventional bond markets.



- **Concluding Remarks**

EM-level returns, Quasi IG-level resilience

- High carry with far lower volatility and default risk than broader EM peers.

Low Beta, High Carry

- Attractive spreads with low correlation to global risk cycles.

From Tactical Trade to Core Allocation

- GCC High Yield is evolving into a strategic, long-term income asset class.

Global Investors Underweight

- Room for re-allocation as GCC enters global HY benchmarks and ESG portfolios.

Regional High Yield gives us 80 % of EM yield, 50 % of the volatility, and 20 % of the default risk — effectively EM carry with Quasi- IG resilience.

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