

Don't be scared off by the credit market. It belongs in every portfolio

KEVIN FOLEY

SPECIAL TO THE GLOBE AND MAIL

Published May 1, 2026

Credit investing is having a moment – mostly for the wrong reasons. The headlines are real but narrow. The opportunity is much broader and the frightening bits more isolated than most investors realize.

Within investments, credit is an oft-used yet inexact term, which leads to confusion. When investment professionals talk about credit, they mean something specific and valuable: Lending money to governments, companies, or individuals and getting paid for the risk of doing so. It is one of the oldest financial activities in human history. And it belongs in every portfolio.

Credit investing, in its simplest form, is money lent for a set period of time, for a fee. Most credit funds maintain a portfolio of those loans, so they don't have a set maturity date. Too many investors misunderstand what credit is, lump all of it together as one, or avoid it entirely based on incorrect assumptions and associations. That should change.

Most investors think in two buckets: equities and fixed income. In the fixed income portion, a bond's yield is the sum of the yield of the government bond of the same term to maturity, plus the credit spread – which is additional yield, to reflect the quality of the borrower. Where the Government of Canada currently borrows at 2.9 per cent in the three-year term, a good corporate borrower might borrow at 2.9 plus an additional credit spread of 0.8, equal to 3.7 per cent to borrow for that same three-year period.

Often, investors aren't fully aware of the two elements that generate bond yields. Credit spreads are a legitimate standalone exposure whose effectiveness has earned its own allocation to be sized and shifted purposefully.

Those who do consider credit often assume it means corporate bonds, while the headlines these days might make you think it's predominately private credit. Corporate bonds likely do make up the bulk of the credit exposure, but to complete the picture, here are the seven distinct types of investible credit that institutional managers select from when building portfolios.

Government and sovereign debt: The baseline. Credit-safe for the most part, mostly reliant on interest rates. Worth understanding as the foundation against which everything else is priced.

Investment grade corporate bonds: With little to no risk of default, these represent high-quality company debt with transparent financials and liquid securities, where price volatility is predominantly driven by shifts in government bond yields, not credit spread changes. An increasing

number of investors are choosing credit funds that eliminate most or all the rate risk, isolating the stable credit spread premium.

Mortgages: Secured by real property, often at conservative loan-to-value or LTV ratios, where a 65-per-cent LTV would allow the lender a 35-per-cent property value cushion before losing a dollar of principal. Less visible to retail investors and less liquid than public bonds, but the collateral backing puts well-selected mortgages closer to investment grade than most people assume.

This is likely one of the most underappreciated credit categories available, despite being an arguably more transparent and secure form of private lending than much of what currently dominates the headlines. Mortgage investing is designed to be distinctly less risky than real estate investing.

Securitized credit: Pools of underlying loans repackaged as bonds or bond-like securities. Risk and complexity vary enormously by structure, with many high-quality and low-risk options available. Worth knowing, and worth being selective.

High yield: Below-investment-grade corporate bonds with varying default risk, depending on rating. Liquidity can be tricky. The added yield can be compelling, and is typically held in smaller portfolio allocations and considered within a broader portfolio risk framework.

Emerging market debt: This is credit risk layered with currency and political risk. Offers a wide spectrum of possibilities. It can include investment-grade names but carries complexity most investors underestimate.

Private credit and direct lending: The source of the unfortunate current headlines. Illiquidity is a feature for some investors and a problem for many. Returns have been attractive, but opacity, valuation questions and lock-up periods deserve serious consideration.

Factoring – buying corporate receivables at a discount and collecting face value – is one small corner of this world. The category also overlaps with secured mortgage investing, which is likely a more transparent and secure choice, now and arguably always.

The data supports a less fearful view of credit. The asset valuation and illiquidity fears generated by the private credit tail shouldn't be wagging the entire credit dog.

According to S&P Global's long-running corporate default study, the highest one-year default rate ever recorded for investment-grade bonds globally – even in the worst years on record – was just over 1 per cent for the lowest-rated investment grade category. For the highest-rated, it was zero.

In Canada, the investment-grade default rate might just be zero. I know of none in my decades in the fixed-income market.

A report by Global Manager Research, a firm dedicated to Canadian fund analysis for institutional investors, shows that a group of five leading, actively managed, investment-grade credit funds outperformed the XBB Canadian bond Index ETF by an average of more than 5.5 percentage points over the past five years and an average of 4.5 percentage points per year over the past 10 years, with similar or lower volatility.

Meanwhile, the Canadian Bankers Association reports that even after rising from pandemic lows, Canadian mortgage arrears – mortgages that are more than 90 days overdue – sit at roughly 0.24 per cent of all mortgages outstanding.

These are not the numbers of a dangerous asset class. These are the numbers of a misunderstood one.

Accessing credit investments has become more straightforward than most investors realize. Actively managed credit funds, bond ETFs, and mortgage investment corporations, known as MICs, have made the full spectrum of credit investments broad and accessible to individual investors.

ETFs offer low-cost exposure but their performance is typically dominated by interest rate risk, and not enough return from other exposures, like the less-volatile investment grade credit spreads.

Active managers and MICs allow for more deliberate choices across the risk spectrum, with varying degrees of rate risk, liquidity and credit quality. Not all MICs are the same. The category deserves careful attention.

The decision has two steps. First, decide how much credit belongs in your portfolio, and which type fits your income needs, risk tolerance and liquidity requirements. That choice also requires a decision about how much intentional interest rate risk you want, if any at all.

Second, once you have chosen a category, evaluate the manager carefully. Track the record through different market conditions, transparency of valuations, underwriting standards, loan-to-value ratios and accounting policies for mortgage funds, liquidity terms including any gating provisions and fees relative to what active management demonstrably adds. These are the questions worth asking.

Credit has been avoided, misunderstood, or accessed carelessly by too many investors for too long. The good news is that the landscape is navigable, the categories are distinct, and the return potential – particularly in investment grade credit with little or no rate risk, and in select mortgage portfolios – is still compelling. You don't need to reach into the riskier or more opaque end of the spectrum to allow credit to work well for you.

Give credit its due. It's not the villain. Misunderstanding it is.

Kevin Foley is managing director, institutional accounts, at Canadian asset manager YTM Capital, which specializes in credit and mortgage funds. He spent two decades trading and managing fixed-income at a major Canadian bank and serves on several Canadian foundation boards and investment committees. Kevin.Foley@YTMCapital.com