# Sidestepping the Stress: QHY's Quality Screen at Work

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## Key Takeaways

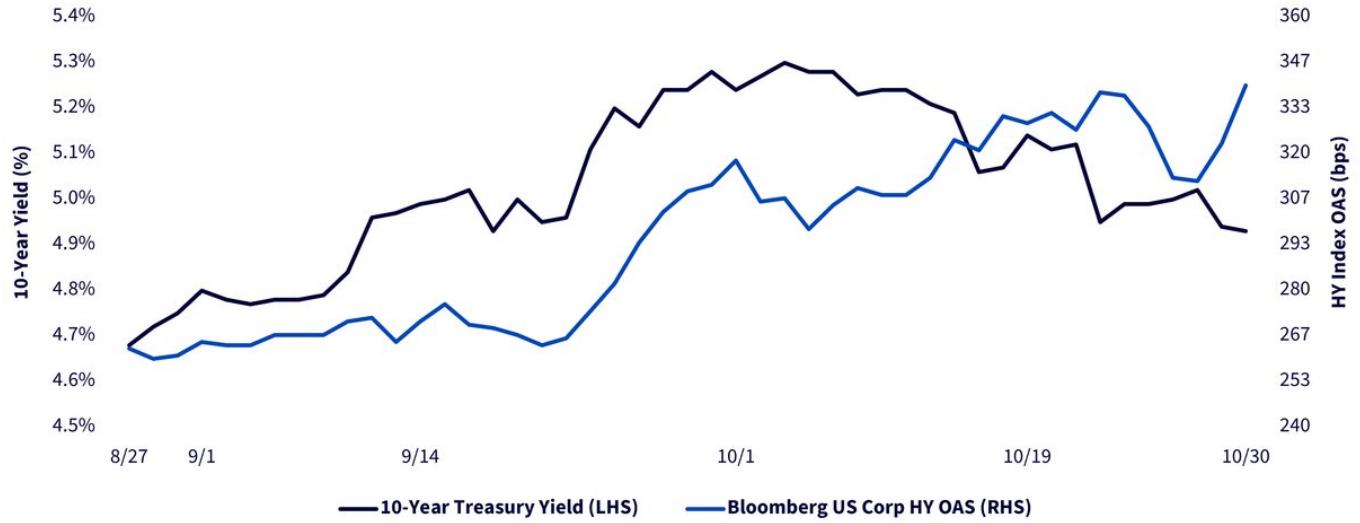
- Concerns about AI-related bond issuance, circular financing and rising rates have pushed high yield spreads 77 basis points wider since late August, with the damage concentrated in CCC-rated bonds, communications issuers and AI data center debt.
- The WisdomTree U.S. High Yield Corporate Bond Fund (QHY) has outperformed the Bloomberg US Corporate High Yield Index by 59 basis points year-to-date at NAV, while the WisdomTree Interest Rate Hedged High Yield Bond Fund (HYZD) is ahead by roughly 325 basis points.
- We believe a quality screen that sidelines distressed and cash-burning issuers before the market reprices them leaves both Funds well positioned as stress works its way through the high yield market.

For most of the summer, high yield (HY) felt like a fairly comfortable place to be, with spreads sitting about where they started the year and defaults still low. That changed in late August, as worries about the wave of AI-related bond issuance, questions around circular financing in the AI ecosystem, where some of the same companies are funding each other's buildouts, and rising rates all hit the market at around the same time. The pain hasn't been spread evenly, and most of it has landed on exactly the kind of issuers our process is designed to stay away from. In this post, we'll look at how the stress has played out and how the quality screen behind the WisdomTree U.S. High Yield Corporate Bond Fund (QHY) and the WisdomTree Interest Rate Hedged High Yield Bond Fund (HYZD) has helped both Funds hold up.

## How Did We Get Here?

Rates were a big part of the story early on, with the 10-year Treasury yield climbing to 5.28% by the end of September and HY spreads widening along with it. Treasuries rallied in October, but HY spreads didn't follow and kept widening, ending the month 77 basis points wider than in late August. That's a sign the market's focus has shifted from rates to credit, and in particular to how much debt is being raised to fund the AI buildout and who will be able to pay it back.

## Figure 1: 10-Year Treasury Yield and High Yield Spreads Since August 27




Source: Bloomberg, as of 10/30/26.

Within HY, the CCC-rated bonds in the benchmark have widened almost five times as much as the BBs since August 27. Communications has been hit the hardest, as a group of cable and media issuers that were already struggling got caught up in the broader selloff. The market has also become a lot more skeptical about the capex-heavy end of the AI trade, and some data center issuers like CoreWeave now yield around 15% as investors question whether those projects will generate enough cash to service the debt behind them.

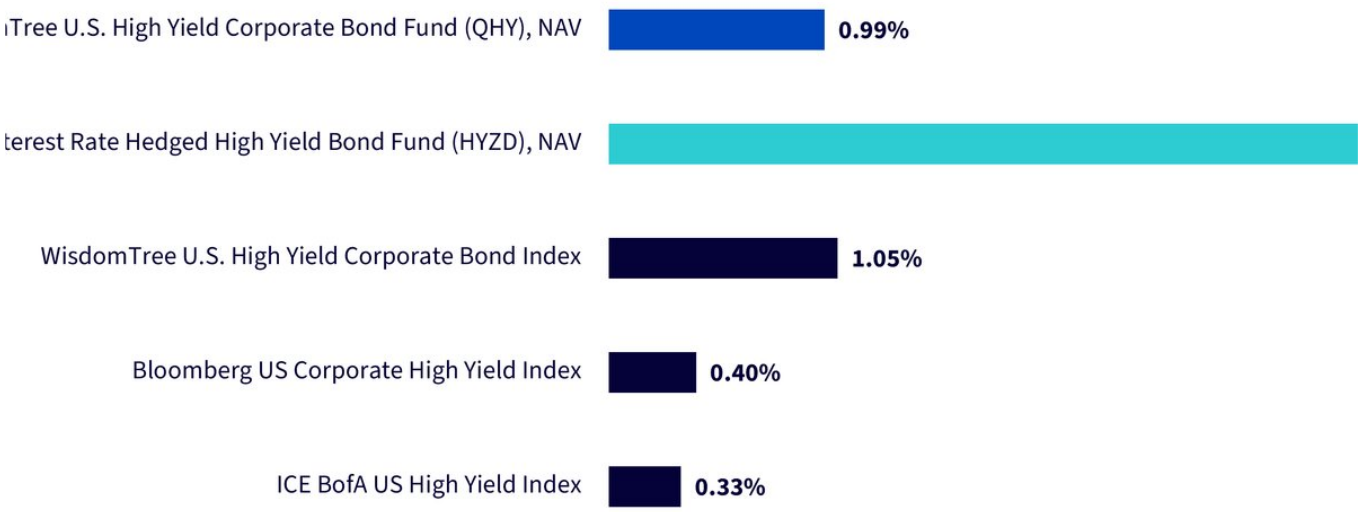
## Is the Extra Yield Worth Chasing?

At over 8%, all-in HY yields look attractive, and we're still constructive on the asset class. However, a good part of that extra yield is coming from the parts of the market that are under the most stress, with the benchmark's CCC bucket now trading at a spread of more than 1,100 basis points. Investors buying the broad index today are collecting more of their income from the issuers the market trusts the least, and we believe it's more prudent to be selective about where that yield comes from than to reach for it.

## How Have QHY and HYZD Held Up?

In our August post, "High Yield in 2026: Quality Is the Differentiator," we wrote that issuer selection would become the main factor separating HY performance going forward, and the last two months have put that to the test. Year-to-date through October, QHY is up 0.99%, ahead of the Bloomberg US Corporate High Yield Index by 59 basis points. HYZD applies the same quality-focused approach while hedging out interest rate risk, so it has benefited from both the screen and the hedge and is ahead by roughly 325 basis points.

## Figure 2: QHY and HYZD Year-to-Date Performance versus High Yield Benchmarks




Sources: WisdomTree, Bloomberg, for the period 12/31/25–10/30/26. Fund returns are NAV total returns. You cannot invest directly in an index. **Past performance is not indicative of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For the most recent month-end and standardized performance, click the respective ticker: QHY, HYZD.**

A big part of this comes from simply owning less of the weakest credits. QHY holds about half the benchmark's weight in CCC-rated bonds and tilts toward BBs, and the Fund's spreads have widened less than the benchmark's in every rating bucket since late August.

## Figure 3: Ratings Exposure and Spread Widening Since 8/27

| Rating | QHY Weight (%) | Benchmark Weight (%) | Active (%) | QHY OAS (bps) | Benchmark OAS (bps) | QHY Widening since 8/27 (bps) | Benchmark Widening since 8/27 (bps) |
|---|---|---|---|---|---|---|---|
| BB | 58.31 | 53.52 | 4.79 | 171 | 196 | 35 | 51 |
| B | 30.84 | 36.35 | -5.51 | 278 | 336 | 69 | 88 |
| CCC | 4.07 | 8.05 | -3.97 | 596 | 1117 | 193 | 253 |
| CC | 0.21 | 0.28 | -0.07 | 595 | 6133 | 89 | 1639 |

Sources: WisdomTree, Bloomberg, as of 10/30/26. Benchmark is the Bloomberg US Corporate High Yield Index. Credit ratings apply to the underlying holdings of the Fund, not to the Fund itself. Standard & Poor's, Moody's and Fitch study the financial condition of an entity to ascertain its creditworthiness. The credit ratings reflect the rating agency's opinion of the holdings' financial condition and histories. The ratings displayed are based on the highest of each portfolio constituent as currently rated by Standard & Poor's, Moody's or Fitch. Long-term ratings are generally measured on a scale ranging from AAA (highest) to D (lowest), while short-term ratings are generally measured on a scale ranging from A-1 to C.

Communications is a good example of where security selection mattered as much as positioning. QHY is only modestly underweight the sector, yet its communications holdings have widened by about a quarter as much as the benchmark's, because our equity momentum and OAS signals had already moved the Fund out of the legacy cable and media issuers that are now under the most pressure.

## Figure 4: Sector Exposure and Spread Widening Since 8/27

| Sector | QHY (%) | Benchmark (%) | Active (%) | QHY OAS (bps) | Benchmark OAS (bps) | QHY Widening since 8/27 (bps) | Benchmark Widening since 8/27 (bps) |
|---|---|---|---|---|---|---|---|
| Industrials | 6.6 | 11.4 | -4.8 | 133 | 220 | 41 | 45 |
| Consumer Discretionary | 15.6 | 18 | -2.3 | 202 | 364 | 51 | 93 |
| **Communications** | **14.6** | **16.6** | **-2** | **360** | **1192** | **116** | **434** |
| Technology | 3.5 | 4.1 | -0.6 | 158 | 481 | 26 | 95 |
| Financials | 10.6 | 10.9 | -0.3 | 340 | 345 | 87 | 88 |
| Materials | 9.6 | 9.6 | 0 | 192 | 294 | 33 | 56 |
| Government | 0.5 | | 0.5 | 1 | | 1 | 0 |
| Real Estate | 3.4 | 2.9 | 0.5 | 295 | 281 | -32 | 88 |
| Health Care | 8.9 | 8.1 | 0.7 | 128 | 280 | 12 | 58 |
| Energy | 12.5 | 11.1 | 1.4 | 143 | 150 | 11 | 21 |
| Consumer Staples | 5.5 | 3.8 | 1.7 | 224 | 251 | 50 | 59 |
| Utilities | 5.5 | 3.5 | 2 | 180 | 189 | 23 | 26 |

Sources: WisdomTree, Bloomberg, as of 10/30/26. Benchmark is the Bloomberg US Corporate High Yield Index.

CoreWeave is a good case study of how our screen works in practice. The issuer was flagged in our May Index rebalance because of its deeply negative long-term free cash flow, months before its spread moved into distressed territory. QHY does have AI-related exposure, but it's with semiconductor and compute infrastructure issuers rated BB- or better that trade at much tighter spreads, rather than the capex-heavy data center buildouts the market is now stress-testing.

## Figure 5: AI-Related Exposure, QHY's Index versus Benchmark

| Issuer | Rating | Benchmark OAS (bps) | Index OAS (bps) | Benchmark YTW (%) | Index YTW (%) | Benchmark Weight (%) | Index Weight (%) |
|---|---|---|---|---|---|---|---|
| **Data centers / compute** | | | | | | | |
| CoreWeave | B+ | 1,009–1,065 | | 14.83–15.39 | | 0.48 | |
| Galaxy Helios Data Center | BB- | 700 | | 11.83 | | 0.23 | |
| Meridian Arc Holdco | BB | 385 | | 8.6 | | 0.37 | |
| CSDC Finance I | BB- | 314 | | 8.1 | | 0.16 | |
| Zenith Arc | BB | 852 | | 13.27 | | 0.14 | |
| Yondr JK 1 | BB- | 494 | | 9.68 | | 0.05 | |
| Iron Mountain | BB- | 103–167 | | 5.82–6.87 | | 0.65 | |
| **Compute / AI infrastructure** | | | | | | | |
| Wulf Compute | BB | 181 | 181 | 6.8 | 6.8 | 0.23 | 0.54 |
| Cipher Compute | BB- | 232 | 232 | 7.28 | 7.28 | 0.12 | 0.42 |
| Black Pearl Compute | BB- | 177 | 177 | 6.65 | 6.65 | 0.14 | 0.4 |
| **Semiconductors / hardware** | | | | | | | |
| Entegris | BB | 92–128 | 92 | 5.75–6.09 | 6.09 | 0.11 | 0.08 |
| Coherent | BB- | 106 | 106 | 5.93 | 5.93 | 0.07 | 0.06 |
| ON Semiconductor | BB | 117 | 117 | 5.78 | 5.78 | 0.05 | 0.11 |
| Amkor Technology | BB | 169 | 169 | 6.75 | 6.75 | 0.03 | 0.1 |
| Synaptics | BB- | 4.84 | | 4.87 | | 0.03 | |
| Skyworks Solutions | BBB- | | 109 | | 5.81 | | 0.09 |
| Qorvo | BBB- | | 183 | | 6.53 | | 0.06 |
| TTM Technologies | BB- | 168–176 | 176 | 6.39–6.94 | 6.39 | 0.07 | 0.13 |

Sources: WisdomTree, Bloomberg, as of 10/30/26. Index is the WisdomTree U.S. High Yield Corporate Bond Index. Blank cells mean the issuer isn't held.

## Conclusion

We're pleased with how QHY and HYZD have held up through this stretch, and we think it's a good reminder of why we keep a quality bias at the center of our HY strategies. The WisdomTree U.S. High Yield Corporate Bond Fund (QHY) and the WisdomTree Interest Rate Hedged High Yield Bond Fund (HYZD) stayed out of the most stressed issuers because their process flagged them well before the market repriced them. As the stress works its way through the market, we believe both Funds are well positioned to keep extending their lead. For investors who want to stay in high yield without reaching for the riskiest credits, that's the kind of discipline this market calls for.

## Important Risks Related to this Article

There are risks associated with investing, including possible loss of principal. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

**QHY:** Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. High-yield or "junk" bonds have lower credit ratings and involve a greater risk to principal. Fixed income investments are also subject to credit risk, the risk that the issuer of a bond will fail to pay interest and principal in a timely manner or that negative perceptions of the issuer's ability to make such payments will cause the price of that bond to decline. While the Fund attempts to limit credit and counterparty exposure, the value of an investment in the Fund may change quickly and without warning in response to issuer or counterparty defaults and changes in the credit ratings of the Fund's portfolio investments. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit.

**HYZD:** High-yield or "junk" bonds have lower credit ratings and involve a greater risk to principal. Fixed income investments are subject to interest rate risk; their value will normally decline as interest rates rise. The Fund seeks to mitigate interest rate risk by taking short positions in U.S. Treasuries (or futures providing exposure to U.S. Treasuries), but there is no guarantee this will be achieved. Derivative investments can be volatile and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions.

Fixed income investments are also subject to credit risk, the risk that the issuer of a bond will fail to pay interest and principal in a timely manner, or that negative perceptions of the issuer's ability to make such payments will cause the price of that bond to decline. The Fund may engage in "short sale" transactions where losses may be exaggerated, potentially losing more money than the actual cost of the investment and the third party to the short sale may fail to honor its contract terms, causing a loss to the Fund. While the Fund attempts to limit credit and counterparty exposure, the value of an investment in the Fund may change quickly and without warning in response to issuer or counterparty defaults and changes in the credit ratings of the Fund's portfolio investments. Due to the investment strategy of the Fund, it may make higher capital gain distributions than other ETFs. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit and the Fund does not attempt to outperform its Index.