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How Macro Forces Shape Credit Markets (With Winnie Cisar)

COLLIN MARTIN: I'm Collin Martin

LIZ ANN SONDEERS: And I'm Liz Ann Sonders.

COLLIN: And this is *On Investing*, an original podcast from Charles Schwab. Every week we analyze what's happening in the markets and discuss how it might affect your investments.

LIZ ANN: Well, hi, Collin. Another week for us here. Well, for us, obviously, one of the main stories this week is the transition from the Jerome Powell era at the Fed to the Kevin Warsh era, with Powell announcing his intention to stay on at the Federal Open Market Committee, FOMC, as governor. So Collin, based on what Warsh said in his confirmation hearings, what sorts of changes do you think he will bring to the role of Fed chair?

COLLIN: There's a handful of changes or potential changes, I should say, or how he's approaching the role. The first thing that we're looking for is just his general approach on monetary policy, you know, level, direction of rates, things like that. But he was pretty tight lipped at the hearing. We assume he'll try to have a lower rate bias, but he didn't really talk about that too much, maybe just to kind of show that he is independent at the hearing. But there are a bunch of things outside of traditional, you know, "What is the fed funds rate monetary policy?" that Warsh has some ideas. The first one is communications. And it seems like he really wants to change how the Fed communicates and the frequency of communications. So there's ideas that maybe the chair doesn't hold a press conference after every single meeting. Maybe it goes back ...

LIZ ANN: What are we going to do at 2:30 on those days then? That's like must-see TV.

COLLIN: Exactly. What are we going to do? It has been must-see TV, but I guess we'll get more time back, more time to dissect the statement and such. But who knows? There's no firm plans just yet. It sounds like he might want to change the outlook for the dot plot, or the summary of economic projections, as well. Every other meeting, so four times a year, we get the dot plot, which projects where the various officials project the Fed funds rate to be at certain points at the end of the next following years.

We also get their updated economic projections, where we see what their growth outlook is, inflation outlook is. And Warsh had said something like, "When officials say things like that or put those forecasts out there, they can become prisoners of their own words." So it seems like maybe we'll hear less from Fed officials. Now, admittedly, we hear from them a lot. I tend to think it's a good thing. My approach, Liz Ann, is I understand that each official is one person with their own views. I take that and I build that to kind of figure out what's the majority of the committee look like, where are they leaning. And you never want to take those projections as gospel. And I think that's what's important. When we see a dot plot, it's the amalgamation of all the Fed officials. And then the headlines will say, "Fed projects one rate cut by the end of the year." And it's like, "Not really." That wasn't what they discussed. It's a summary of all their projections.

So we'll see what the changes bring. There'll probably be a period where maybe it could create some uncertainty and maybe some volatility, given that it's going to be a little bit different if these changes come to fruition, but we'll see. And then finally, Warsh has long been a proponent of a smaller balance sheet. This goes back to his days as governor during the financial crisis.

And this, I think, is what the markets are really focusing on because the Fed's balance sheet, whether it's expanding it or shrinking it, can have an impact on the market. What's important is that Warsh mentioned that it'll take a lot of time, and it should be well communicated. He said something along the lines of "What was done over 18 years can't be undone in 18 minutes." So if there is a plan to shrink the balance sheet, it will likely take time so that the markets don't react or see a pickup in volatility.

So clearly we have a lot of potential changes when Warsh comes in. But Liz Ann, we had a very exciting Fed meeting just this week, where even though the Fed didn't change policy and there were no updated projections or dot plot, plenty of headlines, including some dissents that generally don't happen. So what was your take on the Fed meeting this week?

LIZ ANN: Yeah, I mean it was wild and I was at a conference so I ... even though we just joked earlier that it's must see TV. I was not able to view it but certainly was getting snippets throughout the course of the press conference. So it was interesting, as you already mentioned Collin, no surprise that they didn't do anything with rates. There were dissents, though. So Stephen Miran, the uber dove appointed by President Trump, he dissented in favor of them cutting at this meeting. But the other three dissents were interesting in that they didn't dissent in favor of a hike, but they dissented in favor of taking out the easing-bias language within the statement.

And commentary since then suggests that even more people were in favor of doing that, even though they didn't officially dissent in the proverbial record book. So I know you're in the camp now of very high likelihood that the Fed may not do anything this year. And that is the camp that I'm in. I think it would have to be a pretty high inflation bar for the Fed to consider hiking rates, especially if we don't see a commensurate significant improvement in the labor market, which would maybe give some leeway for the Fed to consider hiking. But I think the default switch is probably set to neutral at this point.

Powell's decision to stay on, that's an interesting one. I think you were part of the email exchange, Collin, just an internal email exchange, where those of us in what we call SCFR, Schwab Center for Financial Research, were having our own internal ... "Do you think he stays on? Do you think he didn't?" I don't remember if you voted, so to speak, on that. My vote was I think he stays on. Were you on the stays on or leaves?

COLLIN: You know, I don't remember if I cast a formal vote there, but I've been on the stay-on to some degree camp for some period of time camp. And it seems like, it seems like that's what he's going to do. And it seems like it's really just to protect in his view, kind of the, I guess, the integrity of the institution. And the challenging thing is that, while you like to think that most Fed officials, like Powell, they're trying to be ... keep politics out of this, it comes off as a political stance to stay on. But hey, it's his decision. His term ends in February 2028. It's up to him to do what he wants.

LIZ ANN: I think it was also driven by the fact that they sort of put on hold, the Justice Department put on hold, the investigation of Powell in order to get the buy-in for the early stage of the nomination from Senator Tillis who had said, "Unless this is dropped, I am not going to vote."

But it doesn't mean that that sort of legal problem for Powell doesn't come back. And I think that was part of the reason. You know, Powell to me seems like a, for the

most part, a fairly humble guy. He doesn't seem to be the type that is going to do anything overt to step on Kevin Warsh's toes here. I've known Kevin, I think we talked about this on an earlier episode, I've known Kevin since 2003, so a long time. I think he's very smart. I do believe he understands the importance of the independence of the institution. But this is certainly going to be seen as somewhat political. But you know, Powell was, I think, right to reinforce that he doesn't intend to be ... let's call it a louder voice on the committee than other governors. But it will be interesting to see.

To me, the interesting component of what you mentioned is Warsh talking about ... not that he's not in favor of what I've often called the "Federal Open Mouth Committee," where so many speakers are out there. But it'll be interesting if he is able, if that's his goal, to sort of maybe rein that in a little bit, not to mention the possibility of not having as many meetings. So whether, ultimately under Warsh leadership, the Fed shifts to maybe just four meetings a year instead of eight meetings a year, that'll be interesting. Do you think that's in the cards? And would it matter?

COLLIN: I don't think that's in the cards. Yeah, would it matter? It might. I mean, there's pros and cons to all the communications we hear. We get a very open look at what everyone's thinking at a given point in time. But then when a given official gives a speech, that can move markets. Now if we lose that ... you know, maybe we focus more on the economic data and our own analysis as opposed to everything they're telling us. So it will be really interesting. I'd be hard pressed to see an outcome where, where they only meet four times a year, but never say never. You never know. I like your points about Powell's approach. He made it very clear that he's staying on, but as just a governor, he's going to have a low profile, and he was very deferential to Warsh coming in as the next chair. And I think that's good.

He said, "Listen, he's going to be one vote now." He'll have his views. He's not going to necessarily change his views based on different leadership, but he is not the chair. He's not the head. And he was very deferential. And I want to touch on one final point, Liz Ann, about the dissents, because this was so interesting. I was very surprised when I saw the release of the statement and the headlines that there were four dissents, the most since 1992, I believe. The three, call them hawkish dissents, there's been a lot of chatter about this in the financial media, about kind of the why, where they wanted less of an easing bias or something like that. But when you look at the actual statement, there's not much in there. But I think the concern is that they have been easing over time. And if you read the statement, and if you've been following the statement that the bias is like, "We'll continue to accommodate over time." The timing is up in the air, but it seems like the path is for more accommodation.

And it seems like these three said, "Well, maybe that's not the approach right now. Maybe there should be no additional accommodation or potentially hikes." And then as Powell mentioned in his press conference, it wasn't just those three. It sounds like there was a non-voting member, at least one, who kind of shared those views. So putting a bow on the discussion about the Fed now and then under Warsh, if he has these plans or views that he wants to lower interest rates, it's going to be really difficult because there is clearly opposition to lower rates with a number of committee members right now.

LIZ ANN: Well, you know, what else is relevant is a lot of people don't realize we've talked about it on a prior episode, but Warsh comes into the Fed replacing Stephen Miran as governor, then the committee will vote him to be chair, but with Warsh, assuming he gets the full confirmation, Stephen Miran is out. He was the ultra-uber dove. If Powell had decided to leave, then President Trump would be able to appoint somebody else, possibly it might have been Stephen Miran, who would have had to go through confirmation again. But that's another important facet of this looking ahead, is that the uber dove is now not a member of the Fed anymore.

COLLIN: Yep, that's right. So the scales are constantly balancing.

LIZ ANN: All right, so let's shift to our guest, which you sat down with. So Collin, tell us about our fabulous guest.

COLLIN: Yeah, absolutely. So this week, our guest is Winnie Cisar. She has been a guest on the show before. She's the global head of strategy at CreditSights, where she is one of the leading voices in corporate credit strategy. She leads a group of analysts that evaluate the credit worthiness of corporations and provide a strategic outlook, largely for institutional clients. We use CreditSights as a resource for our team here in the Schwab Center for Financial Research.

Prior to her role at CreditSights, Winnie was a managing director and the head of credit strategy for Wells Fargo, leading a research team that focused on corporate investment grade and leveraged finance. And also while at Wells Fargo, she developed the leveraged finance strategy product and rolled out coverage on high-yield leveraged loans, which is another type of sub-investment-grade credit lending. She's a frequent guest on CNBC, Bloomberg, NPR, and Yahoo Finance. And again, she's really one of the leading voices in the area of credit markets.

Winnie, thank you so much for joining us today.

WINNIE CISAR: Hey, Collin, thanks for having me.

COLLIN: You've been a guest on this podcast before in the past, but how about you give us a little refresher on your background and what it is you do at CreditSights?

WINNIE: All right, what it is I do at CreditSights? Truly a little bit of everything. So I'm the global head of strategy at CreditSights, which is an independent research firm for the corporate bond market. I lead the team of strategists who are trying to marry up the macro with the micro.

So we're focused on things like economic indicators, inflation readings, what the Fed's going to do, what other central banks are going to do. How is growth? How are investors positioning? Are they risk on or they risk off? What do fund flows look like? What's new issue going to be?

And then we take all of those kind of big high-level thoughts to the sector analysts, the people covering individual companies, and say, "Hey, we think that AI is going to be a massive source of spending in the capital markets. Is that going to be a big issue for technology?" And then our tech team will tell us yes or no. So we work really closely with those analysts to try and figure out how does that micro fit into the macro and come up with real-time investment recommendations for our clients.

COLLIN: That's great, Winnie. I love how you marry the micro and the macro because, at Schwab and our team, we approach it a little bit differently. We're mostly macro. And then we allow our clients to kind of take our guidance and then find out what the best plan of attack is for their investment portfolio.

So I like how you look at it from both sides and how you marry those ideas. I want to focus a little bit on the macro side of the equation. This is sort of a loaded question, but what are some key macro indicators that you think are important for you when you're coming up with a corporate bond outlook or an overall credit outlook?

WINNIE: All right, so I'm going to answer your loaded question with the most lawyerly of answers, which is "It depends," right? It always depends on what is going on in the broader macro. Right now, eyes are all focused on inflation, on the potential for all of these energy price and supply chain issues to be passed through into the broader economy and some sort of transmission mechanism. So looking at things like producer price inflation—that's the PPI—or consumer price inflation, what consumers are actually paying, trying to figure out how these different data points are going to translate into actual company operating margins and see kind of where the direction of earnings are going to go.

This is totally different than when I started my career as a strategist, and inflation was not something that I ever looked at because it was just sub-2%, and no one

really cared. Then it was all about the labor market and trying to figure out what direction is that going to go. What is the decomposition of growth at the kind of higher level? Is it consumer spending driving things? Is it manufacturing spending? Is it residential spending? So it's unfortunate, like every indicator kind of matters. It just depends on what indicator matters most at a specific time.

Right now, it's really tricky because we're trying to balance all those potential inflationary forces with the reality that we've also seen a pretty notable shift in the labor market. And so watching things like high-frequency jobless claims, layoff headlines, trying to figure out where the unemployment rate is headed, especially as we decompose that into the recent-college-grad unemployment rate versus the, kind of, the older-people, more-established-worker unemployment rates. It's really kind of a wild ride of watching the indicators on a day-to-day basis.

COLLIN: I hear you. There's a lot of moving parts, and thank you for ... that's a great response for a loaded question. Do you ever have situations where, let's say we're looking at the big picture labor market, and you might be seeing something that looks concerning, but then when you hear from the team, you know, from the bottoms up, where you have a team of analysts that says, "You know what, my companies are actually doing OK," where you kind of shift your view, where the data that we're seeing, you know, something that I'm looking at from a big-picture level, that your bottoms-up approach might change your mind a little bit.

WINNIE: Absolutely, this was exactly our playbook back in '22 into 2023. We had the Fed hiking. There were a number of different layoff announcements across the tech sector, across home builders, mortgage underwriters, a wide array of potential labor-market slackening. But when we went to our analyst teams, the financials team and the consumer team were both very highly convicted that the consumer was still doing well, that there were still areas where the labor market was going to stay very tight, and also that Fed rate hiking was going to help drive incremental income for anyone who had cash savings, because instead of paying 0%, fed funds was paying 5.5%.

So at the end of 2022, with our '23 outlook, we came out with a pretty high-conviction outperform for corporate credit. And that was very contrarian at the time and ended up being a really great call to which I owe a lot of credit to our analyst team.

COLLIN: That was a great call. I mean, if we look back, I think we're still waiting for that recession that never came. I know we talked about it a lot. It made a lot of headlines when the Fed was hiking so aggressively. Even Fed Chair Powell was talking about the potential negative economic consequences with the consumer,

with businesses. And we saw some cracks here and there, but that recession, it has yet to arrive.

Let me touch on credit quality a little bit. That's something that we look at. So when we look at the bond market, we always obviously want to differentiate between investment-grade and high-yield, very different risk profiles. I think it's important for investors to understand that. But what I see in the indices for both, so the Bloomberg U.S. Corporate Bond Index, which is an investment-grade-rated index, and then you have the Bloomberg Corporate High-Yield Bond Index, which is sub-investment-grade issuers, the average credit quality has been improving.

And when I say credit quality, I'm talking about credit ratings, where with IG, investment-grade, we're seeing more single A's at the expense of BBB's. In high-yield, the high-yield index, we're seeing a larger share of BB's. What's driving that? Because I see that a lot, and it could be a number of things, and maybe you'll give me the "all of the above" answer, but is it upgrades? Is it new entrants to the market with higher credit ratings? What's driving that shift in underlying credit ratings?

WINNIE: This is a really good one, and there are a few different factors that are really important in this change. When we think about leverage finance, so the high-yield markets, and then add into it the broadly syndicated loan market, and also the private credit market, you have a very different ecosystem now than you had, say, pre-great financial crisis in 2007, 2008.

It used to be that the high-yield bond market was kind of ground zero for everything leveraged-buyout related, for those kind of higher-risk M&A^[1] transactions, for new companies that were new to the market and a little bit riskier. Now instead, the high-yield bond market is kind of like the more responsible big sister who can largely get it done. Every once in a while she might be out at a party too late, but for the most part she's pretty trustworthy and can kind of maintain soundness in terms of decision-making and things like that, whereas the leveraged-loan market has been where a lot of the leveraged buyouts have gone, where private-equity firms have preferred to deploy capital and raise capital to do things like sponsor-to-sponsor merger transactions. And we've seen a lot more re-leveraging in the leveraged-loan space than in the high-yield-bond market.

Then we also have the private-credit space, which kind of stepped in to fill that gap of middle-market lending that banks really pulled back from during the great financial crisis and the subsequent regulatory reforms. So you have a leveraged-finance market that's not just kind of this big high-yield bond market that takes everything. Instead, you have a high-yield bond market and a loan market and a private-credit market with three different degrees of risk of leverage points and of potential returns if all goes well, but also potential defaults if things don't go well.

And then one of the direct impacts of the post-GFC regulatory reform for banks was that banks had to issue a lot more debt. And as banks issue a lot more debt, that means there's going to be just naturally a lot more single-A-rated paper within the U.S. investment-grade market, because most banks tend to sit in that kind of single-A level overall.

We've also had more recently a lot of the big high-quality technology companies, the things like the Microsofts and the Amazons, issuing more debt to fund things like capex for AI investment. And that means just kind of the share that they make up of the investment-grade market has also increased. You've also had utilities having to fund a lot of capital spending related to AI and the data center build out and utilities.

Also, regulatory restraint makes them want to have kind of a single-A rating profile versus other sectors that have a little bit more freedom in their capital structure and financial policy overall. So a lot of different moving pieces there. But we agree with you. There have been really notable changes in terms of the composition of all of the corporate credit markets.

COLLIN: OK, lots to unpack there. Fantastic. And there's so many ways I can go, but I'm going to follow up with one question about specific credit ratings and how management teams kind of focus on that. You mentioned that, I think, utilities are still focusing on that single A or above rating, but it seems like, over time, management teams might be caring less about their credit ratings. And that's probably not the right way to phrase it, but maybe being AA or single A is less important now than it was in years past. Is that something that your team or you have come across?

WINNIE: Yeah, so I think that for a lot of management teams, and we'll put aside anything regulatory, where you have to have a rating due to regulatory reasons for this, management teams have become much more willing to embrace balance sheet policies and return of capital to shareholders that might come at the risk of some modest credit rating deterioration. This was especially true during the super-low-borrowing-cost era, pre-pandemic, when even from moving from a BBB cost of capital to a BB cost of capital wasn't really all that big when you look at kind of the long-term history of it.

I would say that now the interest rates are much higher while that delta between BB and BBB has narrowed significantly from some of the wider points where the Fed was initially hiking rates. Companies are still pretty sensitive to ... if I am going to try to move up into investment grade, I really want to put my money where my mouth is, because not only does that improve my cost of capital, it also kind of unlocks a much larger investor pool. And that's the big consideration when we're

thinking about that crossover space of investment-grade, kind of lower-rated and higher-rated high yield.

Within the investment-grade market, moving from a AA to a single A, I think at this point, a lot of companies think "If this gives me some sort of financial flexibility, I'm probably willing to pay up a little bit in my cost of capital," because the reality is most investors are much less sensitive to that AA versus single A credit rating.

COLLIN: Yeah, if you can even find one these days.

WINNIE: I know, right? Yes.

COLLIN: I mean, there's so few AA and AAA, but that makes sense that bigger jump from BBB down to that junk-rated spectrum or sub-investment-grade or BB or below. And that makes sense. There's kind of a line of demarcation there.

Something else you mentioned before, and I knew we'd get to this topic, is the artificial intelligence software build-out and all this debt that's been issued and, you know, I think there's concerns on the equity market. I don't want to say the B word, but I'll say bubble. Not ... that's not me saying it. There's just headlines about it. But there's concerns about what this means for corporate investors, too. Walk us through the why. If ... why are there concerns and headlines about all this AI build-out and new debt issuance?

WINNIE: So I think that the crux of the concern comes from the question around return on investment. We know that the big hyperscalers, the Microsofts of the world, are going to be spending \$750 billion this year alone to fund AI build-out, to build new data centers, and get that infrastructure in place. What we don't know as well is what does this mean, kind of, in five years from now?

Is everyone just going to be incorporating OpenAI products and Anthropic products into their day-to-day living? Is this going to revolutionize how companies are doing business? Is this going to revolutionize the labor market? We've seen a lot of progress between, I would say, just six months ago and today. But there's still a lot of questions around that return on investment.

And when we have companies that are using debt financing to undertake this build-out of infrastructure, then that means there's some sort of potential downside if that ROI never actually plays out. And what's interesting in this new kind of AI build-out environment is you have these really big cash cows driving so much of the expansion and the build-out. And that means that there's been a lot of kind of follower private-credit-type deals and infrastructure funds coming into play. And so

while that \$750 billion number is kind of eye-catching, it also doesn't take into account everything else that is coming into this build-out.

And that means that there is even kind of more capital at risk and more dollars at risk. And if you have companies that are higher quality that are willing to put kind of their cash flow at risk overall, that is something that, as credit investors, we have to sit back and take stock of because that time-to-monetization is such an open question.

COLLIN: Yeah, I think it's easy to look at some of these big companies that are issuing 30-year, 40-year debt, and the simple response might just be, "OK, well, I won't hold that bond. Maybe I don't buy that bond." But that could have implications for all their debt, right? Even if they have a five-year maturity, that long-term debt and risk-to-monetization, that can impact them over the short and intermediate term, right?

WINNIE: Yeah, absolutely. It's all a part of their broader capital structure. If I am a company and I used to have \$50 billion in debt outstanding and now I have \$100 billion in debt outstanding because I'm just building data centers left and right, investors are going to be taking the totality of that capital structure into account even when they're looking at, "Should I play in this refi deal for next year's maturity?" The odds of something really changing between now and next year might feel pretty de minimis, but the odds of something changing between now and five years or seven years or 30 years are feeling much more, kind of, under pressure at this point.

COLLIN: Let's stay on the topic of potential AI and software risks and talk about private credit for a little bit. Private credit makes tons of headlines. I'm sure you're sick of talking about it. We get it all the time. Even though we know it's not something that a lot of investors ... it's not like it's this huge asset class for a lot of individual investors, but we keep hearing these headlines.

So my question ... because I want to focus on what does this mean for most individual investors, especially those focusing on the bond markets, do you see any potential spillover risk to the public markets, knowing that a lot of individual investors are holding, whether it's high-yield bonds or bank loans or bank loan funds, what's the risk of potential spillover?

WINNIE: So I think that most simply, the risk of potential spillover is some sort of broad-based tightening of credit conditions that becomes a result of issues within private credits. And there are a few different transmission mechanisms for that to occur. First, you could have, within different private credit portfolios, companies

that are just not panning out as anticipated, see rising defaults, inability to refinance existing debt, and that means that the investors who are currently involved in those deals are going to have less capital to put to work other places or to extend those maturities.

And that's just kind of a defective tightening of credit conditions. When we think about the public high-yield and broadly syndicated loan markets, they've been tremendous beneficiaries of this private-credit boom because companies that were maybe up against the ropes in '22 and 2023, when the Fed was hiking rates, were often able to get extra liquidity from private credit funds. And so that really took some default pressure out of the public markets and allowed some of the more-stressed issuers to live to fight another day. And so if you have that source of liquidity drying up, then high-yield bond and broadly syndicated loan issuers have a pretty direct transmission mechanism that may impact their cost of capital.

We also have to think about the different lender universe to the world of private credit. There are banks who are lending more frequently in larger size to some of these intermediaries that are big active players in private credit. And that's been a big source of growth for bank loan books over the past few years.

So if these private credit lenders start to face some challenges, that does call into question, what is the bank relationship? Are they going to see kind of all of those deals paid in full? If they're worried about it, then they might just start to kind of throttle back the amount that they're willing to lend these companies overall. And that could be kind of a tightening in credit conditions.

I think a lot of people are worried about private credit because nobody fully understands what's in there, right? Like, you have to be in the deal to know what is actually happening at these individual companies. And that, I think, gets all of our kind of credit spidey senses going and maybe hearkens back to the great financial crisis when there was a lot of just kind of strange off-balance-sheet financing happening and things like that.

When we think about private credit, though, it's a very apples-to-oranges type of situation. We are not expecting private credit to be this big systemic thing that takes down the banks, that takes down insurance companies. But we do think that capital, which has been just kind of a wash for the financial markets, might start to get a little bit more difficult to come by as these private-credit lenders try to understand, "Is this business money good? Did I underwrite it appropriately? What is a real exit? Maybe a real exit doesn't quite exist as I first envisioned it."

And with credit, there's always losses. That's just kind of the rule of underwriting. There's going to be a lot of wins and a couple losses, too.

COLLIN: Yeah, that's the way we frame it. If you see something that's offering a very high yield like that, there's going to be risk involved. And if we get the question about, "Well, what's our outlook on private credit?" We struggle to have a short-term outlook because it's not meant to be a short-term investment. And in any natural business cycle, there's going to be winners. There's going to be losers. And again, that's why you're compensated with those high yields. If there were no defaults, you wouldn't be getting the low-double-digit returns, or potential returns, and yields that they offer. Let me follow up. You mentioned banks, insurance companies, and systemic risk. I think your team, you have some analysts who cover financials. What is their view? Can you dig a little bit deeper in there? Are banks holding these? What degree do they hold them? And it sounds like you said you don't think it's a big risk, but what can we be looking out for?

WINNIE: Yeah, so the things that we need to be looking out for are concentration risk. We can safely assume that pretty much every bank, pretty much every insurance company is involved in some sort of private-credit lending in one way or another. A lot of insurance companies have their own kind of private-credit arms or private-credit managers that they've been working closely with to have private-credit assets on their balance sheets.

And at the same time, we've seen a lot of banks really work to develop their relationships with different private-credit intermediaries to try to expand where they're lending. When we see a lot of concentration, then that's when things start to get a little bit more challenged. Just like the private-credit space is coming under pressure right now because there are so many deals in there that are aligned to technology and software and business services and all of these things that are coming into question, you don't want outsized exposure on insurance company balance sheets or on bank balance sheets.

And so that's where you really have to go through kind of the name-by-name analysis, try and figure out who has had maybe outsized growth in these types of relationships, maybe where kind of that chase for yield, that chase for relationship got maybe ahead of itself, ahead of prudent underwriting overall.

COLLIN: Thank you for that there. We've covered a lot. We've talked about the micro versus the macro, rating trends. Let's go for one last topic here for us, your current outlook. What should investors expect? Where do you see opportunities? Where do you see potential risks in the broad credit markets right now?

WINNIE: Man, the current outlook is one of confusion, right? Because it has just been headline-after-headline. It has been relentless for the past 12+ months at this point with policy at the fiscal level changing, with policy at the Fed being kind of an open question with how are companies going to deal with all of these changing policies? How is the consumer going to deal with it all?

And I feel like every headline, you could paint a constructive picture or a negative picture. The big takeaway for credit investors, if you are focused on yield, if you are focused on income generation, on total returns, we feel reasonably confident with kind of an up-in-quality strategy, staying aligned to in the investment-grade world, where companies are still looking pretty good fundamentally, and they generally have the wherewithal and the flexibility to withstand some degree of economic hardship and challenge.

When we get down into the leveraged-finance spectrum, we're still OK with high yield. You know, that eldest sister is still hanging in OK. Yields are around 7%. That's historically a level that is pretty good from a forward-return perspective. Where we start to get a bit more skittish is in the broadly syndicated loan space, in the private-credit space, with the potential for defaults to be rising, if rates stay elevated, if inflation stays a bit sticky, if this technology evolution continues at the frenetic pace that has been established for the past couple of years, then there are going to be a lot of moving pieces there. And there's going to be, I would say, lot of dispersion within returns.

I think also this is a great credit-pickers market. If you have good single-name analysis, if you have a good understanding of management teams and their balance-sheet policies, and what they are trying to do, that is going to be a tremendous advantage. And we saw that just in performance for the first few months of this year, where sectors that have traditionally been very defensive, like technology, have underperformed, albeit with a wide dispersion within that sector, where energy went from something facing some headwinds to all of a sudden being a massive outperformer because of oil prices changing so significantly, with utilities despite the fact that they have to really be part of the AI capex and infrastructure build out, faring really well because the management team's kind of making sure that they're working with regulators, making sure that they are not having to pass all of this pricing on to their rate payers and they're getting good deals from their AI infrastructure partners.

And so that single-name credit analysis, we think, is very much going to be a big driver of performance over the next 12+ months.

COLLIN: What I think resonated the most there was when I first asked the question, you sort of exhaled and like, "Oof, where do I even start?" And that really resonated with me because it's been a wild ride over the past year. So many headlines, ups and downs, but our view is very similar to yours. So I'm really happy to hear everything you said. We tend to have an up-in-quality bias here at Schwab. You know, if you look at average yields for investment-grade corporates, for example, close to 5%. Very similar outlook for high-yield. Fundamentals appear OK. Credit quality has been improving but very low spreads, meaning there's very low margin for error.

And then we're a little bit less optimistic with bank loans just due to the credit quality mix. And I'll paraphrase the previous host of this podcast, Kathy Jones, who luckily passed it on to me. She used to say things like, you know, "Everything looks good except the valuation." And that's kind of how we're approaching the credit markets right now. Fundamentals seem OK, but you're just not getting rewarded with too much extra yield. So we share a view there, which is great to hear. Winnie, thank you so much. This was a really, really fun conversation. So again, thanks for your time.

WINNIE: Yeah, thanks for having me. Always fun to talk credit.

LIZ ANN: So Collin, in terms of looking ahead to next week, it's always this part of our episodes. Now we have the April FOMC meeting in the rearview mirror. I'm sure our listeners are glad that we now stop talking about it since this whole episode has been largely about that. What is on your radar in the next week or so?

COLLIN: Yeah, next week we get a lot of labor-market data, and I'm sure what we're looking at likely overlaps, as it usually does. But we get the JOLTS data, the Job Openings and Labor Turnover Survey. So that's on Tuesday. We don't just focus on job openings there. We also like to look at the hires rate or the quits rate, because job openings are important. But how many people are actually being hired? That's really important. And the quits rate and the number of quits can be a good indicator of how people view the labor market.

If we see that quits rate declining, it might mean that people are less enthusiastic about job prospects elsewhere. And then of course on Friday, we get the jobs report. The non-farm payrolls are always in focus. They've been a bit choppy lately. So we don't focus just on the number coming in for the previous month. I think revisions are equally as important when we take that data as it comes in. We're also focusing on the unemployment rate.

We know that the Federal Reserve, I'm sorry, Liz Ann, I said it again, but we know the Fed is ... they focus on the unemployment rate. It's been remarkably steady. The

last month it was 4.3%. It's expected to come in again at 4.3%. And it's held between 4% and 4.5% since June 2024. So very, very tight range.

One other economic survey I'll be looking at is the ISM Services for April, the Institute of Supply Management. It'll be good to see how services purchasing managers are viewing the increase in energy prices and potential uncertainty and how that's influencing their decisions. And one thing specifically with the Treasury market, next Wednesday we'll get the Treasury's quarterly refunding announcement, which gives us a look into the government's borrowing for the upcoming quarter. And it can be important because if there are surprises in one direction, that can maybe move yields a little bit over the short run.

So for example, if the announcement shows that the Treasury is going to issue more than the markets were generally expecting, maybe yields will rise because of that expected supply increase. The supply and demand dynamics can influence Treasury yields. So we'll be focusing on that. So how about you, Liz Ann? What do you think investors should be watching for next week?

LIZ ANN: Well, ditto, but I'll say more than that. You mentioned ISM Services. We also ... between us taping this and the next episode, we'll also get an ISM manufacturing. And what I would pay attention to within those two surveys is to see whether the recent trend persists, where you've seen a little bit of a bout of weakness in services, not into contraction territory. So the way the index is reported, anything above 50 is considered expansion. Anything below 50 is considered contraction in that particular segment of the economy. And manufacturing, actually for now three months in a row has been back in expansion territory, after a very long time in contraction territory.

So we have a little bit of convergence that has happened with slightly weaker services, but manufacturing doing some catch-up. So I'll look to see whether that persists. I also find within the ISM readings, one of the more interesting components of it is that they publish verbatim quotes from the purchasing managers that they are surveying. And sometimes that adds a tremendous amount of color that goes beyond just the headlines associated with ISM. So pay attention to those. I ... typically, when those are released, I will put them on my X feed, some of those verbatim comments. We also get the S&P Global version of PMIs. They're not quite as widely followed as ISM, but again, we'll see whether there's some corroboration there.

We also get University of Michigan consumer sentiment data, at least I think it's the first read. It's a preliminary read. That's been an interesting area, too, because we're at literally record lows in consumer sentiment, yet just a week or so ago. We got an

increase in consumer confidence, which is the measure that comes out from the Conference Board. Part of the reason why you see divergences there, and this will now explain why University of Michigan's consumer sentiment is weaker, the way the questions are asked in that survey of consumers, it's more biased to what's going on with inflation. The way the questions are asked by the conference board in their consumer confidence survey, it's driven more by what's going on in the labor market.

So that helps to explain why there's much more of a dour perspective on the part of the respondents to University of Michigan's Consumer Sentiment Survey is the questions are focused more on the inflation side of things. So those are some of the things that are on my radar.

Well, thanks as always, folks, for listening. As a reminder, and as I just mentioned, you can keep up with us in real time on social media. I'm @LizAnnSonders on X and LinkedIn. I had another recent rash of imposters. So please make sure you're following the actual @LizAnnSonders and not some other weird version of me.

COLLIN: And I'm @CollinMartinCS on both X and LinkedIn. So you can follow me there. That's Collin with two Ls, and the CS is for Charles Schwab. And you can always read all of our written reports, including lots of charts and graphs, at schwab.com/learn.

LIZ ANN: And listeners, one more heads up. This Friday, May 1, in honor of National Investing Day, the Schwab Coaching team will be hosting a special day of educational events. You can learn more about those at schwab.com/coaching or follow the link in the show notes.

COLLIN: And if you've enjoyed the show, please consider leaving us a review on Apple Podcasts, a rating on Spotify, or feedback wherever you listen. And please tell a friend or more about the show.

And we will be back with a new episode next week.

For important disclosures, see the show notes, or visit schwab.com/OnInvesting, where you can also find the transcript.

[1] Mergers and acquisitions