

AI disruption and the hidden risk in long-dated credit

Are investors still being paid to move along the credit curve?

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The familiar case for long credit is becoming less reliable

For defined benefit (DB) schemes, long-dated investment-grade credit has long appeared to offer an efficient combination of liability sensitivity, contractual income and additional yield over gilts. The usual assumption is that moving from short to long maturities is rewarded through extra spread, and that a diversified portfolio can absorb isolated defaults or downgrades. That logic is still valid, in principle. But it's less dependable when technological change can impair an issuer's business model faster than its debt matures.

Artificial intelligence (AI) isn't just another cyclical uncertainty. It can alter cost structures, erode barriers to entry and redistribute profit pools across an industry. Businesses once protected by proprietary information, large service teams, established distribution or high switching costs may find those advantages replicated at low marginal cost. Software, media, professional services, outsourcing, customer support and parts of financial services are obvious examples, but the second-order effects are wider. Weaker labour income may affect consumer credit, rapid data-centre investment may create concentrated financing needs and lower-cost digital competitors could pressure incumbents in almost any sector.

Why the long end is especially exposed

Long-dated bonds reflect a forecast about an issuer's relevance, cash generation and refinancing capacity over decades. However, conventional credit analysis often extrapolates recent margins, market shares and changes in ratings. AI shortens the useful life of those assumptions. A company can remain solvent today while its terminal value deteriorates, leaving investors exposed to repeated downgrades, spread widening and poor recovery prospects – well before a formal default.

The danger is asymmetric. Recent official analysis also highlights the scale of AI-related capital expenditure, its increasing reliance on debt and the possibility that earnings fail to meet elevated expectations.

Bondholders don't participate fully if AI creates a new profit pool, but they bear losses if incumbents overinvest, lose pricing power or finance defensive acquisitions.

Has the market become complacent?

There's some cause for concern. Strong demand from insurers and pension schemes can be relatively insensitive to valuations because long-dated assets are needed to hedge liabilities. Robust all-in yields may also make credit look attractive, even when the spread component is historically modest. Index-based mandates reinforce this effect: the most indebted issuers receive the largest weights, while investors are encouraged to treat long maturity as a source of yield rather than a separate risk decision. Stable ratings and low near-term defaults can then create false comfort.

However, a flat or only mildly upward-sloping credit curve isn't proof of mispricing. Long-dated bonds can benefit from scarcity, better-quality issuers and strong institutional demand; short-dated spreads may reflect refinancing concentrations. Therefore, the right question isn't whether long credit is universally expensive – it's whether the incremental spread compensates for additional spread duration, rating downgrades, liquidity risk and uncertainty over the issuer's future business model.

A better framework for DB investors

A more robust approach starts by separating the actions that long credit is often asked to perform simultaneously. Interest-rate and inflation hedging can be obtained through gilts and swaps; credit should then be held only where its expected excess return is attractive. This removes the need to accept weak credit value merely to achieve liability duration.

It's also helpful to reframe credit-curve analysis around breakevens. For each bond, the additional spread from extending the maturity should be compared with the loss from a plausible widening in spreads, a one- or two-notch downgrade and the deterioration in liquidity under stress. Portfolios can also be assessed under AI-specific scenarios: rapid margin compression, loss of customer ownership, higher capital expenditure with delayed payback, dependence on a small number of model or cloud providers, and disruption to collateral values. Particular attention should be paid to covenants, refinancing needs and management's willingness to protect bondholders rather than equity holders.

Alternatives to a blanket long-credit allocation

✦ **Shorter-maturity credit plus gilt or swap duration.**

Short and intermediate bonds provide more frequent opportunities to reassess an issuer and limit exposure to terminal-value uncertainty, while derivatives or gilts retain the desired liability hedge.

✦ **Curated buy-and-maintain portfolios.**

A deliberately concentrated but well-diversified portfolio can exclude sectors with weak adaptability, favour issuers with resilient cash flows and low refinancing dependence, and avoid benchmark-driven exposure to the largest borrowers. 'Buy and maintain' should mean low turnover, not permanent ownership.

✦ **Flexible multi-maturity credit.**

Allow managers to move between short, intermediate and long maturities as curve compensation changes, with explicit limits on spread duration and issuer concentration. The mandate should ideally reward avoidance of impairment as well as yield pickup.

✦ **Higher-quality securitised or secured assets.**

Selected asset-backed securities, covered bonds and secured corporate debt may provide contractual cash flows with less dependence on the long-term franchise value of a single operating company. Structure, collateral and liquidity still require careful analysis.

✦ **Contractual and diversifying credit premia.**

Where governance and liquidity budgets permit, mature private credit, infrastructure debt or asset-based finance can offer covenants, security and complexity premia. These are not automatic substitutes: valuation, manager selection, cash-flow predictability and lock-up terms must be tested against scheme needs.

In summary

AI doesn't make long-dated credit uninvestable. But it does make passive extrapolation more dangerous. For DB schemes, the practical response is to price credit duration independently from interest-rate duration, demand explicit compensation for technological uncertainty and retain the ability to exit when the investment thesis changes. The objective isn't to predict every AI winner and loser: it's to avoid lending for 20 or 30 years on the assumption that today's competitive advantage will survive unchanged.



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