Over the past few years, the high-yield fixed-income market has been one of the few places where investors could find healthy yields. But if interest rates rise as expected, the high-yield space will quickly become much more dangerous, especially for retail investors.

There are a ton of individual investors in the high-yield space right now. That is the result of historically low interest rates: Regular investors need yield so badly that they've been unusually willing to lend money to companies with low credit ratings.

The surge of money into the high-yield market has been a lifeline for companies that, under normal circumstances, would have failed. Rising interest rates, which are widely expected as the federal government gradually phases out its program of propping up the bond market, will be a huge challenge for these weaker issuers.

As a result, we could be in for the kind of shakeout that the high-yield bond market hasn't seen in many years.

The trigger for bankruptcies and defaults is usually when a chunk of an issuer's debt comes due as rates are rising and appetite for risk diminishes. In a rising rate environment, the cost of borrowing will increase for all companies. But it will likely rise even more for non-investment-grade companies because investor capital will flow back toward safer issuers. As it does, lower-quality borrowers will have to pay a premium to attract lenders. And if they are unable to refinance their debt at a reasonable price, the next step is often bankruptcy.

Since we haven't seen a wave of defaults in the high-yield space, it's worth a reminder about how the process plays out. For corporate issuers, most file a Chapter 11 bankruptcy, a renegotiation of their debts. Generally, this process wipes out the stockholders' claim. As for the bondholders, they are divided into two groups, secured and unsecured. Secured debt holders are usually prioritized above unsecured bondholders because they generally have company asset(s) that back the note.

After the company negotiates with the bankruptcy trustee, a plan is generally issued giving equity positions to the former bondholders for a percentage of the face value of the original bond. In the end, the process can take several months to many years longer than the original debt agreement without any interest. It can be a gut-wrenching process, but also can be very profitable for patient investors if the company becomes viable without its former, unbearable debt load.

Even though interest rates remain quite low, pressure on issuers is already increasing in anticipation that rates will rise. Many expect some large municipalities to declare bankruptcy within a matter of months causing greater uncertainty in the fixed-income market. In the corporate market, it's become much harder to find good high-yield investments. Three years ago, 60% of high-yield issuers were worth serious consideration; today, I believe it's more like 5%. Part of the reason is that a flood of investor money has driven prices up and yields down–even for companies with extremely poor credit ratings. But part of it is also that many companies just don't look strong enough to survive in a rising rate environment.

I do not believe that investors should avoid the high-yield market altogether. It's still one of the best places to find decent income. But it's time to proceed with extreme caution. Few individual investors have the knowledge and wherewithal to maneuver through an environment of interest-rate increases and credit tightening. This is exactly the kind of environment that requires professional advice. I'm helping my clients by evaluating high-yield debt issuers' cash flows, debt levels and other factors in order to identify the best opportunities with the least risk of default. Please don't hesitate to contact me if you'd like to discuss a smart approach to high-yield investing.