WEEKLY STRATEGY

Perspectives

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Not-So-Boring Bonds

"Never try to time the bond market. Anyone who claims to know the future of interest rates is certifiable."
- Jane Bryant Quinn, American financial journalist

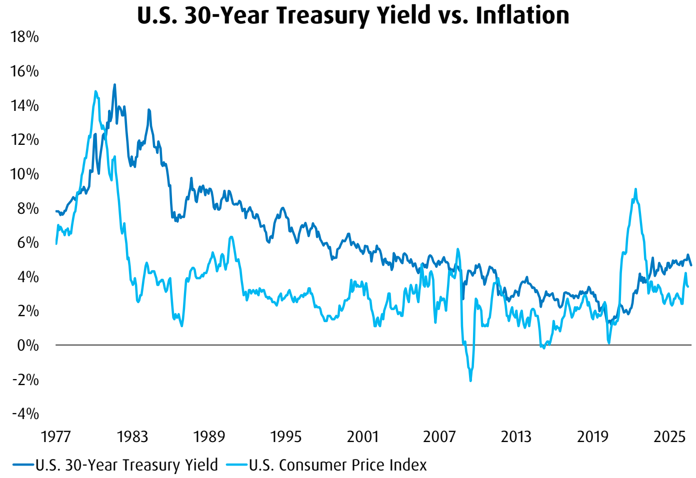
The Through Line: Until recently, equity markets largely looked the other way while intermediate and long-term bond yields pushed steadily higher. That resilience has been tested of late, however, after a catalog of concerns began to challenge the outlook. Extra volatility has been injected into a normally steady corner of the markets thanks to sticky inflation, sovereign indebtedness, record levels of issuance, ongoing wars, constantly shifting tariff policy and all the unknowns arising from new leadership at the U.S. Federal Reserve. This week, we tackle the primary factors driving sovereign yields higher – and the implications of those developments for the economy and investors.

What's the deal with the bond market?

After several decades of near torpor, many aspects of fixed income markets have been in turmoil recently, which helped push rates higher and/or led to elevated volatility:

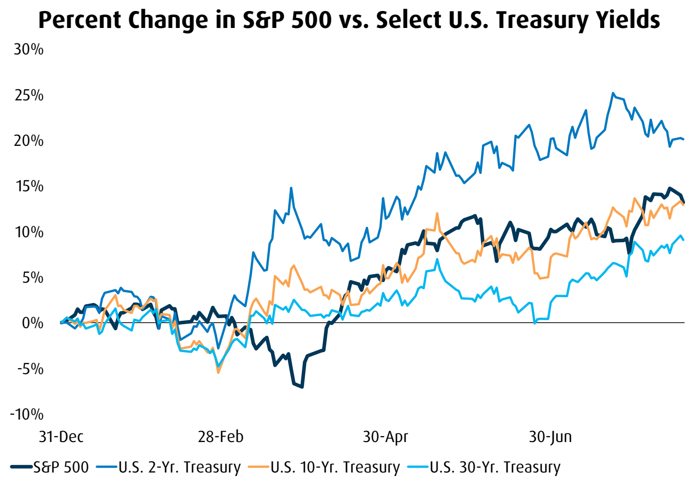
- Nominal (quoted) and real (inflation-adjusted) yields are moving up and through levels previously thought to be problematic for stocks (4.5% yield on 10-year U.S. Treasurys and 5% on 30-year Treasurys). Notably, they are advancing at different rates. Bonds featuring shorter maturities are more influenced by expectations about central bank policies. In contrast, those in intermediate and longer maturities incorporate a wide variety of additional considerations such as expectations for growth and the persistence of inflation.
- Issuance, particularly of intermediate- to long-term debt (e.g., maturity dates 10, 20 or 30 years in the future) of all types sits at record highs. Substantial corporate debt floated by large tech companies to fund AI and cloud computing businesses is competing against sovereign debt issued by many countries looking to fund their growing spending plans and/or tax cuts.
- Public markets (where the bonds are underwritten and traded) are expanding to offer a wide variety of derivative securities that also give investors optionality. In addition to new security types, there are alternate ways to participate (public and private credit, for example) and new buyers stepping in. Broadly speaking, global central banks are buying less of each other's debt (and more gold). This is pushing the buying into other hands such as hedge funds, wealthy individuals and family offices. These buyers – especially when levered – can be more impatient holders, exacerbating an already jumpy prevailing mood and adding to volatility.
- Spreads (the interest rate differential between bonds of different issuers that have the same maturity date) seem unusually tight. Spreads are one way bond investors look to place relative value on fixed income, meaning tighter spreads can lead to holders who are more nervous (and potentially trigger-happy).
- New leadership at the U.S. Federal Reserve, ushering in changes in guidance, information sources and a host of other unknowns, has investors parsing every economic data print for hints about the FOMC's next move. Outlooks (derived from the CME FedWatch tool) have swung from expected cuts, to hikes, and back to hold in just the last few months.

U.S. 30-Year Treasury Yield vs. Inflation

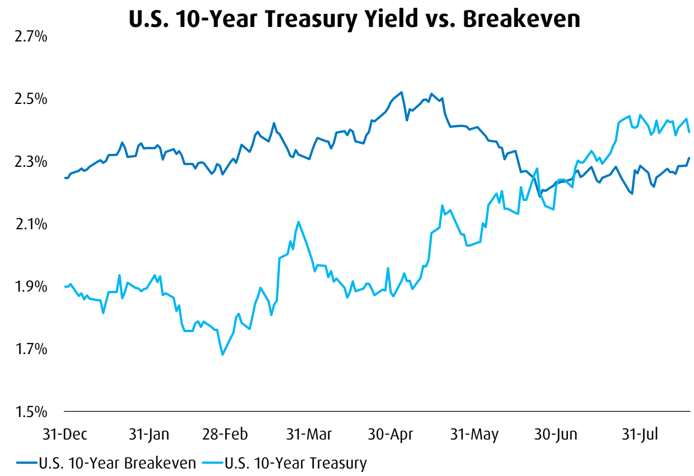


Source: Bloomberg L.P. (2026), as of 7/31/2026

Sticky inflation has been a factor in the investing backdrop for years. Yet, bond yields have only recently punched through the psychologically important levels noted above. Now that the U.S. 10-year Treasury sits at 4.68% and the 30-year at 5.23%, clients are asking why now, what's driving this development and how long higher rates can persist. They also want to know if equities – and the economy – can perform in the face of these hurdles, and whether it's time to move to longer-dated maturities to capture some of the extra yield.



Source: Bloomberg L.P. (2026), as of 8/18/2026



Source: Bloomberg L.P. (2026), as of 8/18/2026

But first a bit of bond-math background

Bond yields, or interest rates, consist of several parts. The **coupon rate** is the one assigned when the bond is originally issued – and the one that indicates the periodic interest payment the buyer gets. That rate is fixed (hence "fixed income" investment) at the time of issue. The yield that a given bond ultimately trades at will be dictated by events that impact prevailing yields in the aftermarket. Since the coupon rate cannot be adjusted, prices will move to make the equivalent yield similar to what is currently available in the marketplace. (If current rates are higher, the bond price will move down, and if yields move lower then the bond would trade at a premium.)

The yield on a bond can be broken into two primary pieces: the **real interest rate** and **inflation expectations**. The real rate, or real yield, is compensation for all the risks accrued from owning the bond, excluding inflation. This includes credit risk, changes in market interest rates, plus central bank actions. The expected inflation component can fluctuate over time due to a variety of factors. For example, through much of the early decades of this century, inflation hovered at (or sometimes below) zero and the Fed had great difficulty getting it UP to its 2% target level. This left nominal and real rates very close together as the starting basis (the "norm") for nearly a full generation of investors.

Coming out of the pandemic, the dislocations in demand and supply, plus the strained logistics of distribution, spiked headline inflation to multi-decade highs. This prompted central banks to aggressively hike their policy rates in an effort to stave off even worse outcomes. Inflation subsided – but not to pre-pandemic levels. This has put a more traditional inflation expectation of between 2% and 3% into the bond math.

What's pushing rates up now?

Real rates are also influenced by other considerations:

- **Term risk, a.k.a. the length of the bond.** Interim (interest) payments are fixed for the term of that bond – while inflation and creditworthiness are not. A buyer of any given bond will/should demand adequate compensation to cover expected loss of purchasing power due to whatever level of inflation prevails during the holding period.
- **Credit risk.** Investors will also demand more in yield from issuers that they believe could potentially have a more problematic ability to repay – especially over longer time periods. In light of mounting debt and deficits in many sovereign nations (where politicians have been elected on spend-more-tax-less platforms), bond investors are hinting they are increasingly discomfited by plans that could negatively impact their long-term holdings.
- **Crowding out.** According to the Securities Industry and Financial Markets 2026 Capital Markets Playbook, global fixed income debt outstanding was $161 trillion in 2025 – up nearly 11% from 2024. Total global fixed income issuance was nearly $30 trillion.[i] That is a lot for investors to absorb, particularly when some of the traditional key buyers (sovereign wealth funds, other central banks) are less active on the buy side due to other commitments. Case in point: the Japanese central bank potentially having to sell some of its most liquid assets (U.S. Treasurys) in order to prop up its ailing currency. The U.S. deficit (the amount per year that spending exceeds revenue) pushed past $1.8 trillion in July, bringing the nation's debt (the total amount of current and past deficits) to $40 trillion – and growing.[ii] Servicing that debt means higher-cost U.S. government T-bills, notes and bonds. Simultaneously, hyperscalers are also issuing record amounts of debt – leaving fixed income investors plenty of choices... and plenty of room to demand higher yields.
- **Monetary policy risk premium.** New Fed Chair Kevin Warsh caused some consternation among bond traders in his inaugural FOMC press conference. He asserted his belief that the Fed should no longer give forward guidance to markets and instead let markets read incoming data on their own. He also announced the formation of five different task forces to (among other things) review and potentially revise the data sets the Fed relies on. Stock and bond markets initially reacted negatively to the changes, including the perception that there would be considerably less transparency in the future. The shifts also reintroduce **policy uncertainty**. Adding to the angst: President Donald Trump has resurrected his desire to remove a Fed governor, once again placing potential White House interference in Fed policy front and center.

- **Expected growth.** Aside from the less appetizing things keeping rates propped up is a more positive one: growth that is stronger than the long-term average, plus the prospect for more of the same. We noted last week (WSP - Q2 in Review – Notable Nuance) that the Q2 reporting season showed strong economic growth across the board – virtually all sectors of the economy are participating. The CapEx, AI and infrastructure spending cycle is new and has much further to run. **Bond investors more easily tolerate inflation and growth rates that are nudging up thanks to strong organic growth** (even accompanied by interim supply shock-related price rises) versus inflation that comes in times of slower growth but tighter labor markets. Then, too, much of the current spending is being underwritten by large, profitable and seasoned entities dipping into their own cash flow (initially), accompanied by a mix of equity and debt issuance.

Here comes the ~~cavalry~~ vigilantes

Bond investors around the globe have been closely watching fundamentals. When necessary, they are playing the key role of feedback mechanism to corporate boards and sovereign policymakers alike – demanding higher yields or higher premiums for credit default swaps (a financial derivative contract that acts like an insurance policy to compensate when an underlying issuer defaults). From a sovereign-debt vantage point, higher yields may force policymakers (monetary or fiscal) to modify the course, which could lead to lower interest rates and still be supportive of risk assets.

The big question is when or at which level will interest rates start impacting risk assets such as stocks? **Now that we are past the previous expected critical levels, it seems 5.00% on the 10-year U.S. Treasury or 5.50% on the 30-year may be the next psychological test.**

Implications for investors

Agita in stock and bond markets is rising alongside the upward drift in rates. The risk assets delivering the highest growth (such as chip stocks) have been the most whipsawed, both because of their rapid growth rates and their increasing need to access debt markets to fund plans. Policy risk is elevated because of tariffs, disruptions to energy/supply chains and the unknowns stemming from new Fed leadership.

Despite rising rates, the U.S. economy continues to chug along, delivering an above-average growth pace and keeping inflation in a holding pattern. The gradual drift means that the economy is adjusting so far. A key reason for this adjustment is that the bond markets, especially in the intermediate- to longer-dated segments, have been orderly and contained within relatively tight ranges since 2023. For example, 10-Year Treasurys have traded roughly between 3.75 and 4.75% most of that period.

Traditionally, high-quality bonds provide ballast in portfolios against volatility in stocks. Yet, this relationship has been fitful at best in recent years. The trauma of 2022, when stocks and bonds declined by double digits (for the first time in over half a century), left scars. Still, we need to put that period in context; at the start of 2022, rates were at record low levels compared to current levels. Real yields back then were primarily negative, so they provided limited protection against rising rates in general.

U.S. rates, and even Canadian rates, are now becoming more attractive for earning decent payment (clipping coupons) and providing a buffer against potential risk-off events. For the first time in years, investors have choices. In the short term, the bias remains for higher rates, although investors are now getting compensated. The fixed income sector has not fully delivered on its short-term diversification benefits, given the volatility in short rates (which have vacillated along with shifting expectations for Fed rate cuts). However, the table is slowly getting set for investors to realize improved longer-term returns.

Next week in North America

As summer – and earnings season – winds down, few economic reports that we can sink our teeth into are on the docket. Friday's presentation from U.S. Federal Reserve Chairman Kevin Warsh at the Fed's annual gathering in Jackson Hole will undoubtedly be fiercely dissected – though it's likely to be utterly lacking in forward guidance. Canada prints GDP are also slated for week's end (who schedules these things for summer Fridays?!).

Monday 8/24:	**U.S.** none scheduled | **Canada** none scheduled
Tuesday 8/25:	**U.S.** Conference Board Consumer confidence | **Canada** none scheduled
Wednesday 8/26:	**U.S.** Durable goods, Q2 GDP, PCE | **Canada** Manufacturing and Wholesale sales
Thursday 8/27:	**U.S.** Weekly jobless claims, Trade balances, Wholesale and Retail inventories | **Canada** Current account, Average weekly earnings
Friday 8/28:	**U.S.** Federal Reserve Chairman Kevin Warsh presents at Jackson Hole, University of Michigan Consumer Sentiment | **Canada** GDP, Budget balances

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Disclosure

[i] Capital Markets Fact Book - SIFMA

[ii] America's Finance Guide | U.S. Treasury Fiscal Data