

INVESTMENT STRATEGY GROUP

Fixed Income: Searching for a Durable Bottom

Special Report — Fall 2026



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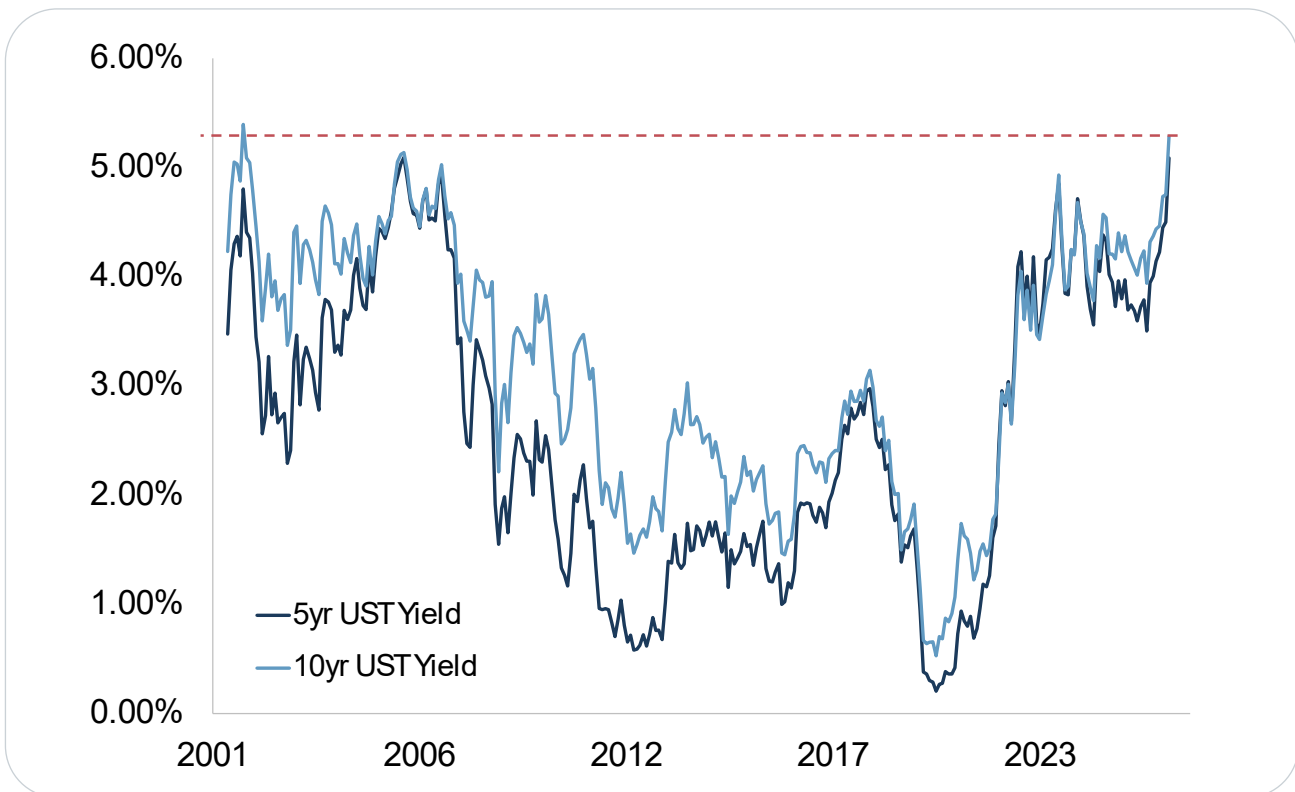
- The U.S. bond market selloff accelerated in September, pushing 5-, 10-, and 30-year Treasury yields to levels last seen roughly two decades ago.
- Energy-led inflation renewed central-bank tightening, resilient U.S. economic activity, and heavy borrowing are all pushing yields higher.
- The selloff has materially improved prospective fixed income returns, but high yields alone do not mean the market has found a durable bottom.
- Within fixed income markets, intermediate- to long-term tax-exempt municipal bonds are the best standout value relative to other sectors.

Bond investors spent much of 2026 waiting for a familiar playbook to reassert itself: slower growth, softer inflation, Fed easing, and lower long-term yields. Instead, the year has delivered nearly the opposite. Energy prices remain high as the Iran conflict has dragged on, inflation has stopped cooling, economic activity has remained resilient despite some signs of fragility, and the Federal Reserve returned to rate hikes in September. The Treasury market has responded by repricing both the expected path of short-term rates and the compensation investors demand to own long-duration bonds.

Treasury Yield Changes & Return

Through September, the 5-year Treasury closed at 5.08%, the 10-year at 5.29%, and the 10-year TIPS real yield at 2.92%. That has been painful for existing bondholders, but lower prices also create better prospective returns through higher starting yields. Starting yields account for the bulk of long-run bond portfolio returns—70% or more, according to some studies.

Chart 1: Yields Are Pushing Up Against Multi-Decade Highs



Source: Janney CIO; Bloomberg; ICE

Table 1: YTD Treasury Yield Changes & Return

	2yr Treasury	5yr Treasury	10yr Treasury	30yr Treasury
Yield as of Sept 30, 2026	4.05%	5.09%	5.29%	5.63%
Yield Change YTD	+1.41%	+1.36%	+1.12%	+0.79%
Total Return YTD*	0.9%	-2.2%	-4.7%	-7.6%

*"Buy & hold" return including income generation and price change
Source: Janney CIO, Bloomberg

Several factors have come together to drive the selloff:

- 1. Energy:** Energy prices have risen and remained high, pushing broader inflation higher. August CPI rose 3.4% from a year earlier, while gasoline prices increased 3.9% during the month. Energy-price swings normally have limited effect on core inflation, but other measures suggest firms are beginning to pass higher fuel and input costs through to other goods and services. The timing is particularly problematic because our forecast—and most market forecasts showed inflation decelerating into fall.
- 2. The Fed:** Markets have effectively forced policymakers to respond to energy-led inflation with rate hikes. Kevin Warsh's Fed raised overnight rates by 25 basis points to 3.75%–4.00% on September 16, reversing the likely direction of Fed policy in the pre-Iran conflict environment.
- 3. Growth:** Economic activity is less fragile than it appeared earlier in the year. Job growth has resumed after a soft patch, while unemployment has held at 4.1%, near historical lows. Business investment in AI data centers is a particularly bright spot and should help sustain growth into at least early 2028.
- 4. Supply:** Bond issuance remains substantial. The U.S. Treasury estimated borrowing of \$1.3 trillion in the final six months of 2026. Corporate borrowing is adding to that total, with near-record September issuance and forecasts for \$1.0 trillion in the back half of the year.

Markets are being asked to absorb more supply just as inflation and policy-rate uncertainty have increased. That combination makes it difficult to call a top in yields. The more useful question is not, “Is this the top?” but, “At what yield is the compensation sufficient to live with the uncertainty?”

A useful way to frame the opportunity is through real yields, which measure returns after inflation. If inflation ultimately stabilizes in the mid-2% range, a 5-year Treasury yield in the low-5% area implies a real yield of roughly 2.5%, a historically rare level. A 10-year Treasury in the mid-to-high-5% range would imply a real yield closer to 3.0%, also historically unusual. Those levels provide a much larger income and purchasing-power cushion than the near-zero or negative real yields that prevailed for much of the 2010s and early 2020s. In short, absent another sustained rise in inflation, investors are being well compensated for taking duration risk.



The table below provides useful context. At these yields, even if interest rates continue to increase, returns on intermediate term bonds could remain positive—in fact, it would take more than a +0.70% further increase in yields over the next 6-months before a 5-Year Treasury purchased today would have a negative return.

Table 2: Horizon Analysis & Breakeven

6-Month Horizon Analysis	5yr Treasury	10yr Treasury
Yield Sept 30, 2026	5.09%	5.29%
Return if Yields +0.50%	1.2%	-1.9%
Return if Yields Unchanged	+5.0%	+5.2%
Return if Yields -0.50%	+9.0%	+12.7%
Breakeven Yield Change	+0.7%	+0.4%

Source: Janney CIO

We cannot be confident that the bond selloff is over, but we can be constructive on multi-year fixed income return potential. For investors using cash or very short maturities as a substitute for a bond allocation, today's return tradeoff argues for extending into intermediate maturities.

Cash protects principal in the short run but leaves investors exposed to reinvestment risk once policy rates stabilize or decline.

Extending duration does not require an all-at-once market call. A ladder approach or simply shifting part of a cash-heavy fixed income allocation into intermediate Treasuries, agencies, high-quality corporates, and municipals, can capture more of today's yields while preserving flexibility if rates rise further.

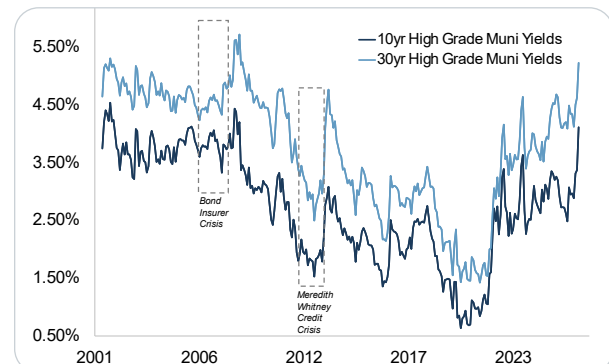
SECTOR COMMENTARY

The Treasury selloff has also changed relative value across spread sectors. Investment-grade corporate bonds are one example. Spreads—the incremental yield on a corporate bond relative to a Treasury—have widened to 0.82% on the U.S. investment-grade bond index, 10 basis points above recent lows. That is an improvement, although spreads remain expensive by historical standards. Corporate balance sheets are generally healthy, however, so relatively tight spreads are not surprising.

Tax-exempt municipals are considerably more compelling. The ratio of 10-year municipal to Treasury yields has risen to 80%, while the 30-year ratio is about 95%, even as Treasury yields themselves have risen. That combination has pushed nominal yields on intermediate- to longer-term municipals into the 4.50%-5.00% range.

Because municipal income is exempt from federal taxes—and, in many cases, state taxes—a 5.00% municipal yield is equivalent to an 8.44% taxable yield for an investor in the highest federal tax bracket. Taxable-equivalent yields at those levels are rare outside periods of acute market stress such as March 2020. We therefore view intermediate- to long-term, high-quality tax-exempt municipals as one of the clearest areas where valuations have moved from merely less expensive to genuinely compelling.

Chart 2: Municipal Bond Yields Have Rarely Been This High



Source: Janney ISG; Bloomberg; ICE

Fixed Income in an Asset Allocation Context

We suggest clients take advantage of these valuations by deploying cash and short-term instruments into bonds, not by reducing equity allocations to buy them. The same conditions producing higher bond yields also reflect an economy with strong nominal growth and corporate profits. Forward S&P 500 price/earnings ratios are in the 19-20x range—not cheap historically, but not expensive, and ultimately very reasonable if double-digit profit growth extends into 2027.

The diversification case for bonds is also weaker than it was during the low-inflation era. When inflation shocks dominate the macro environment, bond yields and equity discount rates can rise together, producing positive stock-bond correlations when investors most want diversification. Once rates stabilize, the relative-return comparison changes again: bonds lock in today's coupons, while equities continue to participate in earnings growth. That leaves room for U.S. equities to outperform bonds even from today's much more attractive bond-yield starting point.

Within fixed income, clients who have allowed cash or very short-term holdings to serve as a surrogate bond allocation should use higher yields to extend toward intermediate duration, including tax-exempt municipals where appropriate. Across the total portfolio, however, we would still maintain a tactical tilt toward equities and a modest underweight to bonds relative to long-run targets.

Those positions are not contradictory. Fixed income now offers some of its best multi-year prospective returns in many years, while U.S. companies continue to generate strong profit growth and may still compound faster once the rate shock stops intensifying.

September may not mark the bottom in bond prices or the peak in yields. But today's yields provide a substantial income cushion and a more favorable return profile than investors have seen in years. Add duration deliberately, favor sectors where valuations have genuinely improved, and allow the income cushion to work while markets search for equilibrium.



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