
# GLOBAL PERSPECTIVES

SEPTEMBER 2026

BY WILLIAM P. STERLING, PH.D.
*Global Strategist*

## WHY BONDS ARE PAYING MORE

HIGHLIGHTS

- This year's rise in bond yields can be attributed to investors' expectations of tougher Fed policy along with their demand for more compensation for lending long term.
- Long-term inflation expectations have changed surprisingly little despite the oil shock. Most of this year's bond selloff has come from higher real yields associated with resilient growth.
- Higher starting yields have historically accompanied better bond returns over the long-term, improving the opportunity for patient bond investors.

### A BROADENING SELLOFF ACROSS MATURITIES

Bond investors entered 2026 hoping for interest-rate relief. By September, the Federal Reserve (Fed) was raising rates instead. Its quarter-point increase on September 16 lifted the target range to 3.75% – 4.00%, and officials' projections pointed to further tightening. The question for investors has changed from when borrowing costs will fall to how long they might remain elevated.

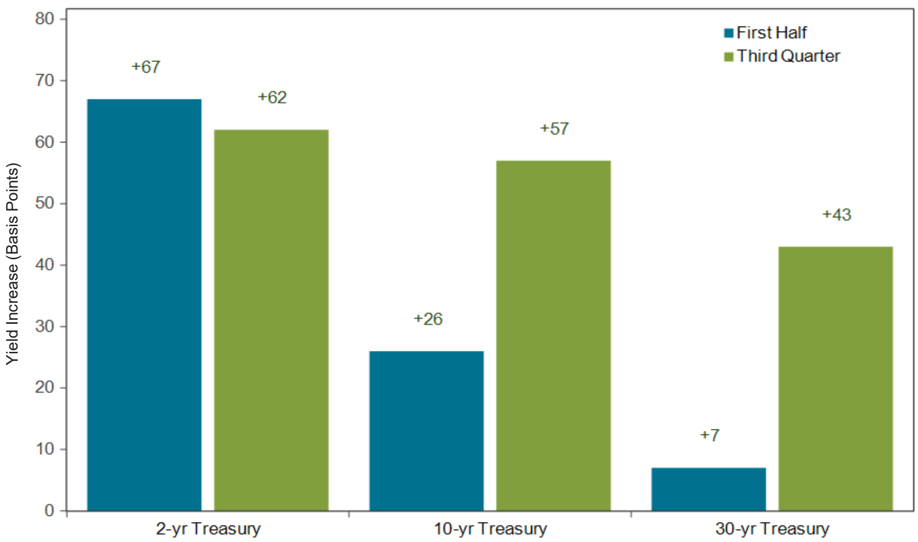
That is uncomfortable for existing bondholders, whose securities lose value when market yields rise. For investors putting money to work, however, the same adjustment creates an opportunity. They can earn more income from high-quality bonds than they could at the start of the year. Understanding why yields rose helps explain both the risks still ahead and the reward now on offer.

The year's selloff has broadened. In the first half, two-year Treasury yields rose 67 basis points (bps), or 0.67 percentage points, while thirty-year yields increased just seven. In the third quarter through September 18, those increases were 60 and 44 bps, respectively. The 10-year yield rose 57 bps in Q3, reaching 5.01%. Investors continued to reassess the Fed while also asking for more compensation for lending over longer periods (**Figure 1**).

FIGURE 1

Treasury Yields on the Rise

*Yield increases in the first half and the third quarter*




Note: Q3 through September 18, 2026. 100 basis points = 1 percentage point.
Sources: GW&K Investment Management and Macrobond

The selloff changed shape over the course of the year. Two-year yields rose much more than 30-year yields in the first half. Since June, increases have also been notable from 10 years out.

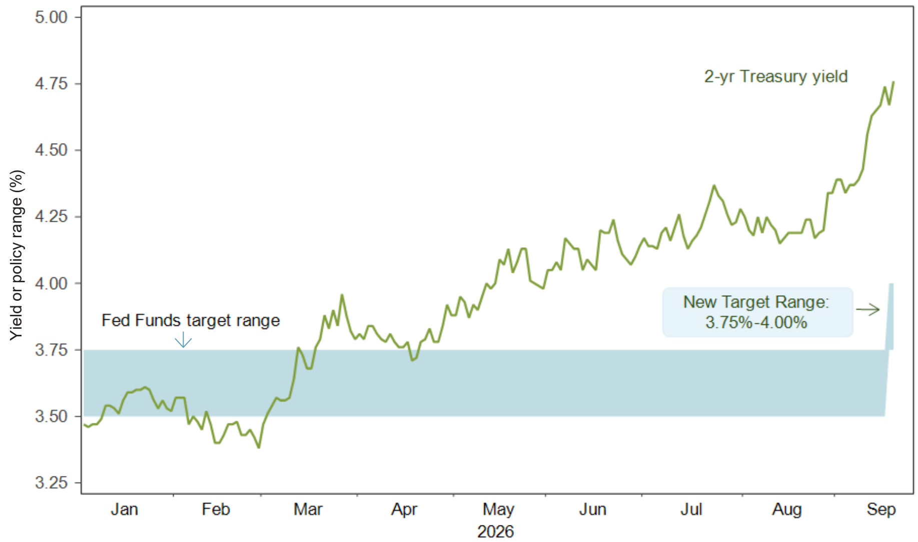
## THE FED'S PIVOT HAS BEEN CRUCIAL

The 2-year Treasury yield offers a useful guide to how investors see the next several years of policy. It stood below the Fed's target range at the end of 2025. By September 18, it had climbed to 4.74%, well above the new range's upper limit. The Fed's actual rate had changed much less than the market's assessment of the outlook (**Figure 2**). The gap is not a precise count of future hikes, because bond yields also incorporate compensation for risk.

FIGURE 2

## Markets Still Expect Higher Rates

*2-Year Treasury yield and the Fed target range*




Note: The 2-year yield is roughly where investors expect the Fed's rate to average over the next two years, so a yield above the current range means hikes are expected.
Sources: GW&K Investment Management, Federal Reserve, US Treasury, and Macrobond

Markets anticipated tighter policy well before the Fed raised its target range on September 16 and continue to discount higher rates in the future.

September's decision confirmed that policymakers see too little progress against inflation to justify easier money. Their statement described solid activity, resilient domestic spending, and robust capital investment. That combination leaves the Fed less reason to worry that a modest increase in rates will tip a solid economy into recession.

The projections reinforce the message. Sixteen of 18 (FOMC) Federal Open Market Committee participants expected at least one more quarter-point increase by year-end. Twelve projected one further increase and four projected two. The median projection for the end of 2027 rose to 4.1%, from 3.6% in June. These are conditional judgments, subject to change, but they suggest that any eventual relief could take longer to arrive.

For bond investors, that distinction is important. A hike that markets already anticipate need not produce another large price decline. The more consequential news may be a change in the expected destination for rates, or how long the Fed intends to stay there. Those expectations remained a source of pressure during the third quarter, even as investors' attention shifted toward the risks of owning longer bonds.

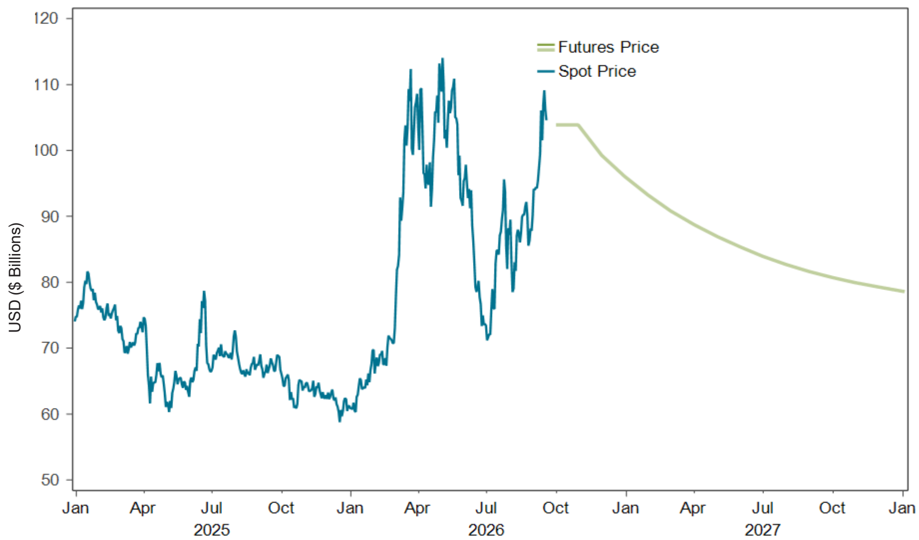
## OIL COMPLICATES THE INFLATION OUTLOOK

March delivered an oil shock. Following an attack on Iran on February 28 by the US and Israel, shipping through the Strait of Hormuz came to a standstill for months. Brent crude jumped from about $71 to $120 a barrel in March and reached $126 on April 30. July brought more US strikes, a return of oil toward $100, and a Fed meeting at which three officials dissented in favor of raising rates. September saw renewed Mideast clashes and another surge in oil prices above $100. It is worth noting, however, that crude oil futures see the price spike as temporary and expect Brent crude to trade below $80 over the course of next year (**Figure 3**).

FIGURE 3

## Markets See Oil Shock as Temporary

*Futures-implied trajectory for the price of Brent crude oil*




Note: Latest data as of September 18, 2026.
Sources: GW&K Investment Management, Bloomberg, and Macrobond

As of mid-September, the price of oil was up about 70% for the year, reflecting the oil supply shock caused by the conflict with Iran. Markets are optimistic that the oil shock will prove to be temporary.

With Brent crude up more than 70% this year, the surge in oil prices has made the Fed's job more difficult. The latest inflation report was already a reminder of that challenge. Consumer prices rose 0.4% in August, with gasoline responsible for more than a third of the monthly increase. Excluding food and energy, prices rose 0.3%. Yet annual core inflation slowed to 2.4%. The report contained both renewed monthly pressure and improvement in the annual core rate. It also preceded September's latest energy disruption.

Signals from bond prices suggest that investors are relatively relaxed about the long-term outlook for inflation despite the near-term surge in oil. The yield difference between conventional Treasuries and inflation-protected securities measures the compensation investors demand for inflation. On a 10-year horizon, that measure of inflation compensation has moved up only 7 bps over the course of the year, from 2.25% to 2.32% (**Figure 4**). This modest move likely reflects confidence that the Fed will be successful in restraining inflation and optimism that the energy shock will be temporary.

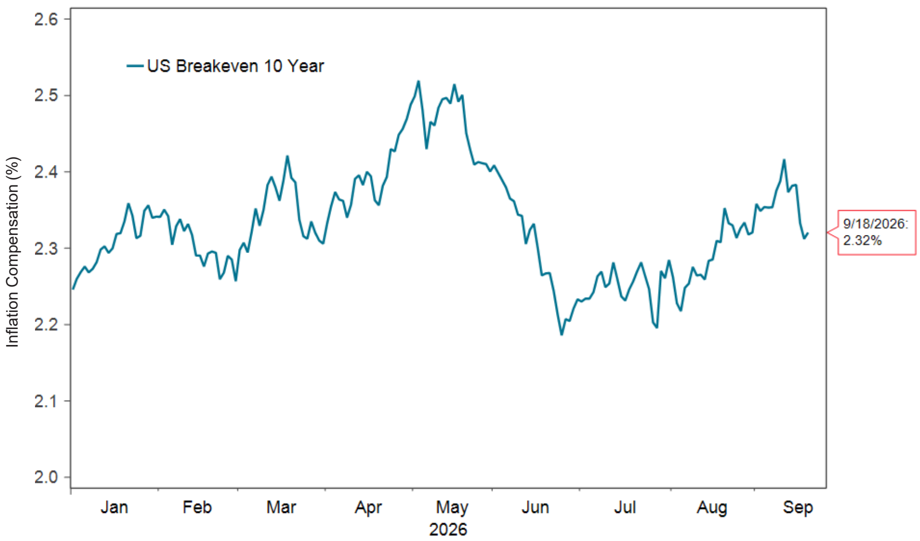
The recent decline in inflation compensation around the Fed's September decision offers one encouraging sign. A determined central bank can help longer bonds if investors believe its actions will contain inflation. Higher policy rates need not push every bond yield higher. What matters is how the decision changes expectations about inflation and future policy.

Figure 4 on next page

## FIGURE 4

### Long-Term Inflation Pricing Has Barely Changed

*US 10-Year Breakeven Inflation*




Note: Derived from conventional and inflation-linked Treasuries. Inflation compensation includes risk and liquidity effects, not just inflation expectations.
Sources: GW&K Investment Management, Bloomberg, and Macrobond

Despite the sharp rise in energy prices this year, long-term inflation pricing has barely changed. Instead, the rise in yields has mostly come from higher real yields associated with strong growth.

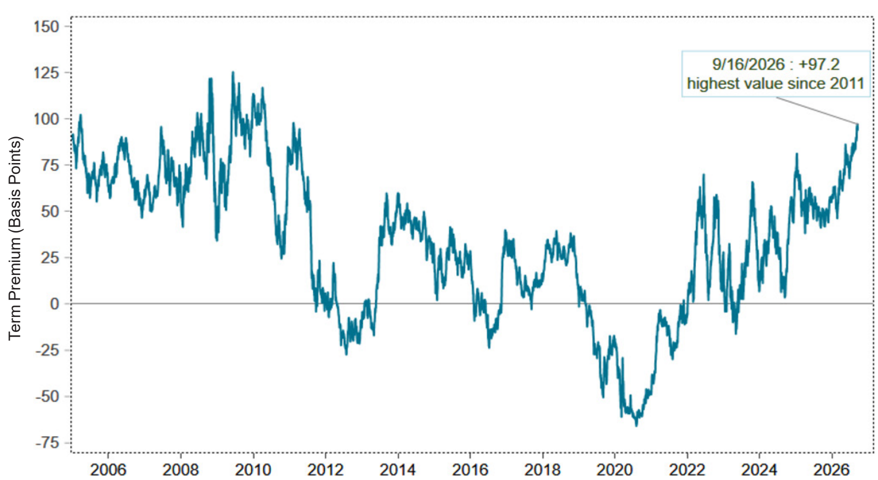
## THE PRICE OF LENDING FOR LONGER

Long-term lenders face another risk: that economic circumstances change a great deal before they get their money back. Economists refer to the extra compensation for that uncertainty as the "term premium." It cannot be observed directly and must be estimated. According to the Federal Reserve Board's Kim-Wright model, the estimated premium reached 0.97% on September 16, which was its highest level since 2011 (**Figure 5**). That means that roughly half of the rise in yields this year can be attributed to the rising term premium and the other half to expectations for tougher Fed policy.

## FIGURE 5

### The Reward for Lending Long Rose

*Estimated extra yield for holding a 10-year bond*




Note: Term Premium = extra yield investors demand to lock up money for 10 years instead of rolling short-term bills, based on estimate from the Federal Reserve's Kim-Wright model. Data through September 18, 2026.
Sources: GW&K Investment Management, Federal Reserve, and Macrobond

The Fed's estimate of the term premium for 10-year yields recently rose to 97 basis points, its highest level in more than 15 years.

There are several plausible reasons. Persistent federal deficits create a heavy supply of debt for markets to absorb. The Treasury said in August that it expected to maintain note and bond auction sizes for at least the next several quarters. Fed Chair Kevin Warsh's preference for sharing less guidance about future policy may also contribute to greater uncertainty among investors, along with less willingness to take duration exposure. Moreover, rising yields in Europe and Japan now provide global investors with more attractive alternatives to Treasuries.

## FEW SIGNS OF PANIC

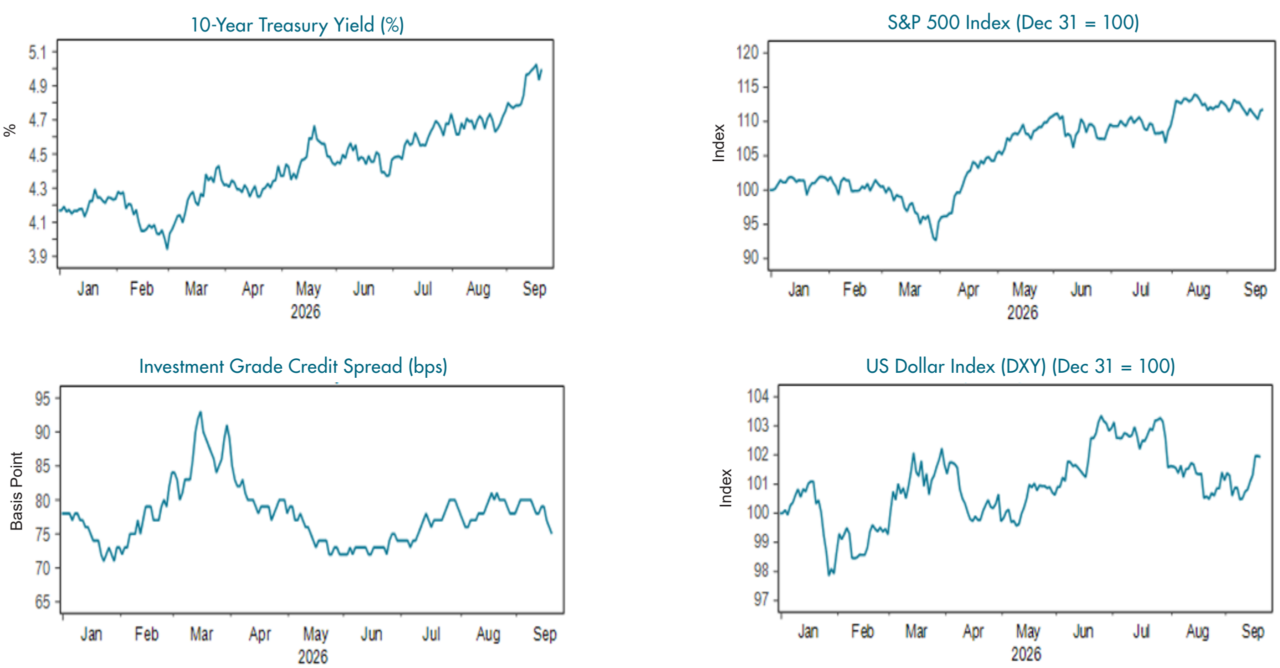
If investors were broadly losing confidence in US assets, one would look for corroborating evidence: a falling dollar, weaker stocks, and wider gaps between corporate and Treasury yields. Britain's 2022 government-bond crisis was a textbook case of how a fiscal shock can spread across markets. Rising Treasury yields alone are not enough to signal that kind of crisis.

The wider market picture offers few signs of panic (**Figure 6**). The S&P 500 is up 12% this year and reached a record in August. Investment-grade corporate bonds yield just 75 bps more than Treasuries, barely changed from year-end. Spreads on riskier bonds have tightened, and the US Dollar Index is up about 2%. These market signals are not enough to absolve Washington of its fiscal problems. But broader market calm in the face of rising yields favors an explanation centered on resilient growth, robust AI investment, and a tougher Fed. Heavy borrowing can still push up yields without triggering a market panic.

### FIGURE 6

### This is Not a Debt Scare

*Stocks Near Records, Credit Calm, and Dollar Firm*




Sources: GW&K Investment Management, Bloomberg, and Macrobond

Financial markets offer little evidence of a broad retreat from US assets. Stocks are higher, corporate borrowing spreads remain tight, and the dollar has firmed even as Treasury yields have climbed.

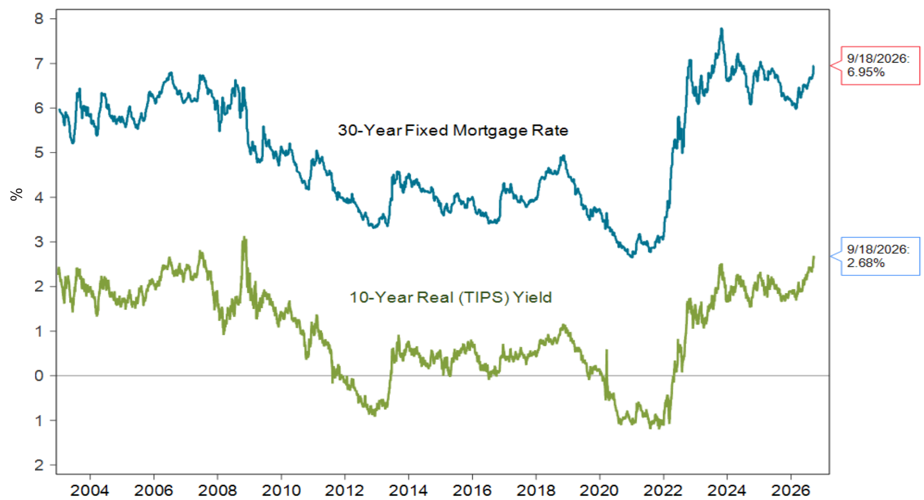
## BETTER YIELDS, FAMILIAR RISKS

For borrowers, the consequences are straightforward. The 30-year mortgage rate has climbed from 6.15% at the start of the year to a 2026 high of nearly 7% (**Figure 7**). Other consumer borrowing rates have also remained elevated.

### FIGURE 7

### Higher Costs for Borrowers, Better Yields for Savers

*30-Year Mortgage Rate and 10-Year TIPS Yield*



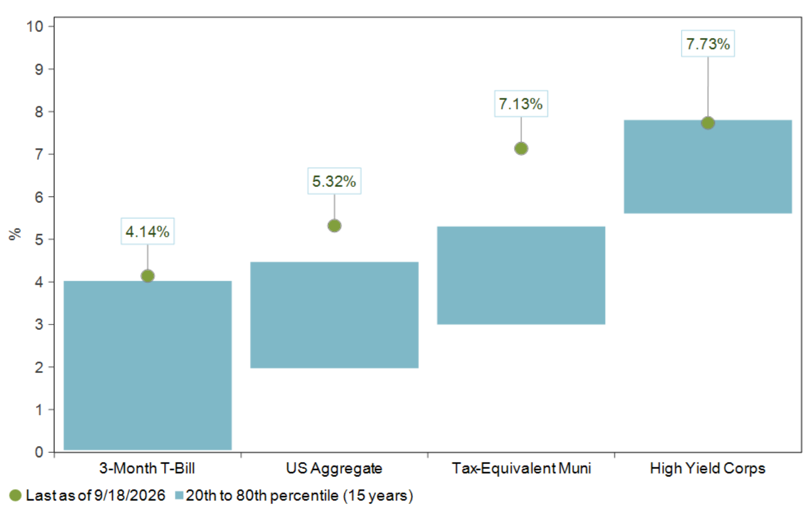

Sources: GW&K Investment Management, Bloomberg, Freddie Mac, and Macrobond

> Mortgage rates have risen this year, while the 10-year inflation-protected Treasury offers a real yield near the top of its post-2008 range.

For savers, the arithmetic is more appealing. The 10-year inflation-protected Treasury offers a real yield of 2.68%, near the top of its range since 2008. That is a substantial improvement compared to the previous decade, when real yields hovered near or below zero. Across a range of fixed income products, yields are either well above or near the top of their ranges seen over the past 15 years (**Figure 8**).

### FIGURE 8

### An Improved Yield Environment Compared to the Last 15 Years




Sources: GW&K Investment Management, Bloomberg, and Macrobond

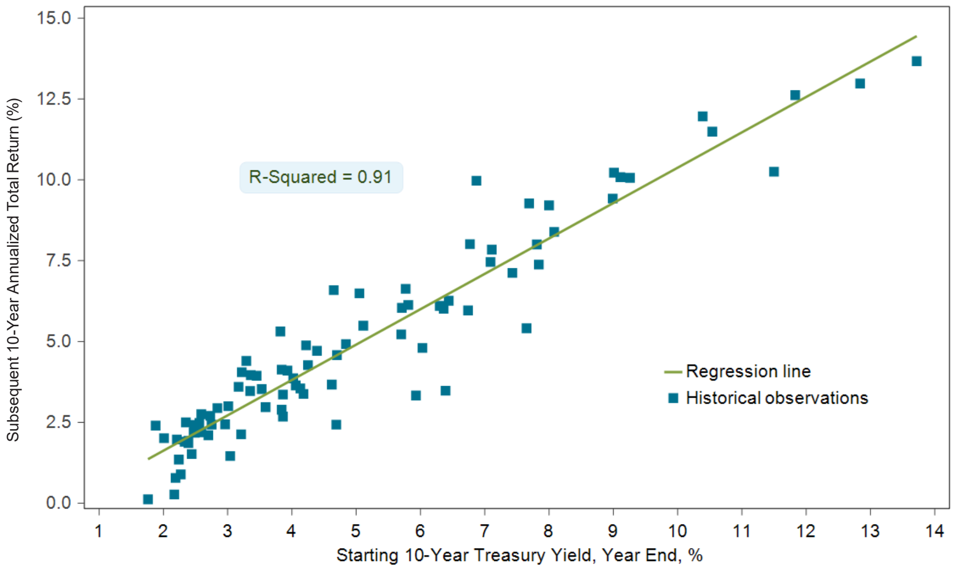
> Yields on a variety of fixed income products are either well above or trading near the high end of their ranges over the past 15 years.

Higher starting yields bolster the case for high-quality bonds held to meet long-term needs. History shows that higher starting yields were generally followed by higher returns (**Figure 9**). Moreover, higher yields can cushion but not prevent further price losses if rates keep rising, especially for bonds with many years to maturity.

### FIGURE 9

### Starting Yields Matter

*10-Year Returns on US Treasuries vs. Starting Yield (1927-2025)*




Note: Constructed constant-maturity returns through 2025. Coupons reinvested. Overlapping periods. Before fees, taxes, and inflation.
Sources: GW&K Investment Management, Aswath Damondaran, NYC Stern, and Macrobond

Higher starting yields have generally accompanied better long-term Treasury returns. Each dot pairs a year-end yield with the following 10-year annualized return.

What could push yields lower? Sustained progress toward 2% inflation, weaker private spending or a durable end to the Iran conflict would help. Another energy shock, faster AI investment, or a further rise in the term premium could send them higher. Whatever scenario unfolds, investors should recognize what has changed: bonds now offer a much better starting yield. The reward for patience has risen.

*William P. Sterling*

William P. Sterling, Ph.D.,
*Global Strategist*