LPL Financial

Rate and Credit View

Financing the Future: AI's Impact on the Bond Market

Lawrence Gillum, CFA
Chief Fixed Income Strategist

Executive Summary

- The Fed now names AI as an inflation source. The September FOMC minutes cite surging AI-related investment alongside energy as a driver of inflation pressure, and the Fed hiked to 3.75% to 4.00%.
- AI borrowers are crowding the long end. Hyperscalers are routinely selling 30- and 40-year bonds, and the Fed's own market desk cited AI debt issuance as a contributor to higher term premiums.
- The supply wave is not done. Capital expenditures (capex) are still growing faster than cash flow, so we expect 2027 hyperscaler issuance to exceed this year's record pace.
- Credit is absorbing it, but at a price. Spreads on hyperscaler bonds have widened across the curve, new deals need concessions, and the weakest AI credits now trade like distressed debt.
- A pause in capex spending is the bullish case for bonds. This month has offered a preview: as AI stocks sold off, the 10-year yield fell about 37 basis points from its recent peak.

AI's Buildout, Bonds' Burden

In his new book, *A Fabulous Debt*, the Financial Times's Robin Wigglesworth traces how the bond market quietly built the modern world. He follows it from the water boards that financed Holland's dikes, through the bonds behind Alexander Hamilton's vision for a young America, to the trillion-dollar portfolios of today. One thread runs through that history: when a society decides to build something enormous, it borrows to do it, and the bond market ends up shaping the cost of money for everyone else.

The AI buildout is the newest chapter in that story, and it is being written in real time. The largest technology companies in the world, long celebrated for funding themselves from cash flow, are now selling, among other tenors, 30- and 40-year bonds to pay for data centers, chips, and power. They are doing so at a pace that is pushing up Federal Reserve (Fed) rate expectations, competing with the U.S. Treasury for long-duration buyers, and repricing the corporate bond market. Bonds have financed humanity's great construction projects for centuries. This one is happening on our watch, and in our view, the AI buildout has become one of the most important domestic drivers of U.S. interest rates.

And right now, this buildout is working against bondholders on two fronts at once. It is keeping growth and inflation hot enough that the Fed is hiking again, and it is flooding the long end of the bond market with corporate duration that competes with Treasuries for the same buyers. Our view is simple: the market is pricing a buildout that keeps accelerating, so any pause or slowdown is the most underappreciated upside catalyst for Treasuries heading into 2027.

The Buildout is a Macro Variable, Not a Sector Story

The scale alone makes AI a macroeconomic force. The four largest hyperscalers are guiding to roughly $730 billion of capital spending in 2026, up about 78% from roughly $410 billion in 2025, and every major guidance revision this year has been upward.

Company	2026 capex guidance	Latest change
Amazon	~$220B	Raised from ~$200B (Jul 30)
Alphabet	$195B to $205B	Raised at Q2 results (Jul 22)
Microsoft	~$175B (calendar year)	Lower figure reflects a lease accounting change, not less building
Meta	$135B to $145B	Range narrowed upward (Oct 21)

Q3 earnings season will provide the next important checkpoint for AI-related capital spending and forward guidance. But the math suggests the investment cycle remains far from its peak. Even if capex growth slows to roughly 37% in 2027, less than half of this year's pace, total spending would still reach $1 trillion.

Two things changed this year that matter for bond investors. First, the spending is now large enough to move the whole economy. The Fed's staff noted in September that the AI buildout continued to support robust increases in business investment and fueled strong imports of high-tech capital goods. In our view, AI capex is now a major swing factor in U.S. growth, a piece of demand that keeps the economy running hot even as housing and lower-income consumers feel the squeeze of higher rates.

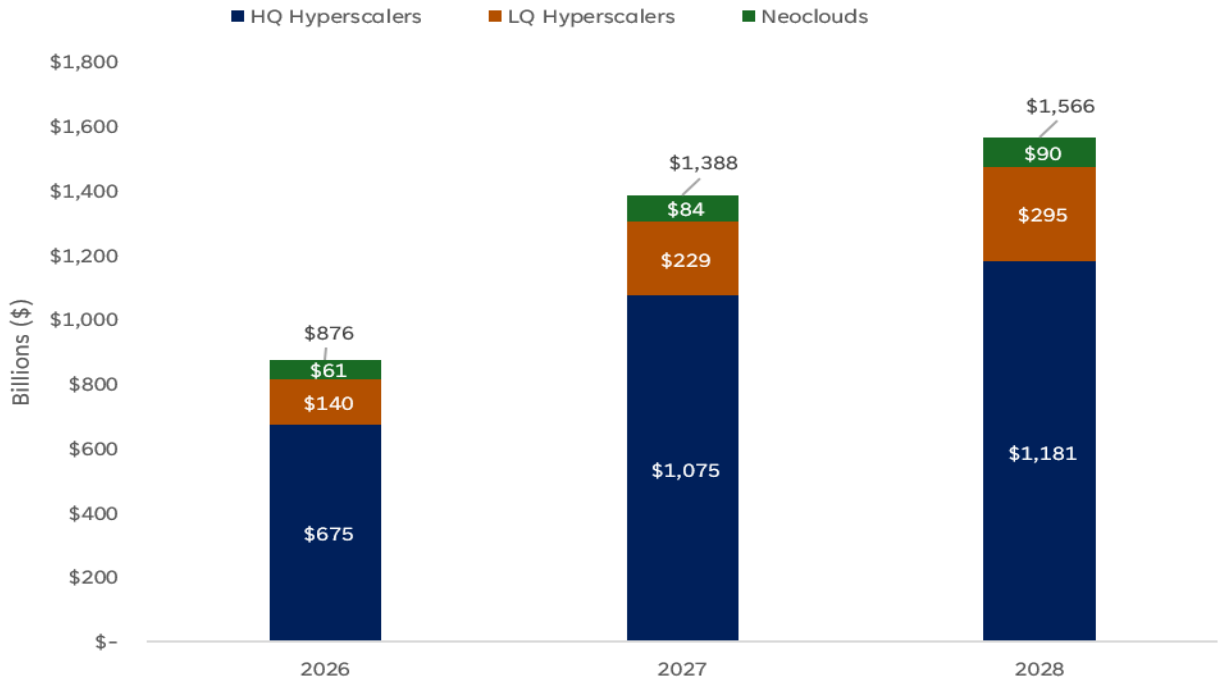
Further, and we'll talk more about this later, but while high-quality (HQ) hyperscalers remain the dominant driver of capex spend, lower-quality (LQ) hyperscalers and neoclouds are expected to ramp up their spend as well. Funding for most of this spend will likely be financed in the bond markets, both public and private. The distinction is important as the market is currently treating each segment differently with LQ and neocloud companies most prone to elevated volatility.

While definitions vary, HQ hyperscalers are the largest cloud and platform companies, rated in the AA category or higher. They generate enough operating cash flow to fund most of their capex. They borrow to supplement that cash, not to survive, so their spending is a choice they could scale back. Their bonds trade as a supply story rather than a credit story.

LQ hyperscalers are companies building data center capacity on a hyperscale level but with balance sheets that cannot fund it internally. They are typically rated in the BBB range, with capex that exceeds operating cash flow. They rely heavily on debt, leases and partner financing, and they often carry large commitments to a few customers. For these borrowers, the buildout is a balance sheet bet, and credit markets price them accordingly.

Neoclouds are specialized cloud providers built specifically to rent AI computing capacity, mainly GPUs, to model developers and other tech companies. They are typically high yield rated or unrated, funded mostly with debt secured by GPUs or customer contracts, and dependent on a small number of large customers. Their revenue rises and falls with AI demand, so they are the most direct credit exposure to the buildout and the first place stress would appear if it slows.

CAPEX Expectations Continue to Climb



Source: LPL Research, Bloomberg 10/26/26
Disclosure: Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

The takeaway for bond investors: strip out AI and the U.S. capex cycle looks like it is contracting under the weight of 5% long rates. Leave it in and the economy looks strong enough to justify more Fed hikes. That is why the Fed, and the bond market, are so sensitive to every AI guidance update.

Second, capex has outrun cash flow, so the buildout is now financed in the bond market. Alphabet reported its first-ever negative quarterly free cash flow (negative $5.9 billion) after $44.9 billion of Q2 capex, and Meta's Q2 capex consumed about 98% of its operating cash flow. When the most cash-rich companies in the world turn into net borrowers, the buildout stops being a stock market story and becomes a rates story.

Channel One: AI is Lifting the Front End Through the Fed

The most direct way the buildout pushes yields higher is through the Fed's reaction function. On September 16 the FOMC raised rates by 25 basis points to 3.75% to 4.00% in a unanimous vote, its first hike since July 2023, and the policy statement described productivity growth as strong and capital investment as robust. While we believe the Fed will likely hold the policy rate at 3.88% (effective) at this week's meeting, the median dot implies one more hike this year, and the longer-run neutral rate estimate moved up to 3.25% from 3.06%.

The minutes, released on October 7, are explicit that AI is part of the inflation problem:

- Participants said surging AI-related investment, alongside higher oil and fuel prices, was contributing to inflation pressure.

- Several participants saw core goods inflation staying elevated as AI buildout effects increased while tariff effects faded.
- Some participants warned the buildout could cause aggregate demand to outpace aggregate supply over the medium term.
- Several noted the scale and pace of the buildout had continued to surprise to the upside, and a couple raised their neutral rate estimates.

Individual officials have gone further. Chicago Fed President Goolsbee said he is watching for evidence that data center construction is spilling out of its own lane and raising output beyond what the economy can absorb. His key point for bond investors: AI spending itself does not have to be rate sensitive for the Fed to hike. Higher rates can cool the rest of the economy to make room for it.

The price data backs this up. Electricity CPI rose about 4.4% year-over-year through September, outpacing headline inflation, and wholesale power prices in Pennsylvania/New Jersey/Maryland (PJM), the largest U.S. grid and home to the heaviest data center concentration, jumped almost 76% year over year in Q1. Memory and chip costs have pushed up prices on consumer electronics.

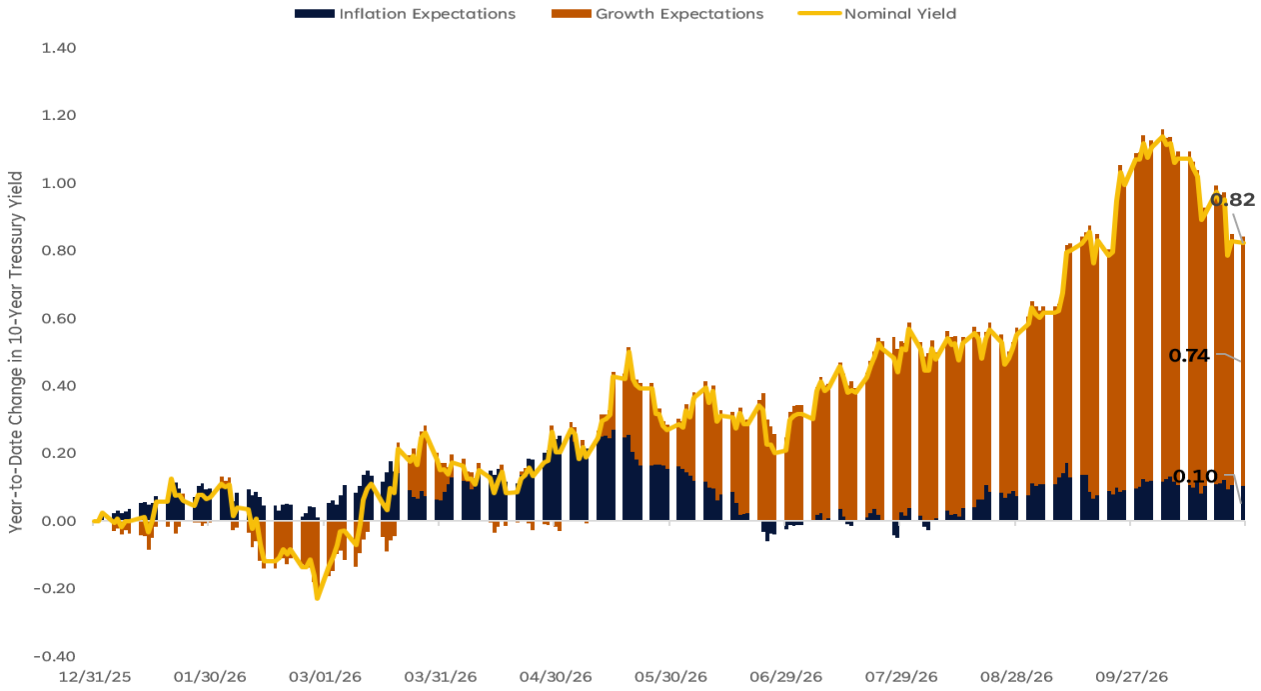
Two inflation channels deserve a closer look, because they behave differently:

- **Chips are a fast channel.** AI data centers are absorbing so much memory and storage capacity that consumer electronics have gone from a reliable source of deflation to a source of inflation. A Fed staff note found that the computer software and accessories category made an unprecedented contribution to core and core goods PCE inflation from November 2025 through March 2026. In the July CPI report, that category was up 21.2% from a year earlier, the largest annual increase on record. Apple raised MacBook and iPad prices this year and cited memory costs. This channel can reverse quickly if chip demand cools.
- **Power is a slow channel.** What is less widely appreciated is the lagged inflation impulse coming from the power and construction bottleneck. Data centers are competing with housing, infrastructure, and reshoring for constrained grid capacity, skilled labor, transformers, and materials. Like the railroad and electrification booms, capital is plentiful but physical capacity is not. Those constraints could keep inflation and longer-term rate premiums elevated even if AI optimism fades.

Labor is a third, smaller channel. The September minutes noted that strong demand for skilled workers tied to the AI buildout has been driving strong wage gains for those workers. This mix matters for our outlook: the fast channel gives the Fed reason to keep hiking now, while the slow channel means some AI-related inflation will outlast any pause in spending.

In our view, this is mostly a real-rate story, not an inflation-expectations story. On October 26, the 10-year Treasury yielded 4.99% while the 10-year Treasury Inflation-Protected Securities (TIPS) yielded 2.64%, leaving inflation compensation near 2.35%. That is generally consistent with the Fed's 2% target over time. The elevated piece of the yield is the real rate, and the Fed's staff found the same thing: real rates drove most of the recent rise in longer-maturity yields. In plain terms, the market believes the economy can sustain a higher policy rate because AI investment is propping up demand. Markets still expect one more hike this year and two more in 2027. That pricing is the opportunity if the AI impulse fades.

10-Year Nominal Treasury Yield Broken Out by Inflation and Growth Drivers



Source: LPL Research, Bloomberg 10/26/26
Disclosure: Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

Channel Two: AI Borrowers are Crowding the Long End

The second channel is supply, and it hits the long end hardest. Data centers have long economic lives, so hyperscalers are matching them with long debt. Amazon's $25 billion July deal is a good example: $9 billion of it, more than a third, was in 20-, 30-, and 40-year bonds maturing in 2046, 2056, and 2066. Alphabet's $25 billion August deal also ran out to 40 years. Most corporate borrowers avoid that part of the curve. The AI borrowers are embracing it.

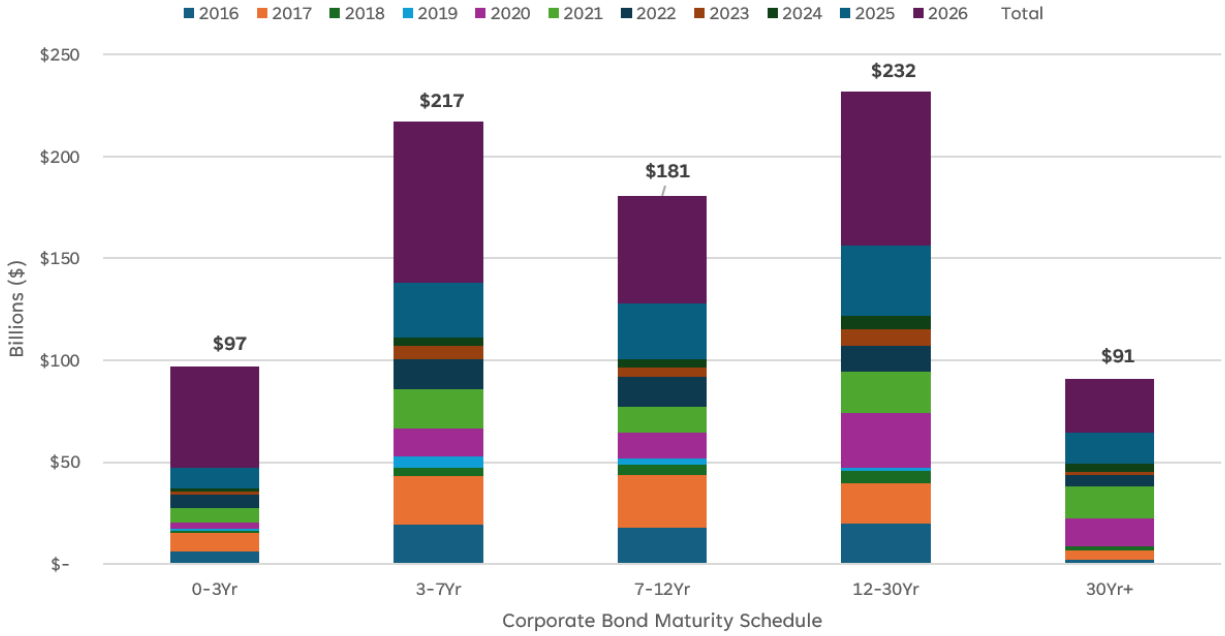
That duration has to be absorbed by the same buyers that anchor the long Treasury market: pensions, insurers, and long-duration asset managers. A $4 billion 30-year corporate tranche takes up liability-matching capacity that would otherwise flow into 30-year Treasuries. And investors who buy the corporate and hedge their rate risk by selling Treasury futures add a second round of pressure at the same point on the curve. Put another way, AI issuance is not just a credit supply story. It is a duration supply story layered on top of record Treasury supply.

Three anecdotes from the past few months show how this plays out:

1. The Treasury Department is fighting for the same buyers. On August 19, after the 30-year yield hit 5.34%, its highest since 2007, the Treasury doubled the size of its long-end buyback operations to at least $4 billion each. For perspective, Amazon's single July deal put $9 billion of 20- to 40-year debt into the market, more than two of those buyback operations combined. The Treasury is retiring long duration with one hand while AI borrowers create it with the other.

2. Treasury auctions are clearing at ever-higher yields. The 30-year auction cleared at 5.21% in August, the highest since 2001, then 5.308% in September and 5.618% on October 8. Demand has held up, but only at a higher price, which is what a market absorbing more duration supply looks like.
3. AI issuance is bringing a lot more duration with it. The $91 billion of 30-year-plus supply that has taken place over the past few years is slightly below the $97 billion in 0–3-year maturities, but par value alone misses the impact on the market. Adjusting for interest-rate sensitivity, and assuming roughly 17 years of duration at the long end versus 1.5 years at the short end, the 30-year-plus bucket represents more than 10 times the duration-equivalent supply. For investors, that means a relatively modest amount of long-dated issuance can require the market to absorb a disproportionately large amount of duration risk. And faced with a choice between Uncle Sam and the AI buildout, investors currently appear willing to take their chances with the machines.

Hyperscaler Issuance is Broad Based but Adds Long Duration Pressures to the Market



Source: LPL Research, Bloomberg 10/26/26
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This is not just a U.S. phenomenon. The European Central Bank found that the five U.S. hyperscalers accounted for 15% of the growth in euro area investors' holdings of euro corporate bonds in the year to March 2026, largely bought by pension funds and insurers that traditionally favor government bonds. When the same pool of global long-duration capital is funding AI, it is not funding Treasuries, Bunds, or gilts.

The Fed has noticed. The New York Fed's market desk reported in September that market commentary pointed to competition for capital from heavy private debt issuance to finance AI infrastructure as one contributor to higher term premiums and Treasury yields. The Fed's Kim-Wright model put the 10-year term premium near 1.10% on October 5, and the 10-year yield touched about 5.35% intraday in early October, its highest since 2002, before settling near 5.0% currently.

That said, AI supply is a marginal force on the long end, not the root cause. Large deficits, a shrinking pool of price-insensitive buyers, and sticky inflation remain the structural drivers of term premium, themes we have written about extensively. But margins matter at these yield levels. AI issuance adds a steady, price-insensitive supplier of long corporate duration at exactly the moment the Treasury market is struggling to find price-insensitive buyers. And because hyperscalers expect returns on AI investment well above their borrowing costs, wider spreads are not slowing them down. That makes the supply technical sticky for as long as the buildout continues.

The Issuance Wave: The Primary Market is Already Straining (Somewhat)

Alphabet, Amazon, Meta, and Oracle have issued more than $228 billion of bonds this year as of October 13, more than double their total for all of 2025. U.S. investment-grade issuance set a monthly record of $145.2 billion in August, the third straight record month. The deals themselves tell the story of a market that is still open but no longer easy.

Date	Issuer	Size and structure	What the deal told us
Aug 6, 2026	Alphabet	$25B, 10 tranches, 2 to 40 years	About $115B of orders, but only after initial concessions of up to 40 basis points versus existing Alphabet debt
Jul 28, 2026	Meta and BlackRock El Paso venture	$12.5B debt financing for a 1 GW campus	AI debt moving off balance sheet; Meta leases the campus rather than owning it
Jul 7, 2026	Amazon	$25B, 8 tranches, 3 to 40 years	$62B of peak orders, half the March book; 40-year priced at +125 basis points
Mar 2026	Amazon	$37B USD plus a EUR 14.5B euro deal	About $126B of orders at the peak of investor appetite
Feb 2026	Oracle	About $25B financing package	Record $129B of orders for an investment-grade deal

Three trends stand out. First, demand is fading at the margin. Cover ratios on hyperscaler deals slipped from nearly five times in February to below two times in July, and Alphabet had to pay up to win buyers back in August. Second, financing is migrating into project bonds and joint ventures like Meta's El Paso venture, which keep debt off hyperscaler balance sheets but still put long-dated AI paper into the market. Finally, given the strains in the primary market, borrowers are rushing deals to market to get ahead of slowing demand. Elon Musk late Sunday warned on his social media platform X that debt markets have become all but shut for companies without revenue streams independent of their AI businesses, a reference to so-called neoclouds that sell high-end computing power to tech companies. “That means the 200+ neoclouds are going to see guppy-level death and consolidation,” Musk wrote. “Some will make it through, but not many.” Citadel’s Pablo Salame, in a rare interview, gave his own warning that credit markets are “getting jammed” as lenders struggle to offload the massive risks tied to the AI buildout.

The borrower base is also broadening well beyond the big five, which is how a sector story becomes a market-wide supply story:

- SpaceX sold $25 billion in its debut investment-grade dollar deal, drawing $85 billion of orders, with proceeds going partly to AI data centers and power.
- QTS, the Blackstone-owned developer, sold a $4.6 billion debut investment-grade bond backed by a Georgia campus with Microsoft as tenant. This is how Microsoft gets long-term financing without issuing bonds itself.

- Hut 8 sold $4.25 billion of 6.129% secured notes due 2042 at 165 bp over Treasuries for a single 352-megawatt Texas data center, non-recourse to the parent. Compare that with Amazon's 40-year bond at 125 basis points: a single-asset project borrowing for 16 years pays more than the strongest hyperscaler borrowing for 40.

All told, investment-grade companies have sold about $1.9 trillion of bonds this year, up roughly 25% from a year earlier, led by mega-cap technology.

We expect the pipeline to get bigger, not smaller. Capex is still rising faster than operating cash flow; Microsoft has yet to come to the bond market in size this cycle, and off-balance-sheet structures are multiplying. Earlier this year, we wrote that AI was transforming investment-grade credit (AI's New Frontier: The Transformation of Investment-Grade Credit). Since then, the volumes have run ahead of even our expectations, and we think 2027 supply will top 2026.

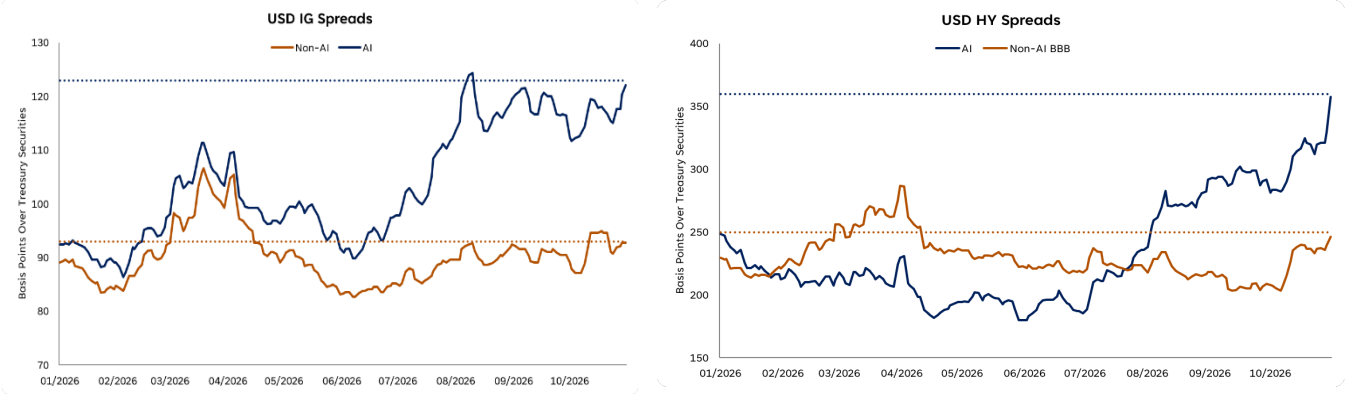
The Secondary Market: Supply Repricing, with a Credit Tail

The clearest sign that AI has become its own credit story is how far its spreads have moved away from everyone else's. In both investment grade and high yield, AI-related borrowers have widened while the rest of the market has held near historically tight levels.

In investment grade, the gap is about supply, not solvency. The Fed's own market review in September noted that spreads on hyperscaler debt remained wide because of the large volume of issuance and the long duration of the bonds (noted above), while spreads on other corporate bonds narrowed modestly. Investment grade AI companies have seen their spreads hit their highest levels since August. Of the 91 hyperscaler bonds issued in 2026 with comparable pricing data, 78 were trading at higher spreads in late October than when they were issued. Meanwhile, the non-AI investment grade market sits near its tightest spreads in decades. When the widening is limited to one group of borrowers, it tells us investors are asking to be paid for absorbing more supply, not for a weaker balance sheet.

In high yield, the gap is about credit risk, and it is much wider. The broad high yield market has been calm, with spreads narrowing alongside investment grade. The AI-linked corner looks very different. CoreWeave, rated B+, saw its October 2031 bonds yield above 16% in mid-October, and its five-year credit default swap hit a record of about 1,195 basis points. A new layer of single-project data center borrowers has also arrived. Hut 8 sold $4.25 billion of 16-year notes at 165 basis points over Treasuries to fund one Texas facility. That is a higher spread than Amazon pays on 40-year money, even though the Hut 8 notes are themselves investment grade.

Markets are Differentiating Between AI and Non-AI Companies



Source: LPL Research, Bloomberg 10/26/26
Disclosure: Bloomberg Corporate Bond Index and the Bloomberg High Yield Index. Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

Our read: the divergence is rational, and it is not finished. In investment grade, the spread gap will track the pace of issuance, so it should narrow if the buildout slows and supply eases. In high yield, the gap reflects real exposure to the buildout itself. That is where losses would show up first if AI spending slows. A slowdown that is good news for Treasuries and high quality hyperscaler bonds would be bad news for the leveraged end of AI credit.

If the Buildout Pauses, Bonds Win on Three Fronts

A pause or even a meaningful slowdown in AI capex would reverse both channels at once, and the market has already given us two previews of how that looks.

Preview one: DeepSeek, January 27, 2025. When a cheaper Chinese model raised doubts about the need for massive AI spending, the 10-year yield fell 9 bp and the 2-year fell 7 bp in a single session, and futures moved from 42 bp to 50 bp of expected Fed cuts for the year.

Preview two: this month. From October 6 to October 23, the Nasdaq 100 fell 6.55% on AI revenue and debt worries while the 10-year yield fell about 41 bp. Treasuries acted like a hedge again, a role they have struggled to play when oil shocks drive stocks and bonds down together.

A sustained slowdown would work through three channels:

1. **The Fed path.** If AI is a big reason the economy can tolerate a 3.88% effective policy rate, less AI investment means less need for more hikes. This is the biggest lever, and it would show up first in 2- to 5-year yields. Markets that were pricing hikes into 2027 would have room to reverse quickly.
2. **Long-end supply.** Every $25 billion jumbo deal that does not happen is long duration the Treasury market no longer has to compete with. Term premium would get some relief, though fiscal pressure would keep a floor under it.
3. **The safe-haven bid.** An AI slowdown would likely hit equities, especially the concentrated AI leadership, and push money into Treasuries.

Scenario	Fed path	2-year yield	10-year yield	Curve	Investment-grade credit
Buildout keeps accelerating (roughly what is priced)	December hike, more in 2027	Sticky near current levels	Range bound near 5% to 5.25%, term premium drifts higher	Bear steepening pressure persists.	Hyperscaler spreads widen with each jumbo deal; tight index spreads elsewhere
Slowdown (capex growth decelerates in 2027 guidance)	Hikes priced out after December	Falls meaningfully, leading the rally	Falls, but less than the 2-year, potentially to 4.5%.	Bull steepener	Hyperscaler spreads tighten as supply eases; weaker AI credits widen
Outright pause (capex cut, projects canceled)	Hiking cycle ends; cuts debated by mid-2027	Largest decline	Largest decline, with yields potentially reaching the low 4s/high 3s.	Bull steepener, possibly sharp	High-quality hyperscalers outperform; neoclouds, Oracle, and data center vehicles reprice sharply lower

One nuance matters for the corporate bond market. A slowdown may be good for the highest quality hyperscaler bonds even as their stocks fell, because the supply that has pushed their spreads wider may reverse. The pain would land on the leveraged borrowers that need the buildout to continue to service their debt.

We do not expect an outright pause anytime soon though. Q2 guidance was raised across the board, and higher rates have not deterred issuers whose returns on capital far exceed their borrowing costs. But the market is priced for the opposite of a pause, which makes the risk asymmetric. Late October and early November earnings from Microsoft, Alphabet, Amazon, and Meta are the first test. Any sign that 2027 capex growth is set to slow would, in our view, be one of the most bond-friendly developments of the year. Meta's recent guidance, however, shows no signs of slowing. In its Q3 2026 earnings report, Meta raised the bottom end of its full-year 2026 capex guidance to $135 billion–$145 billion (up from $130B–$145B) and explicitly told investors it plans to continue "investing aggressively" into 2027. Until then, patience pays, and fortunately for bond investors, it pays rather handsomely for that insurance.

Investment Implications

The asymmetry favors bondholders who are patient with duration and disciplined with credit. Markets are priced for an AI buildout that keeps surprising to the upside. If it continues, yields are already near two-decade highs so investors are getting paid to hold high-quality fixed income. If it falters, the rally could be fast.

- **Keep some duration in portfolios.** We're neutral duration relative to benchmarks on the competing narrative of the AI story and any potential slowdown. With the 10-year near 5.0% and the 2-year near 4.75%, starting yields provide a cushion if the buildout continues, and the intermediate part of the curve is most sensitive to a repricing of the Fed path. That is where an AI slowdown pays off most directly.
- **Keep the long end on a shorter leash**. Fiscal deficits and price-insensitive corporate supply will keep term premium elevated even in a slowdown. We would not chase 30-year Treasuries until AI issuance shows signs of cresting.

- **In credit, treat hyperscalers as a supply trade, not a credit trade.** New issue concessions of 20 to 40 basis points in AA-rated names are attractive entry points for buy-and-hold investors, particularly in short and intermediate maturities. We would be more cautious on long-dated hyperscaler paper ahead of what we expect to be even heavier supply in 2027.
- **Avoid the leveraged AI tail.** Neocloud borrowers, BBB issuers with heavy data center lease commitments, and project vehicles that depend on a single tenant carry the real AI credit risk. Their spreads are the proverbial canary in the coalmine. Be cautious.

What we are watching:

- Q3 capex guidance, and especially any first look at 2027 plans, from Microsoft, Alphabet, Amazon, and Meta over the next few weeks.
- Whether Microsoft begins terming out its capex in the bond market, the largest untapped source of long-dated supply.
- The Fed's October 27 to 28 meeting and any change in how officials describe AI's contribution to inflation.
- Oracle and CoreWeave CDS as real-time gauges of stress in AI financing. They remain elevated.
- The Treasury term premium and new issue concessions on the next jumbo deal, our best read on whether crowding out is building or easing.

The AI buildout may well deliver the productivity gains that eventually bring inflation and rates down. The Fed itself expects that, though it admits the timing is highly uncertain. But that is a 2028 (at the earliest) and beyond story. For the next 12 months, AI is likely a headwind for bonds, but the surest way for that headwind to fade is for the spending to slow. Until then, the buildout may be fabulous. The debt that finances it may be another story.

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