Weekly Market Commentary

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Signs Point to a Normalization, Not a Crisis

August delivered the loudest bond market narrative in years, and almost none of it survived contact with the price action. Total public debt crossed $40 trillion on August 18. The 30-year U.S. Treasury yield reached 5.33% intraweek, a level last seen in 2007. The move was global, with the German 10-year at 3.35% and the Japanese 10-year near 2.89%, both at, or near multi-decade highs. The federal deficit is tracking north of $2 trillion. Treasury Secretary Scott Bessent intervened with an expanded buyback program. A new Fed chair delivered his first Jackson Hole keynote. Commentators reached, predictably, for bond vigilantes, buyers' strikes, and debt spirals. Our view is that this is an uncomfortable but necessary normalization rather than a crisis. That distinction is not semantic hedging, and it is not hopeful optimism (we don't think). It is a claim about mechanisms, and it carries a specific, falsifiable test. In a normalization, higher yields recruit buyers. In a crisis, higher yields chase them away. Everything we observed in August points to the former.

Four Concerns Worth Taking Seriously

The concerns underneath the move are legitimate, and dismissing them would be the wrong kind of contrarianism. We want to acknowledge them properly before explaining why we still think the market is functioning as designed. But, like Aesop's fable about a boy who cried wolf, calling every orderly sell-off a crisis is unhelpful. We don't think we are there yet, but debt and deficit trajectories are unsustainable on this current path. Something will need to be done. The good news is that we were in a similar situation in the 1990s, and Congress acted. There are some similarities, but differences as well.

The debt and deficit arithmetic are real concerns
The Congressional Budget Office's (CBO) February baseline puts the FY2026 deficit at $1.9 trillion, or 5.8% of gross domestic product (GDP), against a 50-year average of 3.8%. Actual receipts and outlays are tracking above that. Federal debt held by the public sits at roughly 101% of GDP and is projected to reach 120% by 2036, surpassing the 1946 record of 106%. Gross federal debt runs to $63.7 trillion by 2036, according to the CBO's projection.

The primary deficit, which excludes interest, is projected to decline from 2.6% of GDP to 2.1%. In other words, the deterioration in the fiscal path from here is almost entirely an interest expense story. The government's operating gap is stabilizing. Its financing costs are not. And unlike discretionary spending, Congress can't change these expenses with a vote.

Interest expense is the compounding problem, and the CBO's projection may be optimistic
Net interest reached roughly $1.0 trillion, or 3.3% of GDP, in FY2026 — eclipsing the 1991 record. The CBO projects it will double to $2.1 trillion, or 4.6% of GDP, by 2036. Interest already consumes about 19% of federal revenue and is projected to consume 26% by 2036. It exceeds defense spending every year of the outlook and surpasses Medicare by FY2028.

The overly optimistic part? The CBO's interest projections embed an interest rate assumption that the curve is already trading above. The February baseline assumed the 10-year Treasury would average 4.1% in 2026 and drift to 4.4% by 2031, holding there through the projection period. The 10-year closed August at 4.75%.

And the math isn't helpful. With roughly $32 trillion of debt held by the public, a sustained 50 basis-point overshoot of the CBO's terminal assumption adds on the order of $160 billion per year to net interest once the stock fully turns over. Treasury's weighted average maturity is short enough that turnover happens faster than what's happened in the past. Since the U.S. doesn’t pay its bills off, but rather refinances them, that $160 billion does not go away. It becomes deficit, which becomes issuance, which pressures yields.

This is the loop that gives the bearish case its teeth: higher yields raise interest expense, which widens the deficit, which increases supply, which pressures yields. In economic textbooks this is called fiscal primacy, which is the condition where fiscal policy, not monetary policy, sets the marginal price of duration. It is not fiscal dominance, in which the central bank is compelled to monetize deficits and abandons its inflation objective. The distinction matters enormously. Fiscal primacy is uncomfortable and expensive. Fiscal dominance is a currency crisis. We are firmly in the first regime, and Chair Warsh's Jackson Hole remarks made it clear that he has no intention of entering the second.

Inflation has stopped cooperating

The July Personal Consumption Expenditures Index (PCE) rose 0.2% month over month against expectations of 0.1%, reversing June's decline. Headline PCE is 3.7% year over year, and core is 3.3%. Both are meaningfully above target. The Strait of Hormuz situation has kept an energy risk premium in the system all summer, and while crude has been more stable recently, the recurring headline cycle has not been resolved.

A gap of roughly 60 to 85 basis points between the federal funds target range and the two-year Treasury yield is the market telling you it expects the next move to be a hike, not a cut. Following Warsh's Jackson Hole speech, September hike odds moved to roughly 70%, up from 31% earlier in the week. We still think the bar for a hike is higher than a Fed on hold, but with probabilities hovering near 50%, the risk that the market will force Fed action is not off the table.

AI issuance is competing directly for the long-duration buyer

The five major hyperscalers issued roughly $28 billion to $35 billion of U.S. corporate bonds annually between 2020 and 2024. In 2025, that figure jumped to $108 billion. Through the first five months of 2026 alone, they issued $159 billion. S&P counts roughly $225 billion from hyperscalers and related issuers, including Nvidia, through July. Full year estimates for the broader AI complex range from $300 billion to $570 billion.

The critical detail is not the volume. It is the tenor. Data centers have multi-decade useful lives, and issuers have matched their liabilities accordingly, including a century bond and Amazon's roughly $54 billion multi-tranche deal in March. Estimates suggest that $300 billion of AI-related investment-grade supply delivers something closer to $360 billion in 10-year duration equivalents.

That duration must be absorbed by the same finite pool of buyers that absorbs Treasury duration: insurance, general accounts, pension plans running liability-driven mandates, and long-duration mutual funds. This is textbook crowding out, running in an unfamiliar direction. It is not the government crowding out private borrowers. It is private borrowers competing with the government for the marginal duration dollar.

The market structure is changing because of this as well. Technology now represents roughly 10% of the Bloomberg Corporate Bond Index and outweighs banks in several major investment grade benchmarks for the first time. Investors running passive core bond exposure have acquired unplanned hyperscaler concentration and unplanned long-dated tech duration. Hyperscaler spreads have already responded, with five-to-seven-year paper widening from roughly 50 to 60 basis points and 20-year-plus paper widening from 108.5 to 118 basis points. Of 91 hyperscaler bonds issued in 2026 with comparable pricing data, 78 were trading at higher yields in late July than at issue, with a median increase of about 22 basis points.

Why We Still Call This a Normalization

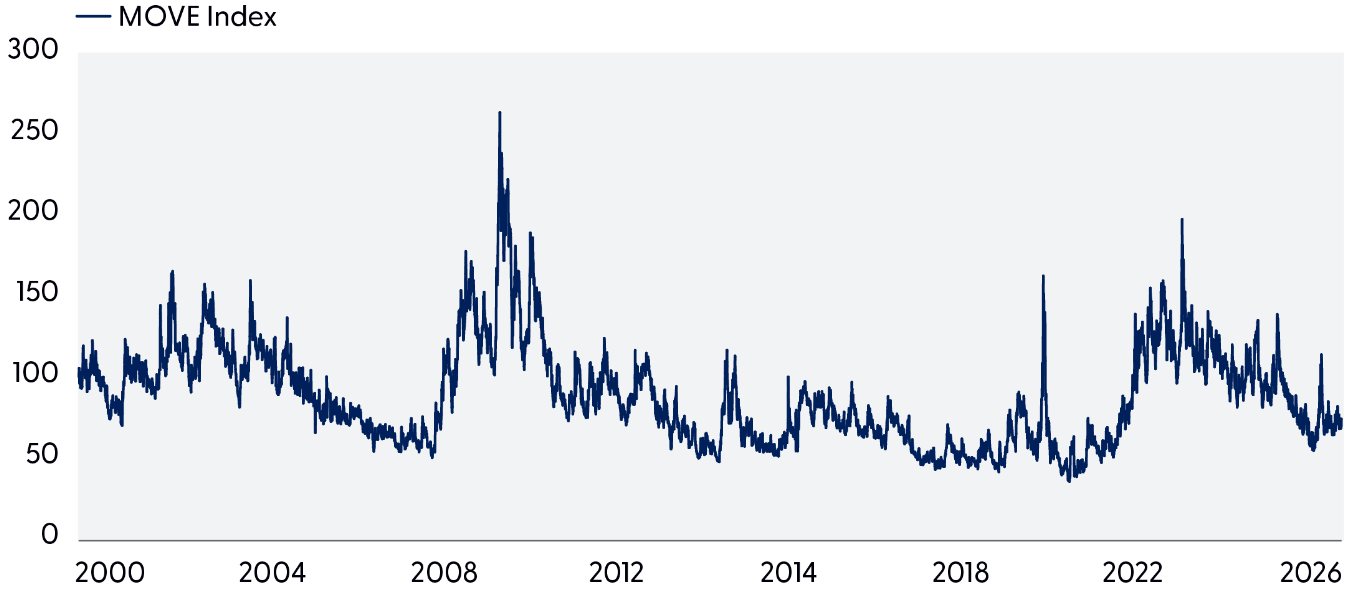
Four real concerns. Now the evidence that the market is absorbing them in an orderly fashion.

Implied rate volatility has refused to confirm the panic

The MOVE Index closed August in the high 60s to low 70s, having printed 69.58 on August 14, its lowest level of 2026. Its 52-week high is above 115. For reference, it approached 200 during the March 2023 regional banking episode.

Implied volatility is the purest available measure of whether sophisticated investors believe the distribution of outcomes has widened, and given all of the noise in August, it says they do not.

Implied Volatility Remains Subdued



Source: LPL Research, Bloomberg 09/03/26
Disclosures: Past performance is no guarantee of future results. All indexes are unmanaged and can't be invested directly.

The auctions did not merely clear, they cleared well

August's coupon calendar was the cleanest available test of the buyers' strike thesis, and it ran during peak hysteria over the last week of the month.

That is $183 billion of coupon supply absorbed across three sessions. The seven-year is the tenor that tails when demand is genuinely impaired, and it did not. Bid-to cover came in above average.

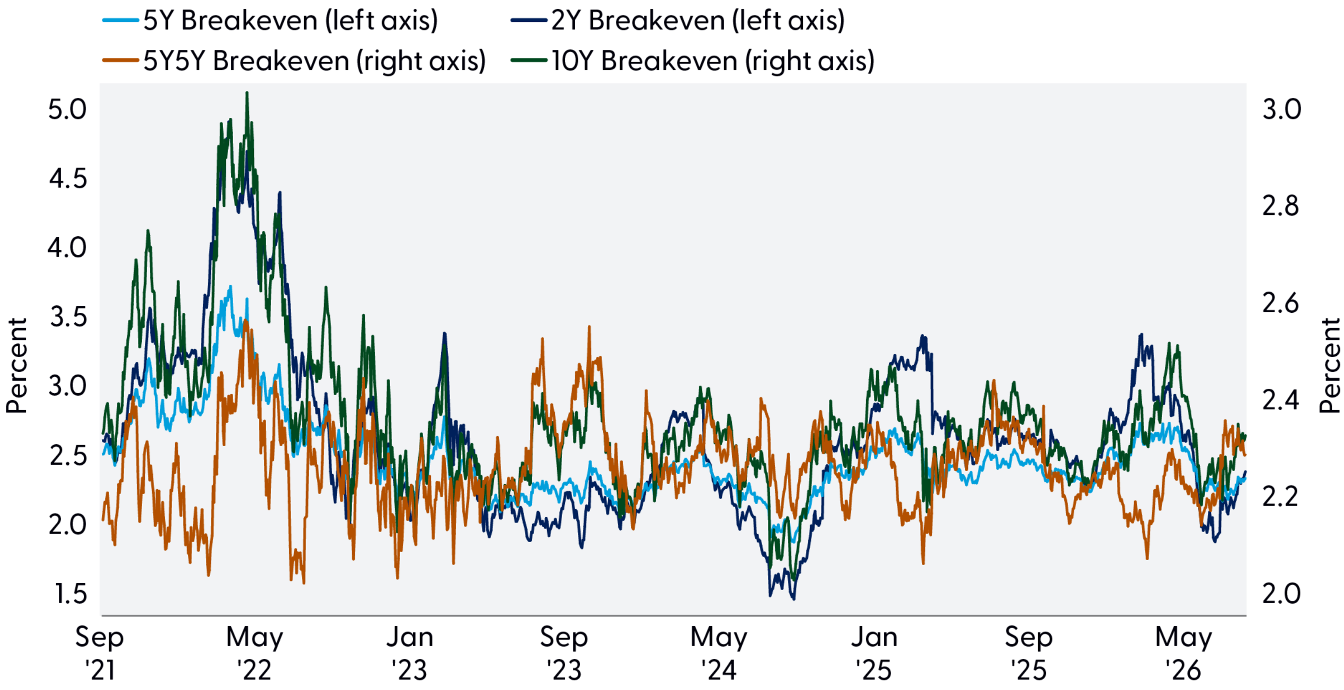
A buyers' strike has a recognizable signature: auctions that tail meaningfully through the when-issued level, primary dealer takedowns climbing above 25% as dealers absorb what nobody else wants, and indirect bidder participation falling sharply. We observed none of those. The market is not refusing to buy Treasuries. It is refusing to buy them at the old price, which is the entire function of a market. While we don't want to put too much emphasis on one week of auctions, that fact that it happened during a week when the noise was the loudest is a good passing test for the market.

Inflation compensation compressed while nominal yields rose
This is the single most important chart and one we've referenced all year.

The five-year breakeven traded at 2.53% to 2.56% as recently as March 2026, and closed August at around 2.32%. So, over a period in which the 10-year nominal yield rose toward 4.75% and the 30-year reached its highest level in 19 years, market-implied inflation expectations went down.

As such, almost the entire backup in long nominal yields is real yield. It is compensation for duration risk, supply, and uncertainty about the policy path. It is not the market pricing an inflationary debasement of the currency. A genuine fiscal crisis of the kind being described in the headlines would show up first and most violently in long dated breakevens and in the currency, but breakevens are anchored inside the Fed's target range. That is not what a debt spiral looks like.

Market-Implied Inflation Expectations Remain Relatively Anchored



Source: LPL Research, Bloomberg 09/03/26
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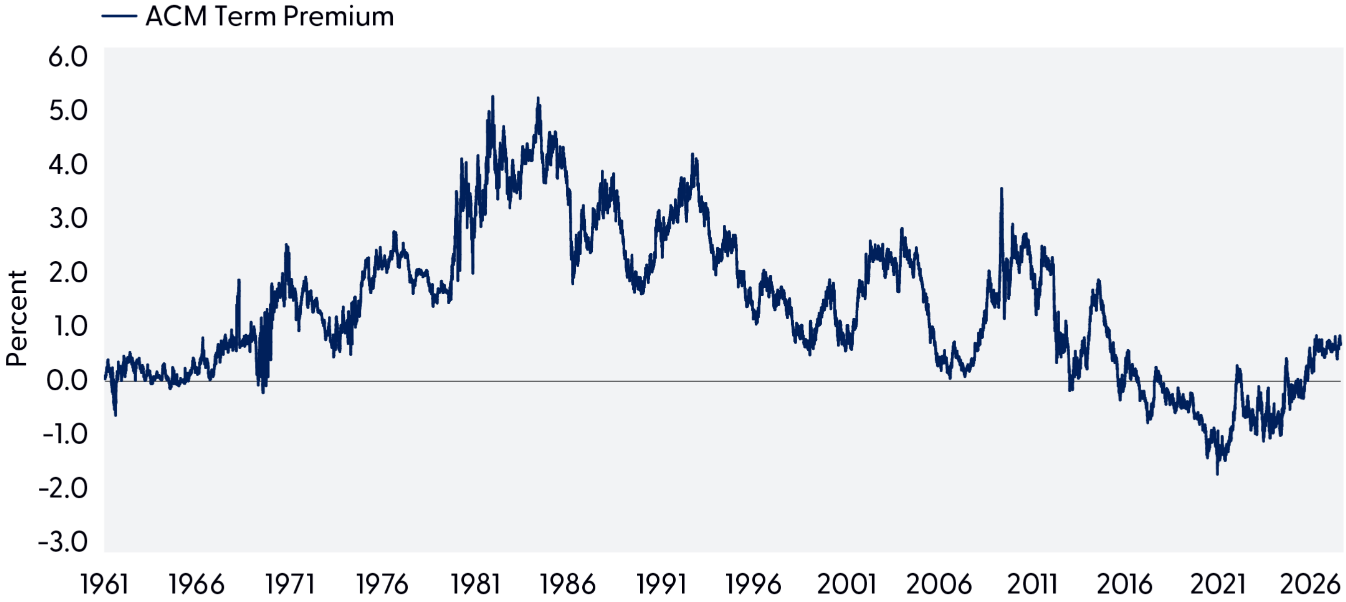
Term premium is rebuilding toward normal, not overshooting it
The New York Fed's Adrian, Crump, & Moench ACM model put the 10-year term premium at approximately 0.75% at August month end. The Fed's Kim-Wright model had it at 0.87% on August 21. The two models correlate at 0.86 over their overlapping history and currently agree closely, which is a useful robustness check given that term premium estimates are model residuals and different specifications can disagree by 50 to 100 basis points.

The ACM series has averaged roughly 1.45% since 1961.

After the largest long-end repricing in years, after $40 trillion in debt and a $2 trillion deficit, term premium sits at roughly half of its six-decade average. It was negative for much of the 2016–2022 period, an artifact of quantitative easing and safe-haven demand that we should never have treated as the baseline. What we are witnessing is the unwinding of an anomaly, not the creation of one.

Moreover, the Fed has withdrawn twice: once as a price-insensitive buyer through quantitative easing, and again as a forward guidance provider under a chair who genuinely prefers to communicate less. Term premium was suppressed by both. Both are gone. The repricing is a market taking this into account.

Treasury Term Premium is Almost Back to Normal



Source: LPL Research, Bloomberg 09/03/26
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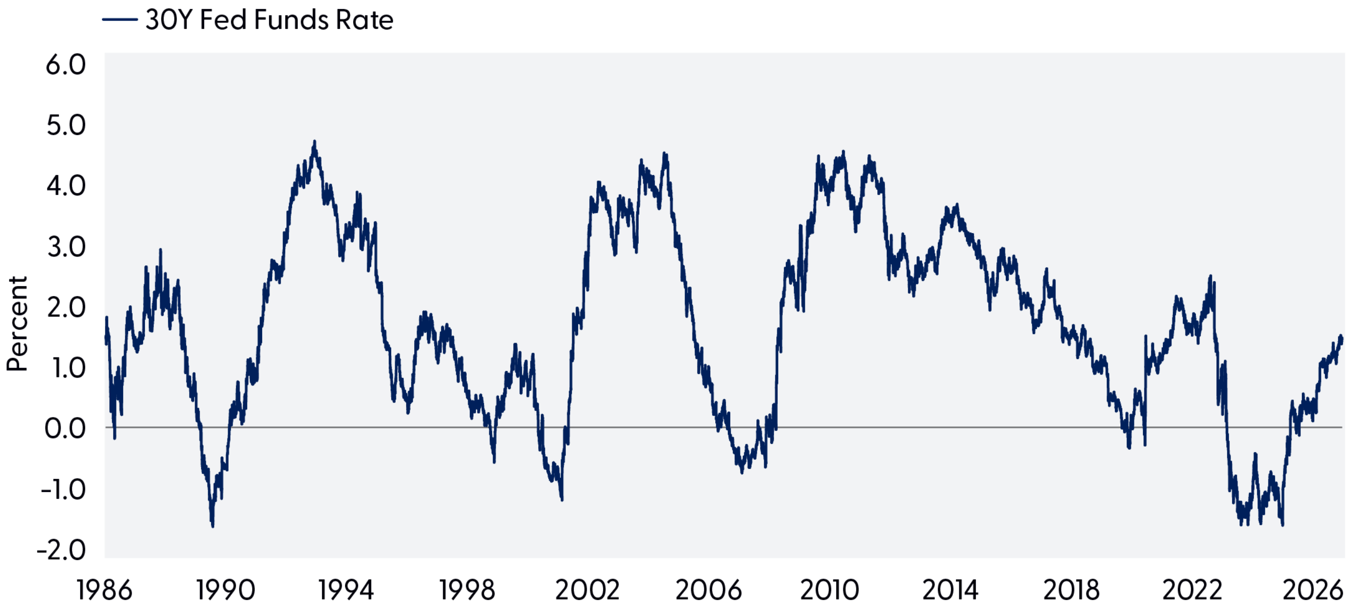
The curve is still not steep
Fed funds to the 30-year is roughly 150 basis points, which is unremarkable by historical standards. The 2s10s curve remains flat relative to a long-run average. We have exited the deep inversion of the past two years, but we have not arrived anywhere unusual.

Note also where the steepness actually lives. The belly is nearly flat, with essentially all the term structure's slope sitting beyond 10 years. That has direct portfolio consequences, which we will take up later.

Treasury Yield Curve is Still Relatively Flat



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What Would Change Our Mind

A normalization view must be willing to say when the facts have stopped supporting it. The market would look more like a crisis, and less like a reset, if several things arrived together.

- Coupon auctions that tail in size, with dealer awards above 25% and a clear drop in indirect participation, especially in the seven-year and the 30-year.
- A sustained break higher in the MOVE Index into the triple digits, accompanied by a widening in Treasury swap spreads that signals dealer balance sheet stress rather than a level adjustment.
- Breakevens or 5y5y forwards that leave the 2.3% neighborhood and start to reprice a permanently higher inflation regime, which would tell us expectations are no longer anchored.
- Failed or withdrawn official support that reveals the buyback bid as the only thing that had been containing the long end.
- A fiscal event that is larger than the current baseline: a debt-ceiling breach, a sudden jump in issuance needs, or a political choice that markets read as the end of even modest restraint.

The more constructive case on extending duration has its own checklist, and it is equally specific: a downside fiscal surprise that cuts coupon supply, a slowing in AI-related issuance that returns long-duration buyers to Treasuries, a lasting shift in Treasury's issuance mix toward bills, and a run of activity data soft enough to pull the funds rate path lower without unanchoring inflation. Until one of those two lists starts to fill in, we think we're in this higher for-longer rate environment that we've talked about for a while now.

The concerns are real. They will keep the long end elevated. They will keep the term premium from collapsing back to the post-quantitative easing (QE) residual. They are not, on the evidence of volatility, auctions, and inflation expectations, a crisis. Yet. A 4–5% Treasury market that clears $183 billion in a week and prices one-month volatility below its own average is doing the job a government bond market is supposed to do. It is discovering a price. Income investors should consider that price. Duration speculators may want to wait for a better one.

Conclusion

If this is the new regime, and we think it is, income investors are the winners. Starting yield explains the overwhelming majority of forward returns in fixed income. Starting yields across the Treasury and high-grade corporate credit complex are the best they have been in 20 years.

Reinvestment risk stops being the threat it was in 2020 and 2021 and becomes the point of the portfolio. A ladder that used to feel like a consolation prize in a zero-rate world is again the correct default architecture for an income investor. Maturities roll off into a 4–5% market rather than into a 1% market. The investor is paid to stay patient. The investor is paid to let the calendar work. Credit at these all-in yields does not need spread tightening to deliver an acceptable total return. Carry and roll are doing the work that price appreciation was asked to do when yields were 150 basis points lower. Higher-for-longer is not the risk case for an income portfolio. It is the bull case.

The concerns are real. Debt at $40 trillion, deficits above $2 trillion, interest expense compounding against a rate assumption the market has already broken, inflation running near 3.7%, and an unprecedented wave of AI-related duration competing for the same finite pool of long-end buyers. None of that is going away, and we expect yields to grind modestly higher with the steepening concentrated beyond 10 years.

But subdued implied volatility, clean auction mechanics, compressing breakevens, a term premium at half of its long-run average, and a curve that is ordinary by historical standards all describe a market that is repricing risk rather than losing faith. Higher yields are recruiting buyers, which is the definitional test of a functioning market.

Asset Allocation Insights

For managed portfolios, we remain neutral relative to benchmark duration. In credit, we prefer to stay up-in-quality and resist the temptation to reach for spreads in a market where AI-related issuance is already filling the index with long, tight, single-name concentration. Agency mortgage-backed securities (MBS) are the relative value beneficiary if buybacks and a contained 30-year keep rate volatility from breaking out. Securitized sectors (ABS and select CMBS) benefit as well. And for diversification purposes, non-U.S. developed and emerging market debt increases income opportunities.

Treasury Inflation-Protected Securities (TIPS) belong in the portfolio in case markets are wrong about inflation staying anchored. And while market-implied inflation is anchored, realized inflation is not. Headline PCE at 3.7% and core PCE at 3.3% mean the investor who is long only nominal duration is underwriting a disinflation path the data have not yet delivered. Breakevens near 2.3% are cheap insurance against an inflation surprise. A TIPS allocation does not require a call that inflation is about to re-accelerate. It requires only the admission that the error term around a 2.3% breakeven is not symmetric after five years of above-target prints, a fiscal stance that is not tightening, and an energy complex that has already shown it can put a floor under headlines.

The real yield on long TIPS is itself part of the income argument. Investors can now lock in a clearly positive real coupon and retain the option that CPI runs hotter than the breakeven. That combination did not exist in usable size for most of the 2010s. It exists now.

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The PE ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

All index data from FactSet or Bloomberg.

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