LPL Financial

Rate and Credit View

Giving Thanks for Bonds: Where Credit Is Due

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Executive Summary

- **Bonds built the modern world.** From canals and railroads to schools, hospitals, airports, and businesses, bond financing has long turned capital into essential infrastructure and economic growth.
- **Higher yields are ultimately good news**. Rising rates hurt prices initially, but higher income and reinvestment yields can improve longer-term return potential. For patient investors, time helps the bond math work.
- **Structure matters.** Maturity dates pull prices toward par, coupons provide dependable income, and seniority gives bondholders priority over shareholders when conditions deteriorate.
- **Diversification is still alive.** High-quality bonds can provide ballast during equity volatility, while ladders create predictable liquidity and regular opportunities to reinvest at prevailing yields.
- **Investment implications:** Stay the course. Today's higher starting yields strengthen the forward return outlook, in our view. Keep high-quality core bonds central, use them for diversification and rebalancing, and consider ladders and municipals where appropriate.

Please Pass the Credit

This week, millions of Americans will drive interstate highways, fly through airports, and gather in homes to give thanks. Few will stop to think about how any of it was paid for. A remarkable share of it was financed with bonds.

Bonds rarely get thanked. Stocks get the headlines in good years, while bonds do their work quietly: paying income on schedule, cushioning portfolios when markets wobble, and returning principal when they said they would. This Thanksgiving, we want to give bonds their due. We start with what they have built, address this year's returns head on, and then thank five features that make bonds work, retiring some common misconceptions along the way.

The Asset That Built the Modern World

As Financial Times journalist Robin Wigglesworth chronicles in his fantastic new book, *A Fabulous Debt: The Epic Story of How Bonds Built the Modern World*, bonds have quietly financed some of humanity's greatest achievements for centuries. The simple bargain at their heart, capital today in exchange for income and the return of principal tomorrow, has financed much of the world we live in.

In 1648, a Dutch water authority (Hoogheemraadschap Lekdijk Bovendams) issued bonds to help protect its dike system, and remarkably, one of those bonds still pays interest today. In 1817, New York State turned to bonds to build the Erie Canal, which opened the Midwest to trade and helped make New York the nation's commercial capital. Through the 1800s, bonds financed much of the railroad network that tied the country together.

The story continues in every town in America. Municipal bonds have paid for the schools our children attend, the hospitals that care for our families, the water systems, bridges, and airports we rely on every day. State and local governments finance the large majority of the nation's infrastructure, and they do it primarily through the bond market. Corporate bonds have funded factories, power plants, and communications networks. Mortgage bonds helped turn homeownership into a reality for tens of millions of families.

That same bargain sits inside every bond in a portfolio today. Bond investors are lending to the next generation of roads, schools, and businesses, and getting paid to do it (especially after the recent rise in interest rates). But like the canals and railroads they once financed, bonds are long-term projects. They are best judged over years, not months, and that is worth remembering in a year like this one.

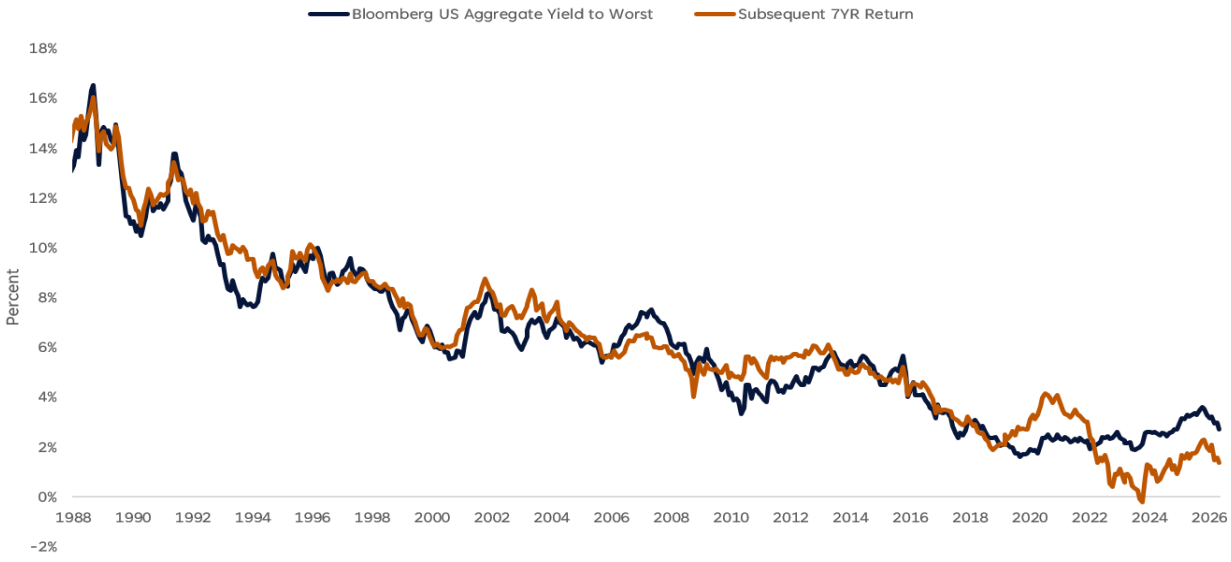
A Word About This Year

This year has put that patience to the test. The Bloomberg U.S. Aggregate Bond Index is down roughly 0.50% year to date through 11/20, as Treasury yields moved sharply higher. For investors who think of bonds as the steady part of the portfolio, a negative statement can be unsettling, especially with 2022 still looming large over past client discussions. It is also normal, and it is not the end of the story.

An existing bond pays a fixed coupon. When yields on new bonds rise, older bonds become less attractive, so their prices adjust down. With a duration of roughly 6 years, the Aggregate Index loses about 6% in price for every 1 percentage point rise in yields. When yields climb quickly, that price effect arrives all at once, while the offsetting benefit arrives slowly.

That benefit is higher income. Every coupon received and every bond that matures gets reinvested at the new, higher yields. Consider a portfolio yielding 4.5% with a 6-year duration that sees yields jump 1 percentage point. It takes a price hit of about 6%, but it now earns roughly an extra point of income every year. After about six years, roughly its duration, it has caught up with a portfolio that never saw rates rise, and from there it pulls ahead. That is why we judge bonds over a 5 to 7 year horizon, not a calendar year.

Future Returns are Highly Correlated to Starting Yields



Starting yield on the Bloomberg U.S. Aggregate against the subsequent annualized seven-year total return
Source: LPL Research, Bloomberg 11/20/26
Disclosure: Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

Counting Our Blessings. One Bond at a Time

With the hard part of the year addressed, we can turn to the more enjoyable task of counting our blessings. Bonds may not get much attention when markets are calm, but they can play several important roles in a portfolio. When issuers remain financially sound and meet their obligations, bonds can provide income, return principal at maturity, and help diversify equity risk. Of course, those outcomes are not guaranteed. If an issuer defaults, investors may miss interest payments or lose some or all of their principal. That is one reason we believe credit quality and diversification matter when building a bond portfolio.

With that important caveat in mind, below are five features of bonds we're especially thankful for this year and every year. Each comes with a common misconception that can cause investors to overlook some of the benefits bonds may provide and that we are happy to leave behind with the leftovers. Taken together, they are a reminder that the less exciting part of a portfolio deserves a little appreciation too.

1. Thank You, Maturity Date
Myth: "Once a bond loses value, that money is gone."

No other major asset offers features like this one. A stock has no end date and no obligation to return what you paid. A bond tells you on day one exactly when your principal comes back.

That feature changes how investors should think about price declines. As long as the issuer keeps paying, a bond's price is pulled steadily back toward 100 as maturity approaches, because that is what the investor will receive. For a bond that ultimately pays back at par, the price decline is temporary for an investor able to hold to maturity. It is a paper loss with a known recovery date, and the investor collects the coupon throughout.

Buying below par can also work to an investor's advantage. As a high-quality bond gets closer to maturity, its price generally moves toward par, while the investor continues collecting coupons. That means the discount paid upfront can ultimately add to the bond's return.

2. Thank You, Coupon
Myth: "Premium bonds are a bad deal."

A bond's coupon provides a steady source of income regardless of what is happening in the stock market. Over time, that income has historically accounted for a significant share of bond returns.

That is also why investors shouldn't automatically shy away from bonds trading above par. A bond priced at 105 may look expensive because investors ultimately receive 100 at maturity, but the higher price reflects a higher coupon. For example, a five-year bond with a 5% coupon priced near 105 will pay more income than a comparable 4% bond priced near 100. Once you account for that additional income, their yields to maturity may be very similar.

Premium bonds also return more cash sooner through higher coupons, which can reduce their sensitivity to changing rates. For municipal investors, deeply discounted bonds can actually create more complications because of the de minimis tax rule. The bottom line is that price alone doesn't tell you whether a bond is attractive. Yield and total return matter more.

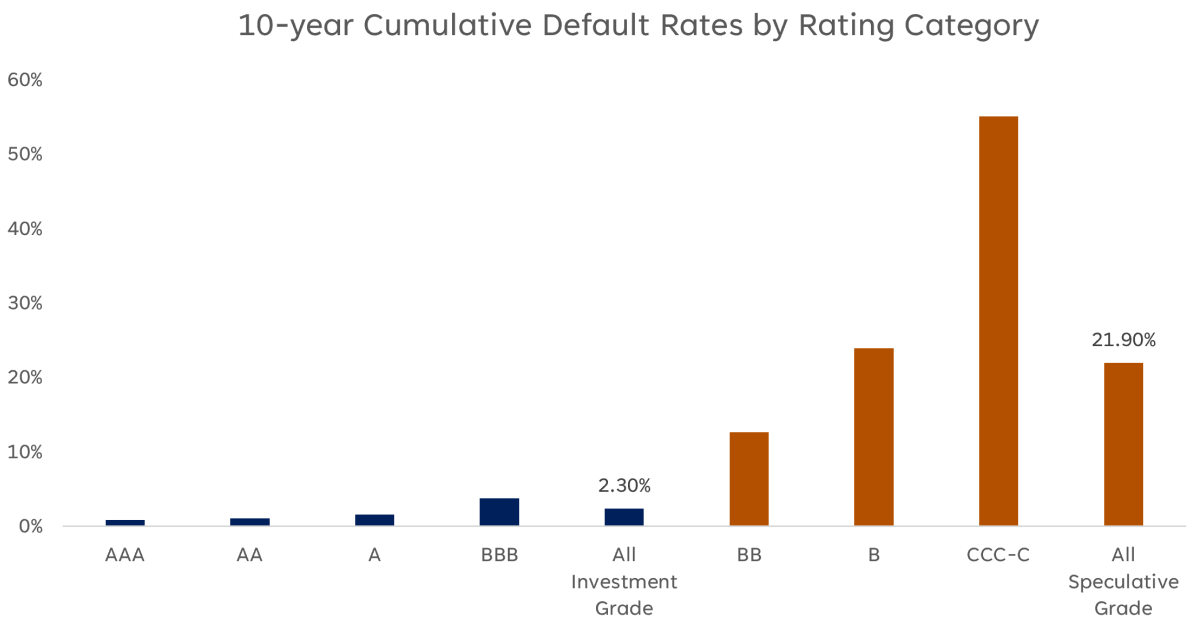
3. Thank You, Seniority
Myth: "A corporate bond is as risky as the company's stock."

A company's stock and bonds represent very different claims on the same business. Shareholders participate in the upside, but bondholders have a more senior claim on the company's cash flows and assets. Interest payments come before dividends and share buybacks, giving bond investors an additional layer of cushion when conditions deteriorate.

Investment grade companies have historically had very low default rates, and even when defaults occur, senior bondholders generally recover more than shareholders.

It also explains why a company's stock can fall sharply on disappointing earnings or a weaker outlook while its bonds move relatively little. If the news doesn't materially change the company's ability to service its debt, bondholders may have much less reason to react.

Default Risk Rises Sharply Below Investment Grade



Source: LPL Research, S&P Global Ratings 11/20/26 (historical averages through 2025)
Disclosure: Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future results.

4. Thank You, Diversification
Myth: "2022 proved bonds don't diversify anymore."

High-quality bonds have historically provided diversification when equity markets come under pressure. That relationship broke down in 2022, when inflation pushed both stock and bond prices lower, leading some investors to question whether bonds still belonged in a diversified portfolio. The past week was a good reminder that they do. As the S&P 500 fell nearly 9%, Treasury yields declined and high-quality bonds gained.

The important point is that stock-bond correlations depend on what is driving markets. Growth concerns, recession risk, and periods of risk aversion have generally been favorable for high-quality bonds. Inflation shocks can be different because they can pressure stocks and bonds at the same time. That was especially true in 2022. During many other major equity selloffs, including 2001–2002, 2008, late 2018, and early 2020, high-quality bonds produced positive returns.

Today's higher starting yields should also help. More coupon income gives bonds a larger cushion against modest increases in rates, while still leaving room for price appreciation if yields fall. Diversification doesn't require bonds to rally every time stocks fall. It requires them to behave differently when investors need them to, and high-quality bonds can still play that role.

5. Thank You, the Bond Ladder
Myth: "Bonds lock up your money."

Some investors avoid individual bonds because they worry about tying up their money for years. A bond ladder can help address that concern by spreading maturities across different dates.

For example, a 1–5 year ladder might hold bonds maturing every year. As each bond matures, principal comes back in cash, while coupons provide income along the way. That creates a regular source of liquidity without requiring investors to sell bonds in the secondary market.

Ladders can also be matched to future spending needs, and maturing principal can be reinvested at prevailing yields. For investors who value predictable cash flow, the ladder provides a simple way to balance income, liquidity, and reinvestment opportunities.

Investment Implications

For investors weighing what to do after a ho-hum kind of year for bond returns, our message is simple: stay the course and let the bond math work over time. Here is how we would put that into practice.

- **Judge bonds over the right horizon.** A negative calendar year says little about what a high-quality bond portfolio may deliver over the next five to seven years. Higher starting yields have historically been one of the best guides to future returns, and today's yields put investors in a stronger position than they have been in for much of the past two decades. Past performance does not guarantee future results.
- **Keep high-quality core bonds at the center.** Treasuries, agency mortgage-backed securities, and investment grade corporates are what provide ballast when equity markets turn volatile, as the past week reminded us. We would not give up that feature in favor of lower-quality bonds simply to reach for yield.
- **Use bonds as a rebalancing tool**. When stocks sell off and high-quality bonds hold up, the bond allocation becomes a source of funds to rebalance into equities at better prices. That is diversification doing exactly what it is meant to do.
- **Put the structure of bonds to work.** Laddered portfolios of individual bonds give investors predictable cash flow, known maturity dates, and the ability to reinvest maturing principal at prevailing yields. They also let investors hold to maturity rather than sell into short-term weakness.
- **Look at yield, not price.** Premium bonds deserve a place in the opportunity set. For investors in higher tax brackets, municipal bonds remain an efficient way to earn tax-exempt income.

Bonds have spent centuries financing the world around us. For patient investors, they remain one of the most dependable ways to build and protect wealth.

Giving Bonds Their Due

From canals and railroads to schools and hospitals, bonds have financed the modern world, and they continue to do their job in portfolios today: paying income on schedule, returning principal on a known date, standing ahead of shareholders, and steadying portfolios when markets turn rough. Even in a year like this one, the math is working in bond investors' favor, as higher yields set the stage for better returns ahead.

The misconceptions above share a common thread. Each judges bonds by the standards of stocks. Judged by what they are built to do, bonds have plenty to be thankful for. For advisors, the holidays are a natural time for these conversations, as clients review year-end statements and field opinions over dinner.

From all of us on the fixed income team, thank you for reading, and Happy Thanksgiving. And for readers who want the full story, we recommend Robin Wigglesworth's *A Fabulous Debt: The Epic Story of How Bonds Built the Modern World*, a timely addition to any holiday reading list.

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Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise, and bonds are subject to availability and change in price.

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The Bloomberg U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.

The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Bloomberg U.S. Treasury Index measures US dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury.

The FTSE 3 Month U.S. T-Bill Index Series is intended to track the daily performance of 3-month U.S. Treasury bills.

All index data from FactSet.

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