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When the Bond Market Speaks

In 1993, Bill Clinton's political strategist James Carville watched bond investors push back against Washington's spending plans. His takeaway became one of Wall Street's favorite lines: "I want to come back as the bond market. You can intimidate everybody."

The bond market is flexing that muscle again. On October 1, the yield on the 10-year Treasury bond touched 5.34%, its highest level since 2002. It started the year at 4.16%. The 30-year Treasury reached 5.68% the same day, and the average 30-year mortgage climbed to 7.28%, the highest since November 2023.

Headlines like these can be unsettling, especially when they involve the part of a portfolio most people think of as the "safe" part. This quarter we want to explain what is pushing rates higher, why we believe it is less alarming than it sounds, and why the U.S. economy underneath it all looks strong.

Why Interest Rates Are Up

Think of interest as the price of money. If you want to borrow for a house or a car, a bank will lend it to you, and interest is what you pay for it. When that price is low, people tend to borrow more. Low mortgage rates, for example, can nudge a family toward a bigger house. Companies borrow too, and some of the largest companies in the world are borrowing at a historic pace. Wall Street estimates that the biggest technology companies, including Alphabet, Amazon, Meta and Microsoft, will spend \$800 to \$900 billion this year on data centers and other AI infrastructure, and more than \$1 trillion in 2027.

To help pay for it, the biggest spenders issued about \$220 billion in bonds through August. In August alone, U.S. companies with strong credit ratings sold a record \$145.2 billion of bonds, the third monthly record in a row.

Guess who else needs to borrow? The U.S. government, the country's largest borrower by far. The national debt passed \$40 trillion this August, and interest on that debt now costs more than \$1 trillion a year.

When the government and the biggest companies in America are all borrowing at once, they compete for investors' dollars. Borrowers win that competition by offering a higher interest rate. Higher rates are a cost for borrowers, but they are a benefit for anyone buying bonds today.



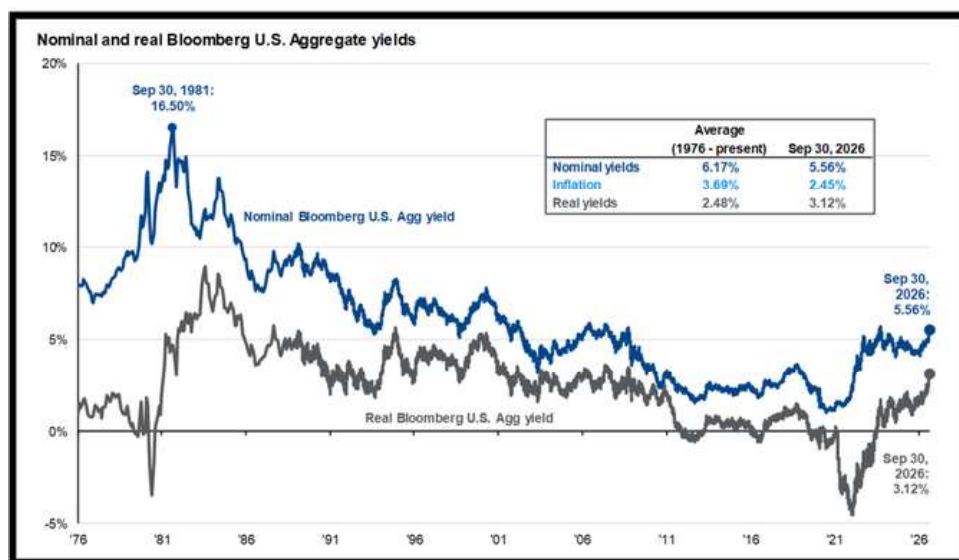
There is also a newer, less obvious reason. For most of the past two decades, under Ben Bernanke, Janet Yellen and Jerome Powell, the Fed made a habit of signaling where it expected rates to go, a practice known as “forward guidance.” Kevin Warsh, who took over as Fed chair this year, has largely stopped doing that. He believes markets came to lean too heavily on the Fed’s hints, and that “financial market prices are probably the most important source of information to guide central bankers.” In other words, he wants markets, not the Fed, to do more of the work of figuring out where rates should go.

That may be a sound idea, but it adds a new layer of uncertainty. Think of a contractor quoting a fixed price on a job with a lot of unknowns: the less certain the job, the bigger the cushion built into the price. Investors lending money for 10 or 30 years do the same thing. When they are less sure where the Fed is headed, they ask for a higher interest rate to make up for it. One estimate from Bespoke Investment Group suggests that losing the Fed’s guidance alone could add about a quarter of a percentage point to mortgage rates.

Some worry this could become a “debt spiral.” Analysts at TD Securities point out that the average rate the government pays on its debt is about 3.4%, still below the economy’s growth rate, and that higher rates feed through gradually as older bonds mature. The debt matters, but this is not an imminent crisis.

What Is Normal?

Yes, rates are at 20-year highs. But they are not high by historical standards. The yield on the broad U.S. bond market (the Bloomberg U.S. Aggregate Index) ended September at 5.56%, still below its 6.17% average since 1976 (see chart).



Source: J.P. Morgan Asset Management, *Guide to the Markets*. Data as of September 30, 2026.



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The Price of Money

Q3 2026 Client Newsletter

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The real anomaly was the period that came before. To pull the economy out of the 2008 financial crisis, the Federal Reserve cut short-term rates to near zero and kept them there for most of the next decade. Just as rates were getting back to normal, COVID hit and they went back to zero. In August 2020 the 10-year Treasury yielded just 0.55%. Think about that: lend the U.S. government your money for ten years, and it would pay you about half of one percent a year.

Money was practically free, and borrowers locked it in for decades. In June 2020, Amazon borrowed for three years at 0.40% and for 40 years at 2.70%. Two months later, Alphabet borrowed for ten years at 1.1%. Overseas, Austria sold a 100-year bond yielding just 0.88%. In January 2021 the average 30-year mortgage hit a record low of 2.65%.

Back then the Fed's worry was inflation that was too low. In August 2020, Fed Chair Jerome Powell called the long stretch of inflation below the Fed's 2% goal "a cause for concern," and the Fed said it would aim for inflation moderately above 2% for some time.

It doesn't take a Nobel Prize to see that money shouldn't be free. When borrowing costs next to nothing, people and businesses borrow and spend, and that can lead to inflation. That is what happened. Inflation peaked at 9.1% in June 2022, the highest since 1981. The Fed raised rates seven times that year, and the broad bond market lost 13%. By many accounts it was the worst year for U.S. bonds in more than two centuries. Bank of America found the 10-year Treasury lost 17%, its worst year since 1788, and Deutsche Bank estimated Treasuries had their worst first half since 1788.

Inflation has come down a long way since, though it remains above the Fed's 2% goal. Consumer prices rose 3.4% over the past year, while "core" inflation, which leaves out volatile food and energy, was 2.4%, its lowest since March 2021. Much of today's inflation comes from oil. The war with Iran pushed oil above \$100 a barrel in March for the first time since 2022, and it climbed back above \$100 in September. In theory, an oil shock is temporary and shouldn't drive long-term inflation. In the short term, it clearly has. Other forces are adding pressure as well, including tariffs, which raise the cost of imported goods, and tighter immigration, which has reduced the supply of workers, especially in blue-collar jobs.



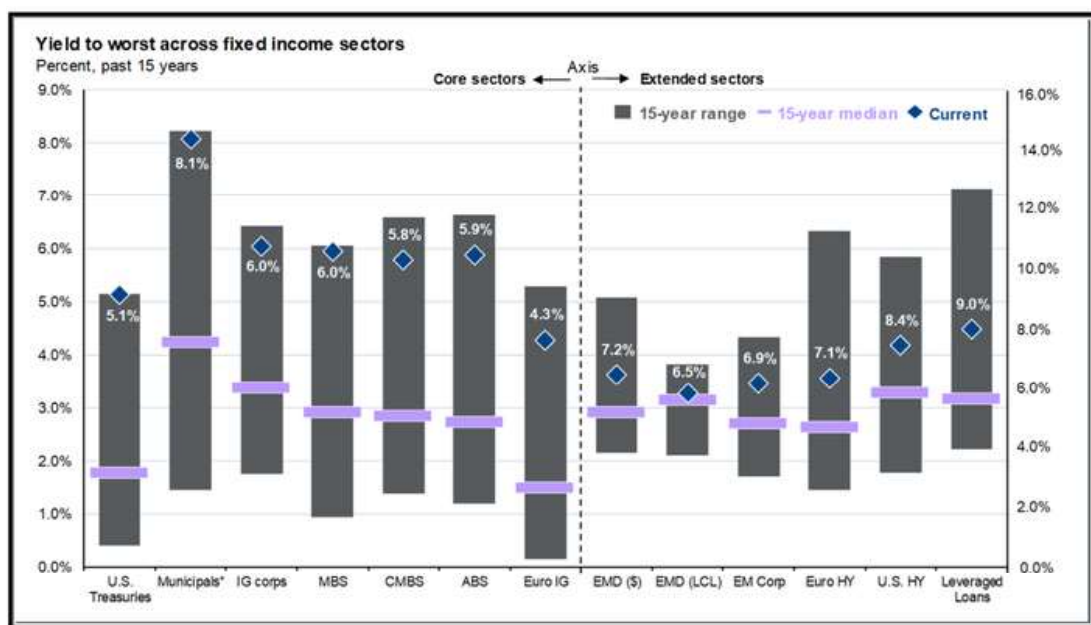
Why Bond Investors Shouldn't Panic

When interest rates rise, the price of existing bonds fall. That's simple math: a new bond paying 5% makes an older bond paying 3% less attractive. But price is only part of the story.

A bond pays you back. As long as the issuer doesn't default, a bond returns its full face value at maturity, no matter what its price did along the way. Bond mutual funds and ETFs hold hundreds or thousands of bonds that are constantly maturing. That money is reinvested in new bonds at today's higher rates, which gradually lifts the income the fund earns.

Income is a cushion. When bonds pay more, that income offsets more of any price decline. As of mid-September, the 10-year Treasury yield had climbed from about 4.2% to 5%+ this year, yet a 10-year Treasury bond was down only about 3%, because its income softened the blow. In 2022, by contrast, bonds started the year paying very little and had almost no cushion.

Starting yield has been a strong guide to future returns. From January 1976 through September 2026, the correlation between the broad bond market's starting yield and its return over the following five years was 0.89, where 1.0 would be a perfect match. Today, nearly every type of bond yields more than its median of the past 15 years (see chart). By many measures, bonds offer a better balance of risk and return than at any point in that span.



Source: J.P. Morgan Asset Management, *Guide to the Markets*.

Bonds are steadier than stocks. Stocks and bonds both dip at some point almost every year. Since 1980, the S&P 500's average drop within a calendar year has been 14.2%, yet it still finished the year positive 76% of the time. Bonds' average drop within a year has been only about 3.5%, and over the past 50 years they finished positive about 90% of the time.

Bonds are still a great diversifier. Over the last century, stocks finished the year with a loss 25 times. Bonds were positive in 21 of those years, or 84% of the time.

The Economy Is Strong

Here is the part of the story that often gets lost: rates are rising in large part because the economy is doing well. When the Fed raised rates in September, its first increase since 2023, Chair Kevin Warsh pointed to a strong economy and job market.

Growth. The Atlanta Fed's GDPNow model estimates the economy grew at a 3.7% annual pace in the third quarter, well above the 1.5% pace of the second quarter.

Jobs. Unemployment was 4.2% in September, still low by historical standards. The September report did show some softening, with just 29,000 jobs added, though much of the rise in unemployment came from more people entering the workforce. Markets took the softer report as a sign the Fed may hold off on another increase at its October meeting. A healthy job market matters because consumer spending drives roughly two-thirds of the economy.

Earnings. Corporate profits are surging. S&P 500 earnings grew about 50% from a year earlier in the second quarter, or about 32% excluding one-time gains at Alphabet and Amazon. Analysts expect about 29.5% growth in the third quarter, which would be the eighth straight quarter of double-digit growth, with all eleven sectors expected to grow.

Valuations. Because earnings have grown faster than prices, stocks are actually cheaper relative to expected earnings than they were at the start of the year. The S&P 500's forward price-to-earnings ratio has fallen from 22.0 at the end of 2025 to 19.0, slightly below its 10-year average.

Productivity. Some respected bond investors believe AI can help bring inflation down over time. Rick Rieder, BlackRock's chief investment officer of global fixed income, recently said "We're going through a productivity revolution" and expects inflation to ease in the coming months. Not everyone agrees on how quickly those gains will show up as lower prices, but the direction is encouraging.

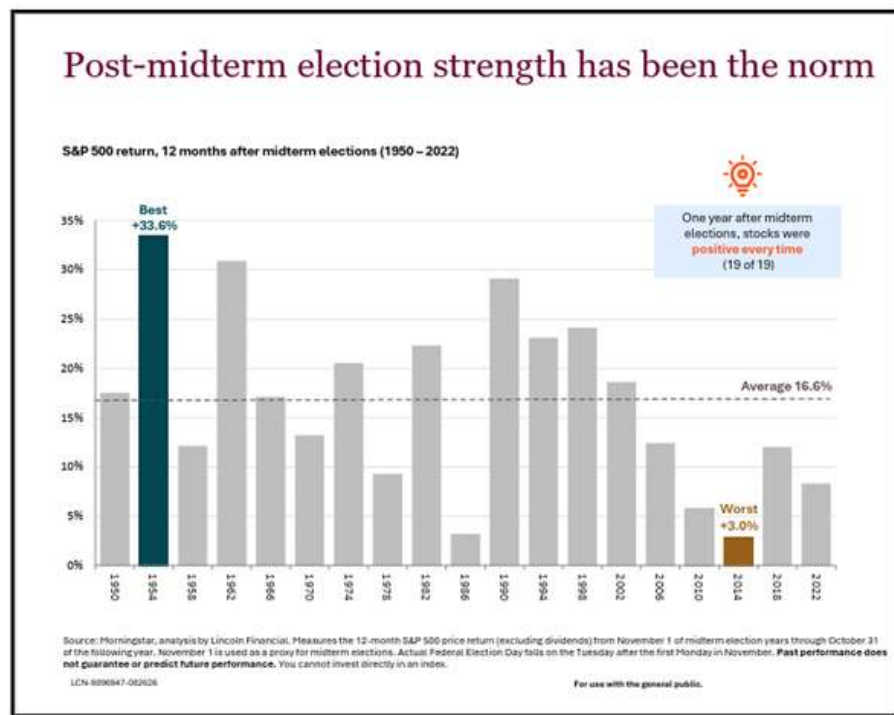


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The forces behind higher rates are largely healthy ones: stronger growth, heavy investment, and a Fed determined to finish the job on inflation. This is also a global move. The European Central Bank and the Bank of Japan raised rates last quarter too, and bond yields across Europe reached multiyear highs. Energy prices remain a wildcard in either direction.

Looking Ahead

Midterm elections are November 3. Markets are often choppy in the months before a midterm, but history has been kind afterward. In all 19 midterm years since 1950, the S&P 500 was higher 12 months after the election, with an average gain of 16.6%. Past performance doesn't guarantee future results, and we would never build a plan around one pattern.



Source: Morningstar, analysis by Lincoln Financial. Past performance does not guarantee future results.

As we said last quarter, nobody knows what markets will do next. The Fed may raise rates again or hold. Oil may spike or fall. What we do know is that bond investors are being paid more than they have been in nearly two decades, the economy is growing, and companies are earning more. That is a far better starting point than the headlines suggest.

Our job isn't to predict the next move in rates. It's to make sure your plan can handle a range of outcomes, with the right mix of stocks and bonds for your goals and timeline. If you have questions about how higher rates affect your portfolio, please reach out. We're always happy to talk.

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