Parametric

Corporate Bond Market Insight | September 2026

Treasury Tensions Test Corporate Bond Ladders

Key takeaways

» August was calmer overall, with modestly higher rates and equities, credit spreads trading in a narrow range and positive investment-grade returns despite rising Treasury yields.

» The Treasury Department intervened at the long end of the Treasury market, signaling concern that higher yields could become an economic headwind and increase future interest expense.

» Chair Kevin Warsh's Jackson Hole address reinforced the Fed's focus on returning inflation to target, raising market expectations for a rate hike.

» Solid earnings, healthy balance sheets and more upgrades than downgrades supported investment-grade corporate fundamentals remaining strong.

Recap

August was less volatile, with rates rising modestly, equities moving somewhat higher and credit spreads trading in a narrow range. The Treasury Department intervened, reducing rates at the long end of the Treasury market. In a hawkish address at Jackson Hole, Federal Reserve (Fed) Chair Kevin Warsh reiterated the Fed's commitment to bringing inflation back to the 2% target. The economy and inflation both slowed somewhat; however, corporate earnings remained extremely strong. Debt and deficits became a focus as the national debt exceeded $40 trillion. Despite rising Treasury yields investment-grade (IG) returns were positive.

The Treasury Department bought and retired off-the-run, long-term Treasuries in mid-August, intervening at the long end of the Treasury market. The Treasury characterized it as a liquidity operation, but the market viewed the intervention as an attempt to arrest the increases in intermediate and long-term yields. The Treasury is likely worried that higher yields are becoming an economic headwind and, given the ever-growing issuance needs, will increase future interest expense.

The first intervention was small. It occurred when the 30-year Treasury rose to 5.34%, the highest yield since 2007. The Treasury found the rise in yields troubling since it happened despite slower economic growth and softness in the monthly inflation data. Senior officials later suggested that the Treasury might draw on the Treasury General Account (TGA) to fund expanded future buybacks. That fund serves as the Treasury Department's cash management account. It funds the government's daily liquidity needs. The fund balance has grown from roughly $600 billion in the Biden administration to nearly $1 trillion under the Trump administration. It would offer significant buyback power.

This was the Treasury's second recent intervention to support rates. On July 31, it moved to support the Japanese yen as the currency fell to a 40-year low against the U.S. dollar. Japan is the largest foreign holder of U.S. Treasurys, and the fear is that Japan would need to liquidate a portion of those holdings to provide currency support. Whether these actions are isolated or part of a larger strategy to cap long-term rates remains to be seen.

We believe the increase in intermediate- and long-term yields has three primary causes. First, the rapidly growing deficit may result in greater Treasury issuance at the long end of the curve. Second, the hyperscalers' flood of issuance is adding significant supply in intermediate- and long-dated bonds. Finally, sovereign yields across the G-7 nations are rising, and U.S. yields need to increase to remain competitive.

The good news is that higher real rates largely drove the yield increase, while inflation expectations have remained relatively flat. For instance, 30-year Treasury Inflation-Protected Securities (TIPS) breakeven inflation rates are near the low end of their five-year range at 2.2%. However, 30-year TIPS real yields have risen and now offer a nearly 3% real, or after-inflation, rate of return. This represents a significant yield above the inflation rate for what is essentially an asset with little or no credit risk.

Chair Warsh delivered his inaugural address at the annual Jackson Hole Economic Policy Symposium. He defended his approach to forward guidance, assessed that the economy is strong even though inflation is too high and reasserted the Fed's commitment to bringing inflation back to target. In a key passage, he said, "I would be hard-pressed to describe broad financial conditions as restrictive." This implies he has room to tighten policy without moving it into restrictive territory.

He said that while this summer's Personal Consumption Expenditures (PCE) and Consumer Price Index readings were better than expected, they don't tell him "that underlying trends have meaningfully improved." He added, "We must be confident that underlying inflation is moving to our objective, clearly and at sufficient speed. Otherwise, we have work to do. That's our job, our mandate and our charge to keep." It's clear to us that his focus is on bringing inflation back to target. After the address, short rates rose sharply and the odds of a rate hike at the next meeting rose from 35% to 61%. However, a Fed committed to price stability is good news for bond investors.

IG corporate spreads continued to trade in the narrow range that has defined trading since April. Earnings at IG firms are still strong, balance sheets are solid and upgrades continue to exceed downgrades. Issuance in the IG corporate market slowed somewhat relative to recent months, but artificial intelligence (AI) hyperscalers again dominated the strong activity.

Against this backdrop, the 10-year Treasury yield rose 16 basis points (bps) for the month, and 1–10-year IG credit spreads narrowed two bps. The ICE BofA/Merrill Lynch 1–10 Year US Corporate Index returned 0.25% for the month and 2.43% over the trailing one year. For the month, changes in credit spreads across sectors were very narrowly mixed. While no sectors stood out, the insurance sector lagged somewhat, while media outperformed slightly after underperforming the prior month.

Economic data was generally weaker. In the employment economy, nonfarm payrolls fell 23,000. Reductions in government employment accounted for most of the weakness, while private payrolls again grew at a reasonable pace. The unemployment rate fell to 4.1%, while the labor force participation rate continued to weaken. Initial unemployment claims remain well behaved. The labor economy appears well balanced overall, while the low-hire, low-fire environment stays intact.

Consumption softened somewhat. Retail sales fell -0.6%, and the control group, the part of retail sales that flows through to GDP, fell -0.4%. The Institute for Supply Management (ISM) manufacturing and services purchasing managers' surveys both remained in expansion with forward-looking new orders in both surveys suggesting coming growth.

Inflation softened, headline CPI of 0.1% translated to a 3.4% year over year (YOY) rate and YOY core was only 2.5%. Energy again played an outsized role in the headline number, with costs up 14.7% YOY. Core PCE, the Fed's preferred gauge, remained the same as the prior month at 3.3% YOY. But, to Chair Warsh's point, the trends haven't changed meaningfully, and inflation is still well above the 2% threshold. In the early stage of the inflation pipeline, commodity prices, particularly foods, are inflating rapidly as the diesel shortage becomes more acute.

Looking forward

Summer ended on a quiet note, but fall is often a more volatile period. The midterm elections or an escalation of the Iran-U.S. conflict may unsettle markets. After Chair Warsh's Jackson Hole address, the Fed appears likely to raise rates. But in general, we think a Fed intent on price stability is good for IG corporates and longer-term bonds. Starting all-in yields on one- to five-year BBB at 4.87% and 5.35% on five- to 10-year BBB corporate ladders provide solid cushions against volatility. In the meantime, Treasury intervention may serve to limit increases in intermediate- and long-term rates.

ABOUT

Parametric Portfolio Associates LLC ("Parametric"), headquartered in Seattle, is registered as an investment advisor with the US Securities and Exchange Commission under the Investment Advisers Act of 1940. Parametric is a leading global asset management firm, providing investment strategies and customized exposure management directly to institutional investors and indirectly to individual investors through financial intermediaries. Parametric offers a variety of rules-based investment strategies, including alpha-seeking equity, fixed income, alternative and options strategies. Parametric also offers implementation services, including customized equity, traditional overlay and centralized portfolio management. Parametric is part of Morgan Stanley Investment Management, the asset management division of Morgan Stanley, and offers these capabilities through offices located in Seattle, Boston, Minneapolis, New York and Westport, Connecticut.

DISCLOSURES

This material may not be forwarded or reproduced, in whole or in part, without the written consent of Parametric. Parametric and its affiliates are not responsible for its use by other parties.

This information is intended for informational purposes and details investment strategies and opportunities identified by Parametric. Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. We believe the information provided here is reliable but do not warrant its accuracy or completeness. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. The views and strategies described may not be suitable for all investors. Past performance is not indicative of future results. Investing entails risk, and there can be no assurance that Parametric will achieve profits or avoid incurring losses. Preferred securities are subject to interest rate risk. They generally decrease in value if rates rise and increase in value if rates fall. Parametric and Morgan Stanley do not provide legal, tax or accounting advice or services. Clients should consult with their own tax or legal advisor prior to entering into any transaction or strategy described herein. Additional information is available on request.

Charts, graphs and other visual presentations and text information were derived from internal, proprietary or service vendor technology sources or may have been extracted from other firm databases. As a result, the tabulation of certain reports may not precisely match other published data. Data may have originated from various sources, including, but not limited to, Bloomberg, MSCI/Barra, FactSet or other systems and programs. Parametric makes no representation or endorsement concerning the accuracy or propriety of information received from any third party.

Source of all data: Bloomberg, 01/31/2026. Bloomberg is a trademark and service mark of Bloomberg Finance LP ("Bloomberg"). "Barclays" is a trademark and service mark of Barclays Bank Plc, used under license. Bloomberg Finance LP and its affiliates (collectively "Bloomberg") or Bloomberg's licensors own all proprietary rights in the Bloomberg Barclays indexes. Neither Bloomberg nor Barclays Bank Plc or its affiliates (collectively "Barclays") guarantees the timeliness, accuracy or completeness of any data or information related to the Bloomberg Barclays indexes. This strategy is not sponsored or endorsed by Bloomberg or Barclays, and each makes no representations regarding the content of this material.

References to specific securities and their issuers are for illustrative purposes only and are not intended to be and should not be interpreted as a recommendation to purchase or sell such securities. Any specific securities mentioned are not representative of all securities purchased, sold or recommended for advisory clients. Actual portfolio holdings vary for each client, and there is no guarantee that a particular client's account will hold any or all of the securities identified. It should not be assumed that any of the securities or recommendations made in the future will be profitable or will equal the performance of the listed securities.

Parametric is located at 800 Fifth Avenue, Suite 2800, Seattle, WA 98104. For more information regarding Parametric and its investment strategies, or to request a copy of the firm's Form ADV or a list of composites, contact us at 206 694 5500 or visit www.parametricportfolio.com.

PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS. INDEX PERFORMANCE IS SHOWN FOR ILLUSTRATIVE PURPOSES ONLY AND NOT MEANT TO DEPICT THE PERFORMANCE OF A SPECIFIC INVESTMENT.

parametricportfolio.com

 RO 5928426 SKU 42513 09/30/2027

NOT FDIC INSURED. NO BANK GUARANTEE. MAY LOSE VALUE. NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY. NOT A DEPOSIT.