Parametric

Corporate Bond Market Insight | January 2026

2025 Year in Review

Key takeaways

» The beginning of the year saw a slew of executive orders from the newly elected president, adding significant economic uncertainty. The deterioration in national finances prompted Moody's to downgrade the United States sovereign debt rating from Aaa to Aa1 in May.

» The Fed ended its policy of quantitative tightening in October, but we believe a new chair, set to take office in May 2026, is likely to be far more tolerant of inflation.

» November marked both the end of the longest government shutdown in US history, a one-year trade truce negotiation with China and the announcement of new trade frameworks with several other Asian nations.

» Investment-grade (IG) corporate bonds performed well overall in 2025 with improving balance sheets, more IG rating upgrades than downgrades and supply continuing to meet robust demand.

Recap

Significant volatility marked the past year. But despite monumental changes to economic and fiscal policy, financial assets performed well, the economy continued to grow and inflation moved somewhat closer to the Fed's 2% target.

The year began with the January inauguration of President Trump, which ushered in a broad array of executive orders targeting trade, immigration, regulation and governance. These changes added significant economic uncertainty and weakened financial markets.

In April, the announcement of higher-than-expected tariffs resulted in a violent repricing of risk assets and rates. Large-cap equity indexes moved sharply lower and credit spreads moved significantly wider. But when the extent of the tariffs and policies became clearer, financial assets recovered. Eventually large capitalization equity indexes moved to new all-time highs, credit spreads recovered to near their all-time tights and ten-year Treasury rates fell 33 basis points (bps) from peak levels.

Fiscal policy and ratings

The President signed the budget reconciliation bill in July. The Congressional Budget Office estimated that the bill would add $4.1 trillion to the projected baseline debt over the next decade. This fiscal deterioration in national finances prompted Moody's to downgrade the United States sovereign debt rating from Aaa to Aa1. The downgrade followed the S&P Global Ratings downgrade in 2011, and the Fitch Ratings downgrade in 2023.

Fed policy

The Fed held interest rate policy steady through October, but it cut rates 75 bps over the last four months of the year in response to the softening labor markets. Recent statements indicate a shift toward prioritizing employment in the Fed's dual mandate. December meeting minutes suggest that at least two additional 25 bps rate cuts are likely in 2026, provided inflation stays contained. To address growing concerns around short-term funding markets, the Fed ended its policy of quantitative tightening in October (letting securities run off their balance sheet). When chair Jerome Powell's term ends in May 2026, new leadership is likely to be far more tolerant of inflation.

Trade and growth

In November, the Trump administration reached a one-year trade truce with China and announced new trade frameworks with several other Asian nations. November also marked the end of the longest government shutdown in US history.

Despite economic fears deriving from tariffs, estimated 2025 full-year GDP growth at 2.3% was only modestly lower than the 2.7% average of the prior three years. Much of the growth can be attributed to the push to develop artificial intelligence (AI) infrastructure. Estimates suggest AI related spending accounted for more than half of first-half growth. Consumption remained strong, particularly among higher-income households who benefited from wealth effects, while lower-income households continued to struggle.

Inflation and employment

The Fed's progress in reducing inflation has mostly stalled. Core Personal Consumption Expenditures, the Fed's favored inflation gauge, fell to 2.8% year over year (YOY). This is still nearly a full percentage point above the Fed's 2% target. November payrolls grew by just 64,000 following October's 105,000 decline, pushing unemployment to its highest since 2021 at 4.6%. Private sector hiring remained positive, offsetting some government job losses tied to policy changes and deferred resignations.

Fixed income performance

Investment-grade (IG) corporate bonds performed well. Reasonable economic growth, low and falling default rates, solid corporate earnings and conservative company management all contributed to improving balance sheets. This resulted in more IG ratings upgrades than downgrades. Issuance was strong in 2025, but supply continued to meet robust demand.

Against this backdrop, the 10-year Treasury yield increased 15 bps for the month, rose two bps for the quarter and 40 bps for the year. Credit spreads narrowed three bps for the month, widened three bps for the quarter and narrowed two bps for the year. As a result, the ICE BofA/Merrill Lynch 1–10 Year US Corporate Index returned 0.13% for the month, 1.22% for the quarter and 7.89% for the trailing one year. For the year, with the exception of technology, sector level spreads moved uniformly narrower.

Technology only widened slightly, due to robust issuance from the AI hyperscalers. Banking and leisure sectors exhibited the most strength. For the month, all sectors except technology narrowed somewhat, with leisure and automotive leading. Technology was unchanged versus the index. In general, over the course of the year, lower quality marginally outperformed higher quality.

Economic indicators

Manufacturing remained weak, with the ISM index at 48.2 for November, its ninth consecutive month of contraction, while services improved slightly. Price pressures persisted across both sectors. Retail sales growth slowed from 5.1% in March to 3.5% YOY, though Q3 GDP surged to 4.3%, the strongest in two years. Early estimates point to 3% growth in Q4.

Retail sales are slowing. After peaking in March at 5.1%, the YOY growth rate is now down to 3.5%. October sales (the last available data) were flat. But the control group, the portion of retail consumption that is accounted for in the GDP calculation, grew 0.8% month over month. The first estimate for third-quarter GDP was an annualized growth rate of 4.3%, the highest in two years and higher than the 3.8% growth in the second quarter. The Atlanta Fed's GDPNow estimate of fourth-quarter growth, with roughly two-thirds of the data in place, suggests 3% growth. Particularly compared to expectations, 2025 was overall a decently strong year.

Looking forward: 2026

2026 has the potential to be a reasonably good year for both the economy and IG corporate investors. While the economy has weakened moderately over the last few months, it's expected to grow, but at a pace that should keep inflation low. Economically, the Congressional Budget Office estimates that the stimulus contained in the latest budget resolution will boost GDP by 0.9%, and the spending around AI should continue to be robust. Additionally, wealth effects buoyed higher-end consumers, and we expect that to continue at a solid rate. Clearly a major equity market correction could influence growth. Failing a correction, the economy appears poised to create reasonable, non-inflationary growth.

Against this backdrop, we expect IG fundamentals will continue to improve. The budget resolution will allow businesses to depreciate their capital expenses immediately, further improving already strong balance sheets and earnings.

The largest concern in 2026 is the avalanche of projected issuance. AI hyperscalers and mergers and acquisition needs have driven corporate issuance projections to eclipse the 2020 record issuance. New net issuance could easily top $1 trillion in total. While this could moderately widen spreads, robust demand should continue to be adequate to absorb the projected issuance.

In May, a new Fed chair will take over from Jerome Powell. We expect that the new chair will be more tolerant of higher inflation, and more amenable to the desire of the administration to ease rates. But the rates committee will continue to have a large say in what happens. In the meantime, IG corporate ladders will continue to provide an important hedge against uncertainty.

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