

Corporate Bond Market Insight | February 2026

Will the New Year Take a New Direction?

Key takeaways

- » The Federal Reserve's current target interest rate range stands at 3.5% to 3.75%, reflecting recent monetary policy decision to take a pause at the last meeting.
- » We expect Kevin Warsh to be easily confirmed as the new Fed chair by the Senate because of his strong qualifications, prior experience and credibility with investors.
- » Despite concerns over consumer health, slowing labor markets and tariffs, growth forecasts continue to be revised higher, supported by strong GDP numbers and persistent economic momentum.

Recap

The new year began quietly for financial markets. Despite significant geopolitical and domestic challenges, large-cap equities posted modest new all-time highs, interest rates rose slightly and gold, silver and other commodities rallied sharply. Economic growth was solid, while inflation remained stubbornly above the Federal Reserve (Fed) target. The Fed left rates unchanged, and the resident announced Kevin Warsh as his nominee for Fed Chair. At month-end, winter storm Fern disrupted economic activity for a sizable area of the nation.

The Fed left rates unchanged at their January meeting. They'd cut rates 25 basis points (bps) at each of the three prior meetings, leaving the target rate resting in the 3.5% to 3.75% range. That's 175 bps lower than the peak rate of 5.25% to 5.5% in September 2024. Markets are now pricing two more 25-bps cuts in the coming year—one in July and one in December. There were again dissents, as Governors Stephen Miran and Christopher Waller both advocated for 25-bps cuts. However, there was broad support among both voting and non-voting members for initiating the pause. It seems clear that the Fed believes the weakness in employment is stabilizing and that inflation may still be a problem, particularly in light of the recent economic strength and the rally in commodities. Chair Powell will preside over the March and April meetings and may choose to remain as a governor after the new chair begins his term in May. But the historical precedent for past chairs to resign after relinquishing their chairmanship is strong.

We expect the Senate to readily confirm Kevin Warsh's nomination. He's highly qualified, having sat on the board from 2006 through 2011, and has held ongoing roles in various government and economic policy settings. He also enjoys a tremendous amount of credibility with investors. While he currently believes that modestly lower rates are appropriate, he has a reputation as an inflation hawk. His current view is that the productivity gains created by artificial intelligence (AI) and financial deregulation will lower the neutral rate for federal funds. His term is likely to be an eventful one, with inflation above target, government borrowing needs escalating, increasing stress on lower income consumers and continuing political pressure to lower rates.

Despite worries around the state of the consumer, the slowing of the labor economy and the impact of tariffs, economists continue to revise growth forecasts higher. The final estimate of third-quarter GDP growth was revised upward from 3.8% to 4.4%, and with two thirds of the data in place, the Atlanta Federal Reserve's GDPNow currently estimates fourth-quarter growth at a strong 4.2%. In short, economic momentum is strong, and with monetary and fiscal stimulus as tailwinds and continued growth in AI infrastructure spending, the near-term prospects for a recession seem low. There will likely be some first-quarter impact from winter storm Fern. Estimates vary widely, but the storm may decrease first-quarter GDP by anywhere from 0.5% to 1.5%; however, much of the lost GDP is delayed rather than destroyed and should serve to boost second quarter's GDP.

Despite near-record January issuance, investment grade (IG) corporate credit spreads, as measured by option-adjusted spread (OAS), tightened to three-decade lows. Spreads are now approaching the all-time low set in the mid-1990s. Solid balance sheets, good earnings, low default rates, excess global liquidity and growing investor confidence in the US economic outlook all are contributing to that strength. Further, 2026 issuance is expected to set a record. The near-record January issuance was centered in banks and finance. AI hyperscalers are projected to issue in February. Impressively, the new supply is being well absorbed, as evidenced by the general tightening of spreads. The good news in corporates continues unabated.

Against this backdrop, the 10-year Treasury yield rose seven bps for the month, and IG credit spreads narrowed five bps. As a result, the ICE BofA/Merrill Lynch 1–10 Year US Corporate Index returned 0.34% for the month and 7.56% for the trailing one-year. For the month, all sectors narrowed modestly, led by autos and followed closely by transportation, energy and capital goods. Services, media and health care, while tighter on the month, lagged somewhat. In general, lower-quality outperformed higher-quality.

Economic indicators were mixed. The most concerning aspect of recent releases has been the sharp decline in consumer confidence. But consumer confidence is often affected by domestic and global political events, rather than the economic outlook. Clearly the lower tiers of the economic distribution are struggling, but the upper tiers continue to spend as incomes and net worths are buoyed by wealth effects.

Despite modest weakness late last year, the labor economy can best be described as low-hire/low-fire. While new jobs are being added only slowly, the unemployment rate is still low, and new claims for unemployment are near 2022 lows. We see evidence of solid spending in retail sales, which rose 0.6%. The control group, which is the portion of retail sales included in the GDP calculation, was higher by 0.4%, leaving year-over-year growth at a respectable 3.3%.

Looking ahead

We continue to expect 2026 to be a good year for the economy and corporate investment, as the stimulus from the budget resolution, Fed easing and continued investment by large AI hyperscalers will all support growth. Inflation should continue to moderate as the weakness in rents and housing continues to press housing inflation lower. The largest concern is the rally in commodities. We're hopeful that much of the rise is the result of winter weather, but strength in copper and other industrial commodities is worrisome.

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