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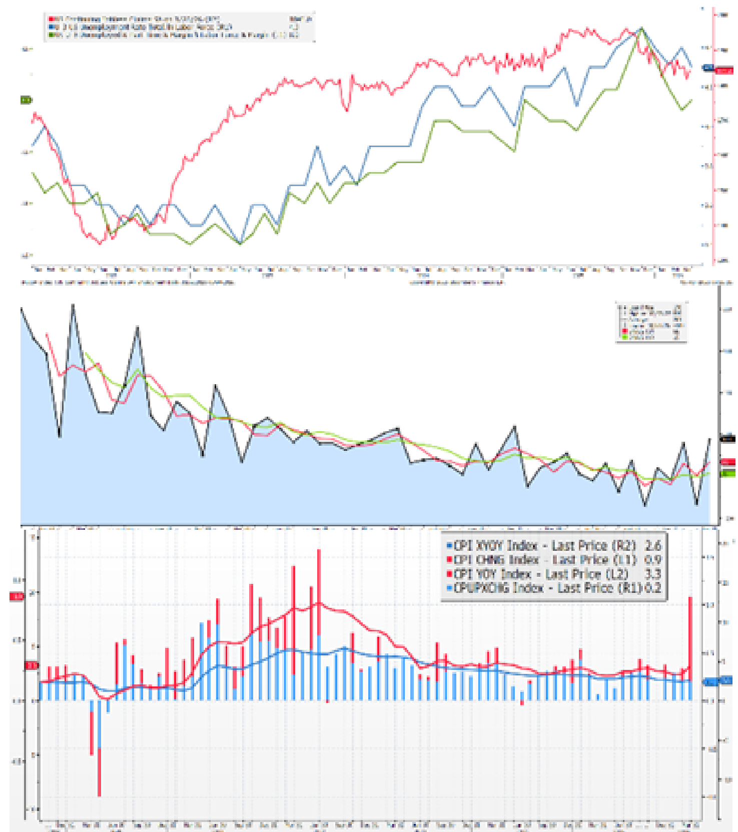
Bond Market Update

As of March 31, 2026 | Volume 15, Issue 1

In the 1st Quarter of 2026, total returns for both taxable and tax-free investments were slightly negative. For taxable portfolios, the Barclays Aggregate generated a total return of -0.03% for the quarter. For tax-free portfolios, the Barclays 1-10yr Muni generated a total return of -0.23% for the quarter. Returns were nicely positive through February; however, that changed in March with the beginning of the war in Iran. The economy continues to show its resilience, inflation once again takes the spotlight amid the rapid rise in oil prices, and the lack of job growth continues to muddy the Fed's outlook.

Economy

GDP in the 4Q of 2025 came in with a final Q/Q reading of 0.5%. GDP Q/Q projections for 1Q 2026 currently stand at 2.3%. GDP Y/Y for 2025 came in at 2.1%. GDP Y/Y projections for 2026 currently reside at 2.3%. AI infrastructure (750B+ projected for 2026) remains a strong tailwind for the economy, not only in capex but also in the productivity gains businesses realize. Consumer spending in the 4Q came in at 1.9%, below expectations. Consumer spending in the 1Q is projected at 1.7%. U.S. unemployment and U.S. continuing jobless claims have risen slightly as job growth remains tempered. The 3- and 6-month payroll growth numbers have improved slightly to +68k and +15k, respectively. The unemployment rate is 4.3% (low by historical standards), but up from a low of 3.4% in early 2023. Inflation has been in a sideways pattern for over a year and was expected to improve slightly in 2026; however, the war with Iran has shifted short-term inflation expectations higher. If oil remains elevated, it will have negative implications for the economy, and recession odds will rise.



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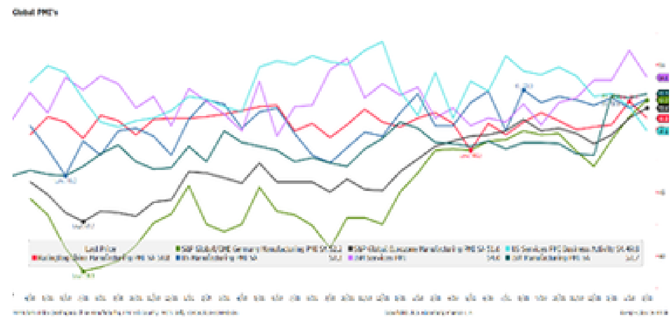
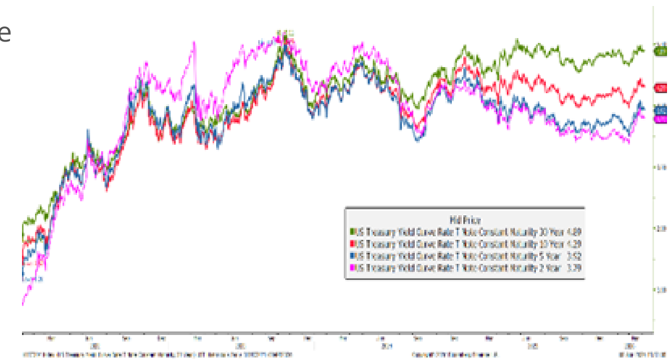
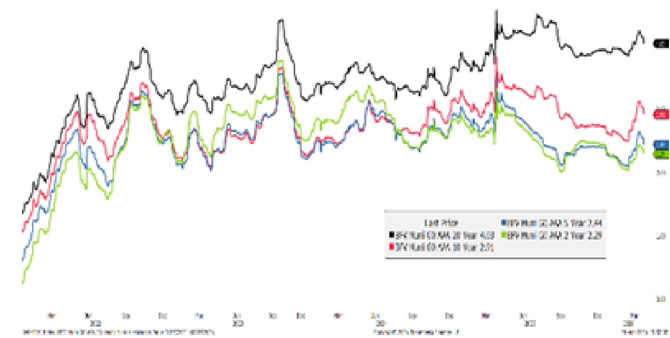


The Manufacturing ISM (30% of the US economy) is starting to show some life, with three consecutive prints above 50 (expansion). A less restrictive interest rate policy has finally started to help this segment of the economy; however, manufacturing has been in contraction for multiple years. Maybe it has found a bottom. The Services ISM (70% of the US economy) is still expanding (reading above 50) and has posted average prints in 1Q that are higher than in 4Q 2025.

Rates



Taxable - YTD for 2026, 2yr, 5yr, and 10yr U.S. risk-free rates (nominal) are up approximately 32bps, 22bps, and 15bps, respectively. The UST yield curve remains upward-sloping following Fed rate cuts in 2025. The 10yr to 2yr UST spread is at 52bps. 10yr TIPS are priced at 1.94%. This rate has remained elevated for several years, indicating that monetary policy is still somewhat restrictive. 30yr mortgage rates have moved up slightly from the end of the year and sit at 6.68%.



Tax-Free - YTD for 2026, 2yr, 10yr, and 20yr AAA tax-free rates are mixed, approximately -3bps, +35bps, and +25bps, respectively. The tax-free yield curve is nicely upward sloping, encouraging longer duration positioning. The 20yr to 2yr AAA tax-free spread currently resides at a positive 177bps.Tax-free rates on the longer part of the curve continue to be attractive. Currently, it is possible to buy excellent credits and get 6.50% + Tax Equivalent Yields. It is highly recommended to lock in these rates now while this opportunity exists.

The Fed

The Fed had two meetings in the 1st Quarter, January and March. At both meetings, the Fed chose to do nothing, maintaining the cash rate at 3.50% to 3.75%. At the March press conference, the Fed communicated that inflation remains above the Fed's 2% target and that the job market appears to have stabilized at very low levels of growth. Powell said the rapid rise in oil prices due to the war in Iran is concerning, and that the Fed will continue to monitor how the war unfolds. Toward the end of March, Powell communicated that the Fed would most likely look through the current oil shock, as it should. Just recently, minutes from the Fed's March meeting were released, confirming that the Fed is still uneasy with the inflation outlook but is a little more worried about the lack of job growth. This outlook provides the basis for the Fed's expectations of one cut this year, towards the end of 2026.

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Credit

Credit risk was slightly negative versus risk-free in the 1st Quarter of 2026. For the quarter, IG spreads widened by roughly 11bps, and HY spreads widened by roughly 51bps. Risk premiums for the quarter came under pressure amid rising oil prices due to the Iran war. Even though spreads widened in the quarter, credit performed pretty well considering the circumstances.

Looking Forward

The economy continues to remain resilient, however, the rapid rise in oil does cast doubt on the ability of the consumer to weather this price shock. AI capex continues to be a major contributor to growth and businesses will benefit from productivity gains inherent with the proliferation of AI. For now, GDP going forward should remain positive due to AI capex and productivity enhancements even if consumer spending slows. However, if oil stays elevated for an extended period, the odds of a recession will continue to rise. The Fed has said they are willing to look through this inflationary price shock for the time being, this is a positive. Kevin Warsh will be the new Fed chair in May. Expectations are for him to hold rates constant under current circumstances. Private credit has come front and center, we do not see this as a systemic issue, but this will linger for the remainder of the year and could put some pressure on credit spreads. We continue to be void of High Yield and continue to build up our US Treasury and Agency MBS/CMBS exposure in lieu of the excellent credit performance over the past several years. We still think credit will perform in 2026, but excess returns will be muted due to credit spreads at historically tight levels in the face of higher oil prices and private credit headwinds. Forward returns continue to look attractive. As always, we run a high-quality portfolio that looks to take advantage of opportunities as they present themselves. We have been active in seeking those opportunities and feel good about the changes that have been made.

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