

A More Normal Era: Bonds Earn Their Place Again

For much of the past fifteen years, investors owned bonds despite their yields, not because of them. Income was scarce, and diversification often came at the cost of accepting limited returns and meaningful interest-rate risk.

Today, the proposition is different. Bonds are once again offering income that makes them worth owning in their own right, including a more compelling real rate of return, meaning the return investors earn after taking inflation into account.

We believe portfolios should reflect that change. Our recommendation is to gradually increase fixed income allocations, tailored to each client's objectives, liquidity needs and tax circumstances.

This is a valuation-driven allocation decision, not a prediction that yields have peaked. We do not need to call the top in interest rates to recognize that the compensation for owning bonds has improved substantially.

Investors can once again earn meaningful income from an asset class that can also provide stability and liquidity when portfolios need it.

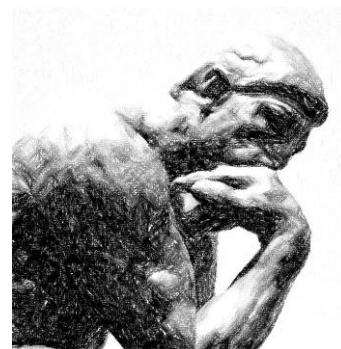
A Constructive Equity Outlook, and a More Attractive Bond Market

Equity investors have good reasons for their enthusiasm. U.S. corporate profits remain strong, and the capital-spending cycle continues to support revenues across much of the economy. Over the longer term, investors expect today's investment, particularly in technology and artificial intelligence, to translate into higher productivity and sustained earnings growth.

But a constructive outlook for stocks does not eliminate the case for bonds. It makes the relative opportunity more important. While equity markets focus on growth, bond markets are confronting the cost of financing it. Persistent fiscal deficits, rising government borrowing needs, and competition for capital are challenging the assumption that money will remain inexpensive. These pressures may keep longer-term yields elevated, even if rates occasionally decline as investors seek safety or anticipate slower growth.

For borrowers, that is a challenge. For investors with capital to deploy, it creates an opportunity.

The Thinking Man



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From No Alternatives to Reasonable Alternatives

The post-financial-crisis era gave investors a familiar acronym: TINA, or “There Is No Alternative” to stocks. With cash and Treasuries yielding very little, investors moved further out on the risk spectrum in search of returns, sometimes accepting more credit risk and less liquidity to earn additional income.

That framework is changing. As Jason De Sena Trennert of Baird Strategas argued in “Move Over TINA, TARA Has Arrived,” TARA stands for “There Are Reasonable Alternatives.” Bonds no longer need to rely exclusively on falling interest rates to justify their place in a portfolio. Their income is becoming a meaningful part of the investment case.

J.P. Morgan Asset Management’s 2027 Long-Term Capital Market Assumptions reinforce this shift, placing global bond return forecasts at their highest levels in two decades as real yields normalize.

The relevant question is no longer whether equities offer greater long-term growth potential. It is how much additional risk investors need to take to meet their objectives, and whether bonds can now do more of that work.

J.P. Morgan Asset Management | 2027 Long-Term Capital Market Assumptions:

2027 assumptions	Cycle-neutral yield / spread	2027 expected return
Inflation	2.4%	—
Cash	3.0%	3.2%
10-year bond	4.3%	5.5%
30-year bond	4.8%	6.2%
Investment-grade credit	5.6% / 140 bps	6.1%
High yield	8.2% / 440 bps	6.7%
Emerging-market debt*	7.6% / 350 bps	6.5%

*Figures reproduced from the original exhibit. Expected returns are forecasts, not guarantees.

Why Starting Yields Matter

A bond’s starting yield is an important anchor for its prospective long-term return.

As of October 19, the 10-year U.S. Treasury yield was approximately 5.09%, compared with September’s reported annual headline inflation rate of 3.7%. That gap is not a guaranteed real return: future inflation, taxes, and investment costs will determine the purchasing power investors ultimately retain. It does, however, represent a more attractive starting point than the near-zero yields that shaped portfolio construction for years.



Higher yields also improve the arithmetic of risk. Bond prices can still fall if interest rates rise, particularly for longer-term bonds, but the income earned along the way helps offset some of that decline.

High-quality bonds can also help stabilize portfolios during a growth shock, providing liquidity and a source of capital for rebalancing. That protection is not universal. As we saw in 2022, an inflation-driven selloff can push both stock and bond prices lower. The case for fixed income rests on income and diversification, not on a promise that bonds will rise whenever equities fall.

The table below illustrates historical annualized total returns for 10-year U.S. Treasuries over the past 20, 10, 5, 3, and 1 years, providing perspective on bond performance across different interest-rate environments. Past performance does not predict future results.

Period	Annualized return
20 years	~3.1% (computed from calendar-year returns, Oct 2006–Oct 2026)
10 years	+0.10%
5 years	-2.05%
3 years	+2.91%
Trailing 1 year	-3.73%

Where We See the Best Opportunities

We are not recommending an indiscriminate purchase of the bond market. We see opportunities in three areas, each serving a different purpose. The yields below are indicative and will change with market prices. Credit quality, maturity, call provisions, and the yield available on each security must be assessed individually.

1. Long-term municipal bonds | Approximately 5% tax-exempt yields

For taxable clients in the highest federal income-tax bracket, a 5% federally tax-exempt yield is roughly equivalent to a 7.9% yield on a taxable bond, before state-tax and alternative-minimum-tax considerations. That is a compelling income proposition for certain taxable accounts. Longer maturities can help secure income for an extended period, but they also introduce meaningful interest-rate risk. Call provisions matter as well: the stated maturity does not necessarily determine how long an investor will receive that income.

2. Intermediate-term investment-grade corporate bonds | Yields above 6%

We are finding selected opportunities at the lower end of investment grade that combine attractive income with intermediate maturities. This limits interest-rate exposure relative to longer-dated bonds while maintaining an investment-grade credit standard. Credit selection remains essential, however. A high yield alone does not establish value; the additional income must adequately compensate investors for the issuer's financial and business risks.



3. Selected hybrid and preferred securities | Approximately 7% yields

Hybrids and preferreds issued by large banks and utilities can provide additional income, but that income comes with greater structural complexity. Their lower priority for repayment, the possibility of deferred or suspended distributions, and call or extension provisions all require careful analysis. We evaluate the terms of the individual security, not simply the strength of the issuer. These holdings belong in the portfolio as selective income complements, not as substitutes for its highest-quality defensive assets.

How We Would Implement the Change

The move toward increasing the fixed income allocation should be gradual and deliberate, rather than dependent on a single entry point. Our priorities are to:

- Add longer-term bonds selectively where the yield justifies the interest-rate exposure.
- Favor tax-exempt municipal bonds where the tax benefit is meaningful.
- Focus corporate exposure on sound issuers with intermediate maturities.
- Size hybrid and preferred positions conservatively.

Funding would come from each portfolio's existing mix of cash and other assets, with attention to liquidity needs, concentration, and the tax consequences of any sales. Implementing in stages also leaves flexibility if yields rise further or new opportunities emerge.

What Are the Biggest Risks to Our Thesis?

These risks argue for selectivity and pacing, not for dismissing the asset class:

- Inflation could accelerate again, pushing yields higher and bond prices lower while reducing purchasing power.
- Large government deficits and Treasury issuance could keep longer-term interest rates elevated.
- A weaker economy could make it harder for some companies to repay debt, especially lower-rated issuers and more complex securities.
- We could be early. Yields may rise after we begin buying, which is one reason to proceed in stages.

Our Conclusion

The investment landscape has become more balanced. Equities continue to offer growth, but investors no longer need to depend on them for every element of portfolio return.

Bonds can now contribute meaningful income, a stronger starting point for preserving purchasing power, and diversification when portfolios need it, provided we remain disciplined about credit quality, duration, and structure.

Dan Ivascyn, PIMCO's Chief Investment Officer, shares our enthusiasm for the opportunity in fixed income.



Speaking at a New York conference sponsored by Grant's Interest Rate Observer, Ivascyn remarked: "We can put a 7% or 8% on the board. You can put together a high-quality portfolio and generate the highest yields in 25 years."

We believe Mr. Ivascyn might be right!

Our recommendation remains to gradually increase fixed income, taking advantage of attractive yields while maintaining a disciplined approach to credit quality, maturity, and structure.

The opportunity is not to predict the next move in interest rates. It is to get paid while we wait.

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