Higher bond yields: Opportunities and tradeoffs

- The post-COVID yield curve normalization has hampered bond returns in 2026
- Higher rates can impact business investment, mortgage origination, and variable-rate credit instruments while savers are more highly compensated, and bonds can once again provide diversification
- Investors might benefit from diversifying their duration exposure and adding inflation protection inside portfolios

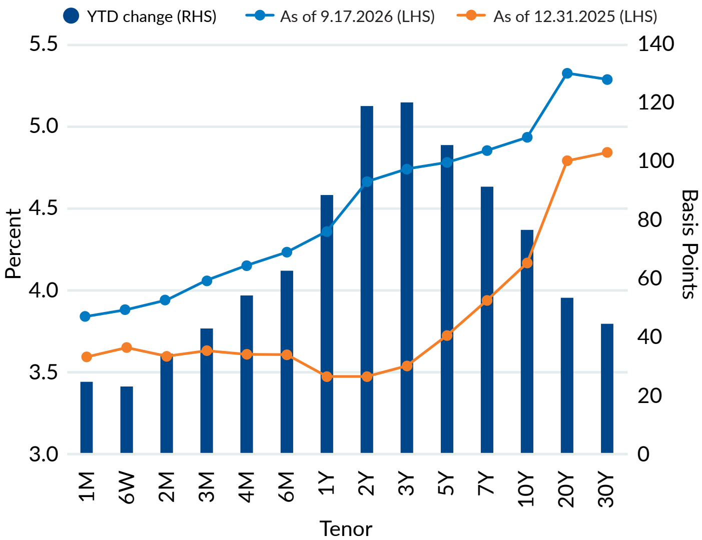
One of the most impactful market trends in recent years has been the continued normalization of the yield curve. For much of the period following the Global Financial Crisis, investors became accustomed to unusually low interest rates. That environment changed in 2022 with the end of a 40-year bull market in bonds. Treasury yields have repriced substantially higher, including another move upward in 2026 (Chart 1).

CHART 1: **10-YEAR TREASURY YIELD**

Source: FRED, Mesirow. Data as of September 17, 2026

Bonds saw further repricing through the first three quarters of 2026, with rates rising across all tenors of the yield curve (Chart 2).

CHART 2: US TREASURY YIELD CURVE



Source: Bloomberg, Mesirow. Data as of September 17, 2026

While the immediate impact of rising rates has been lower total returns from bonds, that impact has been felt differently depending on if your bond exposure is shorter-term or longer-term. Longer-term bonds, which carry more interest rate risk, have underperformed shorter-term bonds by 40.7% cumulatively since 2022, and 3.8% year-to-date (Table 1).

TABLE 1

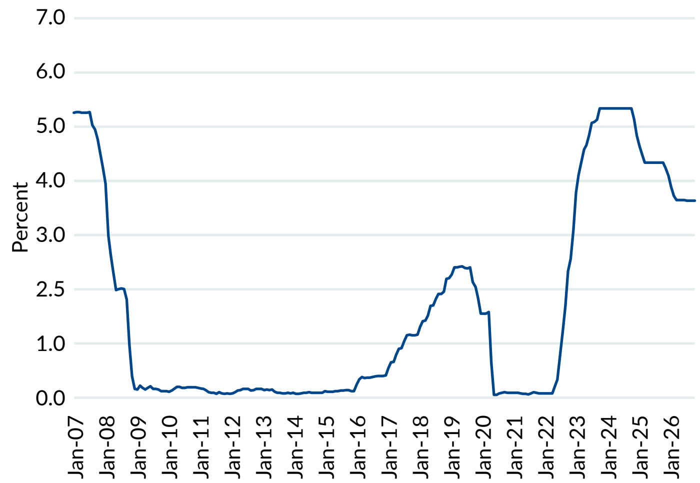
Index	Cumulative return since 2022	Return YTD
Bloomberg US Government Long TR USD	-29.8%	-2.8%
Bloomberg US Government Intermediate TR USD	5.1%	0.1%
Bloomberg US Government 1–3 Yr TR USD	10.9%	1.0%

Source: Morningstar, Mesirow. Data as of Sep-2026

Why is this happening?

The Federal Reserve sets the federal funds rate, which directly influences the front end of the yield curve. This monetary policy tool allows the central bank to manage its dual mandate of price stability and maximum employment by easing or tightening access to money. The Federal Reserve aggressively tightened (increasing federal funds rate) in 2022 post-COVID as they aimed to control inflation (Chart 3).

CHART 3: FEDERAL FUNDS RATE



Source: FRED, Mesirow. Data as of September 17, 2026 (Most recent rate increase not reflected in data yet)

The longer end of the yield curve is driven by market participants' expectation for inflation and growth, future short-term rates, Treasury issuance, fiscal deficits, investor demand, and the additional "term premium" required to hold longer bonds. As mentioned earlier, market participants' concern about unchecked inflation stemming from a combination of the Iran conflict and US government debt load has bid up the middle-to-long end of the yield curve.

Should you care?

Yes! Higher rates have economic trade-offs that ripple through the economy while also creating potential opportunities for fixed income investors. The tradeoff is two-sided. All else equal, higher borrowing costs force the US government to pay more in interest, impact corporations' willingness and ability to invest due to a higher cost of capital, make residential and commercial real estate mortgage rates move higher, and weigh heavily on households that rely on variable-rate borrowing. These are significant concerns, and if rates rise too high, too fast, we could see an economic pullback.

On the positive side of the ledger is the ability for investors to achieve higher income and potentially better diversification. Treasuries are paying a higher yield than earlier in the year, and certainly more than in the post-GFC period. Today's higher starting yields provide investors with substantially more income and a larger potential cushion against inflation than was available during much of the post-GFC period. Further, with rates moving higher, there is the potential for Treasuries to buffer stocks in the event of an economic shock. This diversification was absent in 2022 when stocks and bonds sold off together (Table 2).

TABLE 2

Name	Dot-com Bear market[1]	Global financial crisis[2]	COVID shock[3]	2022 Bear market[4]
S&P 500	-32.82	-45.80	-19.57	-17.70
Bloomberg US Government Long	36.60	22.68	12.97	32.71

Source: Morningstar, Mesirow. Cumulative Returns. Data as of Sep-2026 | 1. March 2000 to October 2002 | 2. October 2007 to March 2009 | 3. February 2020 to March 2020 | 4. January 2022 to October 2022

What steps should investors contemplate inside their portfolios?

Rising yields have created plenty of concern for risky assets inside portfolios, but they have also improved the prospective return and diversification value of bonds. Investors should selectively consider opportunities to rebalance and/or reallocate within the fixed income portion of their portfolio.

1. **Put excess cash and short-term bonds to work thoughtfully:** As absolute rates have increased across the yield curve, intermediate- and long-term bonds provide additional yield. In the event of an economic downturn, their higher duration may provide additional portfolio ballast if interest rates decline. However, with a modest term premium, investors should consider diversifying duration exposure rather than making an explicit rate call.
2. **Review asset allocation mix:** With bonds offering more competitive yields, they may improve the risk-adjusted return prospects of portfolios pursuing a total return objective.
3. **Consider inflation protection:** Markets are not currently pricing in a dramatic acceleration in inflation. Investors may consider TIPS or other inflation hedges in their portfolio to protect purchasing power in the event that higher than expected inflation materializes.

Years of low rates and robust returns on riskier assets have led many investors to ignore the fixed income portion of their portfolio. However, as Treasury yields have reached their highest levels in nearly two decades, bonds may be a more compelling portfolio diversifier than they have been in years. As times change, it is important that investors position their portfolios for the future, not the past.

Whether you're just starting your career, nearing retirement, or thinking about your legacy, your asset allocation choices will shape your financial future. Please consult with an advisor to determine what asset allocation decisions may be best for your financial situation.

About Mesirow

Mesirow is an independent, employee-owned financial services firm founded in 1937. Headquartered in Chicago, with offices around the world, we serve clients through a personal, custom approach to reaching financial goals and acting as a force for social good. With capabilities spanning Private Capital & Currency, Capital Markets & Investment Banking, and Advisory Services, we invest in what matters: our clients, our communities and our culture.

Mesirow Wealth Management is the firm's founding capability. We are the initial namesake business of Norman Mesirow, whose vision was to serve with purpose, applying the highest standards of professionalism in advising individuals and families on their most important life goals.