The Bill Comes Due

Q3 2026 Fixed Income Review and Outlook

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Transforming Access to Alpha

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Authors

Noel McElreath, CFA
Sr. Director, Sr. Portfolio Manager, U.S. Fixed Income

Charles L. Curry, Jr.
Managing Director, Sr. Portfolio Manager, U.S. Fixed Income

As we head into the home stretch of what has been a wild ride for geopolitics and the bond markets, we have a range of topics we would like to weigh in on. Among clients and other market participants with whom we speak on a regular basis, there are a handful of subjects that appear to be top of mind. These take various forms but are concentrated around the sharp move upwards in Treasury yields and what this means for other borrowers. The third quarter delivered the sharpest repricing of interest rates since the 2022 tightening campaign: the Federal Open Market Committee (FOMC) raised the Fed Funds Target Rate (FDTR) for the first time since 2023, Brent crude again topped $100 per barrel, and the 10-year Treasury note closed September at 5.29%, its highest level since 2002. Credit spreads, by contrast, barely flinched across most of the market. We begin with a recap of performance across fixed income markets, where rates rather than credit drove returns. We then turn to the implications of rising coupons and the growing Treasury debt burden, a dynamic we believe is only beginning to show up in the data. Next, we examine the anomalous behavior of CCC spreads, which have widened sharply even as every other investment grade and high yield ratings cohort trades near its twenty-year tights. Lastly, we synthesize these themes into the opportunities and potential pitfalls we see heading into 2027.

Performance Recap: A Rates Story

3Q26 was, first and foremost, a rates story. The yield to worst on the ICE BofA US Treasury Index (G0Q0) rose 76 bps over the quarter to 5.14% (51 bps of which came in September alone), the highest month-end yield for the index since June 2006. The move was broad-based across the curve, with 2-year yields up 72 bps and 10-year yields up 82 bps over the quarter (see **Select US Treasury Yields**, below). Duration was punished accordingly. The investment grade corporate index (C0A0) returned -3.75% for the quarter and is now down 2.78% year to date, while the long-duration AAA cohort fell 6.03%. High yield (J0A0), with its shorter duration and thicker coupon cushion, held up comparatively well at -1.84%. Excess returns, however, tell a very different story. As a reminder, excess returns measure performance against equivalent-duration Treasuries, isolating the contribution of credit risk. On that basis, investment grade corporates gave back only 18 bps for the quarter, and the BBB, BB and B cohorts all finished within 45 bps of their Treasury equivalents (see **3Q26 Scorecard**, ahead of our CCC discussion). Agency MBS (M0A0), by contrast, gave back 121 bps of excess return as spreads widened 12 bps.

Table 1 | **Select US Treasury Yields**
%

	2-year	5-year	7-year	10-year	20-year	30-year	10-2 Slope
12/31/2024	4.24	4.38	4.48	4.57	4.86	4.78	0.33
12/31/2025	3.48	3.73	3.94	4.17	4.79	4.85	0.69
3/31/2026	3.79	3.94	4.13	4.32	4.91	4.91	0.52
6/30/2026	4.17	4.23	4.34	4.47	4.96	4.96	0.29
9/30/2026	4.89	5.09	5.19	5.29	5.67	5.63	0.40
Last twelve month high	4.93	5.09	5.19	5.29	5.67	5.63	0.73
Last twelve month low	3.38	3.50	3.70	3.94	4.51	4.53	0.20
YTD Change	**1.41**	**1.36**	**1.25**	**1.12**	**0.88**	**0.78**	**-0.30**
QTD Change	**0.72**	**0.86**	**0.85**	**0.82**	**0.71**	**0.67**	**0.10**

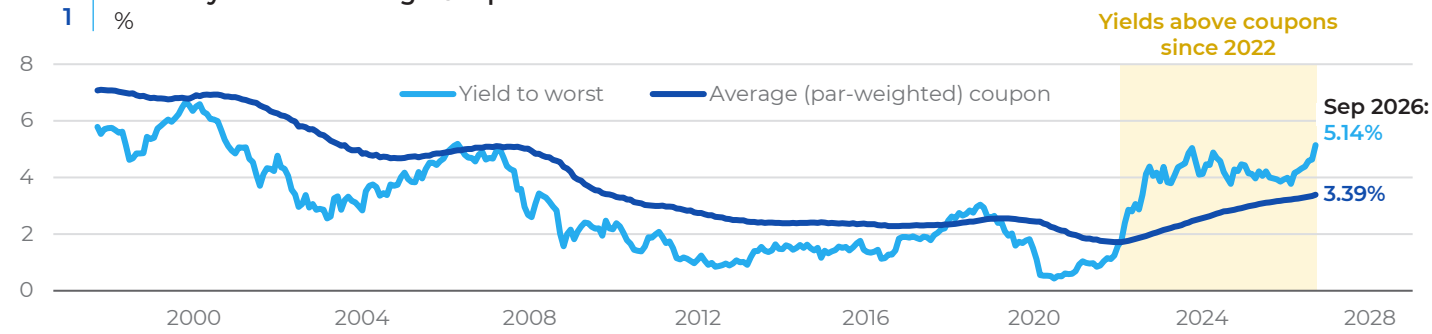
Source: Bloomberg, ICE BofA Indices, Xponance. Changes in percentage points.

Beneath the surface, spread moves were orderly but not uniform. Investment grade OAS widened 8 bps to 84 bps and high yield widened 36 bps to 308 bps, both modest moves given the magnitude of the rate shock. Within investment grade, widening in July was concentrated in technology, media and telecom as markets digested the scale of AI-related capital spending and the hyperscaler issuance funding it (cable and satellite issuers widened 28 bps on average over the quarter, led by Charter and Cox). September brought broader beta widening in cyclical sectors such as leisure and automotive, while energy was effectively unchanged, supported by $100 oil. The glaring exception to this orderly picture was the CCC cohort, which widened 238 bps to 1,216 bps and delivered an excess return of -3.21% for the quarter, a dynamic we explore in detail below.

Coupons and the Treasury Debt Burden

The sell-off in Treasuries matters well beyond the mark-to-market losses in fixed income portfolios. The more lasting consequence is the cost of carrying the debt itself. At quarter-end, the Treasury index yielded 5.14% while paying an average coupon of only 3.39%. That 1.75-point gap between the market rate on new debt and the rate on existing debt sits in the 95th percentile of observations since 1997. For most of that period the relationship ran the other way: from 1997 through 2021, index yields were below the average coupon in 93% of months, meaning each refinancing locked in a lower cost of borrowing and the average coupon declined from 7.1% to 1.7%. Since 2022, the opposite has been true 98% of the time (see **Treasury Yield vs Average Coupon**, below).

Chart 1 | **Treasury Yield vs Average Coupon**
%



Source: ICE BofA Indices (G0Q0), Xponance. Month-end, Dec 1997 – Sep 2026.

Coupons, unlike yields, adjust slowly because only new issuance resets them. Over the past three decades, each 1-point gap between yield and coupon has lifted the average Treasury coupon by roughly 25 bps over the following twelve months. At today's gap, that implies another 40 bps or so of coupon increase per year even if yields go nowhere. The constituent data make the scale of the problem clear. Of the $19.1 trillion of notes and bonds in the index, 52% matures within five years at an average coupon of 3.24% against a current yield of 4.92%. Refinancing that debt at today's yields would add roughly $168 billion per year to coupon payments, and repricing the entire index would raise annual coupon interest by 53%, from $645 billion to $986 billion. Nearly 18% of the index still carries coupons below 2%, legacy issuance from 2020 and 2021 that will reprice at well over twice its current cost. Importantly, this analysis excludes Treasury bills, TIPS and floating-rate notes. Total federal net interest crossed $1 trillion for the first time in fiscal 2026 (a record 3.2% of GDP), and each additional 100 bps on the coupon-bearing debt alone would cost roughly $191 billion per year once fully repriced.

The same arithmetic applies to corporate borrowers. Investment grade corporates yield 6.04% against an average coupon of 4.68%, and high yield 8.26% against 6.69%, with both at their highest yields since late 2023. Corporate coupons have historically adjusted more slowly than Treasury coupons (by about 16 bps per year per point of gap for investment grade and only 5 bps for high yield), largely because corporate issuers can defer issuance when markets are expensive, a luxury the Treasury does not enjoy. That flexibility is finite, however, and the borrowers with the least of it sit at the bottom of the ratings spectrum.

Table 2 | **3Q26 Scorecard**

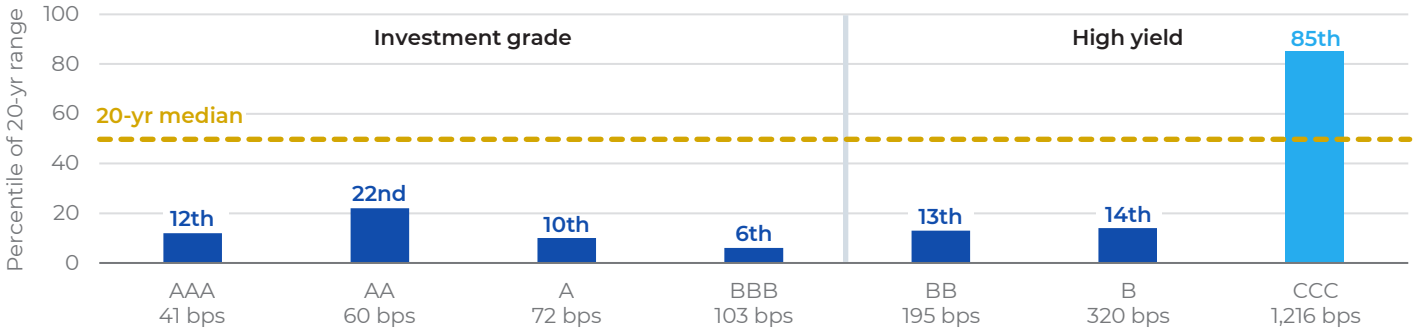
	OAS 6/30/26 (bps)	OAS 9/30/26 (bps)	3Q OAS change (bps)	3Q total return (%)	3Q excess return* (%)	YTD total return (%)	YTD excess return* (%)
IG Corporate (C0A0)	76	84	+8	-3.75	-0.18	-2.78	0.43
AAA (C0A1)	38	41	+3	-6.03	-0.01	-5.78	-0.22
AA (C0A2)	52	60	+8	-4.40	-0.34	-3.92	-0.31
A (C0A3)	63	72	+9	-3.72	-0.21	-2.88	0.28
BBB (C0A4)	95	103	+8	-3.60	-0.12	-2.41	0.74
High Yield (J0A0)	272	308	+36	-1.84	-0.58	0.00	0.75
BB (J0A1)	164	195	+31	-1.87	-0.45	-0.06	0.88
B (J0A2)	301	320	+19	-1.30	-0.22	1.06	1.57
CCC (J0A3)	978	1216	+238	-3.99	-3.21	-3.93	-3.70
MBS (M0A0)	18	30	+12	-4.14	-1.21	-3.02	-0.71

Source: ICE BofA Indices, Xponance. * Excess return vs equivalent-duration Treasuries.

The CCC Anomaly

Which brings us to the most anomalous feature of today's credit market. Every ratings cohort from AAA through single-B currently sits in the bottom quarter of its twenty-year spread range (see **OAS Percentile by Rating**, below). Investment grade set an all-time tight of 74 bps in May, BBB reached 93 bps the same month, and BB set its own record of 152 bps in August. CCC spreads, by contrast, sit at 1,216 bps, in the 85th percentile of their history and wider than the peaks of both the 4Q18 and 2022 sell-offs. The CCC/BB spread ratio reached a record 7.0x in August, more than double its twenty-year median of 2.9x, and closed the quarter at 6.2x.

Chart 2 | **Where Spreads Sit Today: OAS Percentile by Rating**
Sep 30, 2026



Source: ICE BofA Indices (C0A1-C0A4, J0A1-J0A3), Xponance. 0 = tightest month-end since Sep 2006, 100 = widest.

This is not how credit markets have historically behaved. In every major sell-off of the past two decades (the GFC, the 2011 Euro crisis, the 2015-16 energy rout, 4Q18, Covid and 2022), all ratings cohorts widened in tandem. This time, high yield spreads peaked in April 2025 while CCC spreads have largely continued to widen for seventeen months, even as higher quality cohorts set new tights. We attribute much of the divergence to refinancing pressure: many CCC issuers locked in low coupons in 2020 and 2021 and now face refinancing with a 10-year Treasury above 5%, leaving little room for error at companies with limited free cash flow. Investors, in turn, are content to earn 6% to 7% yields in BB credits rather than reach for CCC risk. History also argues for caution in reading wide CCC spreads as cheap. While starting spread has been a strong predictor of forward excess returns across ratings, CCC bonds have realized only 37% of their average spread as excess return over the past twenty years, versus 88% for BBBs and 96% for BBs, with defaults and downgrades consuming the rest. CCC drawdowns have also run 1.3 to 2.3 times those of the broad high yield index in every episode.

Outlook: Opportunities and Pitfalls

What does all this mean in terms of outlook and portfolio positioning? The opportunity is in yield rather than spread. All-in corporate yields are the highest they have been since late 2023, and for income-oriented investors, locking in 6% investment grade yields is compelling against a Treasury curve that steepens from 4.77% inside two years to 5.69% beyond twenty. Yield breakevens reinforce the point. A yield breakeven (yield divided by duration) measures how far yields can rise over twelve months before price declines fully offset a bond's income. After September's sell-off, the investment grade index can absorb roughly 98 bps of higher yields, the 93rd percentile since 2006 and the most cushion since October 2023, while the broad Aggregate index (95 bps) offers its most protection since February 2009. The crossover segment of the market (BBB and BB credits) has historically been the most efficient place to take credit risk, capturing nearly all of its spread as excess return with the best risk-adjusted outcomes of any cohort. It also pairs that efficiency with near-record income cushions: breakevens of 104 bps for BBBs (94th percentile) and 205 bps for BBs (96th percentile, the highest since mid-2009).

The pitfalls are equally clear. Spreads offer little cushion: when investment grade OAS has started at 110 bps or tighter, subsequent twelve-month excess returns have averaged roughly zero since 2010, and the 224 bps gap between high yield and investment grade (17th percentile) offers scant compensation for moving down in quality broadly. The breakeven picture looks very different on a spread basis. Dividing spread rather than yield by duration, investment grade corporates can absorb only about 14 bps of widening before excess returns turn negative (16th percentile since 2006), and high yield roughly 94 bps (29th percentile). In other words, today's income cushion comes almost entirely from Treasury yields rather than from compensation for credit risk. The CCC yield breakeven of 6.6 percentage points (97th percentile) looks enormous for the same reason CCC spreads look optically cheap, which is better read as a gauge of distress than of value. A growing Treasury refinancing need raises the risk of a higher term premium and further curve steepening, a meaningful duration risk for long-dated credit. Finally, the CCC divergence may prove to be an early warning rather than an isolated event; if refinancing pressure works its way up the ratings spectrum, today's record-tight BB and BBB spreads leave little room to absorb it. In light of these factors, we favor capturing high all-in yields in quality crossover credit, remaining selective at the bottom of the capital structure, and staying disciplined on duration as the Treasury's growing interest burden plays out.

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