August 28, 2026

The Bond Market Strikes Back

LIZ ANN SONDERS: I'm Liz Ann Sonders.

COLLIN MARTIN: And I'm Collin Martin.

LIZ ANN: And this is *On Investing*, an original podcast from Charles Schwab. Every week we analyze what's happening in the markets and discuss how it might affect your investments.

COLLIN: Hi, Liz Ann, we're back again. Last week our episode included an interview that you had done with Jim Bullard and the title ended up being something like, "Has the Fed Accepted 3% Inflation?" And I think that's a good place to start because we're recording this on Wednesday morning, and we just got the July Personal Consumption Expenditures report, or PCE for short.

And once again it showed that inflation's a little too high. The report came in, I don't know, I'll call it mixed, not too hot, but on a year-over-year basis, it showed inflation from a headline standpoint at plus 3.7% and core PCE, which is what we know the Fed pays attention to, still came in at 3.3%. So you know, what's going on with inflation? What does it say about, you know, the current economic cycle?

LIZ ANN: First of all, one thing always to make note of when talking about PCE is you don't tend to get PCE prints that are well outside what is typically a very narrow band in terms of expectations. And that's in part because once the Consumer Price Index and the Producer Price Index are reported, economists can essentially map the components within each of those metrics to the PCE version of inflation. So that's why it doesn't tend to be maybe as market-moving as sometimes a CPI report can be, because you basically know what the numbers are going to be.

But you're right. I … you know, we still have very comfortably a three handle, both at the headline and the core level. And I just don't really see what the forces would be to bring that down sustainably. Yes, if you … let's posit at some point we're going to have whatever the end to the Iran war looks like. And assuming you get a move down in oil prices, that would accrue to the benefit of headline measures of inflation, not necessarily to core measures, which excludes food and energy. But the inflation story goes well beyond just energy.

It's a story that even has an AI flavor to it. Notwithstanding what I think is still consensus that AI could potentially be more of a disinflationary force alongside a productivity-boosting force. We do know that in the short term it is adding to inflation pressures. The other interesting piece of data that came out today that I wanted to highlight as it relates to this is we got the most recent update to second-quarter GDP, gross domestic product. And the revision was about in line with expected, some changes to the component parts, but one thing of note alongside this AI boom is that a lot of what is being spent on by companies financing this AI boom are imports.

And the math within the GDP equation is that you net imports and exports. So we have booming capital spending. We have booming imports, but because we don't have the same level of exports, it actually … the net accrues to the disadvantage of GDP and actually takes that net, puts a negative sign next to it. So it's a little bit of a drag on GDP. And that's also in part because import prices have been rising. And a lot of it is related to a lot of what goes into the AI build-out, equipment and otherwise. So you've got an AI story behind inflation.
You don't really have a wage story behind inflation. We're not in a wage-price spiral. So I don't really worry about that traditional driver of inflation. But there are many other sources of inflation that I don't think are easing anytime soon. And that's part of the reason why we're seeing yields where they are. But obviously that's not just an inflation story. So let's talk about the other amazing set of things that have happened in the past week or so with what the Treasury Secretary Bessent announced he would do. And I know we touched on it a little bit last week, but what really captured a lot of attention yesterday, as you and I are recording this, a pretty jaw-dropping op-ed in *The Wall Street Journal* by Secretary Bessent's former mentor in Stan Druckenmiller. So I'm going to toss it back to you because there's just a lot going on in your world. What are your thoughts on all of this?

COLLIN: Ooh, I have a lot of thoughts, so let's see, you know, I'll try to keep it brief. I don't want to ramble on too much. But I was it's funny, I was thinking about our discussion last week and I thought, "Didn't we talk about this?" But we were actually talking about the move up in yields that kind of spurred the action by Treasury Secretary Bessent. But now that's the story. And I think there's a lot of … not so much questions about why he did it, but I think there's … maybe we can go over an explanation. So what Bessent is proposing is an increase in the size of the liquidity buyback operations that are already underway. So Treasury has already been buying back a number of bonds, off-the-run bonds, which are bonds that have already been issued, and the point is to increase their liquidity, because as a bond gets further and further away from its issue date, it might lose some liquidity as investors tend to favor the most recently issued bonds.

But it seems like the increase in the buyback operation is less about managing liquidity and more about the Treasury just trying to buy more bonds in an attempt to lower yields, because bond prices and yields move in opposite directions. So if the Treasury is boosting its demand, that can pull prices up and yields down. I think the most simple example or reason why Treasury Secretary Bessent did this was because long-term yields were rising, and we know that the administration cares about this.

You know, if we go back to, you know, early 2025 when President Trump kind of first came into office, when Bessent first got his role, when they were talking about lower interest rates, often they wouldn't discuss the fed funds rate. They would discuss long term Treasury yields, the 10-year or even mortgage rates, because that impacts Americans in terms of how … what do our home buying, you know, trends look like. We hadn't heard much from them on that front until recently when long-term yields elevated. So the why is for Bessent to try to manage that and maybe put a cap on our long-term yields because that does flow into mortgage rates.

I'll add this that he has every right to do this as Treasury secretary. Just like you and I manage our finances, that's … we can get to finances. That's really the key story. But we, you know, if we have debt outstanding, we can refinance our mortgage if we see fit. People can move around to different credit cards if they see a better rate there. You can manage your debt.

But this isn't likely the fix that the Treasury market needs. This is probably a short-term fix. But brings me to my main point, is a fix even necessary? So the question is, are yields high? If we look at the last 15 years or so or 16 years, yes, they are high. You know, the 30-year Treasury yield touched 5.3%. That's, I think, what probably resulted in the intervention. The 10-year Treasury yield has been touching 4.7% for the past few weeks. That's high relative to the past handful of years. It's not high relative to history. And the most simple way that I would explain why yields are where they are, it doesn't have to be a bad thing. OK, yes, it makes borrowing costs more expensive for homeowners. It weighs on us from a government-interest-expense standpoint.

But when you have a fed funds rate that is in the 3.5% to 3.75% range, that's probably going to hold there for a little while or maybe move higher. That's not our base case, but biased higher. And in an environment where the economy's still growing, the yield curve should be positively sloped. You know, you should earn higher yields by considering a 10- or 30-year Treasury. So I think that's normal.

And it's indicative of, you know, where the fed funds rate is and the fact that the economy does continue to grow, you know, at trend or maybe even higher than trend on a given quarter. And the real fix, if we want to really rein in Treasury yields, a lot of it comes down to fiscal issues. And that doesn't appear to be anything that either side of the aisle wants to address. I don't … I'm not going to dive in on that. but we have a lot of debt outstanding. We have 40 trillion from a total debt standpoint. We have about 32 trillion in marketable debt. That's not something that Bessent can fix. That's something that Congress needs to fix.

LIZ ANN: Which, you know, I'm glad you said that because I think that, to me, what is overarching about what Bessent has announced is he is trying to attack the symptom of what's going on from a concern about fiscal profligacy and how we ever can possibly grow our way out of $40 trillion in debt running massive deficits, and so there's a cause here that is not being addressed. And what they're attempting to address is the symptom.

But let me also ask, because we've got Chairman Kevin Warsh's speech at Jackson Hole this coming Friday, which is the day that our episode will drop, which is why we're not discussing it. But doesn't this throw a wrinkle into the way the Fed needs to think about their monetary policy reaction function? Because it was Warsh himself who not long ago made the comment about the bond market doing some of the Fed's job for it because of the move up in yields in terms of maybe putting some downward pressure on inflation or easing any concerns about frothiness from a growth-rate perspective. So how does Warsh deal with what many are saying is the Treasury now doing something that's a bit at odds with what the Fed's goals are?

COLLIN: Yeah. how he deals with it, we'll have to see, but it clearly puts him in a tough situation. And it's a dilemma for the Fed right now. As you said, Liz Ann, Warsh himself has told us that he can take some cues from the market. You know, let the markets decide what might need to happen, or we can take their cues from there. But if "the market," I'm using air quotes now, no one else can see those, but if the market is being …I mean, I'll say manipulated, but if it's intervention from the Treasury, those aren't necessarily cues from investors or the market; it's cues from the Treasury.

And you could argue it puts the Fed and Treasury at odds a little bit. Maybe not Warsh and the Treasury, but the Fed, because the Fed is a committee, the Federal Open Market Committee. And we know there's a number of voters and nonvoters alike who favor higher rates right now, and there's others that might favor higher rates down the road. And if the Treasury is working to lower rates right now, that can ease financial conditions, and easier financial conditions can result in higher spending and higher inflation down the road. So they're kind of at odds right now. You mentioned his speech this week. Again, it'll come out right around the time of when our podcast … this will be released. I don't know if Warsh will address what's going on with Treasury. That might risk confusing what's going on.

Also he might not have a clear response to what's going on. But here's another risk, and I wonder what kind of spillover this might have to other parts of the market. There's been a discussion first with the Fed about a potential credibility issue. And I don't think we're there yet, because we know that there's members that think they might need to hike rates to bring inflation in. But if the data says the Fed should hike, and it doesn't, I think the Fed risks losing credibility. When we look at the Treasury now, the Treasury, this can be a short-term fix. And maybe Bessent will succeed in bringing down long-term interest rates. But again, it's a fix. It's not addressing the key symptoms.

And if the markets think that Treasury is losing credibility, if they're doing this kind of as a …. it's a rash decision, and they're trying to do what they can instead of other key issues or key fixes, is then they're a Treasury credibility issue. And when you have these two dueling, I'd say, concerns, does the opposite happen, and do long-term yields rise because investors need to demand or want higher yields to compensate for all that uncertainty? And then kind of big picture question, "Well, what does that mean?" Not just for the bond market, but for the stock market. Maybe it doesn't matter, because the stock market generally has been doing OK with the level of interest rates. But if we see volatility pick up or uncertainty pick up, what kind of impact can that have on other asset classes?

LIZ ANN: Well, I think the impact to some degree is already being felt. I think in this type of market environment, especially with such rapid-fire rotations happening, we have to look beyond just what the indexes are telling us. We've had relative stability at the index level, but a heck of a lot of churn underneath. And I think some of that churn, and where we've seen strength and weakness, is a function of what we're seeing in terms of what was the move up in longer yields and then maybe some concern about what Bessent announced and kind of un-anchoring what should be done with fundamentals.

You know, one of the more interesting lines from the op-ed that Stan Druckenmiller wrote was, and I think it was spot on, was that the 10-year yield is the most important price in the world. And along the spectrum of yields, it has the most impact on the equity market. So I think we're already seeing some of the interest-sensitive segments of the market like utilities, like real estate, get hurt. I think that's also in part because there's shiny new objects in the corporate bond market these days with all the issuance from some of the, you know, major tech companies in the world of the AI build-out.

So we are seeing implications for segments of the market, tech struggling a bit more. That's the ultimate long-duration sub-asset class within equities, using that more traditionally fixed income-oriented term to the equity market. To me, though, this brings up something that we've talked about on the program. We don't have to dive into the detail, and in the interest of time, Kevin and I put a piece out a couple of months ago on the end of the Great Moderation Era. And that was an era that spanned from the late '90s up until the inflation spike in 2022. And it was an era when, for the most part, bond yields were moving based on what was happening on the growth side of the equation, with less concern about inflation. So higher yields typically meant higher stock prices. That also meant because higher yields mean lower bond prices, you had bond prices and stock prices for much of that 20-plus-year period moving in the opposite direction, kind of classic good backdrop for 60/40 or 60/30/10.

We're now back in negative correlation territory. And that, by the way, that environment predated the Great Moderation Era, and you had a 30-plus-year span from the mid-'60s to the mid-to-late 1990s when bond yields and stock prices went in the opposite direction, because for much of that 30-plus-year period, bond yields were moving up and down based more on inflation than growth. Higher yields because of higher inflation, not a great backdrop for equities. But that also meant that that was an environment where bond prices and stock prices were moving in the same direction. A little bit trickier a backdrop to get a lot of diversification in that very simple way.

Now I'm going to say something you would say if I turned the mic back to you, which is it's always appropriate to have some bonds in a portfolio. This is not saying, you know, bonds don't offer diversification benefits. It still makes sense for most investors to have a combination of stocks and bonds, but there's also a lot of access now because of democratization to asset classes, much broader asset classes, whether it's commodities or real estate or precious metals or the private markets, both on the equity side and the credit side. So I think that this is not a bad background to be in in an environment where we could see a persistence in that bond/stocks relationship. But that to me is the more secular story that has gotten a little bit lost in the short-term-ism associated with, you know, "What is Bessent doing? What's Warsh's reaction going to be? And what did Druckenmiller, you know, say in his op-ed?"

COLLIN: Well, I want to build on that? So you know, we've talked about this a lot, either on-mic and off-mic about, you know, the shift of your idea about the Great Moderation. And now maybe we're in this era again with more and more shocks, more inflation uncertainty. And it sounds like we're getting into trade wars again. So we're in this environment where there's a lot of uncertainty about everything that's going on in the Middle East and maybe what's happening militarily might shift to an economic war. I think that, you know, something like that, that's what Bessent has mentioned. But now we're also … it looks like trade wars are happening again. So how does all this flow into, you know, our economic outlook and what it means for investors?

LIZ ANN: I think all else equal, it's not a benefit to the economy. Tariffs are taxes. So in a trade war, companies are paying more in taxes. That's just another way to think about tariffs. Notwithstanding sometimes how the headlines are written, tariffs are paid by the U.S. companies importing the goods from whatever, fill-in-the-blank of whatever country is being targeted with those tariffs, and I didn't specifically mention it when we were talking about the drivers of inflation, spoke a bit about AI as an inflation driver, but tariffs are an inflation driver, too. So that's another force that has been kind of teed back up again in earnest that I think, again, all else equal, accrues to the disadvantage of economic growth and to the upside in terms of inflation.

So Collin, it's that time. Let's look ahead. We've addressed the fact that we are not commenting on what Warsh said during Jackson Hole because we're taping this before Jackson Hole. But I would say to our listeners out there, just you know, follow us on social media because that is a place that inevitably both of us will be commenting throughout the course of the day on Jackson Hole.

But what else is on your radar in the next week or so, Collin. It's definitely a big week next week because we've got the jobs report. But what else are you keeping an eye on as we head into next week?

COLLIN: Yeah, you know, one more point on Jackson Hole, just because we do think it's important. And I don't know how much clarity we'll get from Kevin Warsh, but I'm hoping for something about whether, you know … maybe it's as simple as does he view monetary policy as restrictive, accommodative, or neutral? And obviously inflation is still very much present. It's still top of mind. Maybe some of his thoughts on, you know, the drivers of inflation. Is it's supply driven? We know that part of it is because of oil prices, or is it demand driven? Because we know that's where the Fed can really have an impact. And then he might give us some sort of sneak peek on the task forces at hand and maybe some updates there. But unfortunately, I don't think I or many people are expecting too much clarity from Warsh this week.

Looking ahead to next week, it's all about jobs, I think. We get the JOLTS report, the Job Openings and Labor Turnover Survey that comes out on Tuesday, gives us an idea of supply. You know, "Are there job openings?" We can get quits rates, higher rates, layoff rates, a lot of good nuggets in there. As always, we get the initial jobless claims on Thursday. They've generally been pretty low, suggesting we're still kind of in this low-fire economy. But then you know the big report is Friday's jobs report. If we look at non-farm payrolls, the consensus estimate points to about 60,000 increase after the decrease in July. I always think it's important to look at revisions, though. Revisions are very important. So let's see, you know, as of now July was negative. Let's see if it, you know, maybe it gets revised up, maybe it gets revised down. That wouldn't be good, of course.

And then we get the two Institute for Supply Management reports, the ISM, we get manufacturing Tuesday. We get services Thursday. Those always give a nice outlook, kind of a soft data on how the manufacturing and services side of the equation are looking. So what about you, Liz Ann?

LIZ ANN: Certainly the ISM readings, but also S&P Global comes out with their version of the Purchasing Managers' Indexes. And I … may not be as widely followed as ISM, but I do because it's a larger number of companies surveyed, and it has more of a global flavor to it than ISM. So I think it maybe gives an even broader picture of that soft data.

And there's employment components within both ISM and S&P Global's version of the PMI. So on a week where there's so much additional labor market-related news, I would also pay attention to the nuggets therein. One thing I would also say about JOLTS is a bit of a reminder is the JOLTS data lags all other data by a month. So just keep that in mind. It's not … from a calendar perspective, it's not apples to apples.

And we also get the Challenger layoff announcements. So I agree that I think we're most likely to stay in this low-hire, low-fire, but we want to look at that relationship between the supply of jobs, job openings, and where there might be compression with layoff announcements, because that is sort of the ultimate leading indicator. You know, we talk about unemployment claims, which are a classic leading indicator, but before somebody files for unemployment insurance, they've gotten laid off. And so it is really an early read on any cracks that start to form in the labor market. So I don't anticipate anything negative, but that's also on the docket.

So that's it for us this week. As always, thank you for listening. And as a reminder, and as I already mentioned, you can keep up with us in real time on social media. I'm @LizAnnSonders on X and LinkedIn.

COLLIN: And I'm @CollinMartinCS on X and LinkedIn. That's Collin with two Ls, and the CS is for Charles Schwab. You can find all of our written reports, including lots of charts and graphs and tables, at schwab.com/learn.

LIZ ANN: And if you've enjoyed the show, please consider leaving us a review on Apple Podcasts, a rating on Spotify, or feedback wherever you listen. And please tell a friend or more about the show. We will be back with a new episode next week.