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## Q4 2025 Bond Market Update: 4 Key Themes Signal Constructive Fixed Income Backdrop

By Bill Smith, Fixed Income Trader and Portfolio Manager

2025 was an eventful year in the fixed income markets, punctuated by 75 basis points of easing from the Federal Reserve (Fed), the United States losing its last remaining AAA rating, and significant volatility driven by fiscal and trade policy uncertainty. Against this backdrop, fixed income performed well, with many major bond indices returning more than 7% for the year. While investment-grade and high-yield municipals had a strong Q4, they remained relative underperformers for the year, returning 3.92% and 3.35%, respectively. U.S. high yield and emerging market corporate bonds continued their outperformance, returning more than 8% each.

The charts below summarize the yield and performance of select fixed income tenors and indices as of Dec. 31, 2025:

U.S. Treasury Yield Curve				Index Characteristics and Returns				
Maturity	Yield	Change (Basis Points)		Index	Yield (Worst)	Modified Duration	Returns (%)	
		Q4 2025	Year-to-date				Q4 2025	Year-to-date
2-year	3.48	-13.4	-76.8	U.S. Treasury	3.94	5.98	0.74	6.19
5-year	3.73	-1.6	-65.7	U.S. Agency	3.93	3.74	1.09	6.08
10-year	4.17	1.8	-40.3	U.S. Corporate Investment Grade	4.84	6.48	0.77	7.78
30-year	4.85	11.3	6.2	U.S. Corporate High Yield	6.62	2.91	1.35	8.50
Source: Bloomberg, 31 December 2025 (US On/Off The Run Sovereign Curve)				U.S. Mortgage Backed Securities	4.72	5.53	1.59	8.33
				U.S. Broad Market	4.37	5.87	0.96	7.15
				Global Broad Market	3.77	6.07	0.47	3.98
				Emerging Market Corporate	5.35	4.99	1.08	8.53
				Municipal Investment Grade	3.64	6.12	1.45	3.92
				Municipal High Yield	5.13	7.18	1.72	3.35
				Municipal Taxable	4.87	7.54	0.98	7.57
				Source: ICE DATA INDICES, LLC ("ICE DATA"), 31 December 2025. Past performance is no guarantee of future results. U.S. Treasury = ICE BofA US Treasury Index, U.S. Agency = ICE BofA US Agency Index, U.S. Corporate Investment Grade = ICE BofA US Corporate Index, U.S. Corporate High Yield = ICE BofA US High Yield Index, U.S. Mortgage Backed Securities = ICE BofA US Mortgage Backed Securities Index, U.S. Broad Market = ICE BofA US Broad Market Index March 2020 Regular Rebalance, Global Broad Market = ICE BofA Global Broad Market Index, Emerging Market Corporate = ICE BofA Emerging Markets Corporate Plus Index, Municipal Investment Grade = ICE BofA US Municipal Securities Index, Municipal High Yield = ICE US High Yield & Non-Rated Municipal Securities Index, Municipal Taxable = ICE BofA Broad US Taxable Municipal Securities Index.				

U.S. Corporate (Investment Grade) Yield Curve				Federal Open Market Committee (FOMC)			
Maturity	Yield	Change (Basis Points)		Fed Funds Rate - Upper Bound	3.75	Last FOMC Meeting	28-Jan-26
		Q4 2025	Year-to-date				
2-year	4.01	-9.5	-69.8	Fed Funds Effective Rate	3.64		
5-year	4.43	0.8	-62.4	Discount Rate	3.75		
10-year	5.04	1.1	-44.0	Source: Bloomberg, 10 February 2026			
30-year	5.78	15.1	-1.8				
Source: Bloomberg, 31 December 2025 (USD US Corporate IG BVAL Yield Curve)							

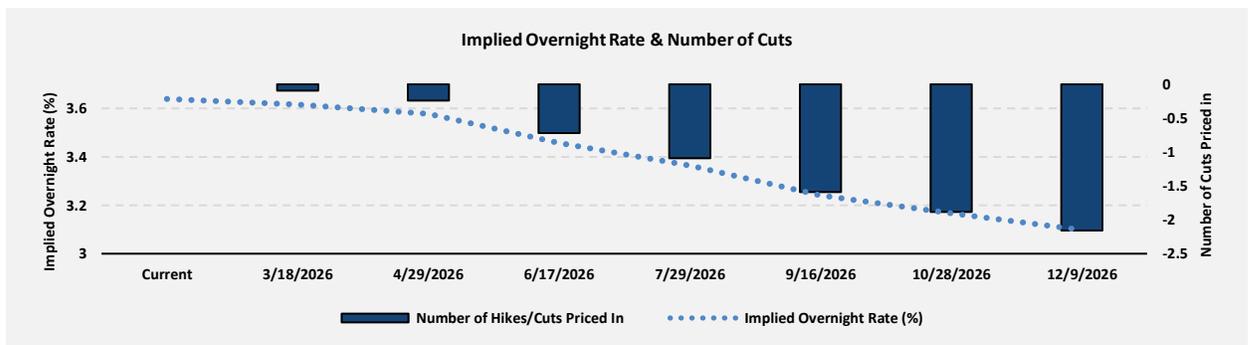
Municipal (AAA) Yield Curve			
Maturity	Yield	Change (Basis Points)	
		Q4 2025	Year-to-date
2-year	2.10	-16.8	-72.2
5-year	2.16	-15.4	-74.5
10-year	2.57	-35.2	-55.8
30-year	4.21	-8.7	33.4
Source: Bloomberg, 31 December 2025 (BVAL Muni AAA Yield Curve)			

*Past performance is not a guarantee of future results.*

As we move further into 2026, four key themes that shaped the fixed income markets last year are expected to remain in focus:

### 1. Further Monetary Easing Appears Likely

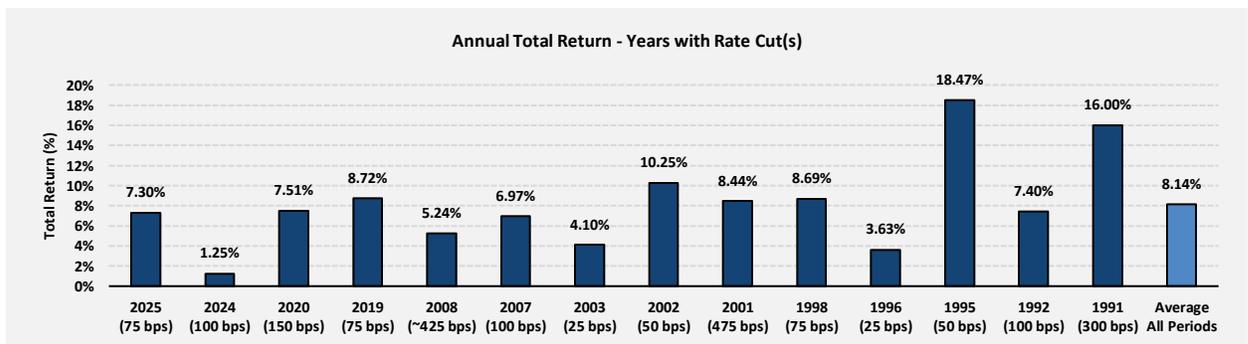
As of February 11, Fed funds futures have priced in at least two 25 basis-point rate cuts this year, with a 100% probability of the first occurring at the Federal Open Market Committee (FOMC) meeting in July, according to Bloomberg’s interest rate probability model. While inflation and labor market data can change this narrative, lower rates remain the base case.



Source: Bloomberg as of Feb. 11, 2026. Past performance is not a guarantee of future results.

### 2. Easing is Generally Constructive for Fixed Income

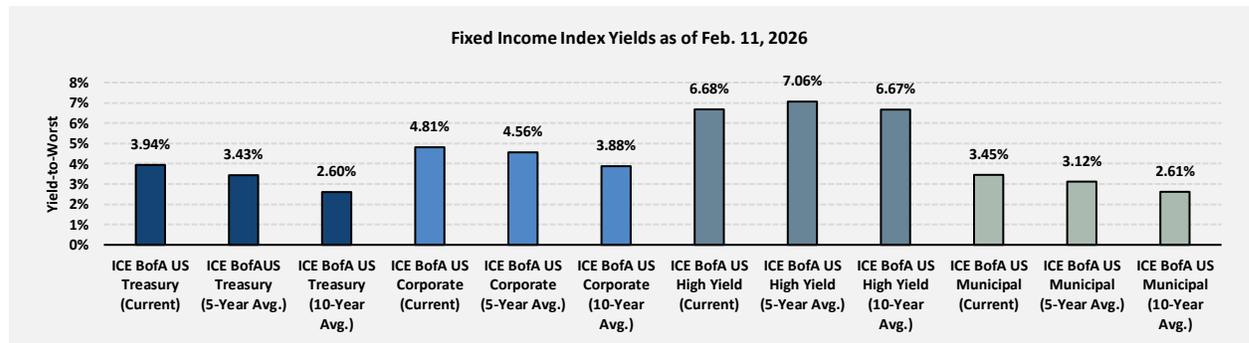
Lower rates often translate into higher bond prices, and an additional two rate cuts from the Fed would likely provide a tailwind for fixed income total returns in 2026. While past performance is no guarantee of future results, for every calendar year over the last 25 that had at least one rate cut, the Bloomberg Aggregate Bond Index had a positive return, as illustrated in the chart below.



Source: Bloomberg. Past performance is not a guarantee of future results.

### 3. Yields Remain High

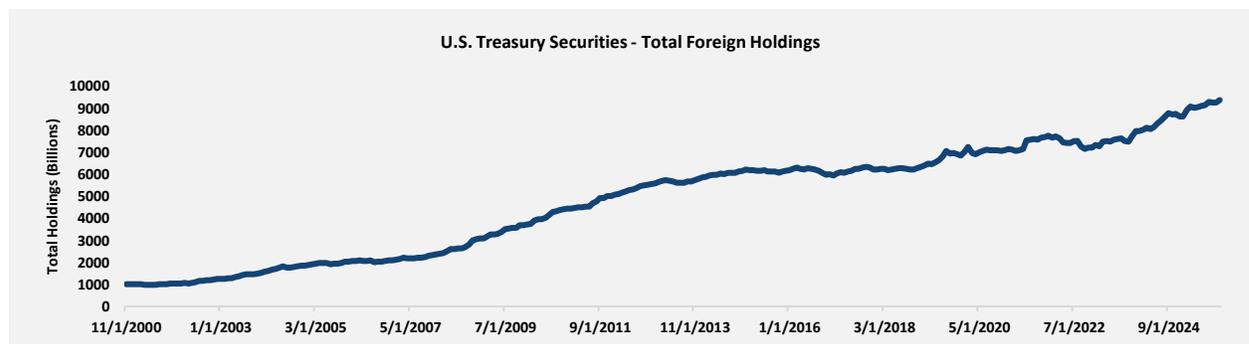
Yields across major fixed income sectors remain attractive. Except for high yield in the chart below, Treasury, corporate, and municipal bond indices are still yielding well above their five and 10-year averages. For income-oriented investors, now may be a good time to look at the bond market.



Source: Bloomberg, ICE DATA INDICES, LLC (“ICE DATA”), as of Feb. 11, 2026. Past performance is not a guarantee of future results.

#### 4. Headline Risks Remain for U.S. Treasuries

Recent Bloomberg news articles have reported Chinese regulators advised financial institutions to reduce and/or limit future purchases of U.S. Treasury (UST). While this has garnered attention in the news cycle, China’s holdings of UST have been steadily declining since 2013. Rather than representing a fundamental shift, this announcement appears to reinforce a well-established trend. Importantly, total foreign holdings of U.S. debt have been steadily increasing, which should help allay fears of an imminent yield spike due to a foreign buyer strike, as illustrated in the chart below. While rising U.S. debt levels and interest costs pose long-term challenges, the U.S. Treasury market remains the world’s largest and most liquid, serving as the bedrock of the global financial system.



Source: Bloomberg. Past performance is not a guarantee of future results.

With additional easing likely and yields still attractive, the bond market enters 2026 with a constructive backdrop. While policy headlines and debt concerns may create periodic volatility,

global demand for income remains intact, and fixed income should continue to play an important role in well-diversified portfolios.

*Fixed income. Flexible thinking.*

A prudent approach to fixed income investing calls for diversification across both credit and duration exposure. As always, Dynamic recommends staying balanced, diversified and invested. Despite short-term market pullbacks, it's more important than ever to focus on the long-term, improving the chances for investors to reach their goals.

*Bill Smith serves as president, Portfolio Management & Trading, of Harmont Fixed Income in Phoenix.*

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