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Year-End Fixed Income Perspectives: Opportunities, Risks, and Positioning for 2027

A Resilient Economy and a Higher-for-Longer Rate Environment

2026 began as another promising year for fixed income investors, with attractive yields across the curve and the prospect of multiple Federal Reserve (Fed) rate cuts. This narrative shifted as inflation from elevated energy prices, ongoing fiscal deficits, and stronger-than-anticipated economic activity drove markets to re-rate bond yields higher. Central banks around the world, including the Fed, maintained restrictive monetary policies while a strong labor market, consumer, and artificial intelligence tailwinds helped support economic growth and keep long-term interest rates up.

While the broader economy has remained durable, the effects of higher borrowing costs are becoming increasingly evident beneath the surface. More leveraged sectors face growing challenges, while companies with stronger balance sheets have generally been rewarded.

The result has been another reminder that fixed income investing remains highly dependent on valuation, risk management, and security selection, particularly during periods of elevated uncertainty.

For investors reviewing fixed income allocations ahead of year-end, the current market environment presents several noteworthy opportunities and considerations for 2027:

Tax-Loss Harvesting Opportunities

With interest rates moving higher over much of 2026, some portfolios and individual fixed income positions remain below their original purchase prices. While losses are far less severe than those experienced during the 2022 bond market selloff, they may nevertheless create valuable tax-planning opportunities.

Unlike 2022, equities have generally performed well this year, increasing the potential value of realized losses that can offset taxable gains elsewhere in a portfolio.

If utilizing a Separately Managed Account (SMA), a portfolio manager can selectively realize losses on individual securities while maintaining the targeted market exposure.

Key Takeaways

Harvest Tax Losses Where Appropriate
Rising interest rates have left some fixed income positions below purchase price, creating opportunities to realize losses that may offset gains elsewhere in a portfolio.

Reassess Duration and Credit Risk
Absolute yields remain highly attractive, but investors are receiving relatively little additional compensation for taking on longer duration, lower credit quality, or more aggressive spread-sector exposure. This may be an opportune time to evaluate whether portfolio risk levels remain aligned with long-term objectives.

Revisit Municipal Bonds
Taxable-equivalent yields (TEYs) in the municipal market are among the most compelling levels seen in years. For many investors, particularly those in retirement or approaching retirement, high-quality municipals may provide after-tax income that rivals or exceeds comparable taxable alternatives while preserving portfolio quality.

As always, investors should work closely with their financial and tax advisors to determine whether the potential benefits justify the associated transaction costs and portfolio adjustments.

Consider Reducing Unnecessary Risk

Many fixed income investors naturally gravitate toward highly rated and widely followed bond strategies managed by large, well-known firms. Frequently, however, these strategies are benchmarked against broad investment-grade indices that contain meaningful exposure to longer-duration securities, lower-quality investment-grade credits, mortgage-backed securities, structured products, and, in some cases, high-yield bonds.

There is nothing inherently wrong with these strategies, and we manage similar portfolios ourselves. However, many high-net-worth investors and smaller institutional accounts may not require the level of interest-rate and credit risk embedded in these benchmarks. The yields will be lower, but by moving away from the riskier parts of the market, they should be better positioned if interest rates spike or spreads suddenly widen.

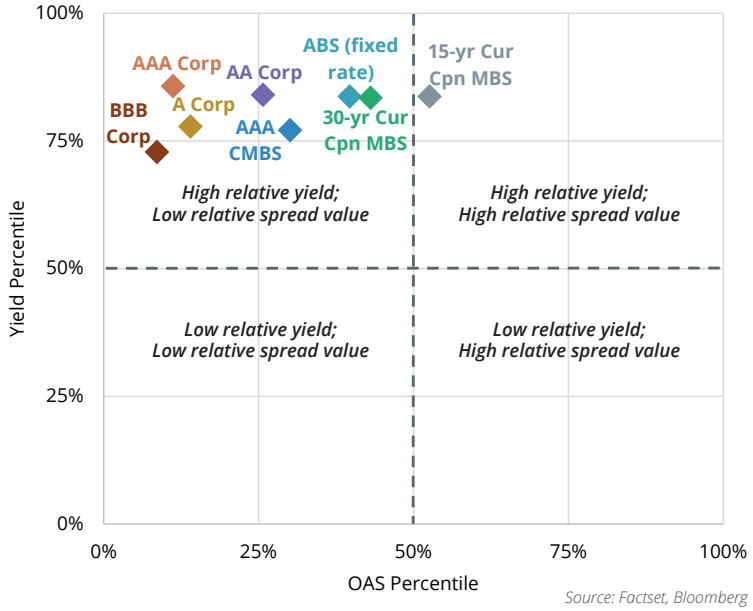
As of 9/30/26	Bloomberg Interm Gov/Credit Bond		Bloomberg Aggregate Bond	
	% Held	Avg. Duration	% Held	Avg. Duration
Utility Bonds	2.47	4.32	2.44	7.56
Industrial Bonds	15.35	4.06	13.88	6.92
Financial Bonds	11.45	3.84	7.77	5.01
Mortgage Backed Securities (MBS)	0.00		23.19	5.90
Commercial MBS	0.00		1.42	3.55
Total	29.27	3.99	48.70	6.06

Source: Bloomberg

Today's environment presents a unique opportunity. Absolute yields across many high-quality fixed income sectors remain among the most attractive levels investors have seen in more than two decades. At the same time, the incremental compensation for taking on additional spread risk remains relatively limited by historical standards.

As the chart shows, investors are currently earning attractive absolute yields while receiving comparatively modest compensation for extending into lower-quality credit sectors. Although certain securitized sectors offer somewhat better relative value, opportunities remain selective rather than broad-based.

Percentile Rank of Option Adjusted Spread (OAS) and Yield
(based on data from 1997 thru 9/30/26)



Source: Factset, Bloomberg

A Compelling Opportunity in Municipal Bonds

Municipal bonds deserve renewed attention. It has been many years since taxable-equivalent yields (TEYs) in the municipal market have been as attractive as they are today, both on an absolute basis and relative to comparable taxable alternatives. Importantly, this opportunity extends beyond investors in the highest tax brackets.

Many retirees and pre-retirees establish minimum after-tax return objectives necessary to support long-term spending needs and financial plans. For much of the past two decades, exceptionally low interest rates often forced investors to assume greater portfolio risk in pursuit of those return targets. That environment has changed significantly. Today, many municipal bonds offer taxable-equivalent yields that can compete with, and in some instances exceed, similarly rated taxable bonds. For investors subject to both federal and state income taxes, the relative advantage may be even greater.

As of 11/2/26	5-Year	10-Year	30-Year
US Treasury	4.71	4.90	5.27
US Corporate-Financial (A-rated)	5.41	5.84	6.27
US Corporate-Industrial (A)	5.23	5.60	6.11
US Corporate-Utility (A)	5.37	5.79	6.24
Municipal (A) – 37% Tax Bracket TEY	5.34	6.18	8.67
Municipal (A) – 22% Tax Bracket TEY	4.26	4.93	6.91
Municipal (A) – 10% Tax Bracket TEY	3.67	4.25	5.95

Corporate and municipal bonds carry greater credit risk than US Treasury bonds and generally offer higher yields as compensation for these additional risks.

Source: Bloomberg, LSEG Municipal Market Monitor

Equally important, these elevated taxable-equivalent yields allow many investors to meet long-term return objectives while remaining focused on high-quality issuers and maintaining a disciplined risk profile.

Summary

While 2026 challenged many traditional fixed income assumptions, it also created opportunities for disciplined investors. Elevated yields, attractive municipal valuations, and the ability to selectively reduce duration and spread risk provide a favorable backdrop heading into 2027.

In our view, the most attractive opportunities are not necessarily found in taking greater risk. Rather, they are found in taking advantage of some of the highest absolute yields available in years while maintaining a disciplined focus on credit quality, diversification, and long-term portfolio objectives.

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In addition to the ongoing market risk applicable to portfolio securities, bonds are subject to interest rate risk, credit risk and inflation risk. When interest rates rise, bond prices fall; generally, the longer a bond's maturity, the more sensitive it is to this risk. Credit risk is the possibility that the issuer of a security will be unable to make interest payments and repay the principal on its debt. Bonds may also be subject to call risk, which allows the issuer to retain the right to redeem the debt, fully or partially, before the scheduled maturity date. Proceeds from sales prior to maturity may be more or less than originally invested due to changes in market conditions or changes in the credit quality of the issuer.

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Bloomberg US Aggregate Bond Index: a broad-based flagship benchmark that measures the investment grade, USD-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, mortgage backed securities, asset-backed securities and corporate securities, with maturities greater than one year.

Bloomberg US Intermediate Government/Credit Bond Index: measures the performance of USD-denominated US Treasuries, government-related and investment-grade US corporate securities that have a remaining maturity of greater than or equal to one year and less than 10 years.

Duration: a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates. Duration measures how long it takes, in years, for an investor to be repaid the bond's price by the bond's total cash flows.

Yield Curve: a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity. There are three main types of yield curve shapes: normal (upward-sloping curve), inverted (downward-sloping curve), and flat. Yield curve strategies involve positioning a portfolio to capitalize on expected changes.

Federal funds rate: the target interest rate range set by the Federal Open Market Committee (FOMC) for banks to lend or borrow excess reserves overnight. It influences monetary and financial conditions, short-term interest rates, and the stock market.

Option-adjusted spread (OAS): measures the difference in yield between a bond with an embedded option (e.g. callable bonds, mortgage-backed securities) with the yield on Treasuries.

Percentile Rank: a statistical measure that indicates the relative standing of a value within a dataset. For example, a sector with an OAS of 35 and a percentile rank of 25 indicates that, historically, the OAS has been below 35 25 percent of the time and above 35 75 percent of the time.

Bond Spread: the difference between yields on differing debt instruments of varying maturities, credit ratings, and risk, calculated by deducting the yield of one instrument from another.

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