# Hamilton-Bates
## Special Update

***August 2026***

P.O. BOX 98   Mertztown, PA 19539   877.768.4247   www.hbir.com

# The Bond Problem

***$40 Trillion in US Debt is a Stack of $100 Dollar Bills that Reaches Past the Moon***

The stock market gets all the attention, and rightly so. It is much more interesting than the bond market.  Fortunes made or lost overnight; dizzying heights, scary crashes. The drama in the stock market is appealing on so many levels that it virtually demands attention. Nearly all financial programming covers stocks.

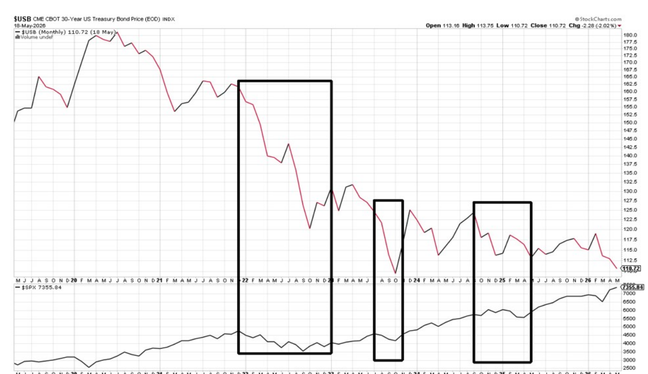
Bonds on the other hand are boring. Coupons, duration, credit rating—who understands all this? Who cares? Nobody talks about their bond portfolio. Boring bonds are for 'widows and orphans', and retirees needing income. Investors know bonds are good for diversification but really not much else about them. That was ok in the past, they didn't need to. From 1981 through 2020 we saw a tremendous secular bull market in bonds, so for 4 decades all you needed to do was hold on. This period also coincided with a secular bull market in stocks that was even more powerful-and not by coincidence. However, since 2020 things have changed.  This is not the 1980s, 90s, or 00's bond market anymore. Investors need to pay attention.

**Why Bonds Matter**

Bond markets are larger than the equity markets, and even more importantly bonds dominate what happens in the currency markets—which are much larger than the stock and bond markets. The bond market tends to get less caught up in speculative narratives and far more focused on growth expectations,  inflation, and deficits. The problem is that the U.S. has a long-term debt problem that is now manifesting itself in higher bond yields ;which in turn are now affecting the financial markets. The Fed controls short-term rate (less than 2yrs) with direct policy but only indirectly control long-term yields.  To move long-term yields the Fed must buy or sell bonds in the open market (known as QE or QT). And they like yields to remain tame.  When bond yields move, they move the price of many things—such as loans, and mortgages, instantly. Financial conditions tighten when yields rise. Corporate borrowing costs rise. Refinancing becomes more expensive. A move in yields spills into stocks too. Valuation models become less forgiving. Most importantly, the higher yields go, the less rational it becomes to pay up for extreme multiples in growth stocks.

**Impact on Portfolio Decisions**

During the bond bull market from 1981-2020 all types of bonds generally went up. It really didn't matter what you owned.  If you had a portfolio and wanted to diversify you added bonds.  Bonds generally went UP when stocks went DOWN over this period.  This made the typical 60/40 portfolio very attractive.  <u>Things changed in 2020. By the time Covid hit US debt and deficits had already ballooned. But since 2020 they have shifted to high gear. After years of putting it off, the bond market has finally responded</u>. Since 2020, long-term US Government bonds are down big (39%). Many other types of bonds have also struggled or been down over this period. The bond market has changed and what you owned in fixed income has mattered greatly. The chart below shows the 30-year Treasury Bond in the top panel (red) and the S&P 500 in the bottom panel (black). Not only can you see the big drop in Treasury Bonds over the full period; but during periods of stock market weakness (shown in the boxed areas), <u>bonds actually went down along with the stock market</u>.



Hamilton-Bates
Special Update

*August 2026*

# The Bond Problem

P.O. BOX 98 Mertztown, PA 19539 877.768.4247 www.hbir.com

Treasury Bonds have offered little diversification benefits since 2020. This is critically important. If Treasury Bonds aren't helping when the market is down big—why own them? We don't see a lot of help coming from the beltway. Those bums love to spend and the U.S. is unlikely to get its financial spending house in order—so Treasury bonds are an unattractive option right now. And they could be for some time.

There is a lot of AI Debt coming to fund the data center build-out. This is adding to the upward pressure on yields and downward pressure on longer maturity bond prices. This wave of corporate funding is now competing with and crowding out long-term government funding. As a result we are looking at other areas for portfolio construction, and for diversification. There could be a price and yield where long-bonds become attractive again, its just not right now.

**What is Happening Right Now**

The fact that the Fed is stuck between a 3.8% CPI and 6% PPI rock and a huge debt problem hard place. Yields have been pushing higher this summer, with yields now at levels not seen in over 20 years. If yields continue to push higher too quickly, it could get ugly for the markets. Markets had become increasingly comfortable assuming inflation would continue cooling, rates would eventually fall, and liquidity would remain abundant enough to support elevated valuations indefinitely. It hasn't worked out that way. Inflation has remained high, earnings have been strong, but so have signs of consumer stress. This is a nasty mess that keeps the Fed with few easy options. The Federal Reserve still looks trapped between two deeply unattractive choices. Tighten policy further and risk breaking highly leveraged parts of the economy and financial markets. Pivot back toward aggressive liquidity support and risk reigniting inflation while further damaging confidence in the dollar. Neither path is clean. Both paths create volatility.

**Portfolio Strategy and Construction**

Traditional fixed income has been a drag on portfolios for over four years now, essentially becoming a black hole. Investors can't just ignore this, nor can they just ignore fixed income and go all-in on equity. That is simply too risky an option for many investors.

As a flexible manager we continue to look at our portfolios as evolving—responding to changing market conditions and adapting allocations accordingly. We do not try to be too smart or too cute—we are not trying to smooth little ripples. We look at the secular picture and make adjustments to allow client portfolios to adapt and handle the new environment. In the case of bonds, we have generally been underweight for years, and have completely avoided long-term government bonds. We have been using alternative income ETF's, along with flexible income ETF's that allow the underlying manager the ability to find the sweet spots in the income arena. We have also been shortening maturities—looking to hold bonds in the 2 to 5 year range—these are less responsive to changes in long-term rates. For income focused investors, we have also been using guaranteed contracts and PGP's for portions of a portfolio to lock in guaranteed income. The point here is flexibility. We continue to monitor the investment landscape and make portfolio changes as conditions change. This is what we do—this is what we are supposed to do. If you have any questions about the fixed income markets, your portfolio, or how to meet income needs in this environment please reach out.

**AI**

AI is here and its here to stay. Opportunities abound but so do risks. What has worked so far in AI investing (buildout) may not be what works in the future (implementation). We'll be putting out an AI Update that covers where we see opportunity in AI—something that is likely to dominate the market for years to come.