Holding the Line

Weitz | INVESTMENT MANAGEMENT



Nolan Anderson
Co-Head of Fixed Income
Portfolio Manager



Tom Carney, CFA®
Co-Head of Fixed Income
Portfolio Manager

The fixed-income landscape entered the second quarter defined by geopolitical and macroeconomic tension surrounding the conflict in the Middle East and its attendant effects on domestic growth and inflation. Depending on the day, the U.S. action in Iran resembled two steps forward and one step back–or the reverse. A chorus from the 1970s band The Clash seemed to describe the U.S. deliberations in the Middle East – "Should I stay, or should I go now? If I go, there will be trouble–and if I stay, it will be double." A tenuous truce in April ultimately led to a peace agreement (memorandum of understanding) in mid-June, providing at least a temporary easing of tensions. The price of oil, a key input to inflationary pressures, made a round trip from the low $70s per barrel at the onset of the conflict in February to more than $100 at its peak, before returning to the low $70s by quarter end. If the current oil price holds, it should help reduce inflationary pressures, particularly at the gas pump.

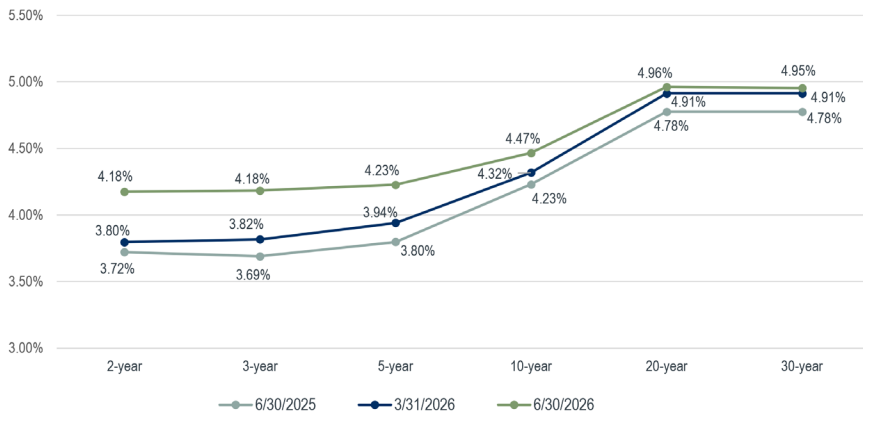
The Federal Reserve

The Federal Reserve also took center stage during the quarter. While no changes were made to the federal funds rate, new Fed Chairman Kevin Warsh was confirmed by the narrowest Senate margin in history. Despite concerns that Warsh would be a puppet of the current president, he demonstrated both his independence and that of the Federal Reserve at his first Fed meeting in June. He reinforced his hawkish stance on inflation while announcing five new task forces to evaluate everything from Fed communication frameworks (no more forward guidance) to balance sheet management and artificial intelligence. The market's response, coupled with recent inflation readings, was to pivot from expectations of further rate cuts in 2026 toward potential rate hikes. Given that the Fed's 2% inflation target has been exceeded for 64 consecutive months, this shift seems more than reasonable.

Despite all the drama of the last 90 days, it was a rather ho-hum quarter for most fixed-income markets. Total returns were middling as coupon income was partially offset by price depreciation resulting from rising U.S. Treasury yields, particularly among bonds maturing in less than 10 years.

The chart below provides a view of U.S. Treasury yields over time (quarter-over-quarter and year-over-year) across the yield curve. The yield curve experienced a bear flattener, with short-term interest rates rising faster than long-term rates. For example, the spread between 2- and 10-year Treasuries declined from 52 to 29 basis points during the quarter as expectations for additional short-term rate cuts gave way to the possibility of rate increases. Longer-term interest rates (20- and 30-year Treasuries) climbed above 5% during the quarter before receding below that level and ultimately ending the quarter only modestly higher than where they began.

U.S. Treasury Yields



Credit Markets

Corporate bonds were characterized by record-breaking new issuance, with June reaching an all-time monthly record of $187 billion, headlined by SpaceX's $25 billion inaugural bond offering. Credit spreads remained remarkably tight, and new issues were met by massive investor demand, with June deals heavily oversubscribed. Issuance was driven by refinancing needs, debt-funded merger and acquisition (M&A) activity, and extensive capital spending for artificial intelligence (AI) infrastructure.

Despite geopolitical shocks in the Middle East and interest-rate volatility triggered by a hawkish Federal Reserve, corporate risk premiums remained near multi-decade lows.

- Investment-Grade (IG) Resilience: The ICE BofA U.S. Corporate Bond Index finished the quarter with an option-adjusted spread of 76 basis points, down from 90 basis points on March 31.
- High Yield (HY) Outperformance: High yield bonds continued to show strength, with the ICE BofA U.S. High Yield Index spread declining from 328 basis points on March 31 to 275 basis points at quarter end.

Despite broad credit spreads hovering near historically low levels, dispersion continued to widen among lower-rated corporate issuers. Lower-tier BBB and sub-investment-grade technology companies continue to face credit pressure through wider spreads due to the enormous capital requirements of funding ongoing AI expansion or fears of outright displacement from AI.

The "all-in yield" magnet remains a powerful force. Spreads stayed tight because corporate bond buyers were less focused on incremental credit premiums and more attracted to the absolute returns, as all-in corporate yields remained above 5%.

Securitized assets delivered solid performance during the second quarter of 2026, supported by generally solid consumer and commercial credit fundamentals, strong investor demand and attractive income relative to similarly rated corporate bonds. Credit spreads remained generally tight across most sectors, although modest volatility created selective opportunities in lower-rated and more specialized segments.

Agency mortgage-backed securities (MBS) benefited from declining interest-rate volatility, while non-agency residential mortgage-backed securities (RMBS) continued to outperform as home prices remained stable and mortgage credit quality stayed strong. Asset-backed securities (ABS), particularly those backed by auto loans, equipment, and consumer receivables, generated favorable returns amid healthy issuance and robust demand. Commercial mortgage-backed securities (CMBS) also posted positive results, although performance remained differentiated by property type, with industrial, multifamily, and lodging sectors outperforming office-related exposures. Collateralized loan obligations (CLOs) continued to attract investors seeking floating-rate income, although market participants became increasingly selective as issuance remained elevated and dispersion widened across underlying loan quality.

Overall, securitized credit remained one of the stronger-performing segments of the fixed income market during the quarter, offering attractive carry and resilient credit performance despite a backdrop of higher interest rates and ongoing macroeconomic uncertainty.

While large portions of the credit markets remain at or near historically low spread levels, there will invariably be select areas of investment opportunity, particularly given our ability to seek out the most attractive risk-adjusted opportunities both within and outside benchmark categories.

Outlook

Across our fixed income strategies, we continue to emphasize liquidity (e.g., Treasuries and agency MBS), higher-quality securities and attractive income generation. We believe this approach positions us well as we begin the second half of 2026 and will allow us to lean in as liquidity providers if and when more favorable risk/reward opportunities present themselves.

We also believe our ability to cast a wider net across the fixed-income landscape—particularly across securitized products with structural enhancements and where we believe income opportunities remain attractive relative to bond indexes—continues to be a meaningful advantage in today's environment. Please see our Quarterly Commentaries for further details around investment activity in the second quarter.

We are thankful for the trust and partnership so many have placed in our firm and our investment process. We are also especially thankful for our home country as we commemorate its 250th birthday. We owe a debt of gratitude to those whose vision of liberty, hard work, self-governance and sacrifice has propelled the "American experiment" for two and a half centuries. Despite its many warts, the United States remains a beacon of freedom for the world and an engine of global finance. While remaining clear-eyed in our investment process, we will continue to heed one of Warren Buffett's foundational philosophies—to "never bet against America"—as well as Benjamin Franklin's famous response when asked whether the Constitutional Convention had created a republic or a monarchy: "A republic, if you can keep it."

IMPORTANT DISCLOSURES

The opinions expressed are those of Weitz Investment Management and are not meant as investment advice or to predict or project the future performance of any investment product. The opinions are current through 7/7/2026, they are subject to change at any time based on market and other current conditions, and no forecasts can be guaranteed. This commentary is being provided as a general source of information and is not intended as a recommendation to purchase, sell, or hold any specific security or to engage in any investment strategy. Investment decisions should always be made based on an investor's specific objectives, financial needs, risk tolerance and time horizon.