Rethinking Duration: The Limits of the Agg

Weitz | INVESTMENT MANAGEMENT

The Agg used to be neutral; with today's market it no longer is.

For many advisors and clients, duration conversations begin with a familiar reference point: the Bloomberg U.S. Aggregate Bond Index (the Agg). Its duration has long been treated as representing the total U.S. bond market, a place to align a portfolio's duration before tilting shorter or longer based on the environment.

However, while the U.S. fixed-income market has evolved dramatically, the Agg's construction rules have not changed alongside it. As a result, **its duration today doesn't reflect the true duration profile of the broader market.** Using it as a default guidepost may leave investors unintentionally overexposed to interest-rate risk.

UNDERSTANDING DURATION

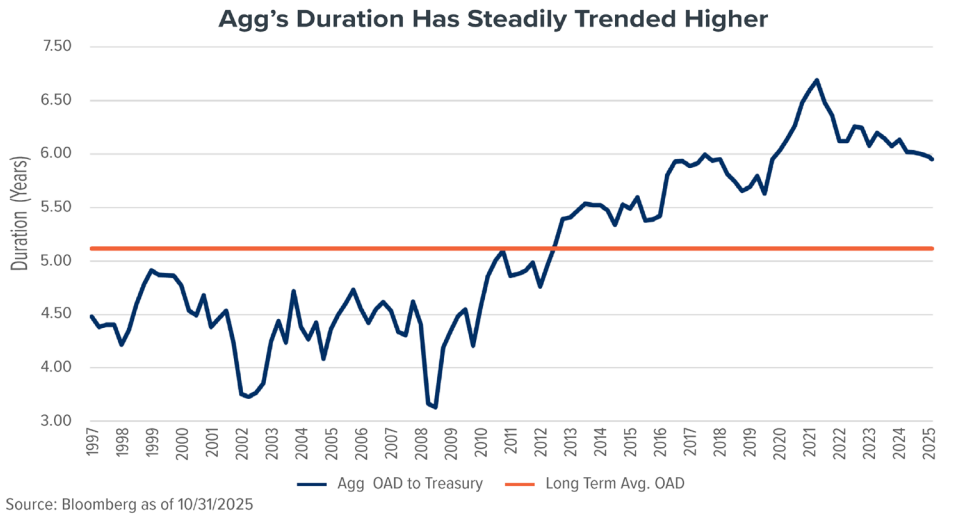
Before reviewing how duration has changed, it's important to understand what duration represents in fixed-income management. Duration, expressed in years, reflects the weighted average time it takes to receive a bond's cash flows (coupons and principal). Duration serves as a measure of interest-rate sensitivity: **the longer the duration, the more a bond's price will move when rates change.**

There are three common ways to calculate and measure duration: Macaulay Duration, Modified Duration, and Effective Duration — each offer a slightly different lens on interest-rate sensitivity. Together, these concepts underscore why understanding duration levels, and how they shift, is essential to evaluating a bond or portfolio's exposure to interest-rate risk.

At Weitz we focus on **Effective Duration**, or **Option-Adjusted Duration (OAD)**, as it is adjusted for embedded options in Mortgages and other securitized investments.

EVOLUTION OF THE AGG'S DURATION

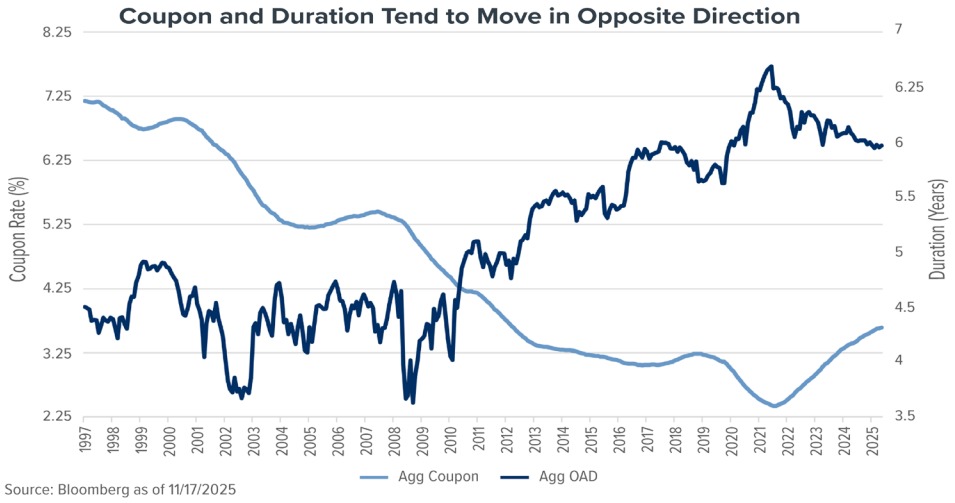
The chart below shows that since September 1997, when the Agg's duration was 4.48 years, it has steadily trended higher. Over the past 28 years, the average is 5.12 years, compared to its current duration of 5.95 years. During that period, duration dipped as low as 3.63 in March 2009 and rose to as high as 6.69 years at the end of 2021. These shifts highlight how duration adjusts over time and why setting portfolios to a fixed "neutral" duration would eventually leave your portfolio out of step with the market.



Source: Bloomberg as of 10/31/2025

DURATION MECHANICS

There are many factors incorporated into a bond's duration: coupon rate, time to maturity, embedded options, payment frequency and bond type. As these factors change, so does the duration. The chart below illustrates the Option-Adjusted Duration (OAD) of the Bloomberg Aggregate Bond Index alongside its average coupon. The bond with the higher coupon will have lower duration. This pattern holds throughout most of the period shown, with the exception of a few periods of extreme market stress ('02 to '03 and '08 to '09), when unusually wide yield and spread movements disrupted the typical relationship.



Source: Bloomberg as of 11/17/2025

Duration, which reached its highest level at the end of 2021, has begun to move lower as average coupon rates have increased. This change happens slower than broader market-rate movements because the index represents an average of 18,000 bonds.

WHERE THE AGG FALLS SHORT

When the Agg was created in 1986, it offered a reasonable snapshot of the U.S. bond market. Since then, the market has expanded and diversified, but the index has not kept pace. Its construction, which is dominated by Treasuries and agency mortgages and shaped by strict eligibility rules, limits the breadth of what can be included. As a result, the Agg now reflects only a portion of the fixed-income universe. For a deeper look at how these structural limitations affect the index, see our expanded discussion in **Casting a Wider Net**.

As a result, roughly half of the U.S. bond market does not appear in the Agg. This means the index's weighted-average duration reflects only part of the market, and often the portion with longer duration. The limited representation of high-yield corporate bonds, floating-rate securities, and smaller issuers has the unintended effect of overstating the duration of the overall market.

THE SEGMENTS THE AGG LEAVES BEHIND

A key reason the Agg no longer represents the full bond market is that it limits or excludes several segments with meaningfully shorter duration profiles, including high-yield bonds and many floating-rate securities. Duration for floating-rate bonds can be less intuitive. For example, many Collateralized Loan Obligations (CLOs) are backed by loans with interest rates tied to a short-term benchmark rate, and adjusted periodically (one, three, or six months) to the corresponding short-term rate.

Floating-rate products generally have shorter durations for two main reasons.

- **Their cash flows adjust to market rates.** Frequent coupon resets allow the bond's cash flows to track prevailing interest rates, which helps keep its value close to par.
- **Their interest-rate risk is tied to the time until the next reset**. For floating-rate bonds, the economic duration is approximately equal to this reset period rather than the bond's stated maturity.

WHY OFF-AGG FLOATING RATE DEBT CHANGES "TRUE" MARKET DURATION

FLOATING-RATE SECURITY EXAMPLE (CLO TRANCHE)

Coupon = SOFR (3-month) + spread
Reset frequency = every 3 months

KEY MECHANICS

Cash flows adjust to market rates
Coupon resets = price stays near par

Economic duration = time to next reset
If next reset = 3 months → duration ≈ 0.25 years

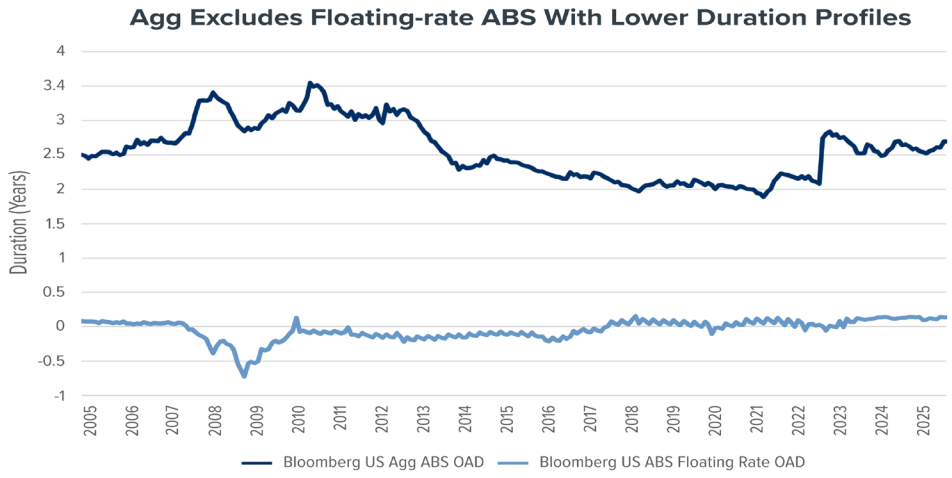
Maturity is irrelevent for rate risk
A 10-year floating-rate bond behaves like a 3-month instrument

WHY THIS MATTERS

- Floating-rate exposure is far more substantial outside the Agg
- These shorter-duration assets are a growing part of today's market
- Their limited representation in the Agg contributes to its longer-duration profile

RETHINKING DURATION: THE LIMITS OF THE AGG

The chart below compares the duration of traditional fixed-rate asset-backed securities (ABS), which are included in the Agg, with floating-rate ABS, which are excluded. This comparison highlights how using the Agg's duration as a neutral milestone may unintentionally position portfolios with more interest-rate risk than intended.



Source: Bloomberg as of 11/17/2025

REDRAWING THE MAP FOR MODERN FIXED INCOME

For many years, the Agg served as a reasonable proxy for the U.S. bond market and a natural reference point for duration. Today, the market is far more complex, and the index no longer captures the full range of available opportunities or the true spectrum of interest-rate risk. Its duration is shaped by structural biases, including heavy Treasury and agency exposure, longer-duration characteristics, and the limited number of floating-rate securities.

As a result, using the Agg's duration as a default target can leave portfolios out of sync with both the market and client expectations. A more effective approach is to define duration intentionally, using forward-looking risk assessments, client income and volatility goals, and the broader set of securities beyond the index. This leads to portfolios that are more adaptable, more diversified, and more reflective of today's fixed-income environment.

Duration remains a vital tool. But the Agg is no longer the compass it once was and may not give investors the truest sense of where they stand. In a market that continues to grow more diverse and more complex, a more complete map, navigated by an active manager, can lead to better long-term outcomes.

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 12/8/2025, 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.

Definitions: Macaulay Duration is the length of time taken by an investor to recover the money they invested in a bond through coupons and principal repayment. **Modified Duration** is an extension of Macaulay Duration and helps to measure the sensitivity of a bond to changes in interest rates. **Effective (options adjusted) Duration** of a bond is the sensitivity of the price of the bond to a change in a benchmark yield curve.