October 2026 Market Update

Are bonds making a comeback?

- Bond yields on the move
- Who benefits and who doesn't?
- "TINA" is no longer the only game in town

One of television advertising's most memorable characters was the Maytag Man. Introduced by the appliance maker in the late 1960s, he was a dependable repairman who was always ready to answer a service call. Unfortunately for him, Maytag appliances were so reliable that he spent most of his time waiting by the phone, earning the nickname "Ol' Lonely."

Bonds often play the role in investor portfolios that Maytag likes to think their appliances play in our homes: reliable, dependable, and perhaps a little dull. They're expected to provide income, stability, and reasonable returns. Stocks, by contrast, bring greater volatility in exchange for the prospect of higher long-term returns.

In recent years, bonds have largely preserved their reputation for safety, but their income and total returns have disappointed. In fact, bonds yielded so little during the pandemic that investors started using the acronym "TINA" (There Is No Alternative) as a rallying cry to describe their preference for stocks over bonds and other traditional yield assets.

After several years of disappointing returns, is it finally time for bonds to regain their reputation for dependable, stable returns? Did Ol' Lonely finally make a house call?

Bond yields on the move

As most investors know, there are two components to bond returns: the interest you earn (coupon) and the movement in the price of a bond. All else equal, a bond becomes more expensive when yields fall, as newly issued bonds will offer lower yields. Investors benefit from the resulting increase in the bond's price. The opposite is true when yields rise.

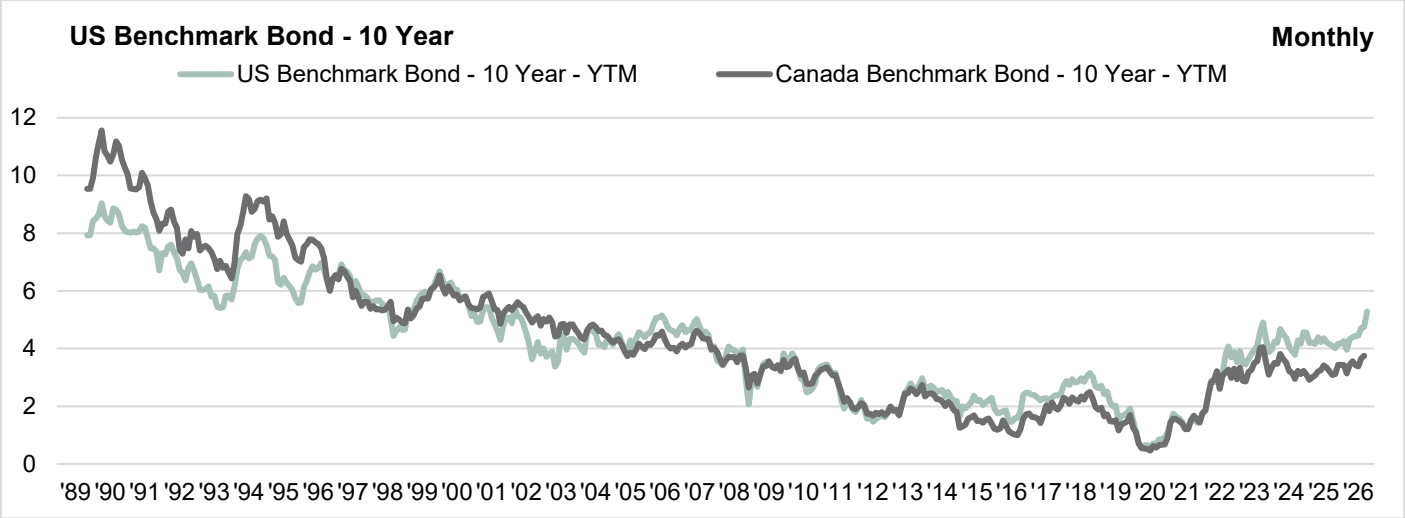
To understand where yields may be headed, it helps to consider where they have come from over the longer term. Figure 1 tracks two closely watched benchmarks – the 10-year Government of Canada bond and the 10-year U.S. Treasury – back to the early 1990s. Yields trended lower through the whole period up to 2020. After record inflation drove interest rates sharply higher in the 1980s, easing inflation allowed rates and yields to decline. Rates were cut again following the dot-com bubble around the turn of the century, during the 2008-09 financial crisis and, as noted, at the start of the pandemic. Bondholders benefited not only from coupon income, but also from capital gains.

As the economy recovered from COVID, inflation rebounded, pushing interest rates and yields higher before they eased somewhat. More recently, yields have resumed their climb. Coupon income remains, but capital gains have given way to losses. This, in a nutshell, is why bond returns have been challenging.

Not all increases in yields tell the same story. When economic growth is strong, higher yields and interest rates can act as a shock absorber, tightening financial conditions, slowing demand, and helping to contain inflation. Today's backdrop is complex. U.S. growth remains solid, while growth in Canada is more subdued, and AI-related investment is driving much of the upside. Inflation remains above central-bank targets, increasing the risk of further rate hikes. Policy decisions, including tariffs, have added to price pressures, while the Iran conflict has pushed energy costs higher. Record fiscal deficits are also exerting upward pressure on yields.

The 10-year U.S. Treasury yield is now at its highest level since 2002, and the Canadian 10-year yield is at levels last seen in 2007. This

Figure 1: Bond yields have moved back to normal



Source: FactSet

may seem unusual, but these levels are much more normal than the yields we've seen recently and given the economic situation described above we likely won't see "TINA" levels of yields again any time soon.

Who benefits and who does not?

The cost of borrowing is fundamental to the economy. Higher bond yields increase interest costs for governments, mortgage rates for homeowners and prospective buyers, financing costs for corporations, and rates on lines of credit. More broadly, interest rates and bond yields influence the value of virtually every financial asset, either directly or indirectly.

Higher yields also create clear winners. Savers can earn more attractive returns on guaranteed investment certificates, money-market funds and bonds. Banks may benefit from wider spreads when lending rates rise faster than deposit costs. Insurers can reinvest premiums at higher yields, strengthening future investment income, while higher discount rates may reduce the present value of long-duration liabilities.

In this environment, balance-sheet strength becomes even more important. Companies with low debt, strong free cash flow, and pricing power are better able to absorb higher financing costs. By contrast, businesses that depend on frequent refinancing, acquisition funding, or distant growth expectations face greater pressure. Rising yields can therefore widen the performance gap between well-capitalized companies and more vulnerable borrowers.

Utilities, pipelines, telecommunications companies, and real estate investment trusts (REITs) are often regarded as bond substitutes because of their relatively stable, high dividends. When government bond yields rise, investors may demand higher dividend yields from these stocks, generally putting downward pressure on share prices. Their capital-intensive business models also make financing costs especially significant. Regulated utilities and pipelines may eventually recover some of these costs through approved rates or contracted cash flows, but the adjustment can take time. REITs face the dual challenge of higher interest expense and rising capitalization rates, which can weigh on property values.

"TINA" is no longer the only game in town

As discussed earlier, with interest rates near zero, many viewed equities as the only compelling option for investing. That belief has been rewarded, with stocks delivering strong returns so far this decade.

Long-running trends can encourage complacency, making it easy to assume that bonds will continue to underperform. It's a phenomenon otherwise known as recency bias. History, however, challenges that assumption.

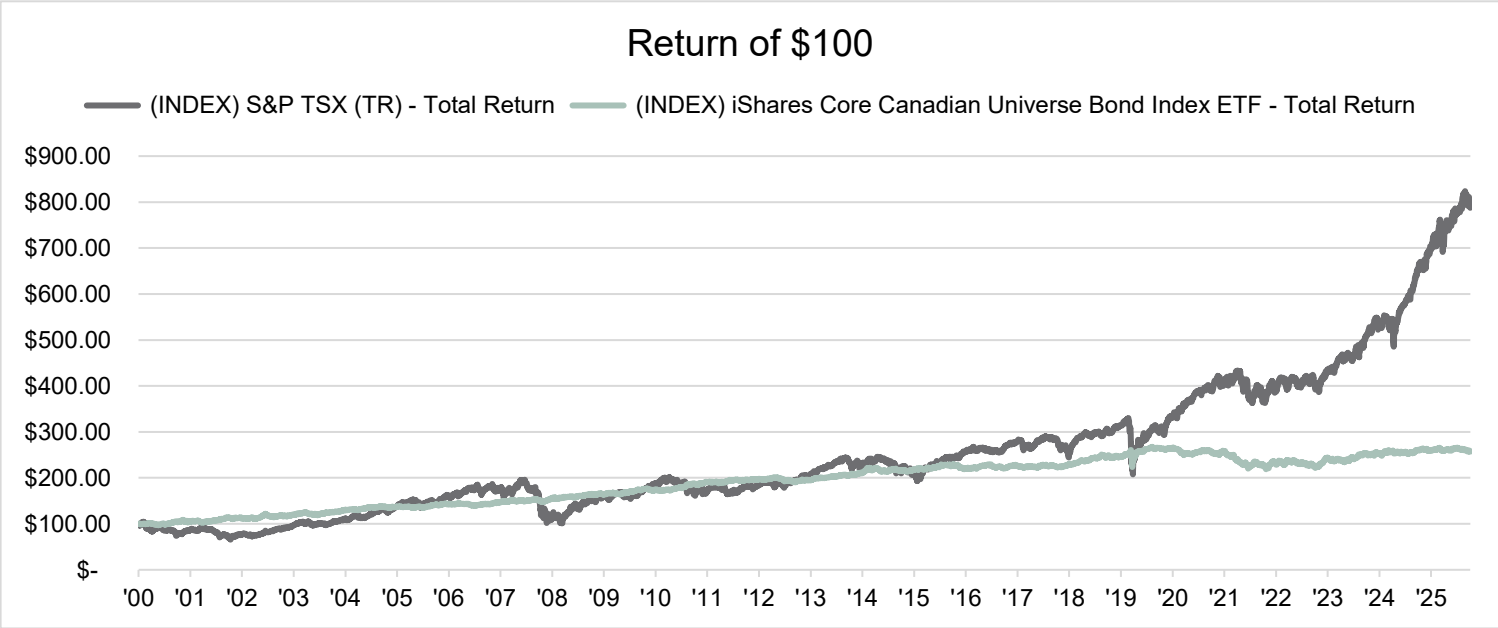
From the beginning of 2001 to the end of September 2026, $100 invested in equities

grew to nearly $788, compared with $257 in bonds (Figure 2). However, all of the stock market's relative outperformance occurred after the market lows of 2020. Earlier periods of equity weakness – including the early 2000s and the financial crisis – coincided with relative strength in bonds, highlighting their potential diversification benefits.

This decade has been exceptional for equity investors and far less rewarding for bondholders. In fact, the post-pandemic world has seen one of the strongest stock markets in history. In such an environment, it is easy to overlook the important role bonds can play in most investor portfolios. Bonds can provide diversification when equity markets falter while also generating reasonable returns. It's likely that many investors have more exposure to the stock market today than they had six years ago on a percentage basis. With the yields now back to a more historical norm, bonds may be resuming their place as the reliable, dependable asset class and, in the process, sending the Maytag Man back to the shop waiting for the phone to ring.

Sources: FactSet

Figure 2: Canadian stock market vs broad bond index



Source: FactSet
Note: Broad bond index holds federal, provincial, and corporate bonds.

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