SanJac Alpha

SANJAC ALPHA'S QUICK TAKE

After the midterms: What's next for bonds?

Andrew Wells, Chief Investment Officer at SanJac Alpha, shares his views on the 2026 midterm election results and what they could mean for the bond market. In this Quick Take, he discusses the Treasury market's reaction, upcoming debt ceiling negotiations and Treasury borrowing plans, along with his outlook for interest rates and market volatility heading into 2027.



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The midterm results

The 2026 midterm election results went beyond a flip in power in the House, but the implications for bonds are playing out in line with what we expected last week. Once Democrats took the House, another large, Republican-led fiscal package in 2027 became much less likely. The Democrats' win in the Senate made it even less likely.

The Treasury market's reaction has been positive. The 10-year has rallied about 6 basis points to 4.89%, the 2-year is near 4.58%, and the 30-year is around 5.30%[1]. I don't attribute all of that to the election. Oil is down sharply too, and at least this year, has been a good indicator of future volatility in rates. Overall, rate volatility as expressed by the ICE BofA MOVE Index eased by 6% from November 3rd to the 4th as the uncertainty around the midterms cleared.

The thing to watch now is the lame duck session. Republicans control both chambers until January 3, 2027, giving them roughly eight weeks to try to raise the debt limit through reconciliation without Democratic votes. After that, they'll have to negotiate with the new majority. With government funding also expiring December 11, 2026, there's a significant sense of urgency to handle that fiscal business before January.

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Leaving the debt limit unresolved would likely start affecting Treasury's borrowing early next year. I'm looking at the first quarter as a risk window rather than a firm deadline. The Bipartisan Policy Center estimates that the government could reach the debt ceiling sometime between late winter and midsummer of 2027. Even then, Treasury could use cash and other measures to provide additional time afterward.

Treasury's refunding announcement

Coupon auction sizes are unchanged, as expected. Buybacks and the guidance, however, were more interesting.

Treasury kept the expanded long-end buybacks and plans up to $70 billion of liquidity-support purchases across the curve this quarter. That compares with $38 billion in the original August plan, before the subsequent expansion. Buying off-the-run bonds will help with liquidity, but the purchases still have to be financed, and don't solve the underlying borrowing problem. Also, whether the liquidity support will continue past the February refunding is another item for bond buyers to watch for.

The guidance also changed. Treasury dropped "at least" from its guidance to hold coupon auction sizes steady for the next several quarters. That sounds like officials want more flexibility over what happens next. To that end, my expectation is that new discussions will arise for 2027 around larger auctions in the front end and belly, with the long end possibly getting smaller. There's support for that: Treasury's borrowing advisory committee said increases would likely be appropriate in the second half of fiscal 2027. That's advisory only though, and not an official announcement.

The 7-year is moving from monthly to quarterly new issues in March 2027, with each of the following two months reopening the same 7-year. Rather than issuing a new CUSIP monthly, it keeps the notes on-the-run longer and builds a larger pool of the same security. That should help liquidity in the 7-year and if the experiment works it will be interesting to see if they consider the same for the 3-year and 5-year.

Looking at the year ahead

We're still focused on early 2027. Divided government makes another large fiscal expansion harder to pass. The existing large fiscal deficits aren't going anywhere, but the debt needed to finance them will become the next big political dilemma.

The debt-limit debate, Treasury's next issuance decisions and the Fed's balance-sheet review could overlap early next year. Warsh has pointed to early first quarter for the task force's recommendations, while leaving some room on timing. Private investors still need a yield that makes long bonds worth owning. I expect there to be a low volatility honeymoon period after the midterms, but rate volatility is likely to return as soon as markets deal with the Treasury's substantial financing needs, the Iran conflict and persistent inflation in the markets.

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IMPORTANT INFORMATION

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Investing involves risk, including possible loss of principal.

[1]Source:Bloomberg as of 11/4/2026

ICE BofA MOVE (MOVE) Index - reflects the level of volatility in U.S. Treasury futures.

Basis points (BPS) - a unit of measure equal to 1/100th of 1% and is used to denote the change in a financial instrument.

Bipartisan Policy Center (BPC) - is a non-profit organization and think tank based in Washington, D.C. that promotes pragmatic, bipartisan policy solutions in United States politics.

Yield - annual rate of return on an investment, expressed as a percentage and calculated by dividing the income an investment generates by its current market price.

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