

SANJAC ALPHA'S QUICK TAKE

Bonds, Inflation and Interest Rates: A Q&A With Andrew Wells

Andrew Wells, Chief Investment Officer at SanJac Alpha, shares his views on bond allocations, areas of opportunity and credit risk. In this Quick Take, he discusses the firm's approach to managing duration and credit quality, along with his outlook for inflation and interest rates into 2027.



Andrew "Andy" Wells
CIO, SanJac Alpha

Have you made any adjustments in allocations?

No wholesale changes, but we have been running our bond funds at below-trend duration levels for risk mitigation. On top of lower duration, we have also leaned bearish the long end of the curve for more than a year now.

The September hike is the first thing in a while that makes me more constructive on longer-dated bonds. I'm not there yet, but a Fed that takes inflation seriously is what the duration trade has needed.

Which segments do you find are most attractive at current yields?

We find the two- to three-year segment of the Treasury market particularly attractive. At around 4.8%¹, yields appear to reflect expectations for several additional rate hikes. In this way, we don't have to pick the precise rate path and the asymmetry may be in our favor at these maturities.

In the intermediate part of the curve, we like agency mortgages, where spreads over Treasuries are wide versus history and credit risk is less of a concern. A third area would be TIPS. Real yields north of 2.9%² on the 10-year are some of the highest we've seen since the global financial crisis era.

"A Fed that takes inflation seriously is what the the duration trade has needed."

What types of funds are you using?

I'm biased because we run two of them, but we favor actively managed bond ETFs. The iShares U.S. Aggregate Bond Index (AGG) is weighted by issuance, so an index fund allocates the most to whoever borrows the most, and at whatever price the market offers. Right now, that means substantial exposure to the U.S. Treasury, and it comes with about six years of duration.

Since 2022 the MOVE Index has reflected much greater volatility. The 10-year treasury yield is near 5.3%³, we see the potential for more volatility around supply, oil, and the Fed. In this market we believe you need someone actively managing overall risk, duration, and credit.

"We are staying up in quality and short in maturity on the credit we own."

Some investors with cash allocations use an active low duration strategy in pursuit of higher potential income than a money market fund. For the core allocation, a core plus manager can look for opportunistic spots in both credit and government bonds while actively managing risk.

Our overall view is that putting a bond allocation into an index sleeve may not be the best approach in this current market.

How are you approaching credit risk and refinancing concerns?

I don't think spreads are paying enough. They're still tight relative to history at the same time Treasury yields are at multi-year highs⁴. There is still substantial demand from the all-in yield buyer who sees 6% on a corporate bond⁵. We view this as simply too close to where government bonds are now, across the curve around 5%⁶, and may not adequately compensate investors for potential credit widening that could reprice corporates.

We're most conservative around the AI buildout. The hyperscalers and the companies around them are funding enormous capital expenditures with debt, and that's a lot of supply from issuers the market views as having a very low likelihood of default. Supply is the issue. Rather than worry primarily about defaults, we are more concerned about a repricing.

Additionally, on refinancing, yes, I'm concerned. Debt issued at 3% and 4% coupons in 2020 and 2021 is coming due into a market where the Treasury yields collectively are around 5%⁷. So we are staying up in quality and short in maturity on the credit we own.

What's your outlook for Q4 and into 2027?

The Fed's own projections indicate one more hike this year. Going into the September meeting, the market had closer to two priced in by December and a peak around 4.5%⁸ late next year.

My base case is another hike in the fourth quarter, probably December, and a Fed that keeps moving at roughly a quarterly pace into 2027 unless oil backs off. Crude has become the swing factor. With Brent around \$100, headline inflation may be difficult to bring down, and I don't think the Fed can wait that out the way it tried to in 2021.

For longer rates, I think the worst of the selloff is likely behind us if the Fed stays credible. What would change my mind is on the fiscal side. If Washington leans harder on buybacks and bill issuance to manage yields, the market could read that as monetization and the long end could sell off again. The midterm elections may affect Treasury's posture.

IMPORTANT INFORMATION

These market observations are the views of SanJac Alpha as of October 2026, and we undertake no obligation to update these observations. Our views are shared for information purposes only, and should not be considered, or relied upon as, financial advice. SanJac Alpha accepts no responsibility for any loss arising from the use of any information contained herein, and investors should consider their own personal circumstances and, as appropriate, seek professional advice for any investment decisions.

Investing involves risk, including possible loss of principal.

¹Source: U.S. Dept of Treasury Daily Rates 10/05/26 yield for the 2-year treasury 4.813%;

²Source: U.S. Dept of Treasury Daily Rates 10/05/26 10-year par real yield 2.95%

³Source: U.S. Dept of Treasury Daily Rates 10/05/26 10-year yield 5.31%

⁴Source: U.S. Treasury 10/05/26 yields for the 5-year 5.06%, 10-year 5.31% and 30-year 5.66%, versus October 2023 peaks of 5-year 4.95%, 10-year 4.98% and 30-year 5.11%)

⁵Source: ICE BofA US Corporate Index effective yield 10/05/26, 6.03%

⁶Source: U.S. Dept of Treasury Daily Rates 10/05/26 par yields of 4.84% to 5.31%, 2-year through 10-year

⁷Source: U.S. Dept of Treasury Daily Rates 10/05/26 par 8 yields of 4.84% to 5.31%, 2-year through 10-year

⁸Source: U.S. Dept of Treasury Daily Rates 10/05/26 par 8 yields of 4.84% to 5.31%, 2-year through 10-year

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

are funds companies use to acquire, upgrade, or maintain physical assets like buildings, technology, or equipment, with the goal of increasing operational scope or future economic benefits. **Duration** - reflects how much a bond's value is expected to move when interest rates rise or fall. **TheFed** - The Federal Reserve System is the central bank and monetary authority of the United States.

Drawdown - the percentage difference between the peak of an investment and its following trough. **iShares Core U.S. Aggregate Bond ETF (AGG)** - seeks to track the investment results of an index composed of the total U.S. investment-grade bond market.

Treasury Inflation-Protected Securities (TIPS) - U.S. Treasury securities whose principal adjusts with changes in the Consumer Price Index, so interest payments and the amount repaid at maturity rise with inflation. **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.

SanJac Alpha offers two exchange traded funds. *The funds' investment objectives, risks, and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company. Please read it carefully before investing. A copy of the prospectus can be found by visiting www.sanjacalpha.com or by calling 1-800-617-0004.*

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