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MARKET COMMENTARY

Interest rates took a wild ride in the second quarter of 2026, climbing sharply in April and May as the Iran conflict kept oil prices elevated and the Strait of Hormuz closed. The 10-year Treasury yield reached a closing high of 4.67% on Tuesday, May 19, 2026, before a ceasefire between the United States and Iran took shape in June. It ended the quarter at 4.46%, only slightly above where it began. WTI crude finished at \$70/barrel, down from its wartime spike but above pre-conflict norms. The oil shock's inflationary effects will linger, though forward indicators have turned lower. Other inflation drivers such as reduced immigration and the AI infrastructure buildout remain in the background, as the energy supply shock has been the defining force on interest rates so far this year.

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Markets broadly recovered from the first quarter's war shock. The Bloomberg U.S. Aggregate Bond Index returned 0.7% in the quarter, municipal bonds outperformed at 2.5%, and the S&P 500 surged 15% as equity investors looked past the conflict. Investment-grade and high-yield corporate spreads widened during the height of the war, then retraced to end the quarter near long-term lows. That pattern typically accompanies strong equity markets. Municipal bonds extended their outperformance over a longer horizon as well, with the Bloomberg Municipal Bond Index returning 7% over the trailing year versus 4.3% for the Aggregate Bond Index. The move appears to be a classic mean reversion after several years of tax-exempt municipal bond underperformance. For investors in high tax brackets, tax-exempt municipals continue to offer taxable-equivalent yields that materially exceed what is available in investment-grade taxable bonds.

Outside traditional fixed-income markets, private credit showed continued stress, with elevated redemption requests in non-traded BDCs and rising loan problems. In our opinion, this is largely an isolated issue: redemption stress is concentrated among newer retail investors in non-traded BDCs, a narrow slice of the private credit market, and the majority of problem loans are concentrated among the sector's weaker lenders.

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OUTLOOK: THE NEW FED AND WHAT IT MEANS

Kevin Warsh's arrival as Fed chair was the quarter's most consequential long-term development. His debut FOMC meeting in June produced a unanimous vote to hold rates at 3.50-3.75%, but the message underneath was hawkish. The dot plot shifted to imply a hike before year-end, and 17 of 18 participants saw inflation risks skewed to the upside. Warsh himself notably declined to submit his own rate projection, a deliberate signal of his skepticism toward the need for that forecasting tool. Markets were leaning toward a hike as of last quarter, so the Fed was primarily catching up.

The philosophy behind the new Fed direction matters more than the mechanics. Warsh has argued that years of heavy Fed communication and influence—forward guidance, dot plots, and a detailed summary of economic projections (SEPs)—were emergency tools deployed after the financial crisis to suppress long-term rates. That era is over.

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By stepping back, the Fed signals that investors should read the data themselves rather than parse central bank signals. Warsh has also argued more broadly for what he calls a "back-seat Fed," telling the IMF that "the central bank should find new comfort in working without applause and without the audience on the edge of its seat." This is likely a win for independent capital markets. In theory, it could mean more volatility in short-term rates as forward guidance fades, but potentially more stable long-term rates as markets reprice based on fundamentals rather than Fed signaling. We believe a lighter policy footprint after two decades of extraordinary intervention is a positive development.

Riverbridge's approach is unchanged. We ground our analysis in real interest rates across the curve and let value, rather than Fed meeting calendars, drive positioning. At current yield levels, investment-grade fixed income—particularly tax-exempt municipals for investors in high brackets—continues to offer attractive after-tax income and stability when equity and other markets get rocky.