



Interest Rates Rise Again as Wall Street Rebounds with Eyes on the Fed

Long-term interest rates rose again in August, continuing the upward trend that began in July. The interest rate on the 10-year government bond reached a 17-month high of 4.76%. What's more, even though many areas of the economy remain relatively strong, inflation is still rising, and consumer confidence is falling.¹ Because of all that, all eyes are now on the Federal Reserve.

Although the central bank took no action at its August meeting, most market analysts expect Chairman Kevin Warsh to announce an increase in short-term interest rates at the Fed's next meeting, scheduled for September 15 and 16. In fact, it's likely that Wall Street has already priced in the rate hike. That's probably one reason the stock market rebounded strongly in August after a slight dip in July.

Once again, the indexes heavily weighted by tech companies saw the biggest gains. The S&P 500 rose by 2.7% while the Nasdaq

added 4.2%. The Dow Jones Industrial Average, which has fewer tech companies, saw a smaller gain of 1.5%.² Of course, none of this is really new.

Bullish Resilience

The stock market — thanks mainly to the AI tech boom — has managed to remain resilient all year despite rising inflation, signs of slowing growth,³ and the emergence of numerous geopolitical issues with economic impacts. For example, even as the war in Iran continues to fuel the inflation problem, in August the trade war with Canada escalated in a way that could make matters worse.

Ultimately, though, Wall Street has managed to shrug off such issues and remain at record highs. That's partly because, despite high inflation and slowing growth, other areas of the economy — such as wages and unemployment — have remained more stable,⁴ and no clear warning signs of a recession have yet emerged.

Still, it seems likely that, at this

point, investor optimism is being driven at least partly by an expectation that the Fed will finally take action to address some of the economy's most pressing problems, namely inflation.

Although the Fed has no power over long-term rates, which are determined by the markets, they do control short-term rates. Historically, increasing short-term rates has been the Fed's go-to move for addressing high inflation, which is why a rate hike is now so widely expected — probably this month.

Your Portfolios

Naturally, since — as Warren Buffett rightly noted — higher in-

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Interest Rates Rise

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Interest rates generally decrease the value of all invested assets, the continuation of rising rates in August will be reflected in your latest statements. Since most of you are invested in our more conservative portfolios of bonds and bond-like instruments, you'll likely see your values down to some extent depending on your individual holdings.

Of course, this is also nothing new because the markets fluctuate, and that's one of the reasons you chose an income-first, growth-second strategy in the first place. With this strategy, regardless of whether your asset values go up or down on paper due to market changes, you can rest assured that your interest and dividend income will remain steady and unaffected.

And if you're reinvesting all or some of your interest and dividends, you should keep in mind that these kinds of market challenges often create buying opportunities that may help you increase your future growth and income potential.

So, if you'd like to talk more about that, or if you have any other questions or concerns at all, never hesitate to reach out. Whether it's something we can address on the phone or that requires scheduling a meeting, we are always available and happy to help.

Have a great September! ■■■

- 1 <https://www.nasdaq.com/articles/august-2026-review-and-outlook>
- 2 <https://www.cnbc.com/2026/08/24/stock-market-today-live-updates.html>
- 3 <https://www.bea.gov/data/gdp/gross-domestic-product>
- 4 <https://www.federalreserve.gov/newsevents/speech/waller20260903a.htm>



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Active vs. Passive Bond Management

Many investors are aware of only one way to manage their bonds: buy them and hold them until they mature, reinvesting the redeemed funds in more bonds to hold until *they* mature. Not surprisingly, this is called a buy-and-hold strategy, and it's considered a form of passive management.

But there is another way to approach a bond portfolio. It's called active management, and it routinely involves selling bonds before they mature.

Bond Income Versus Capital Gains

Everybody knows that bonds generate income in the form of interest payments, but many people don't realize that bonds can also generate capital gains in the secondary market.

Interest rates are the result of the prices that investors are willing to pay to receive the fixed income streams from existing bonds. Whenever potential buyers of existing bonds decide that the bond's annual income isn't enough relative to the bond's price, they'll bid bond prices lower. As a result, the bond's current yield, its effective interest rate, will rise. The result is that at any given time, the market value of any given bond could be higher or lower than its face value, its original price, or its previous transaction price.

Individual bond prices can also change as a result of changes in their credit ratings.

Selling to Capture Premiums or Higher Yield

Bonds whose prices are higher than their face value — something that often happens when interest rates have been falling for some time — are called premium bonds. If you're holding a premium bond to maturity, one thing is certain: no matter what happens to interest rates in the future, you will not benefit from this temporary increase in your bond's market value unless you sell it. So in the right circumstances, it can make sense to sell a premium bond.

In certain circumstances, it can make sense to sell a bond that's fallen to a lower price than it was purchased for. Why? First, selling a bond at a loss generates a potential tax advantage: a capital loss that, come tax time, can be used to offset capital gains taken elsewhere. Second, in a market in which bond prices are falling, bond interest rates are rising. So investors can increase their net income if they sell a lower-yielding bond to purchase a higher-yielding bond.

Using the Yield Curve

Professionals know that the bond markets are more inefficient than the stock markets. One of the results is that anomalies frequently occur in what's known as the yield curve, the line on a graph that shows yield by maturity.

In theory, there is a gradual and proportional relationship between time to maturity and yield. On a normal yield curve, the line rises a bit steeply from left to right over the first few years, and then begins to flatten out, with yields continuing to rise as the maturity gets longer.

In practice, however, abnormal relationships can emerge, where the yield for a slightly shorter maturity is higher than the yield for some longer maturity (an inverted yield curve). In this case, a premium may have developed for the longer maturity that could disappear once the market becomes fully aware of it. In such cases, active managers may decide to sell the longer maturity and buy the shorter one to book that capital gain.

Please call if you'd like to review your bond portfolio.



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