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Using Real Yields to Position Fixed Income Portfolios – 2026 Update

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Two years ago, we introduced our Real Yields model of forward returns in the U.S. bond markets. As of mid-May 2026, following an unexpected spike in interest rates, modeled returns projections are now at their highest point in more than two years.

In the fixed-income markets, we typically talk in terms of “nominal” interest rates. Despite this focus, real yields remain a better tool for evaluating future returns. Janney ISG has built a model of forward return potential based on the tradeoff between cash, inflation, and nominal and real bond yields. While no model can predict the future with certainty, with real yields again at elevated levels, the modeled 12-month forward bond market returns are showing one of the strongest readings of the current cycle. As of May 18, Janney ISG’s Real Yields mode at +8.6% is noting the highest 12-month forward return for the Bloomberg U.S. Aggregate Bond Index since fall 2023, when rates last peaked.

Nominal rates represent the yield promised by an investment instrument, like a bond or savings account, without factoring in the impact of changing purchasing power over time. Nominal interest rates serve as a fundamental metric for evaluating the attractiveness of investment opportunities, offering investors a baseline figure to assess potential returns. However, to grasp an investment’s true profitability amidst fluctuating inflationary pressures, they require more context. Real yields can provide some of that context. Essentially, real yields measure the return on an investment after factoring out the corrosive effects of inflation. By way of example, consider a 10-year Treasury note with a 5% interest rate. If inflation measures 3% over the horizon of that note, the real yield of the hypothetical note is 2%. Real yields, by negating the inflationary impact, arguably offer a better long-term portrayal of an investment’s profitability. Elevated real yields are one factor that signifies strong return potential.

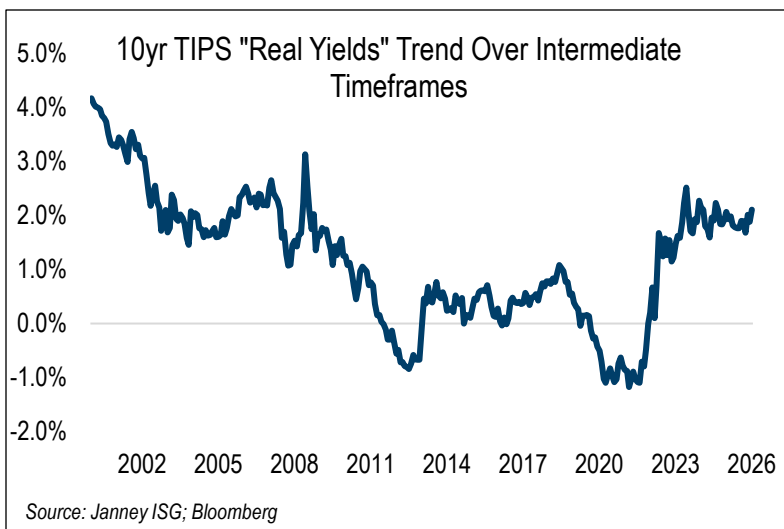
TIPS: Protecting Purchasing Power & Measuring Real Yields
Treasury Inflation-Protected Securities (TIPS) help investors hedge inflation and provide the building block for real yields.

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1 WHAT ARE TIPS?
 - Issued by the U.S. Treasury
 - Available in 5-, 10-, and 30-year maturities
 - Fixed coupon payments every 6 months
 - Principal value adjusts with inflation
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2 HOW TIPS PROTECT AGAINST INFLATION
 - If inflation increases, the principal amount increases
 - Coupon payments rise with the principal
 - At maturity, investors are repaid the higher of the adjusted principal or original principal
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3 TIPS GENERATE A “REAL YIELD”
 - Compare a TIPS yield with a traditional Treasury (same maturity)
 - The difference reflects the market’s expectation for inflation
 - The TIPS yield itself is the “real yield” — return excluding expected inflation

HOW IT WORKS: AN EXAMPLE

Scenario	What Happens with a 10-Year TIPS
 Inflation rises 3% per year	Principal increases each year by 3% Coupons paid on the higher principal More purchasing power at maturity
 Inflation falls 1% per year	Principal decreases each year by 1% Coupons paid on the lower principal Minimum principal protected at maturity

U.S. Treasury Inflation Protected Securities are government bonds designed to shield investors from inflation effects. Unlike traditional bonds, the principal value of TIPS adjusts based on changes in the Consumer Price Index, ensuring that investors receive a return that keeps pace with inflation. Since coupon Treasuries do not adjust for inflation, but TIPS do, we can use the yield on a coupon Treasury and the yield on a TIPS with the same maturity to get a market-based estimate of future inflation. That



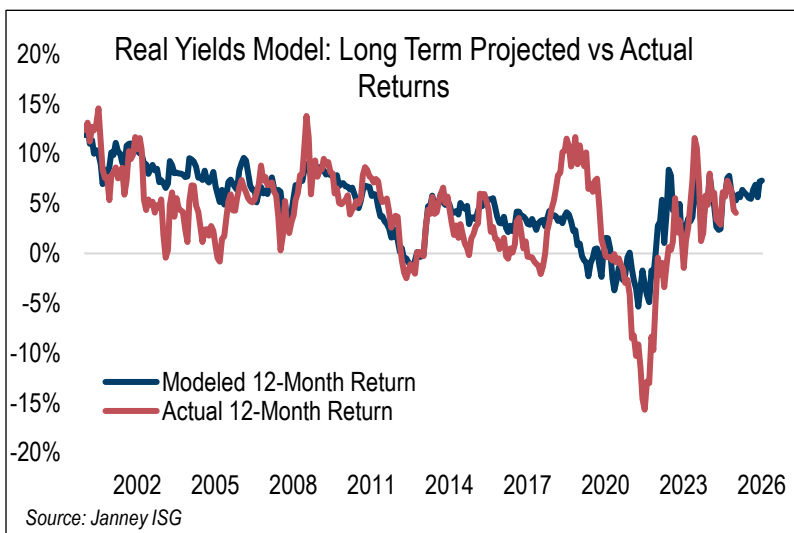
estimate is far from perfect and is subject to bias in extreme market conditions, but in the long run, it is a reasonable proxy for inflation expectations.

Meanwhile, the real yield on a TIPS is a tremendously useful tool for timing allocations for the fixed-income markets. Nominal yields often move more rapidly, but real yields tend to trend over intermediate timeframes. That distinction has been important again in 2026. As of May 18, the U.S. Treasury's 10-year nominal yield stood at 4.61%, while the 10-year real

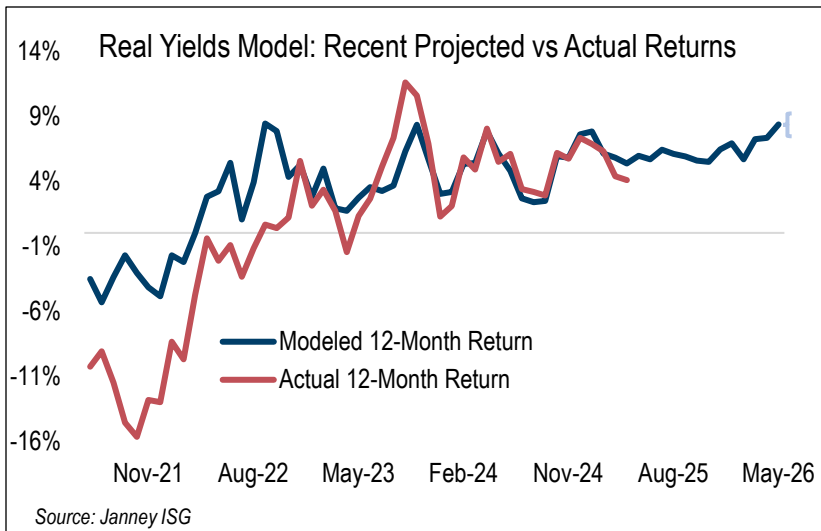
yield stood at 2.13%. Unlike nominal yields, which are more subject to swings in short-term economic data, real yields tend to be more a function of longer-term supply and demand. That is especially relevant today. The bond market is no longer simply repricing a near-term Fed path. One insight we take from TIPS is that using high real yields as an entry point to adding to fixed-income portfolios has been a persistently profitable investing strategy. Conversely, reducing fixed-income portfolios when real yields are low has helped limit drawdowns. Today, real yields are once again relatively high, making it a good time to add to fixed income and/or to extend portfolio durations on the margin.

Many factors affect forward fixed-income returns, from predictable economic developments, to unexpected ones, as well as changes in credit conditions. In order to build a real yield-based return model, we evaluated a number of economic and market variables and compared them to the subsequent 12-month returns of the Bloomberg Aggregate Bond Market Index. Through an iterative process, we narrowed the variables to:

- The current Fed funds rate to capture the returns of remaining in cash,
- The current period core CPI to capture the real return on cash,
- 10-year nominal yields to capture nominal return potential,
- 10-year real yields to capture the real return on bonds, and
- Interaction terms among the variables.



The logic here is that we are comparing the tradeoff between remaining in cash and facing current-period inflation, and buying nominal bonds and facing future expected inflation. As it turns out, analyzing the tradeoff statistically explains a high share of the variability in 12-month forward bond market returns. While we could improve the model by including measures of credit conditions and other factors, the focus here is on real yields. For a "common sense check," our real yields model projected the worst returns in history as of December



2021, which proved prophetic, as 2022 was indeed the worst year for bonds in contemporary history. Similarly, 2019 modeled returns failed to accurately project bond market returns around the COVID-19 pandemic.

As of the most recent update on May 18, 2026, the modeled 12-month forward return on the Bloomberg Aggregate Bond Index is 8.6%, with a one standard deviation range of 7.8% to 9.3%. For context, that is the strongest modeled 12-month forward return since October

2023, and only by a small margin. The magnitude of the signal is important: the model is not merely suggesting that fixed income should produce a positive return. It is suggesting that the combination of elevated real yields, high nominal starting yields, and a still-meaningful real return advantage over cash has created one of the better entry points of the post-2022 cycle.

No model is a perfect representation of the financial markets, as the failures in 2019 show. Credit spreads, geopolitical events, fiscal concerns, and unexpected changes in inflation or monetary policy can all overwhelm a simple real-yields framework in the short run. But based on real yields, we are looking at one of the best entry points in recent years to add to fixed-income allocations and/or to extend portfolio durations to capture potential forward returns. The fixed-income market is still vulnerable to volatility, but the prospective return cushion is meaningfully larger than it was during much of the prior decade. Starting yields matter, and today, based on Janney ISG's Real Yields model, they are doing more work for bond investors than they have in 2.5 years.

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