JAG Fixed Income Thematic Insights: Q2 2025

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Treasury Market Primer: Back to Textbook Basics?

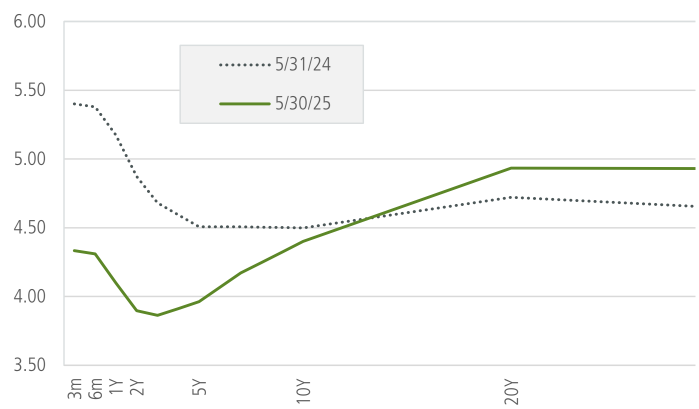
As we enter the final weeks of Q2 – and at the risk of speaking too soon – several key markets may finish the quarter essentially unchanged from Q1. This seeming calm, however, obscures the roller-coaster of volatility investors endured in the first two months of the period. Equity markets and corporate credit spreads were whipsawed following tariff announcements from President Trump in early April, only to recover their footing by mid-May. In contrast, US Treasury yields remain elevated relative to their early-quarter levels. Notably, the yield of the benchmark 30-year surged nearly 50 basis points (bps) in a single week in April, the sharpest weekly increase since 1987. Whether these changes will ultimately register as meaningful in a historical context remains to be seen.

Which factors explain the persistence of higher long-term yields remains a hotly debated topic. At JAG, participation in this discussion is largely academic as we exclude the long bond from our strategies precisely because of its inherent unpredictability. The ever-shifting focus of the in-vogue market narrative – from fear of tariff-related inflation to opaque hedge fund basis trades to an alleged revolt against the US dollar as the global reserve currency – highlights the tenuous foundation on which some yield expectations are built. These shifting narratives serve to validate our disciplined preference for intermediate-term exposure, echoing, as they do, sentiments expressed concurrent to the painful lessons inflicted on long-duration investors throughout most of 2022 and in the third quarter of 2023.

While each of these narratives may play some role in sustaining higher yields, we believe the broader backdrop suggests something more fundamental. The overall rate environment, as depicted by the US Treasury yield curve, increasingly resembles what textbooks refer to as "normal." In this context, today's rate levels and curve structure are less surprising and more a long-overdue reversion away from the policy-distorted regimes of the past two decades.

Exhibit 1 illustrates the current Treasury yield curve, which now exhibits a classic upward-sloping profile. This stands in sharp contrast to the flat, inverted shape observed a year ago. Investors are once again being compensated for extending maturity – a condition that reflects a market not anticipating an imminent decline in rates, and one that aligns with traditional expectations of term structure behavior.

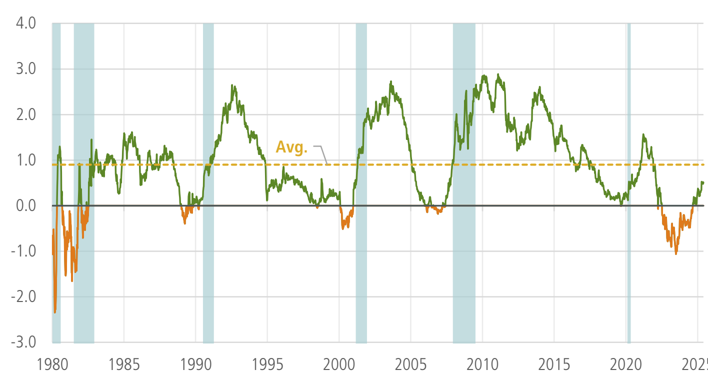
Exhibit 1: Treasury yield curve (%)



Source: Bloomberg Finance LP, JAG Capital Management

Exhibit 2 highlights why this normalization may feel jarring. The spread between 10-year and 2-year Treasury yields has hovered near zero or negative territory for much of the last decade. This inversion persisted even prior to the most recent rate-hiking cycle, briefly interrupted only by the inflation spike of 2021. While past episodes of curve inversion have often preceded recessions (as indicated by shaded regions in the exhibit), the recent steepening has occurred absent other typical recessionary catalysts.

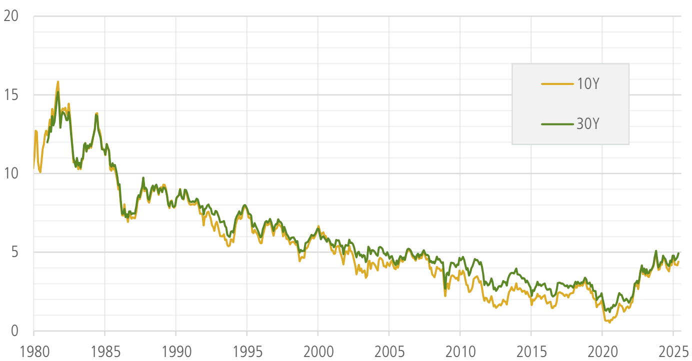
Exhibit 2: 10-year minus 2-year Treasury yields (%)



Source: Bloomberg Finance LP, JAG Capital Management

As shown in Exhibit 3, recent moves at the long end of the curve, while swift, are not unprecedented in magnitude. A 30-year yield near 5% is not an outlier when viewed across decades of history and remains well within the range of what many would consider a normally functioning bond market.

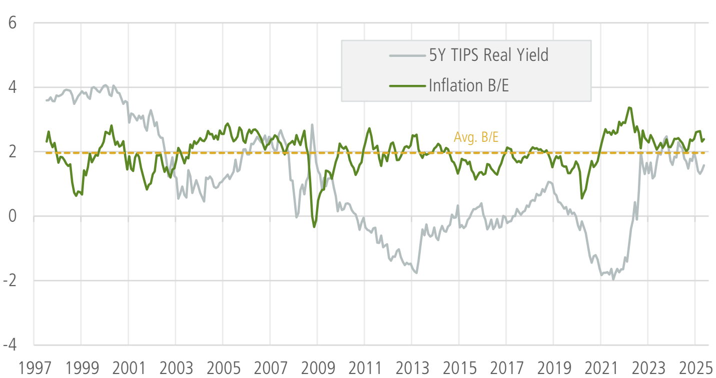
Exhibit 3: Historical Treasury yields (%)



Source: Bloomberg Finance LP, JAG Capital Management

Nominal yields, of course, reflect both real interest rates and inflation expectations. Exhibit 4 shows that, despite a modest uptick in implied inflation, expectations remain close to their long-run average since the inception of this data set nearly three decades ago. This suggests that inflation fears are not driving yields higher in isolation, and that much of the current yield level reflects a healthy real-rate dynamic.

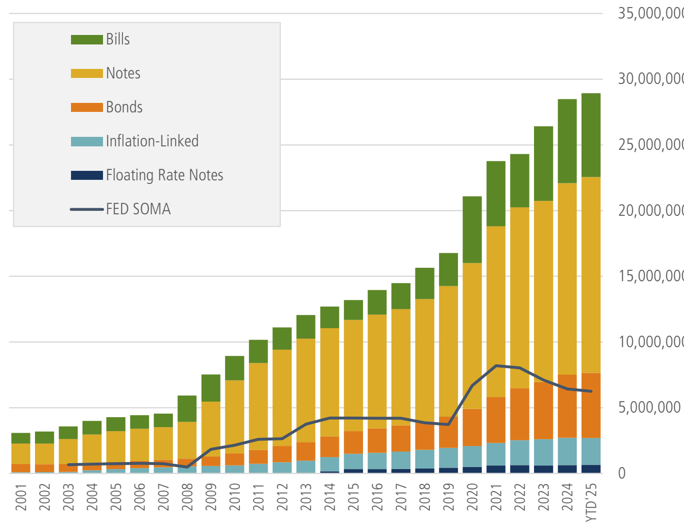
Exhibit 4: 5-year TIPS yield and inflation breakeven



Source: Bloomberg Finance LP, JAG Capital Management

As depicted in Exhibit 5, total outstanding US Treasury debt now approaches $30 trillion, a figure that continues to grow along with interest costs. While we cannot characterize this trajectory as healthy for the Nation's fiscal outlook, we note that it is both widely anticipated and consistently communicated to markets. The Federal Reserve's balance sheet reduction (via System Open Market Account (SOMA)) has been measured, and the maturity structure of Treasury issuance remains broadly unchanged.

Exhibit 5: Outstanding Treasury debt ($millions)



Source: Bloomberg Finance LP, JAG Capital Management

We are cautious when interpreting short-term yield movements as responses to fiscal policy concerns – particularly when those policies are already well-modeled and widely understood. Nevertheless, we expect this long-term debt burden to exert upward pressure on yields over time, creating a constructive environment for investors focused on quality income generation and total return.

At JAG, we do not aim or claim to be market forecasters. What we bring is a seasoned perspective, developed over decades, of navigating bond markets with discipline and consistency. Today's headlines may invite anxiety, but we encourage a steady hand. Our long-standing view – that fixed income remains a vital and resilient component of long-term portfolios – is unchanged.

We continue to believe that intermediate-term bonds, selected through a rigorous research process and monitored with discipline, provide an attractive opportunity for investors seeking consistency and long-run value. While we acknowledge the complexity and uncertainty in today's markets, we remain confident that our approach positions clients to navigate this landscape with clarity and conviction.

– JAG's Fixed Income Research Team

Disclosures

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Ownership: Fifty-one percent ownership by a Veteran or Veterans. The applicant must share in all risk and profits commensurate with their ownership interest.

Control and Management: Proof of active management of the business. Veteran must possess the power to direct or cause to direct the management and policies of the business.

Contribution of Expertise and Capital: Contribution of capital and/or expertise by Veteran owner(s) to acquire their ownership interest shall be real and substantial and be in proportion of the interest acquired.

Independence: The Veteran owner(s) shall have the ability to perform in their area of specialty/expertise without substantial reliance on non-Veteran-owned businesses.

About JAG

JAG Capital Management (JAG) actively invests for institutions and individuals in highly selective, customizable, and nimble equity and fixed income strategies. JAG is a boutique, independent, employee-owned investment management firm in St. Louis.

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