It’s Inflation, Stupid | August 2026

“It’s the economy, stupid.”
James Carville (Bill Clinton’s 1992 Presidential Campaign)

It is rare and unusual for bond markets to dominate financial headlines and news coverage. Most of the time, us bond nerds are relegated to watching our friends in the stock market get all the media attention.

But lately, boring old bonds have been making it to the front page and top of the feed. A short scroll will uncover numerous articles declaring the sky is falling in bond land.

Amidst all these stories of a bond market rout, it may come as a surprise that last month US 10y yields rose a whopping 1 bp. With all the noise and hype, it’s been difficult to parse what is actually happening in the bond market.

Higher ground.

Since the start of the Iran war, global bond yields have trended higher. In most G7 countries, longer-dated rates (i.e., 30y) are at levels not seen since 2007.

The media is attributing this to three primary factors: inflation, ballooning government deficits, and the vast amount of debt required to fund AI capex. The confluence of these forces has also fueled fears of bond vigilantes pushing yields higher as punishment for irresponsible fiscal and monetary policy.

Let’s dig a little deeper and consider each of these factors.

Fiscal deficit disorder.

Last month, the US deficit crossing the $40 tn mark garnered a lot of attention. $40 trillion is a big number, but like a mortgage or a credit card balance, what matters is the cost of servicing that debt.

Currently, the annual interest expense on this debt represents ~19% of the tax revenue the US government collects. And if the US economy continues to grow, tax revenue will too, making deficit servicing less of a burden.

While the $40 tn number makes headlines, we don’t think bond markets are overly concerned about debt-service capacity for now. If costs trended toward 30%+ of tax revenue, the fiscal situation would be much harder to ignore.

Hyperscaling debt.

The AI boom is fuelling stocks higher, but it is having the opposite effect on bonds. The enormous amount of debt being issued by hyperscalers is seen as a substitute and competition for government bonds. As we learnt in Econ101, if demand remains constant and supply increases, prices fall, and yields rise.

Estimates peg 2026 hyperscaler borrowing between $250 bn and $325 bn. This represents ~15% of the anticipated $2 tn of new debt that the US government will issue. While the additional supply adds upward pressure on rates, it seems hard to believe that hyperscaler debt is the leading culprit behind higher yields.

Vigilante justice.

Perhaps the market moves are the work of bond vigilantes pushing yields higher and demanding a greater term premium. If that were the case, we would expect much greater volatility in the bond market and much sharper increases. During the Liz Truss 'mini-budget' moment in September 2022, it took just four days for 30-year gilt yields to surge by 150 bps.

Bond vigilante justice makes for a sensational story and clickbait headlines, but it doesn't seem to be the case yet. While long-end yields have moved higher, the moves have been orderly and short-term yields have increased even more.

It's inflation, stupid.

Through 2026, US and Canadian 10y yields increased 79 bps and 52 bps, respectively. Meanwhile, US 2y rates rose 111 bps, and CAD 2y yields increased 74 bps (as of yesterday's close). Based on the numbers, investors are demanding less of a premium to go further out the curve to buy longer-dated securities.

These moves in short-end rates reflect the shift from expectations of cuts to hikes. Before the war (i.e. February 27th), the bond market had priced ~2.5 rate cuts in the US for this year, and a 50% chance the BoC would cut. Today, expectations are for the Fed to deliver 3 hikes and the BoC 4 hikes over the next twelve months.

These moves imply that amidst the confluence of factors, it is inflation doing the wagging. This theory is further supported by the strong correlation between the ups and downs in oil and rates. As such, the market seems much more focused on inflation than anything else.

The same appears to be true of central bankers. Inflation seems to be the primary focus of those with their fingers on the button, Messrs Warsh and Macklem, something they both reiterated and confirmed in statements last month.

So for now, bond investors should tune out the noise and focus on inflation, with one eye on the bond vigilantes lurking in the shadows.

The Month of August.

Credit.

Last month saw a continuation of this year's supply theme. Both domestic and US markets set August supply records, at $16.2 bn and $160.3 bn, respectively. For context, the August 10-year average for Canadian issuance was $6.7 bn. The record domestic supply pushed the YTD total to $147.1 bn, up ~50% year over year. Utilities led the charge with 27% of volume, Banks followed at 23%, and Maple issuers (foreign borrowers tapping the loonie market) contributed $4.75 bn, keeping their YTD share at a healthy 30% of total issuance.

South of the border, the story remains AI. Hyperscalers and AI-related issuance led the communications sector, which comprised 22% of new supply, as the industry borrows aggressively to fund the data-centre arms race. AA-rated tech paper actually widened even as fundamentals stayed rock-solid, evidence that supply, not credit quality, is setting the tone this cycle.

Demand was sufficient to digest the new supply, with credit spreads flat on both sides of the border. Sector performance in Canada was mixed: Credit Unions & Mid-Caps and Power Generation tightened (-6 bps and -

2 bps, respectively), while Insurance and Retail-Consumer widened (+2 bps). Canadian bank earnings, for their part, gave little cause for concern. Better-than-expected results, stable margins, and no visible cracks in credit quality despite the tariff soap opera playing out with our neighbours.

Investment-grade credit spreads:

- Canadian investment-grade spreads were unchanged at 89 bps.
- US investment-grade spreads were unchanged at 78 bps.

Interest Rates.

For those of us following the market tick-for-tick, August was a rollercoaster ride of ups and downs en route to rates finishing modestly higher.

North of the border, the Canadian jobs report (75k jobs created in July) was followed by a strong Q2 GDP print of 3.3%, fuelling expectations of hikes. The collapse in trade talks with the US led to a short-lived rally before rates reversed and finished the month higher.

South of the border, conflicting economic data led to a bumpy ride in rates, with the big fireworks coming towards the end of the month. Treasury Secretary and the 'nation's top bond salesman', Scott Bessent, attempted to cool the 'fever that was building' in the long-end yields by increasing the Treasury's buybacks from $2 bn to at least $4 bn per operation. The bond market concluded that this was immaterial.

To end the month, Fed Chairman Warsh delivered his first Jackson Hole address, where he struck a notably hawkish tone, declaring the Fed still had 'work to do' on inflation and leaning on rate policy as its 'predominant tool'. In short order, markets shifted the odds of a September hike from 34% to 65%.

- Canadian 2y finished at 3.01% (+9 bps) and the 10y at 3.74% (+8 bps).
- US 2y finished at 4.34% (+5 bps) and the 10y at 4.75% (+1 bps).

The Funds.

Algonquin Debt Strategies Fund.

Gains from portfolio yield and active trading were partially offset by losses from movements in credit spreads and rising shorter-dated yields. We continue to take advantage of higher yields in <1y securities to increase portfolio yield while incurring minimal credit risk.

Portfolio Metrics:

- 5.0- 5.5% yield
- Average credit rating: BBB+
- Average maturity: 1.4y

- IR Duration: 1.3y

	1M	3M	6M	YTD	1Y	3Y	5Y	10y	SI
X Class	0.37%	0.62%	0.96%	1.86%	3.45%	7.86%	5.52%	5.90%	7.78%
F Class	0.31%	0.46%	0.66%	1.42%	2.76%	6.86%	4.68%	5.04%	NA

* As of August 31st,, 2026

The Algonquin Debt Strategies Fund LP was launched on February 2nd, 2015. Returns are shown on 'Series 1 X Founder's Class' since inception and for 'Series 1 F Class' since May 1st, 2016, and are based on NAVs in Canadian dollars as calculated by SGGG Fund Services Inc. net of all fees and expenses. For periods greater than one year, returns are annualized.

Algonquin Fixed Income 2.0

Rising short-end rates created a headwind for the fund, but gains from yield and active trading more than offset duration losses, and the fund finished the month on the right side of zero. With the Canadian market pricing in 4 hikes over the next 12 months, we are using sell-offs in the short end to add duration exposure.

Portfolio Metrics:

- 4.5- 5.0% yield
- Average credit rating: A-
- Average maturity: 2.4y
- IR Duration: 3.6y

	1M	3M	6M	YTD	1Y	2y	3y	5y	SI
F Class	0.10%	-0.27%	-0.74%	0.77%	2.45%	4.98%	7.20%	3.74%	4.67%

* As of August 31st,, 2026

Algonquin Fixed Income 2.0 Fund is an Alternative Mutual Fund and was launched on December 9th, 2019. Returns are shown for Class F since inception and are based on NAVs in Canadian dollars as calculated by SGGG Fund Services Inc., net of all fees and expenses. Investors should read the Simplified Prospectus and Fund Facts Documents and consult their registered investment dealer before making an investment decision. Commissions, trailing commissions, management fees, and operating expenses all may be associated with mutual fund investments. An Alternative Mutual Fund is not guaranteed, its value changes frequently and its past performance is not indicative of future performance and may not be repeated. Payment of quarterly distributions is not guaranteed and paid at the discretion of the manager; therefore, it may vary from period to period and does not infer fund performance or rate of return.

Looking Ahead.

A deterioration in the US-Iran war steadily drove oil prices higher, raising inflation concerns. After being stung in 2021, central bankers worldwide are nervously signalling they are ready to ensure inflation is not reignited. The tougher talk is pushing yields higher. Barring a negative economic shock, the next move by the BoC and the Fed will likely be a hike. The only question up for debate is 'when and how many'.

So far, it appears the only traders who understand that central banks are tightening monetary policy are the rate traders. Equity and credit folks have largely brushed off concerns of higher rates. Perhaps that will change in the coming months. If so, we suspect that any such rate-driven dips will be shallow and short-lived, as people conclude that the hiking cycle will be much tamer than the 2022 episode.

As we type, the Canadian market has priced in over 4 hikes by July 2027. Given the 'elbows up' nature of the trade talks with the US, we feel this is a bit aggressive and see an opportunity to add CAD rate exposure on sell-offs.

On credit, it seems difficult to keep toppling monthly issuance records; however, we anticipate activity to remain robust through the fall. Given that spreads are trading on the tighter end of the range, we are being selective in which issuers we participate in. The tight spread environment compels us to keep our exposures modest. A dislocation would be a welcome buying opportunity.

Contact

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