

Watchful Watching | July 2026

“This is a period of watchful thinking, not watchful waiting.”

Kevin Warsh

Last week, the FOMC voted to keep the policy rate at 3.50%-3.75%. The decision was widely expected, but it would be a stretch to say, ‘it came as no surprise’.

Heading into the meeting, the market had priced the odds of a hike at 33%. The same probability for rain would have weather apps warning of a ‘chance of showers’ with raindrop graphics.

In the end, the greater probability prevailed, and umbrellas were unnecessary. But Chairman Warsh did get his desire for ‘a good family fight’. The decision was not unanimous, with three of the family members voting in favour of a 25 bps hike.

But it wasn’t the dissent nor the bare-bones written statement that caught the bond market’s attention. It was the post-meeting press conference where Chairman Warsh spoke through tight lips.

Watchful thinking.

True to his noncommunicative and anti-forward guidance philosophy, Warsh offered little clarification on the rationale for holding rates steady, nor how the Fed intended to achieve its inflation mandate. He described their stance as ‘watchful thinking, not watchful waiting’.

While he didn’t say a lot, a few remarks caught the bond market’s attention. He opened the door to alternative inflation indicators besides PCE and suggested there are other tools, aside from rate hikes, to fight inflation. He also noted that the bond market is ‘learning to play the ball, not the referee’, and that the rise in yields since their June meeting had done some of the Fed’s heavy lifting.

Watchful reacting.

While the Fed engaged in watchful thinking, the market got busy reacting. US 30y yields rose as much as 14 bps, crossing 5.20% to the highest level since 2007. Meanwhile, 2y rates eased a couple of bps, resulting in one of the biggest post-FOMC bear steepeners since the mid-90s.

Watchful interpreting.

Like the famous Roschach inkblot tests, the interpretation of the Chairman’s remarks and the market reaction depended on the viewer and what they walked in believing.

For those expecting a hike, or at least for Warsh to build a case for tightening, the remarks were interpreted as dovish, and the sell-off in long-dated yields reflected a lack of confidence in the Fed’s resolve to tame inflation.

Other central bank watchers believe that the Fed is still committed to fighting inflation, and that the move in yields was a market overreaction. They see Warsh and the Fed’s current stance as being in line with his predecessor’s ‘wait and see’ approach, with long-end yields reflecting supply from government borrowing and AI-capex financing needs.

Another explanation is the lack of forward guidance creating greater uncertainty and volatility, leading bond investors to demand a greater risk premium for owning Treasuries further out the curve.

Look who's watching.

It seems there is no shortage of explanations behind the sell-off in rates. In all likelihood, the correct answer is all of the above mixed in with some other factors.

But what we can be certain of is that since Warsh's first meeting as Chair, 30y yields are ~25 bps higher. The Fed is watching and thinking. The bond market is watching and thinking.

It's a dual stakeout. Both sides are watching each other, both are aware that they are being watched, and everyone is watching the data.

For now, the bond market is expecting a hike by year-end and pricing a 30% probability of the Fed delivering two. There are 12 voting members on the FOMC. Assuming the three 'watchful thinkers' that dissented do not change their minds, four of the remaining nine need to change from 'hold' to 'hike'.

Their next meeting is on September 16th. Between now and then, there are two full data cycles as well as the 'blank piece of paper' that is the Jackson Hole Symposium. In addition, everyone will be monitoring progress on the US-Iran conflict and its impact on oil prices.

It feels like a game of 3D chess, as bond traders will be trying to decide whether any of the data points or geopolitical developments are sufficient to get the Fed from watching to hiking. Sadly, with all this watching and thinking, it seems that there will be no summer holidays for the FOMC or bond investors.

The Month of July.

Credit.

The Canadian primary market took a breather in July, with just \$10 bn of issuance, the lightest month of 2026, and a sharp comedown from June's record supply. The pause was welcome after several months of heavy issuance left the market oversupplied. While the quieter calendar offered some technical relief, higher oil prices, rate-hike fears, and concerns about AI capex (supply) led to a modest widening of credit spreads.

The lighter July calendar made room for some less typical names to access the market. High-yield issuance was unusually busy for midsummer: Arterra Wines priced \$375mm of 5-year bonds, and New Flyer Industries, Saturn Oil & Gas, MDA Space, and Sleep Country Canada all came to market. On the investment-grade side, Waste Connections, Gibson, Home Equity Bank, AltaLink, New York Life, and Welltower all priced new deals. The banks did their part, with BMO issuing \$1.25bn of bail-in debt and BNS pricing a \$1.25bn NVCC Tier 2, which was notable given NVCC was the worst-performing sector in the month (+5 bps).

Year-to-date issuance now sits at \$130.4 bn, up 54% versus this time last year. Maple issuance has been a theme in its own right, with roughly \$35 bn priced in H1 alone, more than double all of 2025's \$16 bn, and we suspect there's more to come before year-end.

Investment-grade credit spreads:

- Canadian investment-grade spreads widened 2 bps to 89 bps.
- US investment-grade spreads widened 4 bps to 78 bps.

Interest Rates.

However you interpreted the Fed's inaction and Warsh's comments, the outcome was undeniable: a material bear steepening on both sides of the border. On top of the Fed-driven sell-off, rates also took their cue from the oil market, with Brent rallying ~22% as traffic through the Strait of Hormuz fell an estimated 75%, and the conflict in Iran intensified.

The Bank of Canada left its overnight rate unchanged at 2.25% in July, offering little in the way of fresh signal. Canadian rates were dragged along for the ride, following US yields higher and steeper.

- Canadian 2y finished at 2.92% (+17 bps) and the 10y at 3.66% (+28 bps).
- US 2y finished at 4.29% (+12 bps) and the 10y at 4.74% (+27 bps).

The Funds.

Algonquin Debt Strategies Fund.

The gains from the portfolio yield and active trading were offset by widening credit spreads and rising interest rates, with a net result of +7 bps for the month.

Portfolio Metrics:

- 5.0- 5.5% yield
- Average credit rating: BBB+
- Average maturity: 1.5y
- IR Duration: 1.07y

	1M	3M	6M	YTD	1Y	3Y	5Y	10y	SI
X Class	0.11%	0.81%	0.62%	1.48%	3.33%	7.81%	5.47%	6.03%	7.81%
F Class	0.07%	0.64%	0.35%	1.11%	2.64%	6.81%	4.63%	5.16%	NA

* As of July 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

The main driver of returns in July was the sell-off in Canadian rates, with the losses from duration partially offset by yield and active trading.

Portfolio Metrics:

- 4.5-5.0% yield
- Average credit rating: A-
- Average maturity: 2.5y
- IR Duration: 3.9y

	1M	3M	6M	YTD	1Y	2y	3y	5y	SI
F Class	-0.60%	0.53%	-0.06%	0.67%	3.13%	5.19%	7.07%	3.76%	4.72%

* As of July 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, Annual Information Form, 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.

For central bank watchers, the BoC is first up, with its next decision on September 2nd. Between now and then, there is limited new data, with only one Labour Force Survey (July), one CPI print (July), and June's GDP. The August numbers won't land until after the meeting. The bond market is expecting the BoC to remain on hold next month, with a 70% probability of a December hike, and two hikes (cumulatively) built in by spring of next year.

The Fed's turn comes two weeks later, on September 16th. As aforementioned, between now and then there are two full jobs-and-CPI reports and the Jackson Hole Symposium. It will be interesting to see if Chairman Warsh uses his Jackson Hole speech to fill in any of the clarification and guidance he withheld in July. Absent a clearer signal, we expect markets to keep leaning on oil and the Gulf conflict as the dominant swing factor for both the timing and size of any eventual move. With all the watching and thinking from the Fed and bond investors, we expect the Treasury market to have a volatile summer.

On the credit side, we expect the dominant theme to continue to be supply. Following the summer lull, we expect the primary calendar to pick back up in September. Year-to-date issuance is already running well ahead of last year's pace. Between Maple issuance, ongoing bank capital needs, and AI-capex-linked financing, we wouldn't be surprised to see Canadian corporate supply approach the \$200 bn mark by year-end.

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