Overweight Short-Term US TIPS/Underweight Short-Term US Treasuries

Recommended since July 31, 2026

Investment thesis: We expect short-term US TIPS will outperform short-term US Treasuries, given elevated real yields and short-term breakeven inflation rates that appear too low for the current macro and geopolitical environment. Whether the current expansion continues or the environment becomes more stagflationary, low short-term breakeven levels leave room for the position to perform well.

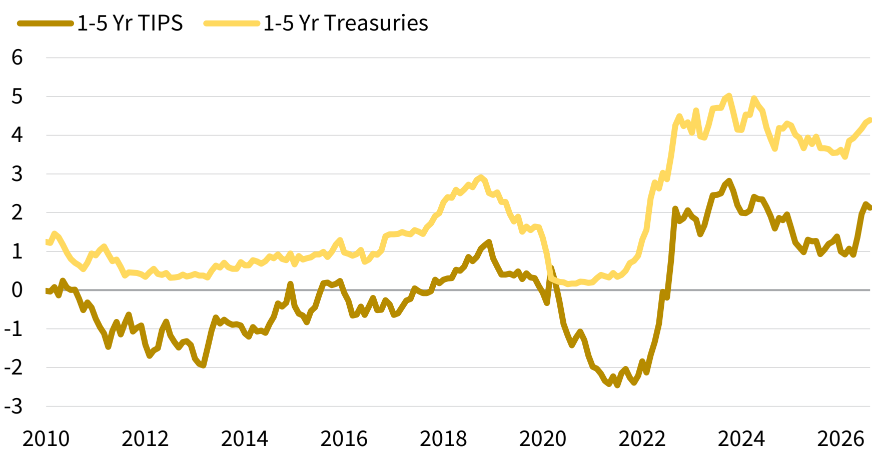
Key support 1: Short-term real yields have risen sharply this year, climbing from below 1.0% in early 2026 to above 2%—back in the top decile of observations since 2010. The spread between nominal and real yields (i.e., breakeven inflation spreads) has also compressed, as the recent rise in yields largely reflects a repricing of policy rate expectations rather than inflation expectations. Excluding the negative real rate era, periods with similarly compressed breakeven inflation spreads have been followed by TIPS outperformance over subsequent three-year horizons 100% of the time, averaging approximately 200 basis points of annualized excess return.

Key support 2: Breakeven inflation spreads appear too low for the current environment, given ongoing uncertainty over the Iran War and oil prices, leaving breakevens compressed even as inflation risks remain skewed to the upside. TIPS typically produce the best excess returns relative to Treasuries when real growth is positive and/or inflation is high or rising. More broadly, the increased frequency of supply shocks since COVID-19 has reduced the diversification role of nominal bonds and increased the appeal of inflation-sensitive assets like TIPS, particularly at current real yield levels..

Key risks: The primary risks are a rapid unwinding of inflationary pressures or a growth shock that sharply lowers inflation expectations—both outcomes we view as less likely. Additional risks include a widening TIPS liquidity premium—the TIPS market is smaller and less actively traded than nominal Treasuries—or a faster-than-expected rise in real yields if the Federal Reserve tightens more than expected.

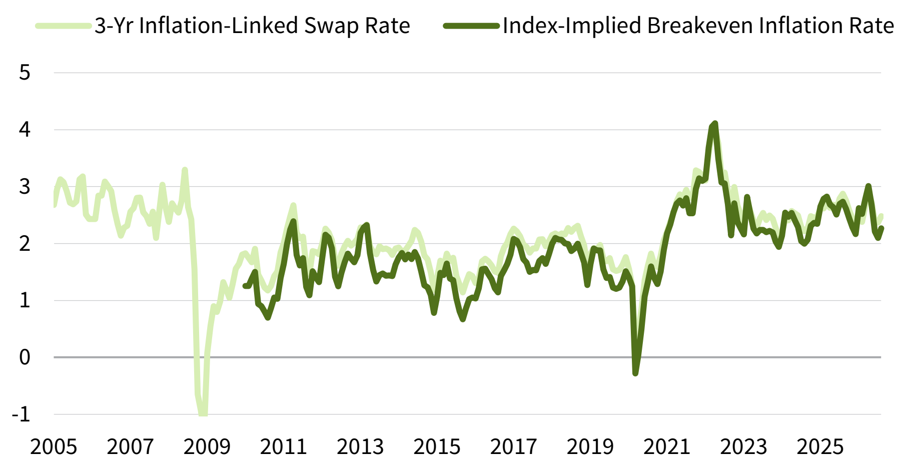
Absolute yields: 1-5 yr US TIPS and 1-5 yr US Treasuries

January 31, 2010 – August 31, 2026 • Percent (%)



Inflation expectations

January 31, 2005 – August 31, 2026 • Percent (%)



Sources: Bloomberg Index Services Limited, ICAP, Standard & Poor's, and Thomson Reuters Datastream. Third-party data provided "as is" without any express or implied warranties.
Note: The index-implied breakeven inflation rate is the difference of the 1–5-year US Treasury Index yield and the 1–5-year US TIPS Index yield.