

The Fed and the Bond Market Are Telling Two Different Stories

Treasury yields near their highest levels since 2007 show investors expect more rate increases than the Federal Reserve has promised. History suggests that gap doesn't last — and how it closes will set the tone for stocks into year-end.

Erie Wealth Advisors • September 21, 2026

The Federal Reserve raised interest rates for the first time in three years on Sept. 16, a quarter-point move that few investors doubted was coming. ^[1] What rattled markets wasn't the decision. It was what came after: updated projections showing most policymakers expect at least one more increase before year-end, delivered by a Fed chair, Kevin Warsh, who has deliberately avoided saying much about the path ahead^[2] — and a bond market that is now betting on even more tightening than those projections show.

That disagreement — between what the Fed says it will do and what traders are actually pricing — is the story to watch for the rest of 2026. It will shape where Treasury yields land, and it will have a direct bearing on how stocks perform through the final months of the year.

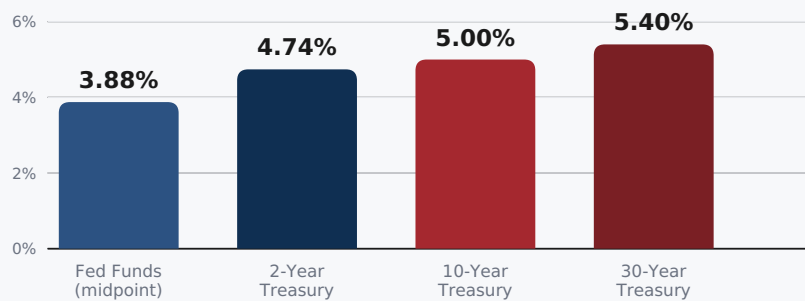
A rate increase nobody argued with

The Fed's move lifted its benchmark rate to a range of 3.75% to 4.00%, unanimously approved by all twelve voting members.^[1] Behind the decision is an uncomfortable mix: inflation running hot, driven largely by oil prices tied to the conflict in Iran, at the same time that economic growth is cooling. Second-quarter gross domestic product was revised to show inflation running at a 5.3% annual pace, well above the Fed's 2% target, while headline growth held at just 1.5%.^[3]

Wall Street had priced in the hike with near certainty. What surprised traders was what followed it. Warsh, in keeping with his stated preference for less forward guidance, offered few specifics of his own in the press conference.^[2] But the committee's updated quarterly projections did the talking for him: 16 of the 18 policymakers who submit forecasts see at least one more hike this year, and the median projection holds near 4.125% through the end of 2027 — a full reversal from March, when the same committee was still projecting rate cuts.^[1]

WHERE RATES STAND TODAY

Short-term Treasurys are already pricing in more than the Fed has delivered



Source: Federal Reserve; U.S. Department of the Treasury, H.15 Selected Interest Rates.^[6] Yields as of Sept. 18, 2026.

The market is betting on more

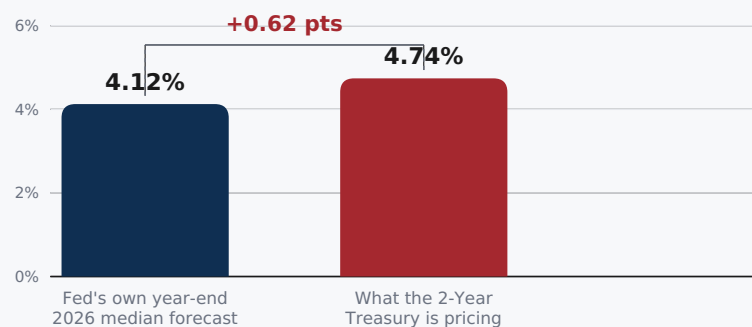
Here is the mismatch. The two-year Treasury yield — the maturity most sensitive to Fed policy — has climbed to roughly 4.74%.^[6] That is nearly 0.85 percentage point above the midpoint of the Fed's current target range, and above where the Fed's own median projection suggests rates will be a year from now. In plain terms, bond traders are wagering on a tighter path than the central bank has actually committed to.

The 10-year yield, which drives mortgage rates and corporate borrowing costs, tells a similar story. It touched 5.04% the week of the Fed's decision — the highest level since 2007 — before settling back to around 5.00%.^[4] The 30-year yield brushed against 5.40% the same week.^[5]

"A central bank can hold its ground only as long as markets believe the data supports it. When investors price in more than a bank has promised, something usually has to give."

THE GAP THAT MATTERS

The Fed's own forecast vs. what bond traders are pricing in



Source: Federal Reserve Summary of Economic Projections, median year-end 2026 rate; U.S. Treasury 2-year constant maturity yield.^[6]

Treasury officials, for their part, are trying to keep the bond market orderly rather than fight its direction. Beginning Sept. 9, the department at least doubled the size of its long-end debt buybacks, to \$4 billion or more per operation, through Nov. 4.^[8] The move won't offset further Fed tightening, but it should help smooth trading in a market that has been unusually volatile.

Three paths from here

Base case — higher for longer

Oil prices stay elevated, inflation doesn't cool meaningfully, and the Fed delivers the additional hike it has signaled at its Oct. 28 or December meeting. The two-year yield holds in the high-4% range, and the 10-year stays anchored near 5%.

Yields move higher — the market keeps outrunning the Fed

If inflation data surprises to the upside again, the gap between market pricing and the Fed's dot plot widens further, pulling the 10-year back toward — or above — its 5.04% pre-decision peak.

Yields move lower — relief on oil

A de-escalation in the Middle East and softer oil prices would be the fastest route to lower yields across the curve, with the two-year — most sensitive to Fed expectations — likely to fall first and furthest.

What it means for stocks

For equity investors, the path of yields is now as important as the path of earnings. If the 10-year holds near 5%, valuation multiples stay under pressure — there is little room for disappointment when investors can earn 5% risk-free. Rate-sensitive corners of the market, including housing-linked stocks, small-caps and high-growth technology names, are likely to feel it most. The market's reaction on decision day itself was telling in its own way: with the hike fully expected, the S&P 500 and Nasdaq closed only modestly higher and the Dow finished roughly flat — a sign that the real tension isn't the hike itself, but whether the path beyond it turns out to be steeper than priced in.^[10]

Working in the other direction is earnings. Analysts currently expect S&P 500 profit growth of roughly 28.7% for the third quarter, which would mark a third straight quarter above 25%.^[9] Strong enough profit growth can carry stock prices even against a higher discount rate — but it narrows the margin for error considerably.

One thread worth watching closely: spending on artificial-intelligence infrastructure is now estimated at somewhere between 1.4% and 2% of U.S. GDP,^[11] yet is estimated to be driving somewhere between a third and half of overall economic growth.^[12] If persistently higher borrowing costs cause that investment cycle to merely plateau, rather than keep accelerating, the hit to both growth and corporate earnings could be larger than AI's modest share of the economy would suggest. Notably, some of

the recent pressure on long-term yields has itself been linked to heavy corporate debt issuance from AI companies competing for capital alongside Treasury supply.^[4] Corporate capital-spending guidance during third-quarter earnings season, which begins in mid-October, should offer the first real read on that risk.

Dates that could move markets

Sept. 30	Third estimate and annual revisions of GDP
Oct. 28	Federal Reserve rate decision
Mid-October	Third-quarter earnings, including hyperscaler capital-spending guidance
Nov. 4	Treasury quarterly refunding announcement and buyback guidance

The bottom line for the months ahead: the Fed and the bond market are not yet reading from the same script. That kind of gap tends to close through incoming data, not through argument — either the Fed ultimately delivers what the market already expects, or the data gives the market reason to pare back its bets.

References

1. J.P. Morgan Wealth Management, "Fed raises rates at September meeting: Key takeaways for investors," Sept. 17, 2026. chase.com; Newsquawk, "FOMC Summary: Fed hikes as expected in unanimous decision," Sept. 16, 2026. newsquawk.com
2. OrbitRemit, "Federal Reserve raises rates to 3.75-4.00% for the first time since 2023," Sept. 16, 2026. blog.orbitremit.com
3. InvestingLive, "US GDP 2nd estimate for Q2: 1.5% vs. 1.5% preliminary," Aug. 26, 2026 (data via U.S. Bureau of Economic Analysis). investinglive.com
4. The Korea Herald (Business), "US 10-year yield briefly tops 5% ahead of FOMC, hitting highest since 2007," Sept. 16, 2026. mbiz.heraldcorp.com; Trading Economics, "US 10-Year Yield Rises to 19-Year High," Sept. 16, 2026. tradingeconomics.com
5. The Korea Herald (Business), "US 10-year yield briefly tops 5% ahead of FOMC, hitting highest since 2007," Sept. 16, 2026 (30-year yield at 5.401%). mbiz.heraldcorp.com
6. CNBC, "U.S. 2 Year Treasury — Stock Price, Quote and News," accessed Sept. 18, 2026. cnbc.com
7. Trading Economics, "US 10 Year Treasury Note Yield," accessed Sept. 18, 2026. tradingeconomics.com
8. U.S. Department of the Treasury, "Treasury Announces Increased Sizes of Nominal Long-End Liquidity Support Buybacks Beginning September 9," Aug. 19, 2026. home.treasury.gov
9. FactSet, "Earnings Insight," Sept. 11, 2026 (John Butters, VP, Senior Earnings Analyst). advantage.factset.com
10. Norada Real Estate, "Stock Market Rises as Nasdaq and S&P 500 Rally Following Expected Fed Rate Hike," Sept. 16, 2026. noradarealestate.com
11. Epoch AI, "The AI boom has doubled computing infrastructure's share of US GDP," June 5, 2026. epoch.ai; Goldman Sachs, "Global AI Investment Is Forecast to Exceed \$1 Trillion in 2026," Aug. 7, 2026. goldmansachs.com; Forbes, "AI Investment Will Hit 2% Of U.S. GDP This Year, Analyst Says," July 9, 2026 (TS Lombard). forbes.com
12. ING Think, "How much is AI contributing to US economic growth?" 2026. think.ing.com

Erie Wealth Advisors — This material is for informational purposes only and does not constitute investment, legal or tax advice, and should not be relied upon as such. It does not take into account the investment objectives, financial situation or particular needs of any specific person. Opinions and forecasts reflect judgment as of the date of publication, are subject to change without notice, and may not come to pass. Past performance is not indicative of future results. All investing involves risk, including the possible loss of principal. Please consult your financial, tax and legal advisors before making any investment decisions.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results. The economic forecasts set forth in this material may not develop as predicted and there can be no guarantee that strategies promoted will be successful. Stock investing includes risks, including fluctuating prices and loss of principal. Any company names noted herein are for educational purposes only and not an indication of trading intent or a solicitation of their products or services. LPL Financial doesn't provide research on individual equities. Because of their narrow focus, investments concentrated in certain sectors or industries will be subject to greater volatility and specific risks compared with investing more broadly across many sectors, industries, and companies.