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Bonds

A guide to buying bonds when yields are on the rise

Story by Ashlea Ebeling 2026-10-11

With 10-year Treasury yields hitting multidecade highs, some investors are looking to add more fixed income to their portfolios.

They are moving cash to 2-year Treasuries, building ladders of Treasury Inflation-Protected Securities and buying target-maturity bond funds.

Bonds can offer income, safety and diversification. But for those wading in, they also come with a unique set of risks.

Credit risk

One mistake novice buyers make is chasing yields for yields' sake. When you buy a bond, you're lending money to the issuer who promises to pay you interest and return the principal when the bond matures on a set date. The lower the credit quality of the issuer you're lending to, the higher the rate you'll get. That is because there is a higher risk of default.

"I've had new clients come in with most of their fixed income allocation in high-yield funds," said James Mayo, a financial planner at IronFjord Wealth Management in Lakewood, Colo. "They didn't understand that those were junk bonds with low ratings. They just see the high yield."

Bonds come with letter grades from credit-rating firms. Investment-grade bonds are safer in terms of default risk, but have lower yields. Speculative grade or junk bonds are riskier, although the higher yields are enticing. The issuers are paying you for taking on the risk of believing in them. You decide whom you want to lend money to and how much risk you're willing to take.

"The Bloomberg US Aggregate Bond Index used to be called the Lehman Brothers Aggregate Bond Index," said Allan Roth, a financial planner in Colorado Springs, Colo. "Big and iconic companies do go under."

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If you're drawing on bonds as an income source, and you'll need to sell even if prices are down, consider holding shorter-term bonds and intermediate term bonds. You can also mitigate duration risk by using a ladder strategy, buying bonds with staggered maturity dates.

Call risk

Many corporate and most municipal bonds are callable. That means the issuers are giving themselves an out if they can refinance their debt at lower rates. If market interest rates go down, the issuer might call the bond, returning your principal plus interest to date. You don't get to keep that higher rate you had hoped for.

By choosing noncallable bonds, you eliminate call risk but you might sacrifice some yield. You can also look for bonds with call protection or a "lockout" period, typically five to 10 years.

Prepayment risk

Mortgage-backed securities are essentially home loans packaged into bonds. They come with the risk that if rates go down, homeowners refinance out of their old higher-rate mortgages. The mortgage bonds thus pay off faster and you end up not being locked in as long as you thought, so you don't get all the interest you expected.

Tax risks

Location matters. The interest on bonds is generally taxed at ordinary income rates, so holding bonds in tax-deferred retirement accounts, such as IRAs or 401(k)s, can be tax efficient. "It's not hitting the tax return in the short term," said Mayo. You pay taxes later when you take distributions. (Note: You don't pay federal income tax on most muni bond interest, and you don't pay state or local income tax on income from Treasuries.)

Investors who hold Treasury Inflation-Protected Securities, or TIPS, in taxable accounts must come up with the cash to pay tax on the annual inflation-adjusted income, which is essentially "phantom income." Holding TIPS in tax-deferred accounts solves this problem, although there is an argument for high-income taxpayers in high-tax states to hold TIPS in taxable accounts because they are state-tax exempt.

Perhaps the biggest risk of all is forgoing bonds and keeping cash earning next to nothing in a checking account or some legacy and sweep bank accounts, said Roth.

This explanatory article may be periodically updated.

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