

Global Fixed Income Monthly

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Monthly Macro View

- War, investment spending, fiscal and political woes. Those are the issues.
- War. A war that never needed to take place pushing up inflation and interest rates. It remains uncertain when this will end, albeit both sides have incentives to stop.
- Investment spending is the prominent issue currently. In 2004 Ben Bernanke wrote a paper on the global savings glut, thus explaining puzzlingly low interest rates. Very briefly large savings outside the US, exacerbated by reactions to the Asian financial Crisis found their way to the US which had to be encouraged to spend through the medium of lower interest rates. The Global Financial crisis caused the investment side of the equation to weaken and led to a period of even lower interest rates. The savings glut (China's domestic consumption woes, Europe's high savings rate) remains but the demand for investment has increased with AI being very prominent here. The pressure here is likely to intensify as AI investment projections are very high, infrastructure spending on electricity grid is needed, climate change demands (either to prevent or respond to the consequences) and defence spending increases are all heading upwards. Government borrowing levels are unhelpful here. Yields have clearly responded. Assuming inflation comes near to target real ten-year yields are above the levels which prompted Bernanke's speech and are at the lower level of the range that prevailed in the years before this. The downside risks to yields are that AI returns are inadequate to match the investment costs. Many have written on this and concluded this is likely. Upside risks to yields are that the pressures should imply we fully return to levels seen as normal before the savings glut. The other risk is that China manages to shift its savings and investment imbalance. At the moment we think the shift in yields seen has made some higher yielding markets reasonable value, but the case is not overwhelming and so although we will take a long duration stance it is with some nervousness.
- Fiscal issues remain of concern. They are not at unsustainable levels, but the lack of population or political will to forcefully address them as well as continued upward pressure on government spending on defence and ageing populations is not positive.
- Politics itself is uncomfortable. The shift to populism is undermining assumptions that have been a prevailing philosophical underpinning in Western economies for many decades and perhaps well beyond that. We have noted before the shift in the US toward attempted autocracy and there are numerous examples of behaviours that would have led to outrage within society previously that are deemed acceptable now. The impact on markets and the economy is subtle, long term and too diffuse to go into detail here. One thing to mention, though, is that Central Bank Independence has been a mainstay of standard thinking for a long time now. For the moment it remains a very firm pillar. However, Trump's constant calls for interest rate cuts, his degrading of other Federal institutions, his attacks on individual Fed members through dubious legal means are uncomfortable. Trust in that bedrock, although still solid, is not as inviolable in the long run as it was once considered.
- Inflation has persistently been above target in many areas for a considerable period. This has been largely due to shocks and Central Banks have largely looked through it. That has been the correct response. Yet at some point and particularly with economies holding up there are obvious upside risks or at least risks that expectations become embedded. Thus far, though, the de-anchoring of expectations remains just a risk.
- Currencies are dependent on the war as well as the relative strength of the US economy. We were long AUD before the war and would continue with that. Otherwise, we have little conviction. The US benefits from being an oil exporter, a safe haven if the war worsens and the economy has remained very resilient, but it is increasingly isolating itself internationally and is becoming less trusted. Its debt situation is also troubling in that there is no sign any party wants to control it. Its policies are diminishing rather than enhancing its huge fundamental strengths. There is no clear alternative, though.

- Spread remains tight. Healthy corporates, little sign of concentrations of risk, a much greater supply of treasury paper and less trust in governments themselves are all likely contributing to this. Disillusionment with AI hopes could damage this. For the moment we keep a low but positive profile.

Portfolio Positioning

- Rates and Duration

The market began pricing in a prolonged period of high energy prices. Driven by expanding inflation, concerns over fiscal deterioration, and the absorption of heavy issuance in AI-related corporate bonds, the US 10-year yield surged past the 5% level. However, an increasing number of developed countries are also seeing their 10-year yields surpass 5%, and economic indicators are beginning to worsen—particularly in countries with shorter-term mortgage structures. Consequently, we extended duration primarily in Australia and New Zealand, where the impact of high interest rates is significant and relative yield levels remain high. We also increased our overall risk tolerance for total duration, shifting from our previous stance of neutral-to-slightly long to a neutral-to-long positioning. Regarding the yield curve, we managed the portfolio by capturing carry primarily at the short end while keeping curve risk contained, focusing our allocation on commodity-exporting countries.

While further details are provided in the market commentary section, a 5% yield level in developed economies tends to act as a drag on economic growth. Furthermore, with mid-term elections approaching and geopolitical situations in both Iran and Russia/Ukraine potentially reaching a turning point, a ceiling for interest rates may come into view. Although the market remains cautious about an immediate turnaround given the sharp yield surge in September, we expect rates to plateau and eventually decline. Therefore, we will maintain a neutral-to-long duration stance and continue to capture carry at the short end of the yield curve while limiting curve risk. While we will sustain our bond allocation centred on commodity-producing nations such as Norway, Australia, and the US, we plan to adjust this opportunistically based on energy market trends. We also look to increase our credit weighting during phases of credit spread widening.

In Euro area, we maintain and reinforce a neutral stance on short-term rates, broadly in line with current market pricing of further hikes towards a terminal deposit rate a little above 3.00%. At its most recent 10 September 2026 meeting, the ECB raised all three key rates by 25bp, taking the deposit facility rate to 2.50%. Market implied policy rates continue to reflect two distinct forces; on the hawkish side, the energy shock has pushed headline inflation to a fresh peak for this episode, core has edged up, activity has proved firmer than assumed, and Germany's fiscal expansion still adds a demand impulse; on the dovish side, wages show no material response to the shock, negotiated pay has eased, wider sovereign spreads have themselves tightened financial conditions, and indirect effects remain contained.

In the UK, market volatility in gilt yields remains notable, and long-dated yields have risen further since the summer. Long-term gilts continue to offer value as the rise has been global and led by the front end, with the long forward rate barely moved. The BoE's pause in gilt sales to the market adds a modest technical tailwind. The elevated term premium still appears to compensate and looks more a demand-structure phenomenon than a verdict on a debt level near the G7's lower end.

In the Japanese government bond market, we expect upward pressure on yields to persist across maturities. Further monetary policy normalisation by the Bank of Japan, together with growing concerns about fiscal sustainability and future government borrowing, should continue to weigh on bond prices. At the same time, reduced BoJ purchases and weaker demand from some domestic institutional investors mean that private investors will need to absorb more duration risk. This is likely to keep term premium elevated, particularly at the long end, reinforcing our expectation of higher JGB yields across the curve.

- Currencies

As previously mentioned, we remain broadly neutral on currency although we maintain a modestly bullish view on AUD because of the divergence of monetary policy between Australia and the US.

For the Japanese yen, structural headwinds remain firmly in place. Higher energy import costs are weighing on Japan's terms of trade, while wide interest rate differentials continue to encourage investment overseas. Although the authorities have intervened to support the currency, such measures are unlikely to reverse the underlying trend. Instead, intervention is more likely to limit excessive volatility and slow the pace of depreciation.

Further intervention remains a risk if yen weakness becomes disorderly, but any resulting appreciation is likely to be temporary unless accompanied by a meaningful narrowing of interest rate differentials. We therefore expect the yen

to weaken gradually over the medium term, although further monetary tightening by the BOJ could provide some support.

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