

Investment Strategy Insights

Rising bond yields don't always deliver pain

- Developed market global bond yields are rising rapidly as structurally stronger investment growth and increasing US productivity combine with cyclically stubborn inflation and large government borrowing programs that are partially funding the investment growth. These factors are unlikely to abate in the short to medium term.
- Current account positions amongst the world's largest importers and exporters of capital remain large. But the downward pressure this was placing on yields prior to COVID-19 has abated. More of the US current account deficit is being funded by both AI-related equity and debt issuance and less by issuance of Treasuries.
- Concerns about bond yields becoming dislocated from the positive structural growth fundamentals are overblown, but tighter monetary policy is a key risk. US government debt is probably on an unsustainable path but over the next 30 years it is still on track to only reach Japan's level of 15 years ago. Japan is also showing there is a way out of a high debt trap, with a combination of economic reform, inflation and a weaker currency driving stronger nominal GDP.

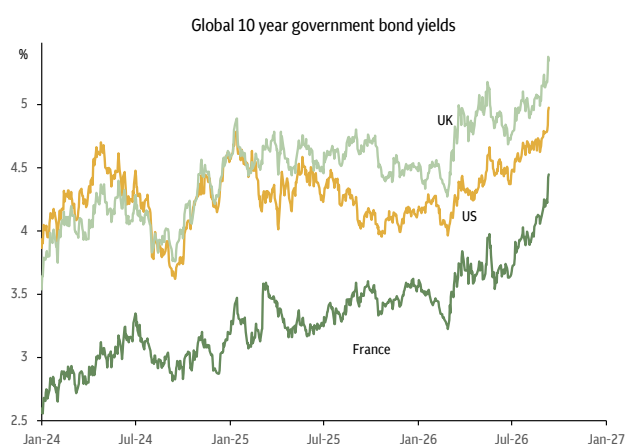
Bond yields are marching higher

In the past two months the US 10-year yield has surged by around 30bp to around 4.7%, but this hasn't caused a problem for equities, so far, with the S&P 500 only around 3% below the record high.

Rising yields can create a problem for equity valuations as future earnings are discounted using the risk-free rate. All else being equal, a higher discount rate would lower equity valuations. This would continue the recent, positive correlation between equity and bond returns. This is historically not the norm and makes it difficult for investors to allocate for risk asset protection in portfolio construction.

But the global stock market rally is not being driven by rising valuations, it is being driven by expectations of stronger earnings growth, which is a component of broader GDP growth. Over the past 12 months S&P 500 EPS growth has risen by 23%, while the consensus among stock analysts is for a similar increase over the next 12 months. The threat to equities is that earnings may not be delivered as consensus expects, rather than valuations being squeezed by rising yields.

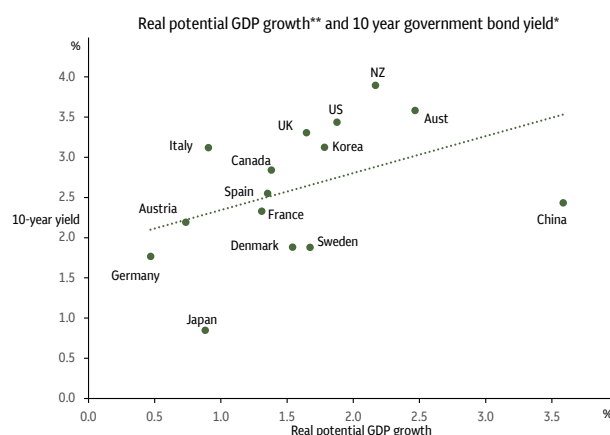
Government bond yields are rising rapidly



Source: LSEG, MWM Research, September 2026

Stronger real GDP growth normally goes hand in hand with higher government bond yields. For example, increasing government debt issuance means more government spending and stronger economic growth.

Higher yields also mean stronger growth



Source: OECD, MWM Research, September 2026 ** Average OECD potential GDP growth estimate between 2027 and 2030. * indicates average 2026 Ytd.

But the bond market has also shown that it can signal when there is too much government debt issuance for investors to absorb, or when governments are tossing aside fiscal discipline. An example of this was in April 2025 after the Liberation Day

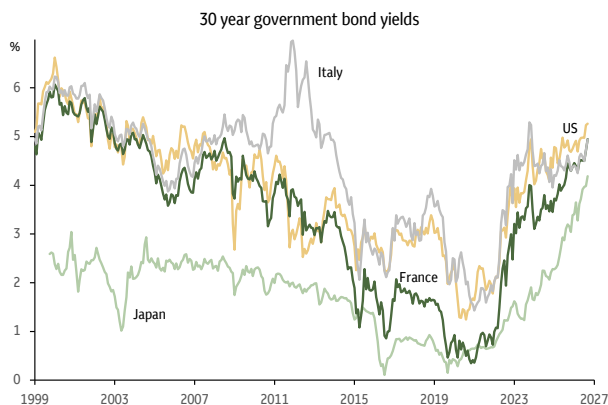
tariffs were announced with their stagflationary consequences. Another example occurred in 2022 when newly elected UK Prime Minister Liz Truss announced large tax cuts that were not funded by cuts in spending. The European debt crisis (2011) and the Asian debt crisis (1997) are other examples.

Monetary policy adjustments impact mainly the short end of the yield curve, particularly Treasury bills of less than 1 year duration and Treasury notes of less than 3 years duration. However, changes in policy extend to longer duration yields as well even though the marginal change from a change in policy is smaller.

Monetary policy movements also tend to be reasonably well synchronised because of financial and trade linkages between countries. It is not surprising that global government bond yields move in similar directions over the longer term, with relatively short periods of under and outperformance between countries.

In the current cycle, it's noteworthy that 30-year government bond yields are at their highest level since 2007 in both the US and France. The level of Italian 30-year yields has only been surpassed during the European debt crisis. Meanwhile, Japanese 30-year yields are at their highest level since September 1996.

Long duration bond yields are rising rapidly too



Source: LSEG, MWM Research, September 2026

After a 20 year decline such a large reversal is causing angst amongst some investors. But it's important to recognise that the increase in yields since 2021 has a large structural component. Sure, inflation rose following Covid lockdowns, and central banks raised rates in response, and inflation is yet to be properly tamed, but it's important to also recognise the structural change that is driving the rise in yields.

Economic growth has stepped up structurally for several reasons.

- *Adoption of a new technology* - the boom in investment in AI.
- *Military spending* – wars in the Middle East and Ukraine, and the response to China's increase in military spending.

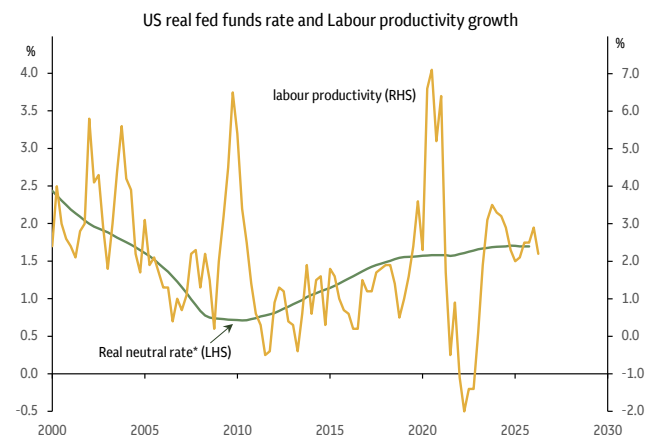
- *Population ageing-related spending* – healthcare, safety net support.
- *Investment in green energy*. Technological advances are making EVs and clean energy more cost effective than traditional sources of energy.
- *Critical minerals and national security*. Both are related to defence spending because they have increased because of rising global political risks.

Another factor driving yields higher is stronger US productivity growth.

Yields are rising in response to not only stronger economic growth, which has a large structural component but also a higher real neutral rate of interest.

In the US, productivity growth has accelerated and as this occurs the real neutral rate tends to rise as well. The real neutral rate concept is important because it's the interest rate that delivers growth that is neither too strong nor too soft and just enough to keep inflation steady. A higher real neutral rate also means the economy can keep growing at a higher rate of interest.

The neutral rate is rising steadily



Source: New York Fed. The real neutral rate is the two-sided estimate of the Laubach-Williams model. MWM Research, September 2026.

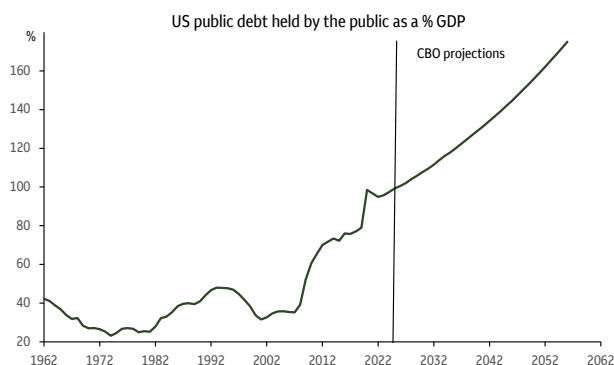
Of course, government spending is rising because several of the structural factors we identified are funded by government spending.

The alarm bells have been ringing about the US fiscal position since the GFC, although successive governments have been unwilling to address the rising pile of debt and rein in spending.

The Congressional Budget Office also warns that US federal government debt will rise to around 170% of GDP over the next 30 years. This is equivalent to gross debt reaching 190% of GDP over this period. This is large and probably unsustainable but it's not unsurpassed. Japanese gross debt reached that level back in 2011 and it did not trigger a fiscal crisis.

Economic reform implemented by the Abe government resulted in a painless way out, with stronger growth, a pick-up in inflation following Covid and a weaker Yen more recently. These developments have led to the IMF forecasting the debt-to-GDP ratio to fall over the next 10 years as nominal GDP grows faster than debt issuance.

US government debt will only grow unless action is taken



Source: Congressional Budget Office, MWM Research, September 2026

Even if there is a painless way out, hard decisions need to be made. Policymakers should be acutely aware that the bond market is very good at providing a guardrail around fiscal discipline. It provides probably the best available assessment of growth, inflation and fiscal sustainability and sharp movements in yields, particularly in response to unfunded spending should not be ignored.

Movements in global savings and the distribution of asset purchases are driving bond yields

The link between structural factors impacting economic growth and bond yields is best explained by movements in global savings.

Several countries increased their savings between the early 1990s and the GFC by growing their trade surplus. China began building trade surpluses after it joined the World Trade Organisation in 2001. Similarly, Japan and Germany became manufacturing powerhouses after WWII. The oil producing countries such as Kuwait, Russia, Norway and Qatar also tend to run large current account surpluses.

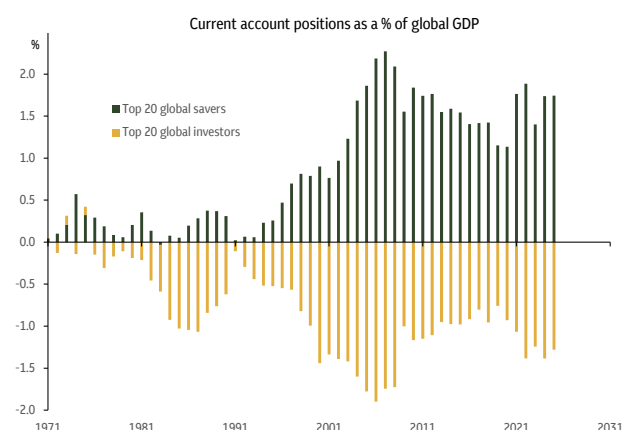
But matching the group of countries saving there must be a group of countries that spend and invest the saved capital. The US, UK, Turkey, India and Ukraine all run large current account deficits that are funded by the countries generating surpluses. Australia is now running a current account deficit even though the trade surplus is positive.

A current account balance records an economy's transactions with the rest of the world in goods, services, income and transfers. Surplus countries save more than they invest domestically; while countries with deficits invest more than they save and draw on net foreign capital to plug the gap.

Current account balances are therefore shaped by the saving and investment decisions of households, firms and governments. Government incentives and disincentives play a major role in how these decisions are made.

Current account = savings - investment

The current account surpluses are still wide

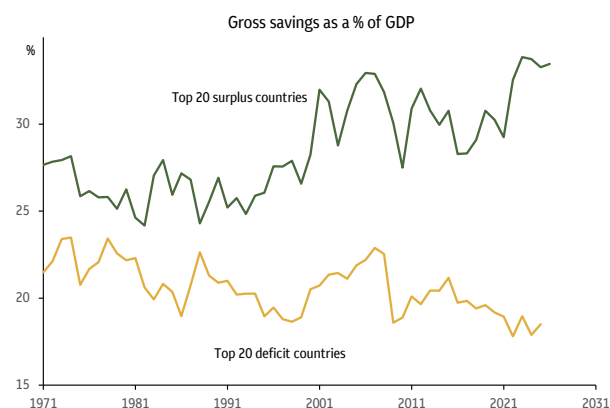


Source: LSEG, MWM Research, September 2026. The top 20 in surplus and deficit countries are determined by averaging the current account position over the past 10 years, so the deficit and surplus of the top 20 is not equal for the entire timeseries.

Savings decisions in surplus countries and not investment decisions in deficit countries are driving the size of the wedge in surpluses and deficits.

The large size of the current account positions that were built between the early 1990s and the GFC is mainly due to rising savings amongst the countries that run current account surpluses. Countries with current account deficits are saving a little less than they were 35 years ago, but it is a relatively small change compared to the increase in savings from surplus countries.

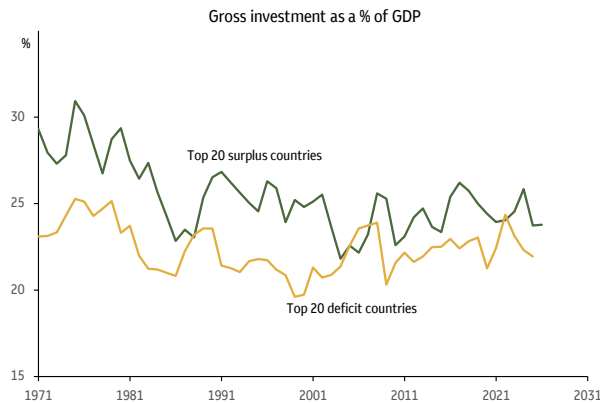
Savings amongst surplus countries is driving the imbalance



Source: LSEG, MWM Research, September 2026. The top 20 in surplus and deficit countries are determined by averaging the current account position over the past 10 years, so the deficit and surplus of the top 20 is not equal for the entire timeseries.

Similarly, the difference between investment in the surplus countries and investment in the deficit countries has been relatively small and steady.

The investment gap is relatively narrow

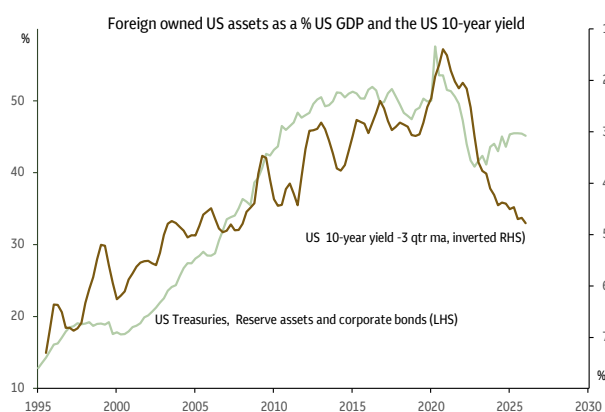


Source: LSEG, MWM Research, September 2026. The top 20 is surplus and deficit countries are determined by averaging the current account position over the past 10 years, so the deficit and surplus of the top 20 is not equal for the entire timeseries.

It's also important for investors to understand how the surpluses are being invested in deficit countries.

The large increase in surpluses of the global savers between the early 1990s and the GFC was invested in US Treasuries, US reserve assets and US corporate bonds. This put downward pressure on bond yields in the 30 years before Covid. This then reversed following the pandemic as there was less demand for assets such as US Treasuries, US Reserve assets and US corporate bonds.

Global savers also drove the decline in yields for 30 years



Source: LSEG, MWM Research, September 2026

However, the increase in yields over the past couple of years hasn't been driven by significantly less foreign demand for US Treasuries. Purchases of Treasuries have risen a little but remain well below the Covid peak and this is putting significantly less downward pressure on yields. Instead, global current account surpluses have been invested in US equities to help fund the AI

boom. Furthermore, the pick-up in investment, particularly in deficit countries, is adding upward pressure on yields.

Foreign ownership of US equities has surged



Source: LSEG, MWM Research, September 2026

Stronger economic growth from structural factors is a key driver of the increase in bond yields. There has only been one brief instance where the capacity of the US government to issue debt has caused bond yields to rise. Nonetheless, the US budget position is on a difficult path, and tough decisions will need to be made at some point.

There is also less downward pressure on bond yields from global savings compared to the pre-Covid period as more of the US current account deficit is being funded by equity issuance, particularly related to the AI boom. Rising US productivity is also playing a role because it lifts the threshold where the economy would normally slow under rising rates. But structural tailwinds pushing up bond yields does not mean monetary policy cannot cause yields to rise even further and slow growth if inflation remains elevated. This is now reflected in market pricing.

Macquarie WM Investment Strategy Team

This Report was finalised on 18 September 2026.

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