Investment Matters

Higher yields, less margin for error

October 2026

MACQUARIE



Investors will remember 2022, when the US 10-year yield rose by around 200 bps and the US stock market fell by 18%. The 52 bps increase in the 10-year bond yield over the past month has a similar feel, but there are some important differences:

- The S&P 500 is up by around 16% year-to-date in 2026 and only 1.4% below its record high.
- Investment in AI is turbocharging stock markets around the world. In 2022, ChatGPT had just kicked off the AI race.
- In 2022, inflation escaped the clutches of central banks post pandemic reopening, and they were going about reining it in. Now the inflation problem is less pressing, but central banks have clearly lost their patience, with it stubbornly above their inflation target.

Central banks have the blunt, but effective, tool of interest rates to deal with inflation due to excess demand. However, they have been dealt a series of supply-side shocks such as the pandemic lockdowns, US tariffs and the closure of the Strait of Hormuz. Interest rates are a less effective tool to address supply-induced inflation, but central banks must nevertheless pursue their dual mandate goal to maximise employment and keep inflation at target.

Another key difference between 2022 and 2026 is that bond yields have risen materially without the Fed raising rates. US 10-year yields are up 65 bps between March and August before the Fed raised rates. A large part of this has been due to global factors such as less savings and more investment in countries like Japan and Germany that have traditionally run current account surpluses. Another important factor is the redirection of Chinese savings away from US Treasuries and into US risk assets, particularly those with an AI exposure.

Global investment is picking up in areas such as defence, green energy, health and aged care. These are structural changes that draw on many economies' productive capacity and add to inflation if other parts of the economy don't take a back seat.

The structural increase in growth means that economies can cope with higher interest rates. Strong US labour productivity growth also bolsters the economy's shield to higher rates. All these factors are putting upward pressure on real bond yields. Breakeven rates have remained around 2.2%-2.4% anchored by the Fed's goal of PCE price stability at 2%.

The global oil shock has come at the wrong time given the inflation battle was still on. This means yields are now rising as central banks attempt to tighten financial conditions and slow growth. Many central banks haven't been able to pull inflation back to target for the past five years and if left unchecked, inflation expectations can rise making the job even more difficult.

The government spending component of the structural increase in growth has created concerns about fiscal sustainability, given the starting point is already high levels of debt. Japan, the US, the UK, Italy and France are the advanced economies of most concern.

It's difficult to quantify the extent of concern by disentangling term premia from bond yields. But the bond market has a good track record of reining in reckless spending plans. Ex-UK PM Truss, Japanese PM Takaichi, and US President Trump have all earned the ire of the bond market and shown that seemingly longer-term budget issues can become short-term emergencies.

By tightening policy, central banks are trying to make room for the structural drivers of growth by squeezing out housing and consumer spending. This is no more apparent than in Australia where the RBA has raised the cash rate four times this year. Pain is being felt in household budgets and housing prices are falling across all capital cities.

But the higher interest rates rise, the closer we come to the precipice. Central banks will be conscious of this when raising rates as they weigh up the costs of their policy adjustments. Fine-tuning the engines of growth is never easy because of a range of factors such as the long transmission period and the different channels through which policy works.

Resumption of tightening after a long pause also means central banks are looking for signs of a slowdown and are unlikely to stop raising rates until either i) they are confident this is unfolding, or ii) inflationary pressures are easing.

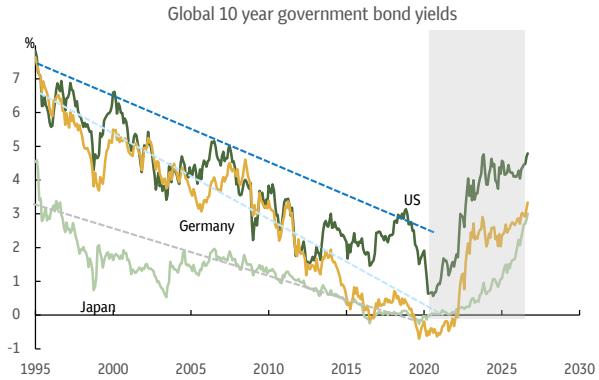
The wildcard is the war in the Middle East. If the flow of oil can properly resume out of the Strait of Hormuz, then central bank concerns will ease, leaving a much better outlook for growth. But negotiating a deal has shown to be difficult and this makes it hard to be certain about the investment outlook.

Investors will take this to mean that bond yields are going to continue to rise until either growth or inflation swing in the favour of central banks. This raises the risk of holding risk assets, particularly in the traditional interest rate sensitive sectors such as discretionary spending and property.

The good news is that AI investment is not as sensitive to rising rates. But the overhanging question about the size of the return on invested capital remains. Equity returns have been driven by an improving earnings outlook and not valuation increases, so markets will be sensitive to signs that an economic slowdown is underway and particularly if it becomes large enough to feed back into AI earnings.

Australia began tightening before other central banks and is already seeing clear signs of a slowdown in business survey data and interest rate sensitive sectors such as housing. But the RBA has indicated that it needs to see more of this.

Yields have broken out of a multi-decade decline



Source: LSEG, MWM Research, October 2026. Shaded area shows the structural increase in bond yields.

We remain positive on risk assets, but yields driven by tightening policy will continue to rise until central banks are confident growth is slowing and this makes us more cautious about the outlook.

Macquarie Wealth Management Investment Strategy Team

Global Economics: A slowdown is coming

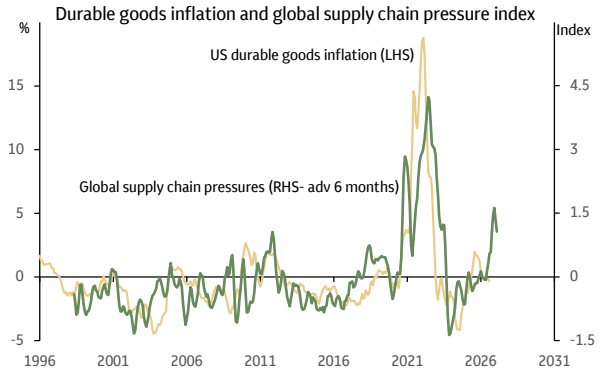
- Global central banks have stepped up to the plate in pursuit of their inflation target. The challenge isn't as big as it was in 2022, but more work needs to be done.
- Structurally stronger growth from private sector and government spending in defence and age-related areas are forcing central banks to squeeze out consumer spending and housing. Fine-tuning growth is a difficult task, but it must be done to bring inflation down.
- The increase in oil prices and its ability to become embedded into a wide number of items in CPI baskets has made the response more urgent. Unemployment is set to rise in the months ahead. But investors should also remain conscious that inflation could turn favourably if a deal to end the war in the Middle East can be reached.

The Fed joined the RBA, ECB, BoJ, Bank of Korea, the Norges Bank and RBNZ in tightening policy this year. Global central banks have the difficult job of trying to maintain the job gains made since the pandemic while at the same time achieving their inflation target. The job is even more difficult because the upward pressure on inflation this year is coming from another supply shock. The closure of the Strait of Hormuz joins the increase in US trade tariffs and the pandemic as recent supply shocks that have put upward pressure on inflation.

Global bond yields are also rising due to a range of factors. Some of these are related to the structural lift in growth from private sector sources of investment such as AI and clean energy, but also government investment such as military and age-related spending. The byproduct of this structural increase in growth is Inflation and upward pressure on already high levels of government debt in some countries.

Central banks' job is to squeeze out consumer spending and housing to make room for these areas of structural growth. In doing this, unemployment rates are likely to rise and inflation should ease over time. The difference this time around versus 2022 is that rates aren't starting from zero and US inflation isn't starting at 8%, so it's more likely central banks will engineer a slowdown rather than a recession.

Upward pressure on inflation remains



Source: LSEG, MWM Research, October 2026

Australian Economics: Rates may not have yet peaked

- The RBA delivered on its messaging and raised rates in September by 25 bps, taking the cash rate to 4.60%. There are signs that the changes to capital gains tax and the three prior rate rises are already taking effect.
- But the RBA needs to see more progress on inflation and said it would like to see the unemployment rate closer to 5%. Financial markets have another 25 bps rate rise priced in for November, and another by mid-2027.
- The price of oil can tip the scales in either direction. If an agreement on oil supply out of the Strait can be reached and the oil price falls, then there is less pressure on the RBA to raise rates. But if the oil stalemate remains and temporary supply measures are exhausted, then upward pressure on rates will remain.

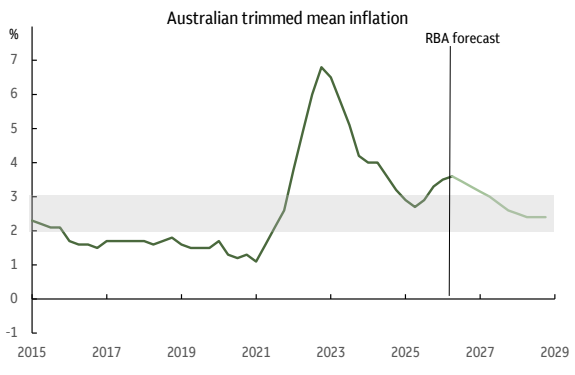
The RBA surprised no one by raising the cash rate at its September board meeting. The supply shock to fuel prices has now triggered four interest rate rises this year and, according to the Bank's statement published after the decision, there could easily be more to come.

The Bank left the door open to further rate rises, conscious that it will take time for policy changes to impact inflation. The price of oil is the wildcard, given its ability to ripple through the price of many goods and services via second round effects. The Bank will want to see more spare capacity and an unemployment rate closer to 5% than 4.5%.

But there are already clear signs that the tax changes to negative gearing and capital gains, along with the three rate rises before the tightening in September, are impacting growth. Dwelling prices are falling across all the capital cities and business surveys are pointing to a slowdown broadening beyond just housing. Productivity growth remains weak, highlighting the broader structural issues facing the economy, particularly its ability to absorb cost pressures.

Data on inflation released after the RBA decision showed no relief. In August, the trimmed mean measure of consumer prices increased by 0.2% in the month and 3.6% over the past 12 months, well above RBA targets.

Inflation remains the key challenge for the RBA



Source: RBA August Statement on Monetary Policy, MWM Research, October 2026

Total returns (AUD) – as of 30th September 2026

	1 month	3 month	YTD	1 year	3 year p.a.	5 year p.a.
Australian equity indices						
S&P/ASX 200	-2.4	1.3	3.7	2.7	11.4	7.7
S&P/ASX 300	-2.4	1.3	3.3	2.4	11.3	7.5
S&P/ASX Small Ordinaries	-2.3	-0.5	-8.4	-6.7	10.4	2.2
S&P/ASX 200 Industrials	-1.2	-0.8	-1.8	-6.3	10.3	5.3
S&P/ASX 200 Resources	-5.1	6.8	20.0	33.7	14.4	15.9
International equity indices (AUD unhedged)						
MSCI AC World ex Australia	1.9	1.2	8.4	11.3	18.8	12.5
MSCI Developed World ex Australia	1.9	1.5	7.1	9.9	18.5	12.8
MSCI Emerging Markets	2.4	-0.8	18.3	23.1	21.0	9.8
Regional equity indices (AUD unhedged)						
S&P 500	2.7	1.9	8.1	10.3	19.9	14.6
NASDAQ Composite	5.0	2.2	11.3	13.6	24.4	14.9
Euro STOXX 50	-1.6	-1.7	2.9	7.3	17.8	13.1
FTSE 100	-1.0	1.5	3.6	10.0	15.9	12.9
Japan TOPIX	4.4	6.8	17.7	19.8	18.6	11.0
MSCI China	-1.7	3.2	-15.5	-22.2	7.1	-1.4
International equity thematic indices (AUD unhedged)						
MSCI World Growth	2.9	-0.4	4.3	6.5	20.4	12.6
MSCI World Value	0.7	3.4	10.0	13.0	16.1	12.4
MSCI World Cyclicals	2.2	1.4	7.9	9.8	22.1	14.1
MSCI World Defensives	0.2	1.9	4.3	9.6	7.6	8.4
Australian sector indices						
Energy	0.6	17.4	34.9	36.4	2.9	11.1
Materials	-5.9	4.6	16.9	32.1	15.9	15.2
Industrials	-1.1	-3.9	-1.9	-1.8	10.9	7.6
Consumer Discretionary	-3.0	-9.9	-8.4	-19.1	7.8	2.9
Consumer Staples	-1.0	-0.4	16.2	15.0	5.5	2.4
Health Care	4.4	26.9	-0.9	-10.7	-2.8	-4.8
Financials	-1.0	-0.9	1.5	-0.5	18.1	10.9
Information Technology	-10.6	-7.6	-22.1	-42.4	-0.5	-5.4
Communication Services	-3.0	-3.4	-8.3	-14.2	4.7	3.3
Utilities	-3.1	3.1	6.2	3.5	11.4	16.1
Real Estate	-1.9	-8.7	-14.1	-15.5	7.8	1.8

Note: All returns are in AUD, and unhedged unless otherwise stated

Source: FactSet, MWM Research, October 2026

Total returns (AUD) – as of 30th September 2026

	1 month	3 month	YTD	1 year	3 year p.a.	5 year p.a.
Real estate/infrastructure equity indices (AUD hedged)						
S&P/ASX A-REIT	-1.8	-8.4	-13.1	-14.3	9.4	3.0
FTSE EPRA Nareit Global Developed (hedged)	-5.2	-5.9	3.9	3.9	9.8	1.5
S&P Global Infrastructure (hedged)	-4.2	-7.0	3.3	5.8	16.1	10.1
Global fixed income indices (AUD hedged)						
Bloomberg Global Aggregate (hedged)	-1.7	-2.4	-1.3	-0.6	3.6	-0.5
Bloomberg Global Treasury (hedged)	-1.4	-2.2	-1.4	-0.9	2.8	-0.8
Bloomberg Global Corporates (hedged)	-2.1	-3.0	-1.7	-0.9	4.7	-0.6
Bloomberg Global High Yield (hedged)	-2.5	-2.0	0.7	3.0	9.0	3.2
Morningstar LSTA US Leveraged Loan 100 (hedged)	0.3	2.8	3.4	5.8	7.2	5.6
Bloomberg Emerging Markets USD Aggregate (unhedged)	0.0	-3.9	-5.6	-3.9	5.4	2.2
Bloomberg EM Local Currency Government Universal (unhedged)	2.4	0.9	-1.7	-0.8	3.8	2.8
Australian fixed income indices						
Bloomberg AusBond Bank Bill	0.4	1.1	3.1	4.1	4.2	3.3
Bloomberg AusBond Composite (0+Y)	-0.9	-1.5	0.8	-0.4	3.6	0.0
Bloomberg AusBond Credit (0+Y)	-0.5	-0.7	1.6	1.1	4.9	1.8
Commodities (in AUD)						
Crude oil (Brent)	11.5	38.5	53.2	36.3	-1.7	5.5
Gold	-5.7	3.3	-8.3	4.0	27.5	20.0
Iron ore (62% fe cfr China cash)	3.6	-4.0	-13.6	-12.6	-9.5	-3.5
Coal (Newcastle - Near Term IFEU)	6.5	12.5	30.6	31.4	-5.3	-6.9
Copper (Cash Official LME)	2.7	8.1	11.1	34.0	17.8	10.7
Nickel (Cash Official LME)	-3.0	-3.0	-7.8	0.2	-7.4	-2.0
S&P GSCI Index	5.0	17.4	27.6	26.5	3.6	6.3
FX						
AUD/USD	-2.8	0.6	4.3	5.3	2.7	-0.8
AUD/EUR	-0.6	1.1	7.9	8.8	0.2	-0.4
AUD/GBP	-1.0	0.4	5.7	6.4	-0.2	-0.5
AUD/JPY	-4.5	-2.8	4.6	11.8	4.4	6.3
USD/EUR	2.5	0.8	3.7	3.6	-2.3	0.4

Note: All returns are in AUD, and unhedged unless otherwise stated

Source: FactSet, MWM Research, October 2026

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This Report was finalised on 9 October 2026.

Recommendation definitions (Macquarie Australia/New Zealand): Outperform – return >10% in excess of benchmark return Neutral – return within 10% of benchmark return Underperform – return >10% below benchmark return.

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