Daily: Navigating higher long-end yields

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From the studio

Podcast: Signal over Noise | How AI may complicate inflation signals , on Apple and Spotify (6 mins)Podcast: Jump Start | NVIDIA earnings, US PCE inflation, and European data (5 mins)Video: CIO Monthly | Kiran Ganesh on market drivers, scenarios, and opportunities (4 mins)Video: The AI Show | China tech earnings update and what's next (3 mins)

Thought of the day

Long-dated US Treasury yields remain elevated despite the US government's recent intervention, as markets await details of a fiscal consolidation plan signaled by Treasury Secretary Scott Bessent. Last week, the Treasury announced that it would double the size of its planned USD 2bn buyback program in long-dated debt, and Bessent noted that the buybacks "could be more" than USD 4bn per operation. The move signals the importance the US administration places on bringing down long-term borrowing costs. The 30-year Treasury yield closed above 5.27% on Friday, not far from its 2007 peak of 5.41%.

Higher real yields have driven the recent rise at the long end of the curve, with markets repricing the risk premium as fiscal and inflation concerns come back to the fore. Total US federal debt has crossed USD 40tr, the US-Iran war is still ongoing, and Fed Chair Kevin Warsh has offered little forward guidance on the central bank's policy path. Persistently large US fiscal deficits are likely to require increased Treasury issuance, while the surge in longer-dated debt offerings by hyperscalers this year has added further upward pressure to long-term borrowing costs.

It is worth noting that long-end yields can rise when economic growth is gaining momentum. This could occur, for example, if advances in AI generate tangible productivity gains sooner than expected, while stronger AI monetization keeps capital expenditures elevated for longer.

For investors, the essential question now is how, if at all, to respond to the rise in yields. Our base case remains that yields should decline as inflation moderates. Such a benign macroeconomic outcome should support a continued broadening of the equity rally. Over the longer term, initiatives that result in financial repression and artificially bring down yields should also be favorable for equities, while gold would be another beneficiary of this scenario.

Focus on quality bonds with short- to medium-term maturities. We continue to favor quality bonds with short- to medium-term maturities, as they are less susceptible to volatility at the long end of the curve. Their attractive yields should also provide a meaningful cushion against further rate increases before price declines outweigh income returns. Our analysis indicates that US Treasury yields in the two- and five-year tenors would need to rise by around 100 to 230 basis points from current levels for capital losses to offset the income earned. This segment of the market should also benefit if rate hike expectations recede. If long-end yields remain elevated for a prolonged period, Treasury inflation-protected securities (TIPS) may become attractive, given their compelling real yields. At the same time, floating-rate borrowers may face heavier real debt service burdens.

Stay invested as the equity rally broadens. While higher yields are typically a headwind for equities, we believe strong corporate earnings and expectations of further growth should continue to support global equities broadly. We now expect S&P 500 earnings per share to grow 25% this year and another 14% next year. In Europe, we see 15% growth in both 2026 and 2027, while we estimate Asia ex-Japan should enjoy earnings growth of 72% this year. We continue to favor a diversified approach that balances targeted allocations to structural growth opportunities with sectors that stand to benefit from a broadening earnings cycle. This positioning should also help portfolios withstand the potential volatility associated with higher long-end yields.

Maintain a strategic allocation to gold. We have long argued that concerns about debt sustainability should support gold. As a non-fiat real asset, it can benefit when financial repression fuels fears of currency debasement. As investors reassess their elevated exposure to US dollar assets, we believe a renewed focus on diversification should provide additional support for the precious metal. We continue to see gold as a strategic diversifier, and consider a mid-single-digit allocation appropriate within a well-diversified portfolio for investors with an affinity for the yellow metal.

So, despite market concerns over long-end yields, we believe long-term investors should stay invested through a broadly diversified portfolio. We retain a constructive outlook on global equities, favoring short- to medium-maturity quality bonds, and view gold as an effective portfolio diversifier.

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