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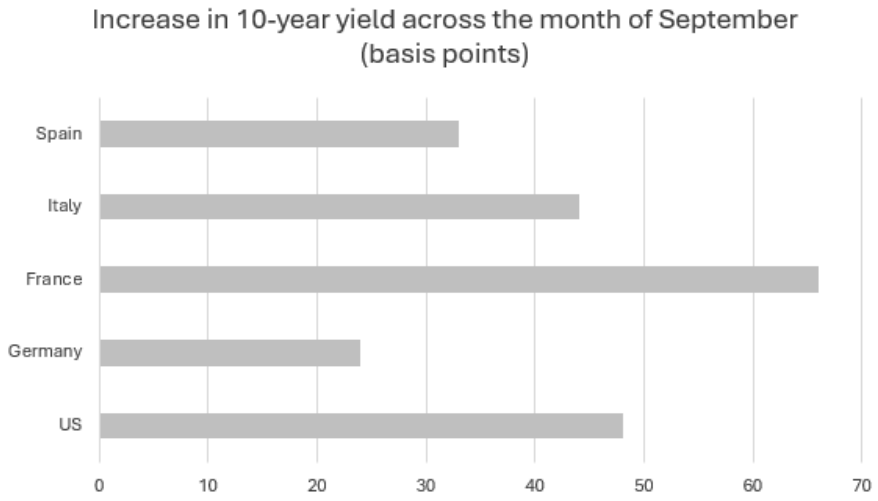
BIL Board October 2026 – Long-Term Yields Still Lack a Stable Cruising Altitude

Global bond markets have come under pressure in recent months, pushing long-term yields sharply higher. The US 10-year Treasury yield, potentially one of the most critical numbers in global finance given its widespread use as a benchmark, has touched 5.35%, its highest level since 2002. In Europe, government bond markets have become increasingly fragmented, with countries carrying weaker fiscal profiles - particularly France - facing a more pronounced rise in borrowing costs.



Source: Bloomberg, BIL

Markets are currently trying to determine where long-term interest rates should settle in a world characterised by higher borrowing needs among corporates and countries, resilient growth, and greater inflation uncertainty. In aviation terms, bond markets are still climbing and have yet to find a clear cruising altitude. Further turbulence could ensue.

WHY ARE LONG-TERM YIELDS MOVING HIGHER?

Several factors continue to exert upward pressure on yields.

First, governments continue to run large budget deficits. Global public debt hit 94% of world GDP last year, up more than 10 percentage points from pre-pandemic levels. The IMF now believes it will reach 100% by the end of this decade, with government financing needs showing very few signs of slowing. Reasons for this include needs to fund defense in an increasingly volatile world, to upgrade energy infrastructure, or to service existing debt. Regarding the latter, it is estimated that 78% of borrowing by OECD governments in 2026 will go to refinancing existing debt. In light of this, investors are increasingly demanding additional compensation to absorb the growing supply of sovereign debt entering the market.

Second, corporate borrowing demand remains exceptionally strong. The AI investment cycle is driving one of the largest capital expenditure booms in recent history. Until now, a lot of the spending has been financed by the hyperscalers' large cash piles. That is changing, and now more are tapping the bond market. The OECD expects that corporate bond issuance by nine major AI players will hit USD 1.2 trillion between now and 2030. A flow of new bonds – often with solid fundamentals - intensifies competition for capital and adds further pressure to bond

markets.

Third, inflation uncertainty has resurfaced. Hostilities in the Middle East continue to stoke energy supply worries, with Brent trading above $100/ barrel. The reality is that even if oil prices eventually stabilise at lower levels, higher energy costs could continue feeding through to other categories such as utility bills, wages, services and food costs, with a lag. As a result, central banks can no longer look through the supply shock and have been forced to adopt a more hawkish stance.

Fourth, economic growth has proven more resilient than expected. Business activity indicators continue to point to resilient private sector activity. While stronger growth is generally positive for corporate earnings, it also reduces the urgency for central banks to ease policy and supports higher real interest rates.

Finally, policy normalisation in Japan has removed an important source of global liquidity. For years, Japanese investors helped anchor global bond markets through large overseas purchases. As yields in Japan have become more attractive, some of that capital has begun to return home.

WHAT WOULD ALLOW YIELDS TO STABILISE?

Although yields have already risen significantly, for them to reach some sort of equilibrium, we would need to see a combination of things happen.

The most important requirement would be credible fiscal consolidation. Investors need confidence that governments are willing and able to place public finances on a more sustainable path over the medium term. At present, political constraints make meaningful deficit reduction difficult in many developed economies, suggesting that fiscal concerns are likely to remain a feature of markets. In France, for example, attempts at consolidation have been met with violent nationwide protests.

A second requirement would be a moderation in borrowing demand. The AI investment cycle and extensive government financing programmes have created a large supply of new bonds. Over time, higher financing costs should naturally dampen issuance, but there is little evidence of that dynamic emerging yet.

Third, investors would need greater confidence that inflation risks are contained. A stabilisation in energy prices, or a reduction in geopolitical tensions would help ensure long-term inflation expectations stay anchored.

Absent these developments, long-term yields may continue searching for their equilibrium level

in the months ahead.

INVESTMENT STRATEGY

Against this backdrop, we continue to favour **equities over bonds**.

Equity markets have shown remarkable resilience despite rising yields and elevated geopolitical uncertainty. The main explanation remains **earnings growth**. Companies continue to generate strong profitability, while the AI investment cycle is creating powerful growth opportunities across technology, infrastructure and industrial value chains. Although valuations are no longer cheap, earnings momentum remains supportive: expected earnings-per-share growth in the US is 28.5% this year, and 17.3% in Europe.

Within equities, we continue to favour the **United States**. We do not want to be on the sidelines of the AI revolution, but our focus is evolving. More concretely, we are growing more cautious on the "picks and shovels" of AI but we continue to like hyper-scalers. We increasingly see opportunities among companies that can use AI to improve productivity, expand margins and strengthen competitive positioning. The long-term winners may not necessarily be the developers of AI models themselves or those with the best models, but the businesses that can successfully integrate these technologies across large existing customer bases.

At our latest investment committee, we also increased exposure to **value-oriented sectors** in the US. Historically, periods of higher interest rates and rising bond yields have favoured value stocks, whose earnings tend to be generated over shorter time horizons and are therefore less sensitive to changes in discount rates.

Within **fixed income**, we remain **cautious on duration**, given that rates could move even higher amid heavy bond issuance. We took additional measures **to reduce exposure to French government sovereigns**, as fiscal challenges, political uncertainty and rising borrowing costs continue to create an unfavourable risk-reward profile. Note that we have also been actively reviewing our French equity exposure too, and adjusting where necessary.

Investment grade corporate bonds remain the cornerstone of our fixed-income allocation. Corporate fundamentals remain healthy, balance sheets are generally robust and current yields continue to offer attractive income opportunities. Selectivity is the name of the game when it comes to **high-yield**: nice income opportunities persist, but moving up the quality curve is prudent. In the US, for example, we see stress gathering among the lowest rated issuers, and the risk premium for companies rated triple C or lower has risen to levels unseen since 2022.

In summary, while long-term yields have already climbed significantly, we believe the market has yet to reach a stable cruising altitude. Until fiscal, inflation and issuance dynamics look more encouraging, upward pressure on long-term rates is likely to persist. In that environment, we continue to favour equities, maintain a cautious stance on duration, and focus on high-quality corporate credit.

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