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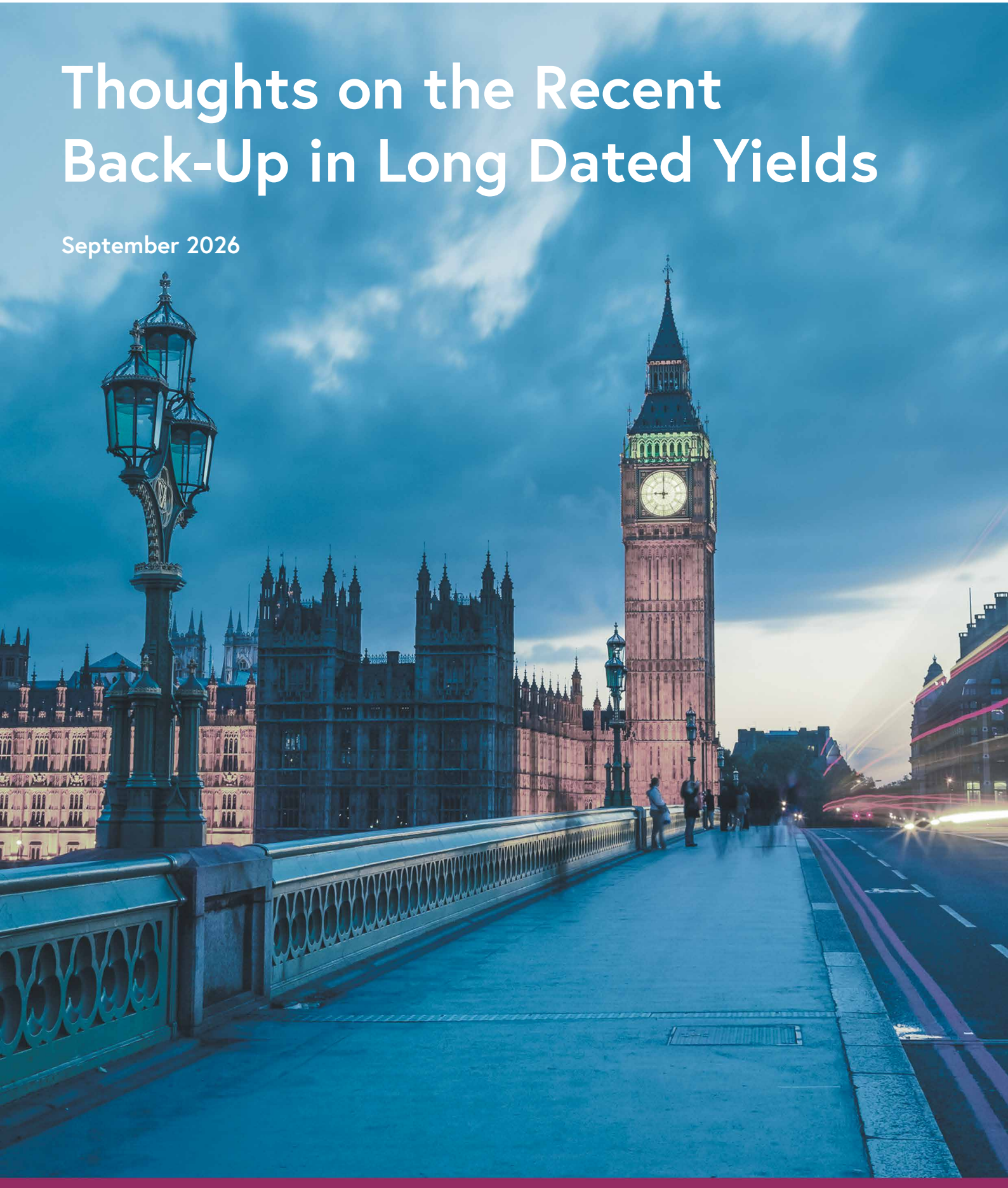
GLOBAL INVESTORS

Thoughts on the Recent Back-Up in Long Dated Yields

September 2026



How to Interpret the Recent Move Higher in Long Term Interest Rates

Headlines touting multi-decade highs in long-dated yields, coupled with the US Treasury's unusual intervention in their domestic bond market and support of the Japanese yen via the sale of Euros (not US dollars) has unnerved some investors recently. This occurred in an environment in which global yields had been drifting higher since the turn of the year. That rise was primarily driven by a reassessment of the inflation outlook, increasing concerns about the fiscal path in some countries pushing up the risk premium demanded by investors, and increased private sector issuance of debt, most notably to fund AI investments. Whilst difficult to disentangle the respective importance of each factor, or for that matter the marginal impact of recent events, we at Colchester believe the reassessment of the inflation outlook has probably been the dominant driver of the drift higher in global yields. The trend deterioration in fiscal paths and increased public and private sector issuance has probably played a lesser role.

Notwithstanding the rise in yields, some context is warranted: the increase in 30-year yields from the end of 2025 to their recent peak in mid-August was slightly less than 50 basis points (bps) in the US, 40bps in the likes of Australia, and just below 30bps in Germany. While not insignificant, hardly the makings of a bond market collapse as some commentary may suggest. Larger moves in Japan (75bps) and the UK (60bps) may be attributed to specific country factors such the ongoing normalisation of yields from extreme lows in the former, and perhaps political and heightened fiscal uncertainty in the latter. Similarly, whilst the focus has been on the rise in government yields, their rise has been felt across all fixed income markets and segments as changes in the risk-free rate (the yield on government bonds) are translated into yields in other markets, and ultimately into the cost of capital that underpins an array of asset prices.

A Brief Recap of Recent Events

The increase in long end government bond yields gathered momentum over the Northern Hemisphere summer, reaching a peak over August 17th and 18th. This prompted the US Treasury to announce on the August 19th that it would at least double the maximum size of its liquidity-support buyback operations for longer-dated nominal coupon securities, covering the 10-to-20-year and 20-to-30-year sectors, taking the cap from $2 billion to at least $4 billion per operation. The change takes effect on September 9th and runs through the current refunding quarter to November 4th this year, when the US Treasury will reassess sizing at its next Quarterly Refunding. The action took place in the context of rising interest payments as a percent of revenue[1], sustained fiscal deficits in the order of 6% of GDP, rising debt, and a shortening maturity structure of that debt in the US.

This Treasury buyback expansion did not emerge in isolation. It followed a separate episode that we would argue is directly connected – the coordinated US-Japan intervention to support the Japanese yen. On July 31st, the US Treasury and Japan's Ministry of Finance conducted their first joint Yen-buying intervention since 2011, following persistent Yen weakness that saw the currency fall to its weakest levels in roughly forty years. Notably, the US funded its side of the intervention by selling Euros rather than Dollars, a choice that in our view was not incidental.

The more consequential development was US Treasury Secretary Bessent's subsequent call for the Federal Reserve to expand its Foreign and International Monetary Authorities (FIMA) Repo Facility. This facility allows eligible foreign central banks to obtain dollar liquidity by pledging their US Treasury holdings as collateral, rather than selling those Treasuries outright in the secondary market. For Japan, the largest foreign official holder of US Treasuries, this distinction is important.

[1] General government interest payments have increased from 5.8% of revenue in 2015 to 11.8% in 2025 (Fitch data)

A conventional intervention funded through outright Treasury sales would have introduced a large, price-insensitive seller into an already fragile long end, just as the US Treasury continues to expect investors to absorb record issuance. Using FIMA instead maintains Treasury bonds on Japan's balance sheet and out of the market. In effect, this represents a second channel through which US authorities have sought to prevent a self-reinforcing rise in bond yields: Yen weakness forcing Treasury liquidation, Treasury sales pushing yields higher.

While presented as liquidity-management tools, both actions appear to support demand for US Treasuries and limit the risk of a self-reinforcing rise in yields for now.

How to Interpret Recent Yield Changes

If we step back and consider what has driven recent yield changes, we can broadly identify three avenues that are relevant. Firstly, interest rates can move as the demand for capital changes relative to the supply of savings. Secondly, investors may demand greater or less compensation for the risk as their perceptions change about a borrower's ability and willingness to repay their debt. And, thirdly, changes in inflation expectations. These potential drivers all have different implications. The first represents a change in the price of capital, the second may reflect a change in the perceived quality of the borrower, and the third impacts on the nominal yield required to protect purchasing power, or the real return.

Increased demand for Capital

The competition for capital has clearly intensified. The very substantial investment required to build AI-related infrastructure has led technology companies and other borrowers to issue considerably more debt. The largest "hyperscalers," having previously funded much of this AI expenditure from their substantial internal cash flows, are increasingly turning to the public bond markets to obtain funding. Moreover, a portion of the AI build-out has also been financed through private credit, where transparency is more limited and reasonable questions have been raised about the interconnected nature of some financing arrangements in which the same companies increasingly finance one another. This increased private sector demand for funding has occurred at the same time that a number of governments have been borrowing more. This has intensified competition for investor capital and at the margin is likely to have placed some upward pressure on the yields required to absorb the growing supply of debt. Collectively this is a classic case of "crowding out" where the increasing needs of one borrower (typically associated with the Government, but in this case, together with the private sector) pushes up the "price" that they need to pay i.e. the yield.

Greater focus on Fiscal Paths

Perceived changes in government solvency risk may be appealing to some as a potential driver of recent moves, and indeed received plenty of "airtime." However, fiscal trends have been well entrenched in a number of countries for a period of time and there has really been little material change to either the direction or scale in the recent past. Yes, there has been some slippage in Japan, fiscal spending in Germany is ramping up and the US continues to spend at will, but the broad trajectory has not really changed, nor have these countries suddenly moved onto an unsustainable debt path. Still, fiscal weakness and rising government debt issuance is likely to have played a small role in pushing yields higher. Government debt increased across many developed markets following the pandemic, as governments provided substantial fiscal support to their economies. The deterioration in sovereign balance sheets has therefore been visible for some time and has long formed part of Colchester's assessment of financial stability. What has changed is the compensation investors require to absorb an increasing supply of debt in an environment of higher inflation, reduced central bank support and greater competition for capital. In this sense, the recent rise in yields may be interpreted as the market placing a marginally higher price on risks that were already present, rather than the sudden emergence of an entirely new dynamic.

The Inflation Dynamics

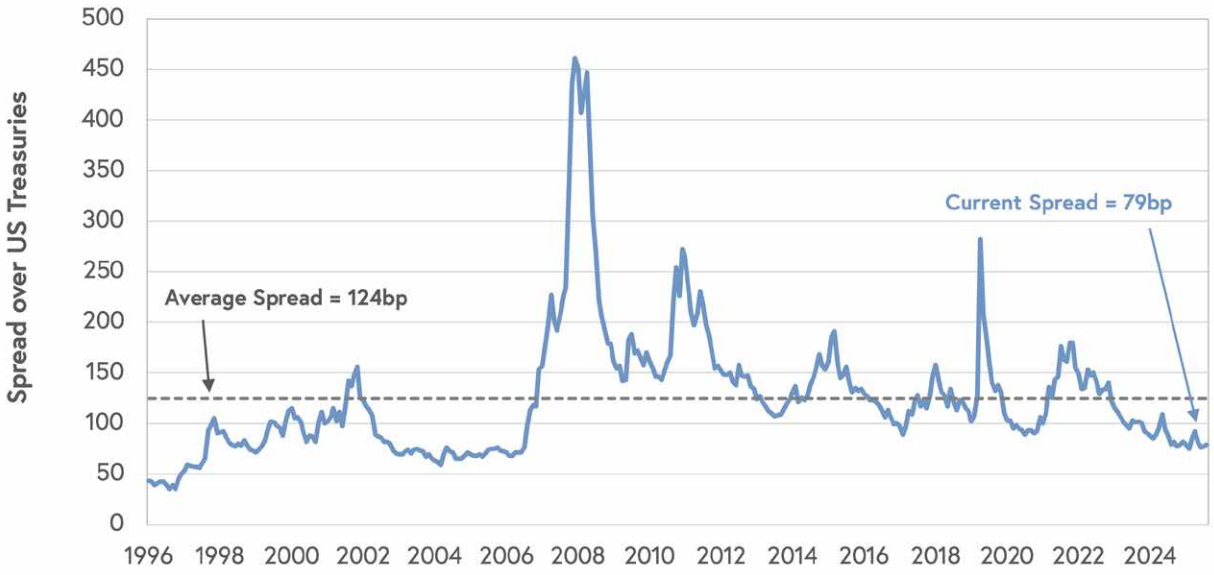
As noted, the changing inflation environment has also contributed to the rise in yields and in our opinion has probably been the most important driver. Resilient global growth, steady labour markets, asset price strength, the AI investment boom, and ongoing energy, tariff, and other supply shocks, have sustained inflationary pressures, pointing to higher inflation for longer. The increase in energy and other prices associated with the Iran conflict have placed further upward pressure on near-term inflation expectations. From Colchester's perspective, the conflict reinforces the secular inflationary forces that we have highlighted for some time, represented by the five Ds of Diversification, De-globalisation, Defence, Demographics and Decarbonisation. Together, these forces suggest that equilibrium inflation going forward is likely to be higher and more variable than during the decade following the Global Financial Crisis (GFC). This appears to be a conclusion the market is gradually adjusting to, prompting upward revisions in inflation expectations. As a result, nominal yields are moving higher to compensate for higher expected inflation and to protect real returns.

What Does this Mean for Sovereign Bonds within a Diversified Portfolio?

If the move higher in yields has primarily been a function of a shift in the inflation regime, then does this undermine the case for holding government bonds within a multi-asset portfolio as a safe harbour and diversifier of risk? The short answer is probably not. No other alternative provides the same combination of potential income, liquidity, capital preservation and potential diversification.

Within fixed income, some find it tempting to take on more credit risk through corporate bonds that provide an additional yield spread over government securities. However, the additional yield must be considered against their valuation, illiquidity at points of stress, and underlying risk. As Chart 1 shows, spreads on investment-grade bonds are currently towards the lower end of their historical ranges. The additional compensation available for assuming corporate credit risk is therefore relatively limited, suggesting a skewed distribution of potential outcomes. Spreads could get marginally tighter in a benign environment, but they are more likely to revert to their mean over the medium term as the economic cycle takes it natural course.

Chart 1: Investment Grade Corporate Spread

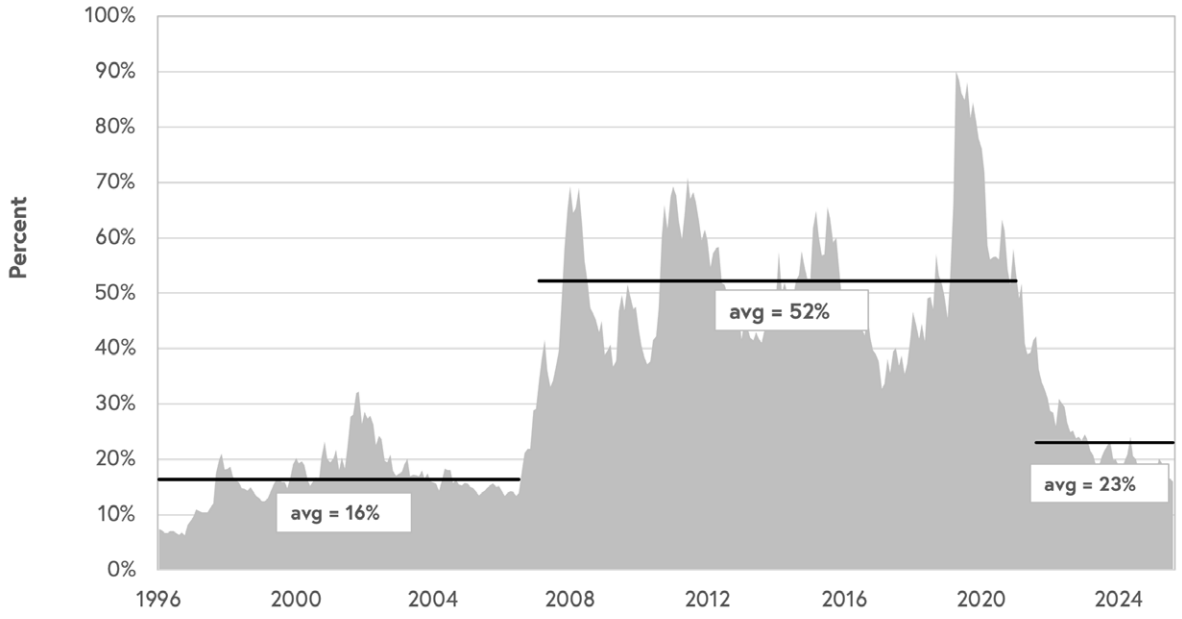


Source: ICE BofA Global Corporate Index, data from December 1996 to July 2026.

Corporate bonds also carry explicit default, downgrade and liquidity risk, and can behave more like equities during periods of financial stress as spreads widen and market liquidity deteriorates. A meaningful proportion of outstanding corporate debt was issued when financing costs were lower. As that debt matures, borrowers will progressively need to refinance at higher prevailing rates, placing pressure on interest coverage, cash flow and, in weaker cases, credit quality. These risks are greater in more leveraged segments of the investment-grade market, high yield and private credit. Corporate bonds may offer additional yield, but it should be evident from Chart 1 that corporate bonds currently offer relatively modest compensation for their additional credit and liquidity risks, rather than providing an obviously more attractive defensive substitute for government bonds.

A case could potentially have been made to reach for yield in corporate bonds, and the like, when interest rates were at their lows in the aftermath of the GFC and through the Pandemic. The potential yield enhancement, or carry, was a more meaningful proportion of the total running yield and anticipated return. As Chart 2 shows, the credit spread component accounted for some 50% of the yield in the aftermath of the GFC, through the Covid shock. Today it has compressed to roughly 20% of the total corporate yield, more in line with the levels observed in the early to mid-2000's. The rise in underlying sovereign bond yields has diminished the relative contribution of the credit spread in potential returns. This presents investors with different calculus in assessing the illiquidity and credit risk return trade-off in determining their bond allocations.

Chart 2: Ratio of IG credit spread as % of total yield

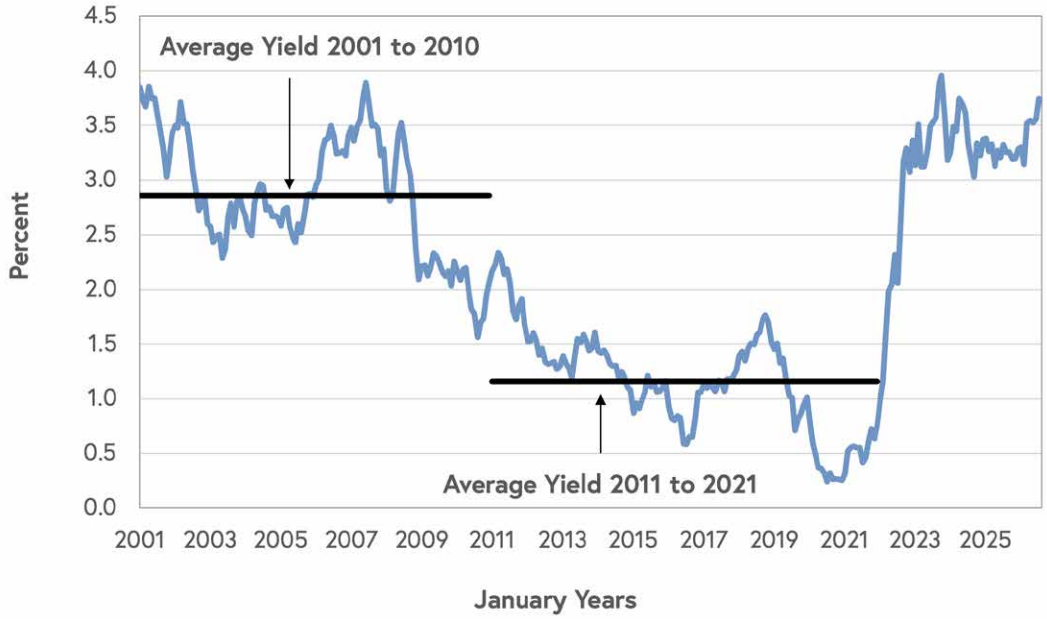


Ratio calculated as Govt OAS divided by Yield to Worst.
Source: ICE BofA Global Corporate Index, data from December 1996 to July 2026.

The decade following the GFC was, in many respects, highly unusual. Central banks maintained policy rates at, or close to, zero for a prolonged period and, in several cases, moved them into negative territory. Successive programmes of quantitative easing also made central banks large and persistent buyers of government debt. This combination of exceptionally loose monetary policy and substantial official demand deliberately suppressed yields and term premia across government bond markets, and lowered private sector interest rates in tandem, leading investors to accept very low, and at times negative, prospective real yields.

The withdrawal of these policies and return to more normal economic and inflation cycles, should therefore be expected to result in higher nominal yields and a restoration of the term premium required to hold longer-dated securities. In this context, the post-COVID interest rate adjustment and the more recent moves are better understood as a repricing from an unusually suppressed starting point than as evidence of a fundamental impairment of the global government bond asset class. This transition is clearly evident in Chart 3 showing the weighted average nominal yield for the FTSE World Government Bond Index (WGBI). Yields today have returned to a level broadly comparable with, rather than materially above, the range observed during the decade before the GFC. These higher starting yields provide a greater income cushion than was available when yields were close to zero. Higher yields do not prevent short-term mark-to-market losses if yields rise further, but they allow income to offset part of the price decline and improve prospective medium-term returns.

Chart 3: Nominal Yield to Maturity for WGBI



Source: Bloomberg, FTSE WGBI is the FTSE World Government Bond Index, data from January 2001 to 26th August 2026.

As the running yield on bonds is a reasonable estimate of expected returns, Charts 2 and 3 suggest (1) you are now being "paid" to own bonds relative to history, most notably compared with the recent past through the abnormal decade following the GFC; (2) the case to own corporate bonds is less compelling as they are likely to make a smaller contribution to the potential return at the expense of greater credit and illiquidity risk; (3) higher starting yields today provide greater room for the positive duration impact to kick-in within a diversified portfolio should any dislocation or shock occur. In other words, interest rates have more room to fall from around 5% today, than they did when they were at 2%. Given where yields are today, government bonds are more likely to perform and deliver their traditional diversifying role at times of stress going forward.

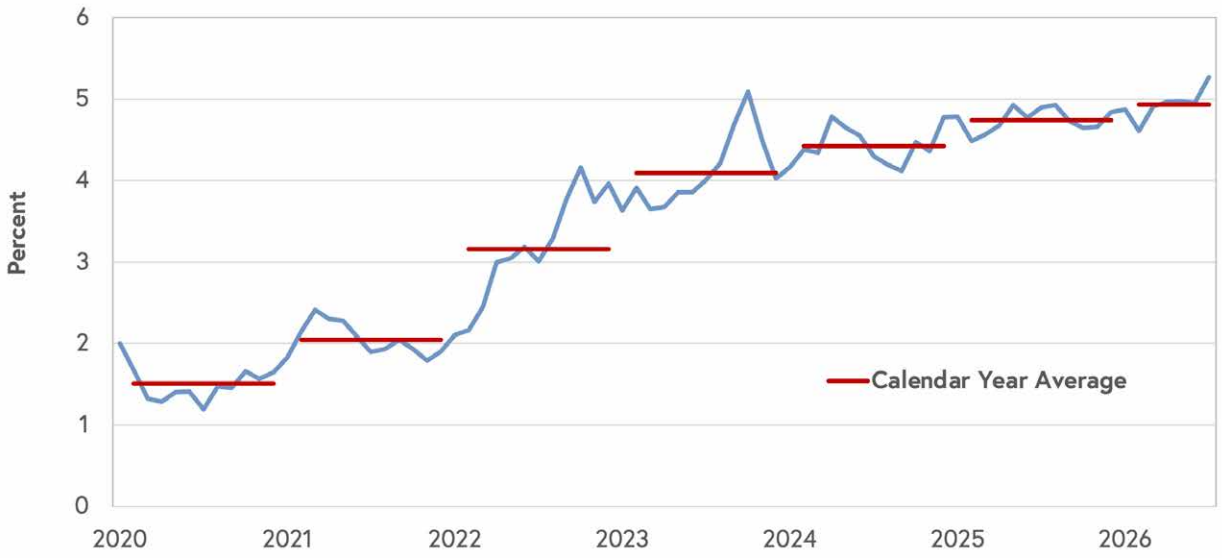
Historical Context

Chart 3 also places recent yield changes in context. Seen in this longer-term historical context, the rise in global government bond yields appears less exceptional than recent headlines might suggest. The unusually low yields of the past decade and a half have influenced investors' reference points. As a result, yields that would previously have been regarded as relatively normal can now appear unusually high. In other words, it is not that government bond yields have risen to crisis levels, but that the exceptionally low-yield environment that followed the GFC has come to pass. Viewed through this lens, today's higher nominal yields are not simply a temporary overshoot, but in part are a rational, forward-looking repricing of a genuinely

higher inflation regime – which is why we would describe the move as a return to normal rather than a source of concern. Long-dated yields in the 4-5% range look far less anomalous once measured against a structurally higher inflation backdrop than against the unusually low inflation and interest rate decade, or so, that preceded it.

The US long end provides a useful illustration. As Chart 4 shows, the principal adjustment in the 30-year Treasury yield occurred during 2021 and 2022, as rising inflation resulted in a material tightening in monetary policy and the withdrawal of the exceptional accommodation introduced during the pandemic. Since then, yields have risen more gradually and, notwithstanding some volatility, the recent increase has been comparatively modest. The move above 5% should therefore be viewed less as a new step change in the Treasury market and more as a continuation of the normalisation that began several years ago.

Chart 4: 30yr US Treasury Yield



Source: Bloomberg, data from Dec 1999 to July 2026.

The US?

Much of recent market attention has focused on the US. Colchester has long recognised the risks associated with its loose fiscal policy, rising debt burden and comparatively unfavourable inflation outlook. These concerns have persisted for some time and have thus informed both our relatively unattractive assessment of US Treasuries and the underweight exposure maintained across our portfolios. To be clear, our concern is not that US Treasuries have become unsafe in an absolute sense, but that their prospective real returns and sovereign fundamentals remain less attractive than those available elsewhere. This distinction is important because government bond markets are not homogeneous. Countries differ materially in their inflation outlooks, fiscal positions, external balance sheets, institutional strength and valuations. A global sovereign strategy can therefore reduce exposure to markets where investors are inadequately compensated and allocate towards those offering more attractive prospective real yields and stronger fundamentals, including Norway, Australia, and New Zealand in the traditional developed market space and to the likes of Mexico and Indonesia in the so-called emerging space. Greater divergence across sovereign markets may therefore increase valuation dispersion and enhance the opportunities available to a global, value-based investment approach.

Conclusion

There has been much discussion about the recent rise in long dated yields. Whilst focus has been on the deteriorating fiscal paths in a number of countries, and the associated supply of debt, we would suggest the dominant driver has been a market realisation that we are in a higher inflation regime. The moves have not been as dramatic as some headlines may suggest and should be considered in the context of the post pandemic normalisation of rates post the abnormal decade that preceded it. The principal interest rate adjustment occurred during 2021 and 2022 as inflation rose, monetary policy tightened and central banks began to withdraw the extraordinary accommodation introduced during the Pandemic. Subsequent increases have been comparatively modest and are better understood as a continuation of that normalisation process rather than as the emergence of a new crisis.

Importantly, this adjustment has restored income and improved the prospective returns available from global government bonds. Higher starting yields provide investors with greater compensation for inflation and duration risk, as well as a larger cushion against further increases in interest rates. At the same time, greater dispersion in prospective real yields and sovereign fundamentals has broadened the opportunity set for active country allocation. Colchester's investment process is designed to assess these differences, allocating towards markets where prospective real yields and financial stability provide adequate compensation for the risks assumed. In our view, the return to a more normal interest-rate environment strengthens, rather than weakens, the case for a disciplined, value-based allocation to global government bonds. In our opinion, you are now being "paid" to own government bonds, they remain the most liquid part of the fixed income market, and now have sufficient yield cushion to provide the positive duration impact should financial market or economic conditions deteriorate. History suggests the case to remain meaningfully underweight government bonds is getting increasingly tenuous.

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