

Phoney Press Panic

Why Bonds Are Becoming Attractive Again

With some private US *nowcasts* suggesting that Q3 growth may already be approaching an extraordinary 7%, buying long-dated bonds might appear premature. We have been bearish fixed income throughout this year for exactly this reason. In the near term, this stronger economic growth could still push yields higher. Over the longer run, yields are also likely to remain above the depressed levels of the past decade because nominal GDP (NGDP) growth is settling at a structurally faster pace.

Yet investors should not confuse a long-term trend with a cyclical opportunity. While secular forces may keep yields elevated relative to their post-GFC averages, the next phase of the cycle could still generate attractive bond returns. Indeed, long-duration Treasuries may offer returns of 10-15% over the coming 12 months. That possibility stands in sharp contrast to the current wave of media pessimism surrounding bonds. **Put simply, cycles often matter more than trends, and the next bond rally may be closer than many investors appreciate. And, when long-dated government bonds rally in this late phase of the investment cycle, it often coincides with poor risk asset performance.**

Subscribed

Main Points

- **Yields finally offer genuine value:** 5%-plus nominal Treasury yields and near-3% real TIPS yields are the most attractive entry levels in years
- **The economic and commodity booms may be sowing the seeds of their own reversal:** rising energy and financing costs typically cap growth and ultimately pull yields lower
- **Term premia are already falling:** a classic early signal that the bond market is transitioning toward a more defensive phase
- **Consensus is heavily bearish:** media pessimism toward bonds is extreme, yet the best bond returns are often generated when investors are most convinced yields can only rise

What may surprise investors is that current market behaviour looks remarkably normal. Bond markets tend to move through four recurring yield-curve regimes:

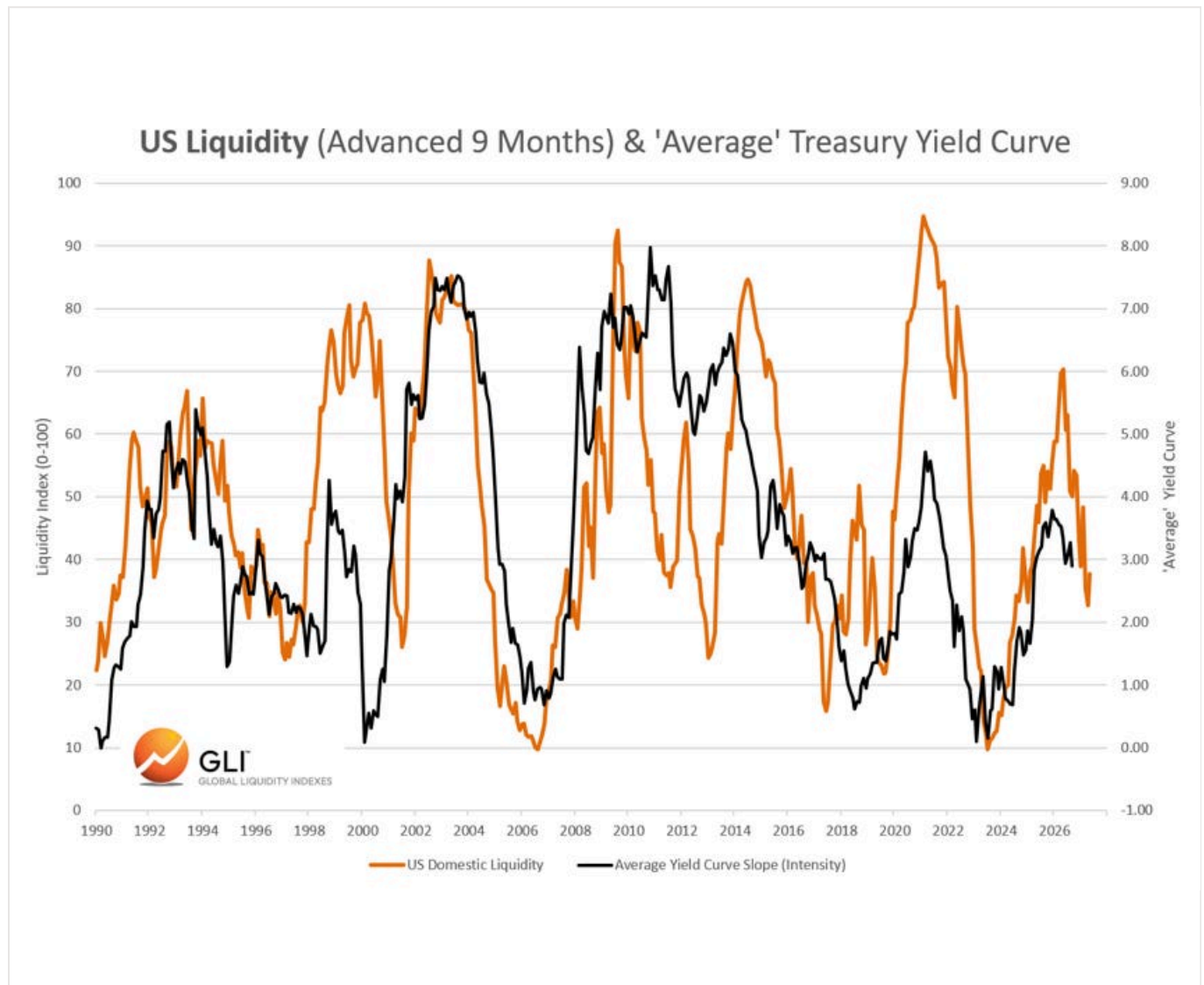
1. Bull steepening
2. Bear steepening
3. Bear flattening

4. Bull flattening

Each regime reflects a distinct phase of the liquidity cycle and associated, business-cycle dynamics.

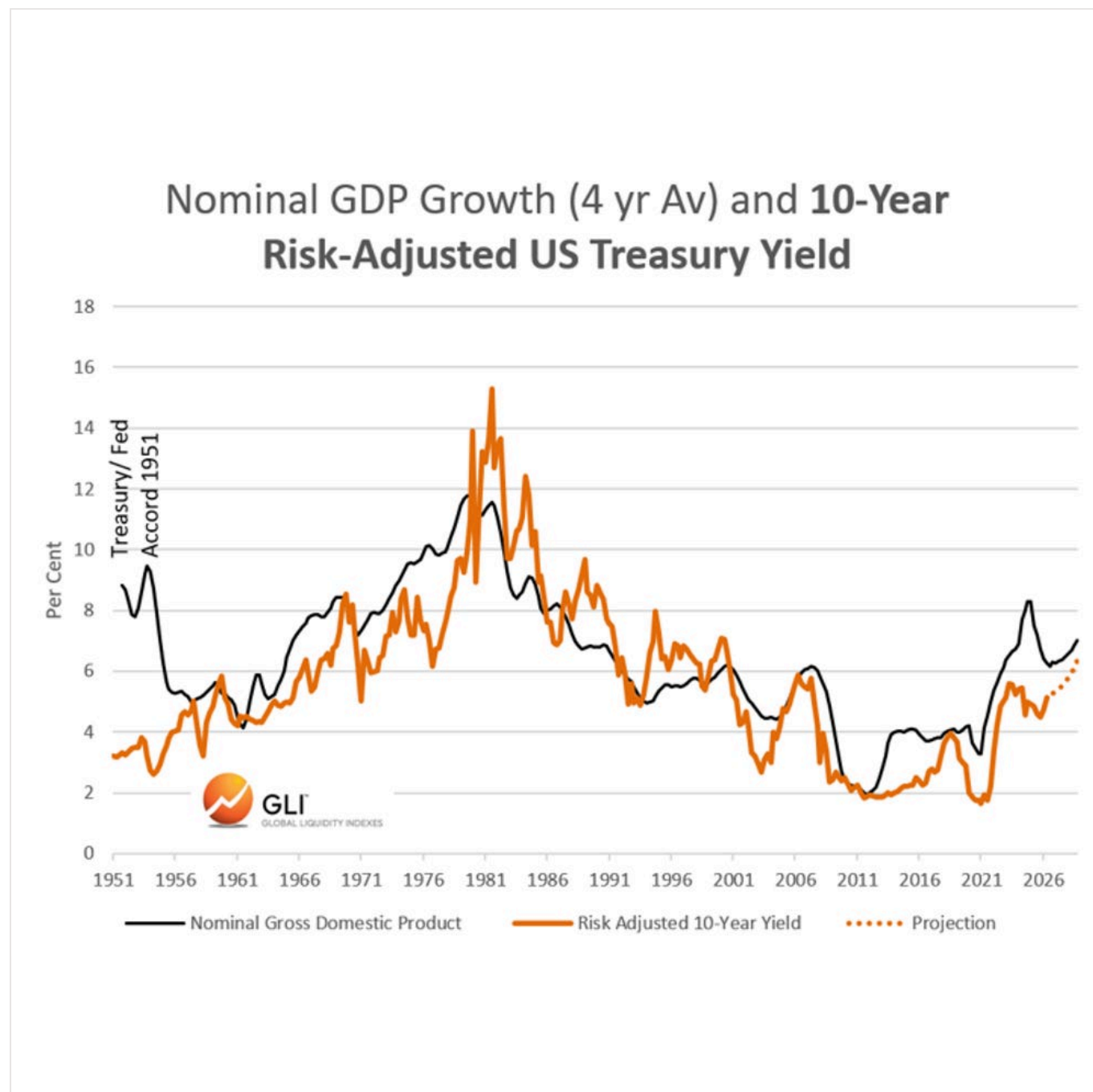
'Steepenings' ('flattenings') mean that longer maturity yields are rising (falling) relatively faster than short-dated yields. And, 'bullish' ('bearish') indicates that long yields are falling (rising) in absolute terms.

The yield curve has historically tracked the Global Liquidity cycle with a lag of roughly six to nine months. The chart below plots our monthly index of US liquidity, advanced by nine months, against the average slope of the Treasury curve measured by the area beneath the term structure.



Since late 2025, the US Treasury market, along with many other developed bond markets, has entered a bear-flattening phase. Such periods are characterised by two simultaneous developments: rising **policy-rate expectations** and falling **term premia**. Higher expected policy rates reflect liquidity being redirected into the real economy, stimulating activity and supporting rapid NGDP growth. Meanwhile, declining term premia indicate liquidity is being withdrawn from financial markets, a hallmark of the "Speculation" phase of the Global Liquidity cycle.

US NGDP growth is plotted below as a 4-year moving average and charted alongside US 10-year bond yields, risk-adjusted by removing term premia to highlight average policy rate expectations over the bond's term. The broken line is a projection.

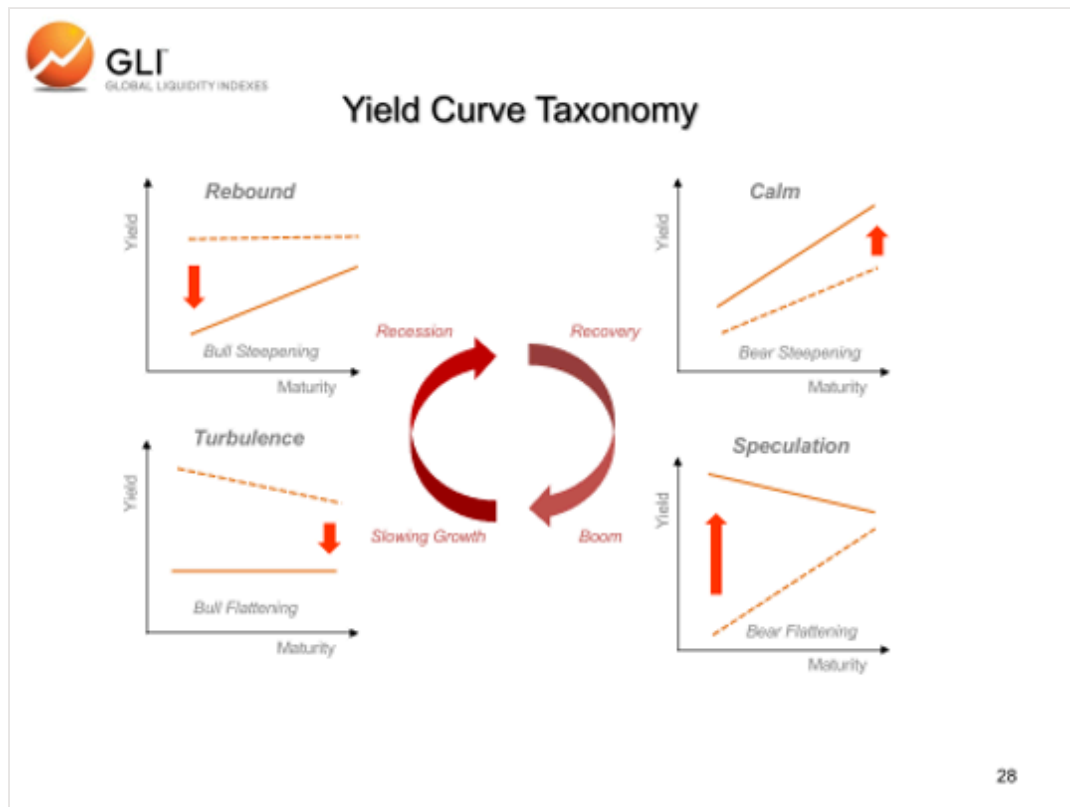


In our framework, monetary conditions operate through two distinct circuits. The financial circuit is captured by the Global Liquidity cycle, while the real economy circuit is reflected in business activity and NGDP growth. During the Speculation phase, liquidity drains from financial assets and migrates into real economic activity. The result is typically a peak in Global Liquidity, accelerating nominal economic growth and surging commodity prices.

That pattern is exactly what we see today. Our estimates suggest Global Liquidity peaked in late 2025, while commodity prices have already risen roughly 50% this year. The ongoing boom in commodity markets is not

an anomaly; it is a typical feature of this stage of the cycle.

The next chart presents our taxonomy of yield-curve regimes and their relationship to both liquidity and business cycles. Each market regime corresponds to a different combination of financial and economic conditions, e.g. 'Speculation' and economic 'Boom'.

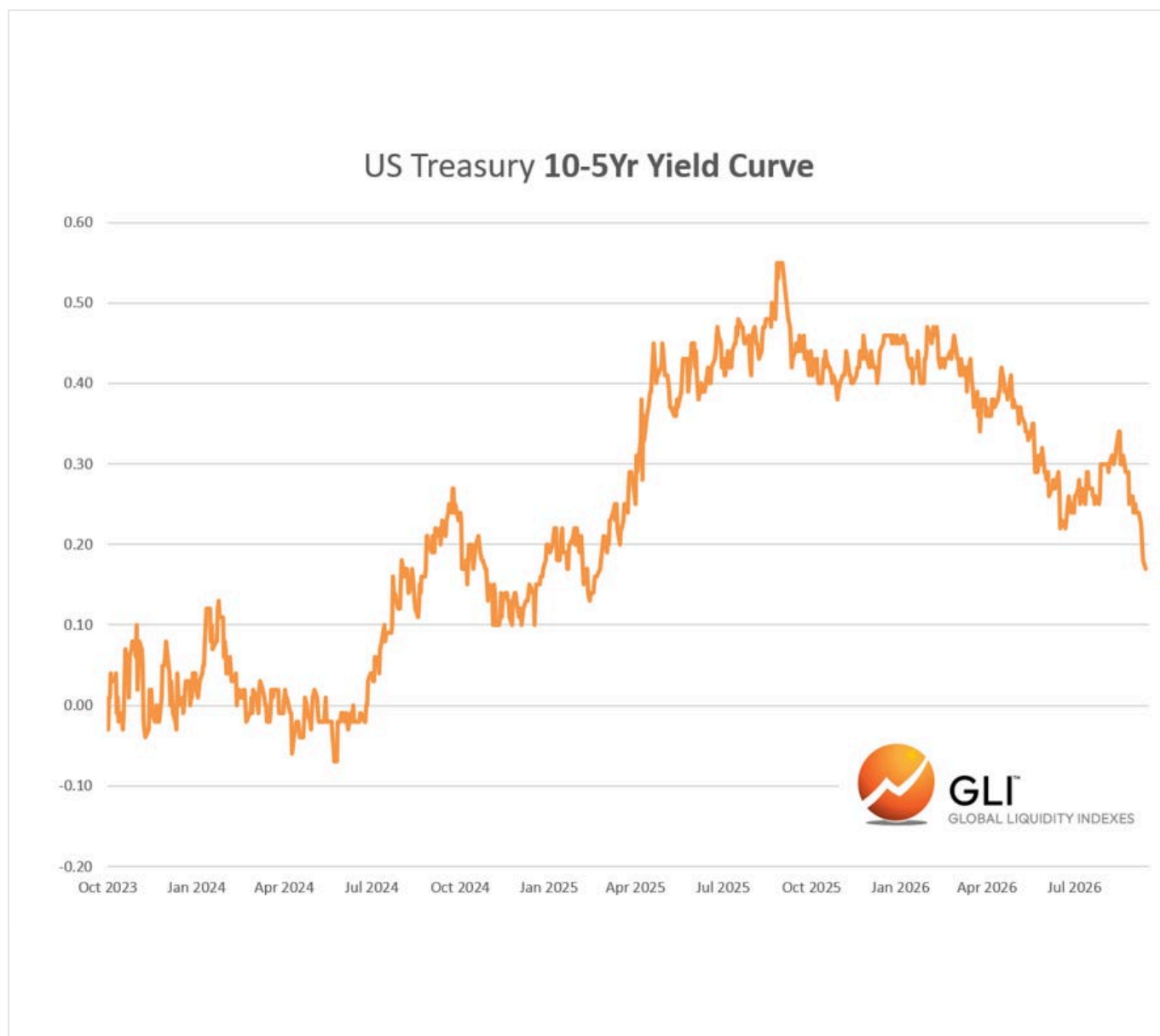


The preceding "Calm" phase, characterised by bear steepening, reflected both rising policy-rate expectations and increasing term premia. Business activity was strengthening, while liquidity continued flowing into financial assets.

Today's environment is notably different. Term premia are already falling, signalling that the market is moving toward the next stage of the cycle: Turbulence.

Historically, Turbulence has been challenging for risk assets but favourable for government bonds. There is a scramble for 'safe' assets. This explains why US Treasury and German bund term premia are currently falling relative to other markets like French OATS and British gilts. During the Turbulence phase, both policy-rate expectations and term premia decline. As a result, bond yields fall and the yield curve undergoes a bullish flattening. Government bonds resume their traditional role as portfolio stabilisers precisely when investors have become least interested in owning them.

Evidence of falling term premia is already visible in the narrowing 10-year versus 5-year yield spread to 13bp from over 45bp at start of 2026. However, policy-rate expectations continue to rise, supported by exceptionally strong nominal growth. US NGDP is currently expanding at a pace rarely seen since the mid-1980s. Commodity prices continue to surge, while diesel crack spreads imply oil-equivalent prices approaching US\$180 per barrel.



Such conditions rarely persist indefinitely. High interest costs and escalating resource prices eventually act as a brake on economic expansion. Sometimes the effect is direct, as higher financing costs suppress demand. In other cases, central banks reinforce the slowdown through tighter monetary policy. Either way, supply constraints eventually cap and reverse NGDP growth.

When NGDP growth slows, the entire yield structure is pulled lower. Meanwhile, term premia typically continue to decline, creating the conditions for further curve flattening and stronger bond returns.

That turning point may still lie a few months ahead. Although the Speculation phase normally lasts around nine to twelve months, policymakers appear intent on extending the current expansion for as long as possible. Nevertheless, investors should already be thinking about the asymmetry in prospective bond returns.

Consider a 10-year Treasury with a duration of roughly seven years. If yields rise another 100 basis points, bondholders would suffer an approximate 7% capital loss, partly offset by a 5% running yield, resulting in a net loss of around 2%. Conversely, a 100-basis-point decline in yields would generate a capital gain of roughly 7%, producing a total return close to 12%.

The skew is increasingly favourable. Looking forward, the probabilities of yields rising or falling by a similar magnitude appear increasingly balanced. Yet history suggests the real economy becomes vulnerable as long-term rates approach the 5.5% area. If so, the next major move in yields may be lower rather than higher.

A similar pattern applies to 5-year bonds. Assuming a 5% starting yield, the prospective downside from a further 100-basis-point rise is roughly 1%, while the upside from an equivalent decline approaches 9%.

Investors should also consider Treasury Inflation-Protected Securities (TIPS). A 10-year TIPS currently carries a duration of roughly 8½ years, somewhat higher than a conventional 10-year Treasury. Consequently, a 100bp decline in real yields could generate capital gains approaching 8-9%, before accounting for inflation accretion. With real yields near 3%, TIPS offer some of the most attractive government-guaranteed inflation-adjusted returns available in decades.

Note that duration on TIPS measures sensitivity to **real yields**, not nominal yields. It should be stressed that the bullish case for TIPS depends primarily on **falling real rates** and/or unexpectedly higher inflation, whereas the bullish case for nominal Treasuries depends on **falling nominal yields**. That distinction often gets overlooked.

In short, today's widespread hostility toward bonds may prove to be a classic case of backward-looking thinking. The media remains focused on the losses already experienced, while markets are beginning to discount the next phase of the cycle. Bond yields have finally reached levels where investors are being compensated for risk. **After years of looking unattractive, bonds are once again becoming investable.**