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Research Note

The Return of Yield: Why Higher Bond Yields May Strengthen the Case for Global Fixed Income

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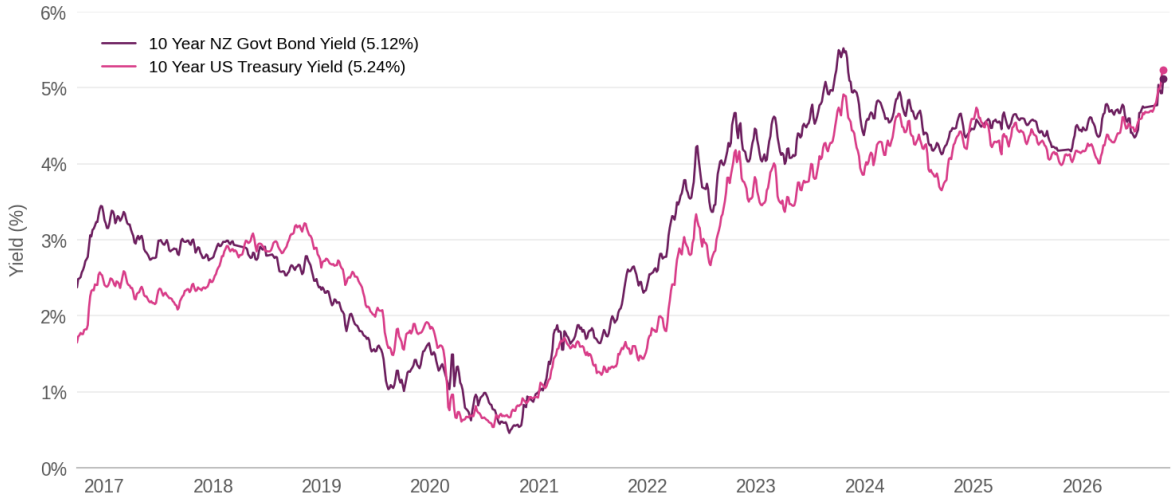
A more attractive starting point for bond investors

For much of the decade following the Global Financial Crisis, bond investors faced an uncomfortable reality: yields were low, income was scarce, and prospective returns appeared limited.

Today, the environment looks very different.

Long-dated government bond yields have moved materially higher across most developed markets over the past few years, and again through 2026, recently hitting levels not seen since well before the pandemic (graph one below).

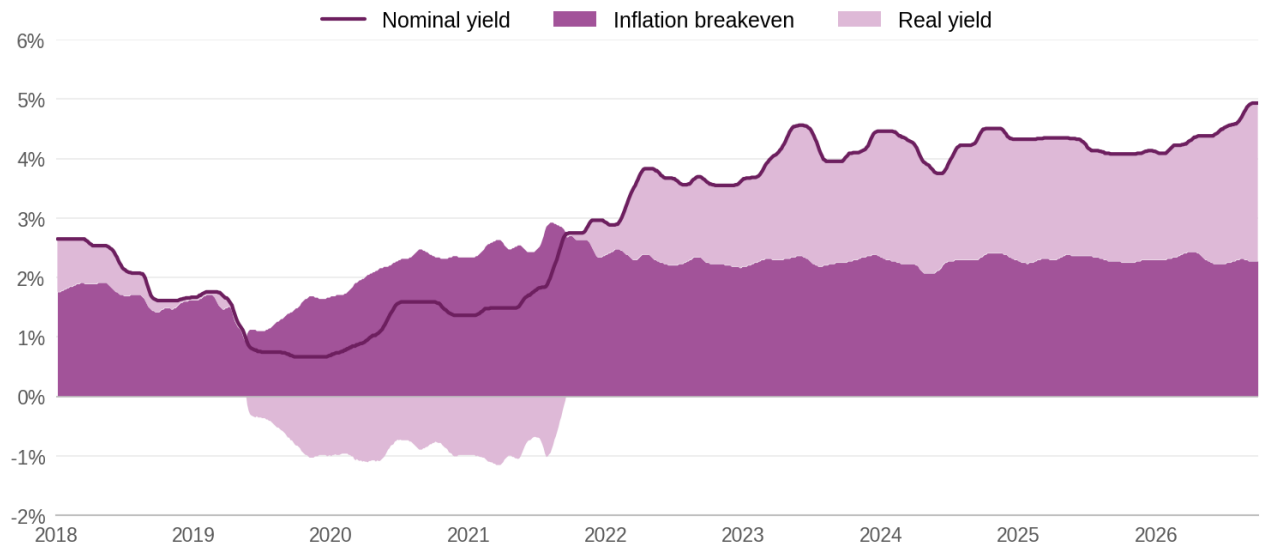
Graph One: NZ /US Government 10 yr bond yields 30 September 2016 – 29 September 2026



Source: Bloomberg, Trust Investments

The significance of today's higher yields is clearer when they are considered relative to inflation. As Graph Two below shows, nominal bond yields now sit well above prevailing inflation in key developed markets, providing investors with positive real yields and the prospect of meaningful income after allowing for the erosion of purchasing power.

Graph Two: Nominal US 10-year US Government Bond Yields versus Inflation

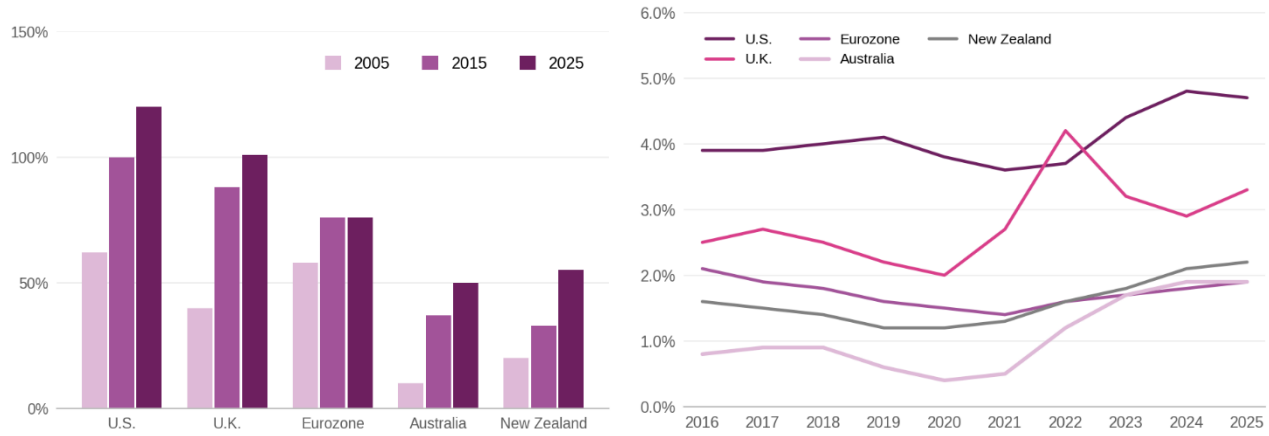


Source: LSEG Datastream; BlackRock Investment Institute, 23 September 2026

Fiscal Concerns Matter, But They Are Not the Whole Story

Much market commentary has focused on deteriorating government finances, particularly in the United States. Fiscal deficits remain elevated, debt burdens have grown and interest costs are consuming a larger share of government revenues. These factors undoubtedly play a role in shaping investor sentiment.

Graphs Three and Four: Government Debt as % of GDP and Government Interest Payments as % of GDP



Sources: IMF, OECD, Northern Trust. Data as of September 2026

However, fiscal concerns alone do not appear sufficient to explain recent bond market moves.

As several market participants have noted, fiscal trajectories have been deteriorating for many years. What appears to have changed is the willingness of investors to lend at exceptionally low yields in an environment where inflation is likely to be more variable, central bank balance sheets are shrinking, and the demand for capital continues to grow.

In other words, markets may be demanding higher yields to compensate for greater uncertainty around the long term outlook, rather than signalling an imminent sovereign debt crisis.

The bond market is demanding a higher price of capital

The bond market appears to be responding to a wider range of factors.

Global investment manager Nuveen, underlying specialist manager of the *Trust Management ESG International Bond Fund (the Fund)*, recently observed that “resilient global growth, expansionary fiscal policy, geopolitical uncertainty and unprecedented capital expenditure requirements are increasing competition for investor capital, all contributing to a "higher-for-longer" rate environment”.

Importantly, investors appear to be demanding higher real yields, not simply greater inflation compensation.

Governments continue to run significant fiscal deficits, particularly in the U.S., while businesses are simultaneously investing in reshoring supply chains, energy infrastructure, defence capabilities and digital transformation.

The result is increased competition for capital. Investors are requiring greater compensation to commit funds for long periods, particularly longer-term government bonds.

This should not necessarily be interpreted as a sign of stress. Rather, it could represent a normalisation of bond markets following an extended period when quantitative easing (central bank asset purchasing programs) and stimulatory monetary policy suppressed yields and term premia (the additional returns investors require for committing capital to longer-term bonds).

The AI Investment Boom Is Creating New Demand for Capital

A key development in financial markets is the scale of investment associated with Artificial Intelligence (AI).

Data centres, power generation, transmission networks and semiconductor infrastructure require enormous amounts of capital. Global capital expenditure related to AI and supporting infrastructure is expected to reach trillions of dollars over coming years, adding to already significant funding demands associated with energy transition initiatives, industrial reshoring and defence spending.

While many large technology companies initially funded AI investment from internal cash flows, debt markets are increasingly becoming part of the financing solution. This has fuelled debate over whether private sector demand for capital could contribute to higher bond yields by competing directly with governments seeking to finance fiscal deficits.

Whether this ultimately creates a structural shortage of capital remains uncertain. Global capital markets remain deep, sophisticated and adaptable. However, there is no doubt that investors are asking tougher questions about how the growing supply of debt will be absorbed, where capital is allocated and what return is required to fund increasingly large borrowing requirements.

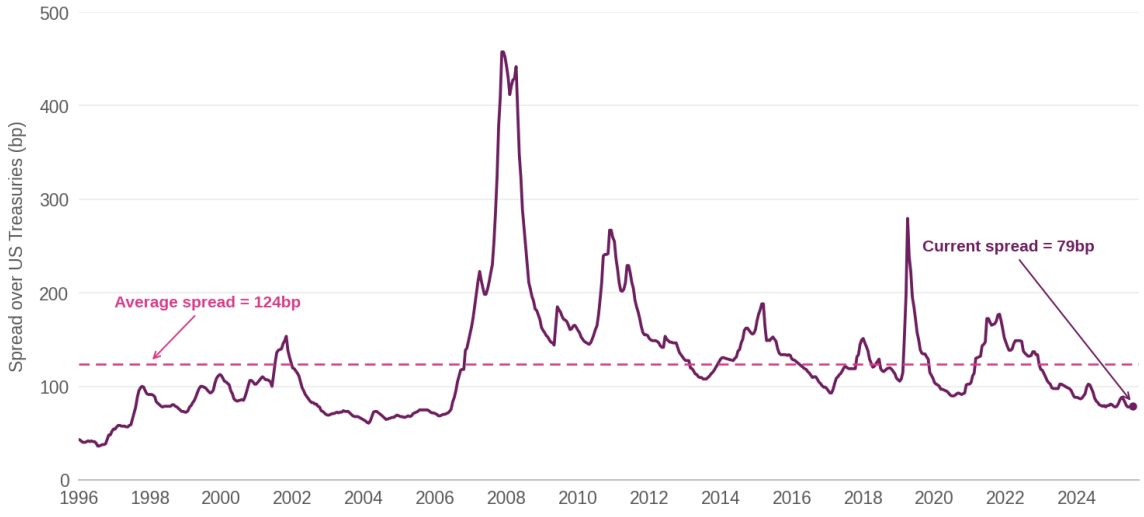
In some respects, this may be healthy. Higher funding costs encourage greater capital discipline, potentially helping moderate speculative excesses and improving the quality of long-term investment decisions.

Credit Markets Are Sending a Different Message

Another notable feature of the current environment is that investment grade corporate credit spreads have remained relatively tight, despite the rise in government bond yields. A credit spread is the additional yield a corporate bond offers over a comparable government bond to compensate investors for credit and default risk.

Credit markets do not appear to be signalling a sharp deterioration in economic conditions or corporate fundamentals. However, tight spreads also mean investors are receiving limited compensation for taking credit risk.

Graph Five: US Investment Grade Corporate Spread



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

Higher yields today are largely being driven by changes in risk-free rates rather than a significant increase in credit risk. For investors, this means they can access attractive portfolio yields without necessarily moving further down the credit spectrum or accepting materially greater default risk.

The availability of higher quality yield is one of the defining features of today's bond market and represents a meaningful improvement from the environment that existed for much of the last decade.

Is This a New Regime?

Today's higher interest-rate environment may be better understood as a normalisation of rates following the unusually low rates that prevailed in the pre-pandemic period.

Structural forces including demographic change, deglobalisation, defence spending, decarbonisation and ongoing fiscal expansion point towards a world where equilibrium interest rates may be higher than investors became accustomed to during the 2010s. At the same time, many market participants continue to expect resilient global growth and persistent inflation pressures, supporting the case for higher term premia.

Recent upward pressure on oil prices is also a reminder that inflation can be affected by supply-side and geopolitical shocks. If sustained, higher energy costs could complicate the inflation outlook and limit the scope for central banks to reduce interest rates, even if economic growth begins to weaken.

For bond yields to fall materially from current levels would likely require a meaningful growth shock, a significant easing in inflation pressures, or a renewed commitment to fiscal restraint.

Taken together, these factors may support a higher average yield environment than investors became accustomed to after the Global Financial Crisis.

Why Global Bonds Still Matter

Although rising yields can create short-term discomfort, they ultimately improve the long-term attractiveness of the asset class.

Today, core global fixed income portfolios offer yields around 5%. These higher starting yields increase expected long-term returns while providing a larger income cushion against future market volatility.

Perhaps more importantly, duration (a measure of interest rate sensitivity) once again has the potential to play its traditional defensive role. Should global growth weaken materially or economic conditions deteriorate, higher starting yields provide greater scope for bond prices to appreciate as interest rates decline. This remains one of the key reasons bonds continue to occupy an important role in diversified portfolios. Investors can earn attractive income today while retaining some downside protection if the economic outlook deteriorates and inflation pressures ease sufficiently for central banks to reduce interest rates.

Diversification, but not protection against every risk

High-quality bonds remain an important source of portfolio diversification because their returns are driven by different forces from equities and other risk assets. In a conventional growth shock, where weaker activity brings lower inflation and falling interest rates, bonds can provide both income and capital appreciation, helping to cushion broader portfolio losses.

However, bonds are less reliable protection against an inflation shock. A sharp rise in energy prices, renewed supply disruption or another source of persistent inflation could place upward pressure on interest rates and weigh on both bond and equity valuations. Higher starting yields provide a greater income cushion than investors had during the low-yield period, but they do not eliminate this risk.

From a portfolio construction perspective, diversification can be considered not only across equity and bond markets, but also across the economic risks a portfolio is intended to withstand. Assets with more direct sensitivity to inflation, including selected real assets or inflation-linked securities, may complement the defensive role played by high-quality bonds. The appropriate mix will depend on each investor's objectives, liabilities, liquidity requirements and tolerance for volatility.

Navigating a higher yield environment

The underlying manager of the Fund, Nuveen, is focused less on predicting the exact direction of long-dated yields and more on identifying relative value opportunities across countries, sectors and issuers.

In an environment defined by greater dispersion and uncertainty, security selection and active portfolio construction may prove more important than making large macroeconomic bets on the direction of long term interest rates.

A key point for global bond investors is not simply that yields have risen, but that the income available from high-quality fixed income is meaningfully more attractive than it has been for much of the past decade.

This environment highlights the different roles that asset classes can play within diversified portfolios. High-quality bonds can provide valuable protection from a disinflationary growth shock. Other assets may be needed to improve resilience to an inflationary shock. The appropriate mix will depend on each investor's objectives, liabilities, liquidity requirements and tolerance for volatility.

We welcome the opportunity to discuss the themes explored in this paper, including the evolving role of global bonds and other asset classes within diversified investment portfolios.

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