Allianz Global Investors

SEPTEMBER 2026

Fixed Income Forward

Bonds just got cheaper

"I don't think a 10-year bond yield of 5% is that unusual." – Mervyn King, ex-Governor of the Bank of England

Key takeaways

- Rising government bond yields reflect a shift away from the era of ultra-low interest rates towards **a new regime of tighter money**, driven by inflation risks, fiscal deficits and fierce competition for capital.
- **Fixed income investors are once again being paid to own bonds.** As bond yields rise, they become more appealing relative to equities.
- **Floating rate notes may be particularly attractive** given that their coupons adjust upwards as interest rates rise. We also favour **emerging market debt and Asian high yield credit.**

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What happened in August

The US-Iran conflict showed no signs of final resolution, reinforcing concerns about sustained inflation from high energy prices. Long-maturity core government bond prices were under pressure as yields remained high. Japanese debt performed the worst, while the US and UK did better than the euro area. The move by the US Treasury to repurchase billions of long-dated US debt may have helped contain volatility but did not pull yields down. Yield curves mostly flattened, with short-term yields moving up on rising expectations of central bank rate hikes. In currency markets, the US dollar weakened against major peers, with commodity-linked currencies performing well. Emerging market debt and corporate credit outperformed, especially high yield.

Our take and investment implications

We are now in an era of tighter money. The first half of September was punishing for ultra-long government bonds as yields rose to multi-year highs. The European Central Bank lifted its key interest rate by 25 basis points to 2.50% and raised its inflation forecast just as oil prices jumped again above USD 100 a barrel. Bond investors seemed unfazed by the US Treasury's market interventions in August and September. The 10-year Treasury yield has been nearing 5% and the 30-year yield is hovering just under 5.4%.

Yet today's yields only appear elevated when compared with suppressed levels since the 2008 global financial crisis. For many investors, the last two decades are the benchmark, but core government bond yields are below long-run averages. **We may be witnessing a regime change rather than a bond market crisis – a new regime characterised by inflation risks, expanding fiscal deficits and fiercer competition for capital between government and the tech giants funding the AI infrastructure buildout.**

The good news is that bonds are less overvalued than before. It is also reassuring that the end of easy money seems to have arrived in an orderly fashion. The US 10-year Treasury yield has mostly traded within a range of around 90 basis points since the start of the second Trump administration. **For a market supposedly facing existential threats, that is a remarkably disciplined outcome**. Of course, there is still plenty to keep us alert (see **What to watch**, page 3). And, importantly, this new market environment requires a different way of managing bonds than during the time of artificially suppressed rates.

For fixed income investors, a world of higher yields is not necessarily a bad thing; they are once again getting paid to own bonds. That should motivate an increase in bond allocations from a relatively low base currently. And the higher bond yields rise, the more appealing they get relative to and as a complement to equities. Traditional diversification has become harder since 2020 as in many cases bonds and stocks moved in tandem during sharp selloffs. However, the main culprits for that have been unexpected inflation flare-ups, as well as a market behaving as if 5% yields are something unusual. As the "higher-for-longer" regime gets more entrenched, we expect bonds to reassert their hedging quality.

Higher yields and the compounding income they provide can act as a cushion for equity market volatility. **In a reflationary world with higher interest rates, floating rate notes issued largely by financial institutions are attractive given that the coupons they pay adjust upwards as interest rates rise**. We also favour emerging market debt and Asian high yield credit, not only for their high all-in yields, but because the underlying sovereign or corporate credit fundamentals are healthy or improving – and have little reliance on the AI momentum trade.

We continue to shun big outright bets on the direction of core government bond yields, preferring to trade tactically around yield differentials across countries and maturities. For both credit and rates, we believe this environment lends itself to strategies free of geographical and sector biases. As we have highlighted, the important question is no longer where Treasury yields will be next month, but how portfolios should adapt to a world in which capital is no longer free.

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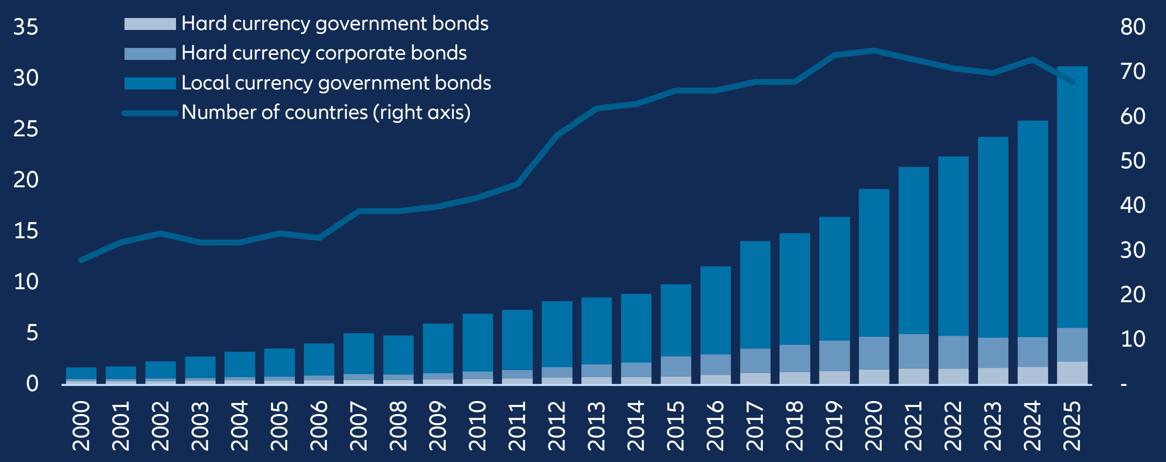
CHART OF THE MONTH

Local currency bonds help to drive rise in emerging market debt

Total emerging market debt outstanding
USD trillions



Source: Allianz Global Investors, Bloomberg, JP Morgan, Bank of America, Bank for International Settlements, 11 September 2026.

Despite rising US Treasury yields generally acting as a pressure point for emerging market debt, the asset class has stood its ground. Underlying sovereign and corporate credit fundamentals are healthy or improving, with little reliance on AI momentum. According to the Institute of International Finance, foreign investors put more than USD 214 billion into emerging market debt this year to July, up from around USD 178 billion in the same period last year. Historically, it was hard currency debt that dominated flows, but local currency debt is experiencing a renaissance, backed by a weaker US dollar, attractive local rates and growing confidence in the stability of emerging economies. Many emerging markets now fund themselves largely through domestic debt markets, reducing reliance on more volatile external (hard currency) financing.

FIXED INCOME FORWARD | WHAT TO WATCH

1 Japanese yields

We expect the Bank of Japan to raise rates in September, and then perhaps once more this year. The yield on 10-year Japanese government bonds has risen to a three-decade high of above 3%. As inflation and rates in the country continue to normalise, the role of Japanese investors as anchor buyers of global bonds may diminish as they start to look for higher returns closer to home.

2 Federal Reserve

The US central bank is scheduled to meet on 15-16 September to decide whether to raise rates or keep them on hold again. Chairman Kevin Warsh struck a more hawkish tone at the annual Jackson Hole gathering of central bankers in late August, seeking to reinforce his inflation-fighting credibility. We think a rate hike is all but certain given that the bank is unlikely to base a decision on any single data point.

3 AI IPOs

Higher bond yields have come at a crucial moment for artificial intelligence (AI) public listings, as Anthropic gears up for its initial public offering (IPO) which could value the AI assistant and large language model Claude at USD 2 trillion. While a late-September or October listing is in the works, any material delay or a downgrade in expected valuations would be a sign of more restrictive financial conditions taking a bite.

FIXED INCOME MARKET PERFORMANCE

Indicative market indices Data as at 3 September 2026	**Total return year-to-date 2026 (%)**	**Total return August 2026 (%)**	**Yield-to-worst (%)**	**Effective duration (years)**
Global convertible bonds	14.52	0.73	-2.0	1.6
Asian high yield	5.20	1.08	7.6	3.2
US floating-rate notes	2.96	0.36	4.2	0.0
Global emerging-market sovereign bonds	2.70	0.89	7.2	6.2
US high yield	2.56	0.99	7.3	3.0
Euro high yield	1.60	0.32	5.8	3.0
US Treasury bonds 1-3 years	1.03	0.22	4.3	1.7
Euro government bonds 1-3 years	0.25	0.04	3.0	2.0
Global aggregate	0.13	0.10	4.1	6.3
Global government bonds AAA-AA	0.10	-0.18	3.8	7.1
Asian investment grade	0.01	0.33	5.5	4.6
Euro investment grade	-0.05	-0.25	3.9	4.5
US aggregate	-0.37	0.39	5.0	6.0
US investment grade	-0.59	0.43	5.5	6.8
Euro aggregate	-0.83	-0.47	3.6	6.2

Source: Bloomberg, ICE BofA and JP Morgan indices; Allianz Global Investors, data as at 3 September 2026. Index returns in USD-hedged except for Euro indices (in EUR). Asian and emerging-market indices represent USD denominated bonds. Yield-to-worst adjusts down the yield-to-maturity for corporate bonds which can be "called away" (redeemed optionally at predetermined times before their maturity date). Effective duration also takes into account the effect of these "call options". The information above is provided for illustrative purposes only, it should not be considered a recommendation to purchase or sell any particular security or strategy or as investment advice. Past performance, or any prediction, projection or forecast, is not indicative of future performance. Index returns reflect the reinvestment of income dividends and capital gains, if any, but do not reflect fees, brokerage commissions or other expenses of investing. It is not possible to invest directly in an index.

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