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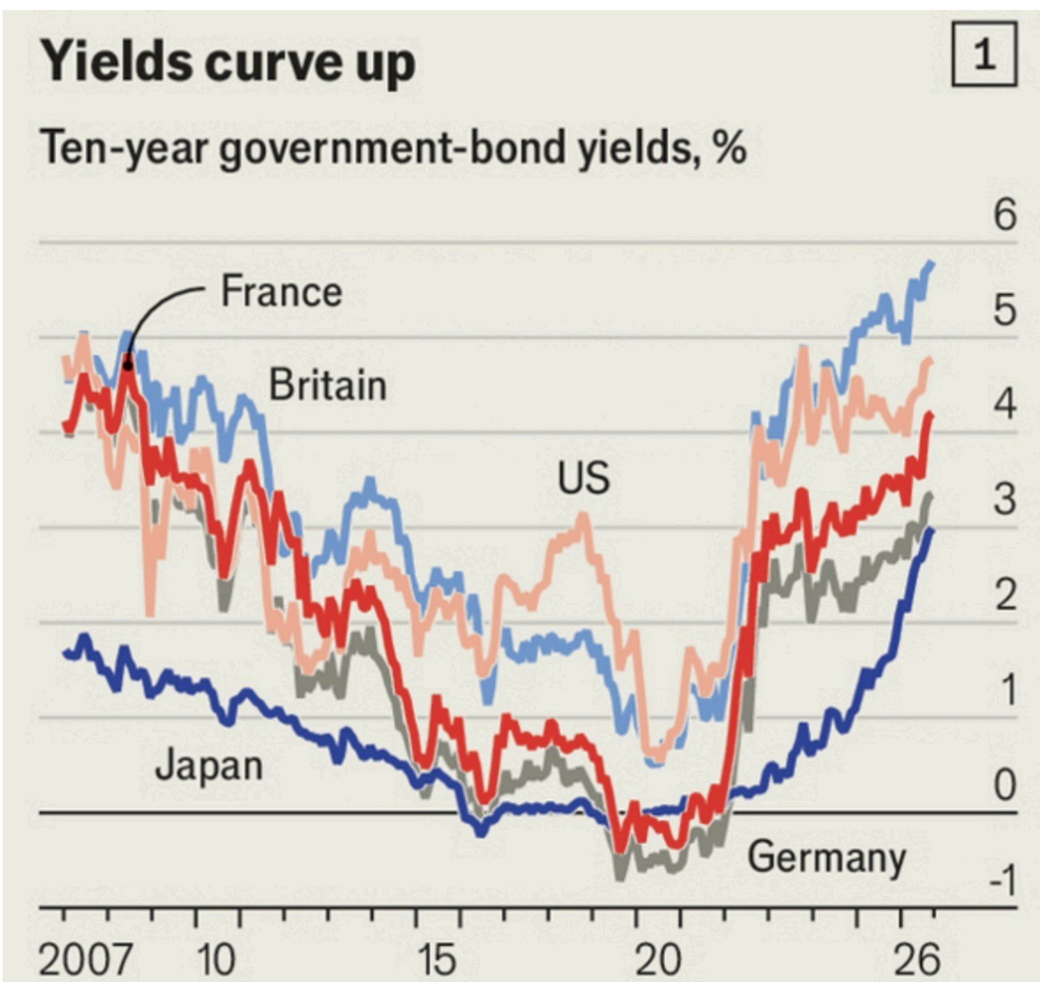
In recent weeks global bond markets have been febrile. Yields have jumped just about everywhere as investors have sold off government debt (whose price falls as yields rise), spooked by rising inflation risk, uncertainty about economic growth and zero appetite for belt-tightening. On September 1st yields on Japan's ten-year bonds hit 3% for the first time in 30 years. American Treasuries (US government bonds) are not far off their 19-year high of 5.3% reached in mid-August. Equivalent British Gilts (English government bonds), now offer a 5.9% return and have not been this cheap since 1998. [2]



European government issuers face peculiar challenges of their own. Inflation is problem number one. In contrast to America, where rising prices chiefly reflect strong domestic demand, the culprit in Europe is on the supply side, and out of policymakers' control: **the energy shock from the Iran war**. Markets expect the European Central Bank (ECB) to raise its benchmark interest rate to 3% by mid-2027, up from 2% before America and Israel attacked Iran in late February. [3]

Moreover, when inflation risk is high and stems from a supply shock, investors demand extra compensation for holding longer-term securities. In part, that is because they expect a premium for taking on inflationary uncertainty. It is also because in a supply shock, bonds and stocks tend to sell off together rather than move in opposite directions. This makes debt a less attractive way to diversify a portfolio, so yields must rise to draw buyers.

Europe's second challenge is fiscal. Germany's new-found love of debt-funded investment and persistent French profligacy have pushed interest rates up since 2025. This in turn has raised debt-servicing costs. In 2028 France will spend 6% of government revenue to service their national debt, compared with 3% in 2019. For Italy this will climb from 7% to 9% in the same period. [4]

Because European taxes are much higher than in America as a share of GDP raising them further to fill the fiscal gap is hard. Cutting spending is politically unpalatable, especially with populist insurgents on the rise across the continent. So neither increasing revenue nor decreasing spending represent viable options.

And The third problem is that aside from inflation, the rise in yields is driven by growth and investment outside Europe, which is sucking up capital. America's economy is motoring along, helped by the building of artificial-intelligence infrastructure. The technology giants leading the charge are projected to spend over $5T on AI data centres between 2025 and 2030. By contrast, such spending in Europe is tiny. [5]

Yet even though European firms are on the sidelines of the AI race, European bond-issuers are nonetheless caught up in it. American tech titans are selling their own long-dated bonds to fund the splurge—to the tune of $250B this year and $400B in 2027. These rich corporate issuers are as creditworthy as governments, and so compete with them for investors' money. They are responsible for almost a tenth of euro-denominated corporate-bond issuance this year, according to the ECB. [6]

Ever-more debt globally means lots of long-term bonds. This leaves investors to absorb more *duration risk* (a change in a bond's price in response to a change in interest rates). In Europe supply is even higher because the ECB is running down its holdings, by €1.2T since 2022 and counting. At the same time, demand from big buyers is softening. Pension funds which bought long-dated debt to fund defined-benefit retirement schemes are switching to defined-contribution plans that try to boost returns with riskier assets like stocks. Investors stepping into their place, like hedge funds, drive a harder bargain by demanding higher yields. [7]

All of this means investors shouldn't expect yields to come down soon, so focussing on short and medium term bonds while building a laddered bond portfolio is prudent. As bonds mature, you reinvest the proceeds at whatever yields are available at that time. This strategy works particularly well because if yields continue rising, your maturing bonds can be re-invested at higher rates. If yields fall, the long bonds you already own should appreciate in value. This avoids having to predict interest rates perfectly (which in practice can't be done of course).

As we approach the end of Q3 (September 30th) this would be a good time to discuss how this laddered strategy is working in your portfolio. Bonds serve a purpose and play a defensive role in mitigating stock market risk -but only if you're investing in bonds in the right way.

Thanks for reading!

Martin

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1,2,3,4,5,6,7 Source: The Economist September 7th, 2026

Yes, when the bond market stabilizes then you can get a puppy

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