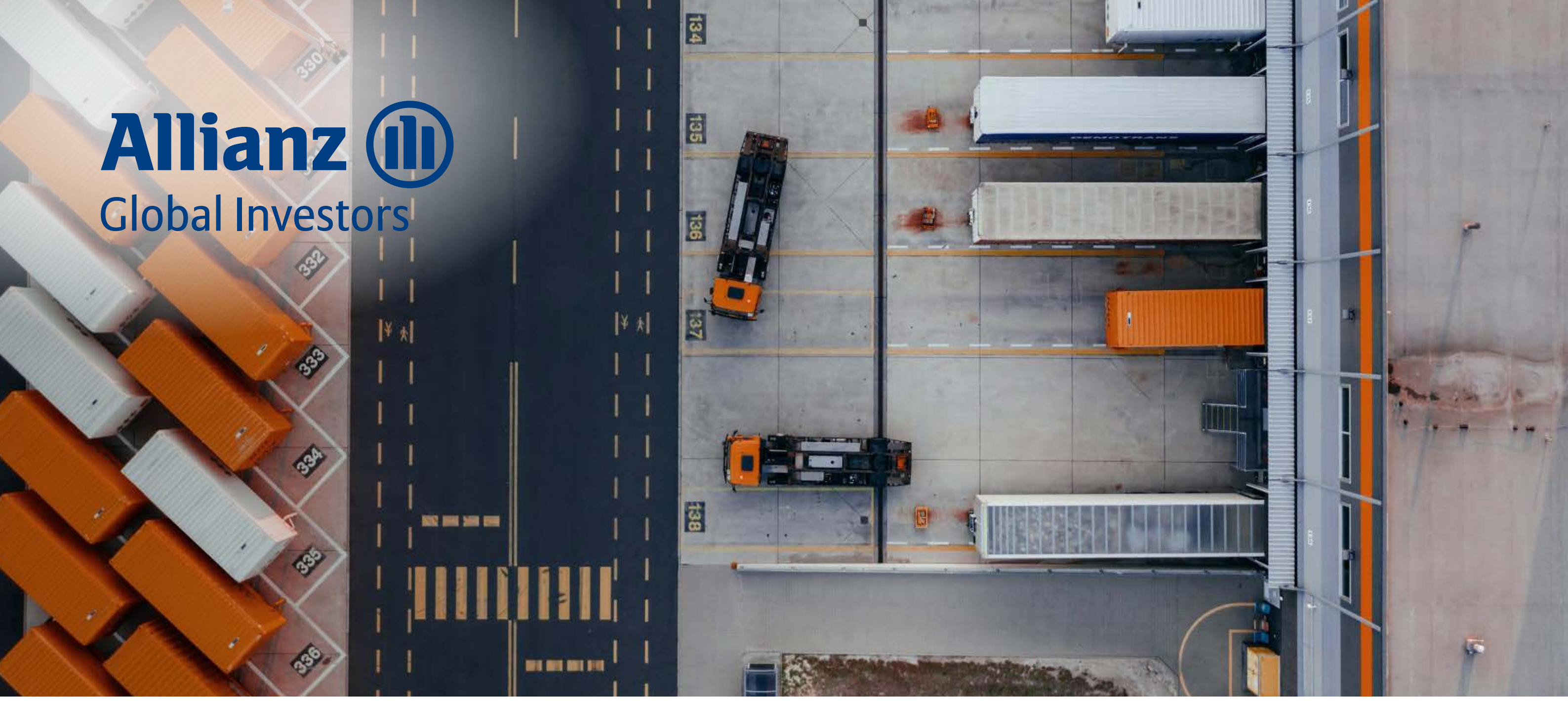

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Higher yields in Europe are sending more than one message

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Bond yields are rising in Europe driven by global spillover and political uncertainty, but price moves also reflect a resilient eurozone economy, which could favour long-term investors.

Eurozone government bond yields have continued to grind higher, and the move can no longer be explained by energy prices alone.

The initial sell-off earlier this year was straightforward. Higher energy prices following the Iran conflict pushed inflation expectations higher and led markets to price a more restrictive posture from the European Central Bank (ECB). While energy markets have since retraced a meaningful portion of that shock, sovereign yields have not. In fact, eurozone yields are now above their spring highs, suggesting other forces are at work.

We see three drivers behind the move.

1 Spillover from global trends

Bond markets do not operate in isolation, and the repricing of duration globally has inevitably spilled into Europe. Higher yields in the US, UK and Japan have placed upward pressure on eurozone borrowing costs regardless of the region's domestic fundamentals. For Europe, this

Key takeaways

- The repricing of duration globally has spilled into Europe, placing upward pressure on eurozone borrowing costs.
- Markets are pricing in the effects of political uncertainty in states such as France.
- But higher yields also reflect a resilient eurozone economy, indicating a more attractive backdrop for long-term fixed income investors.

represents an imported tightening of financial conditions, particularly challenging for the more fragile parts of the bloc.

2 Political uncertainty raises risk premia

The second is political. The fiscal debate in France remains unresolved, and investors are increasingly demanding compensation for the risk that public finances continue to deteriorate ahead of the 2027 election cycle. Political uncertainty is also rising elsewhere across Europe. While this is far from being a replay of the eurozone sovereign crisis, lingering political risks keep risk premiums higher.

3 A resilient eurozone offers good growth prospects

The third driver, and arguably the most important, is more constructive. Beneath a generally negative news flow, eurozone economic data have quietly improved. Growth has stabilised, surveys have recovered from their post-Iran-war weakness, and Germany is finally showing more convincing signs of emerging from several years of stagnation. Corporate earnings are accelerating. The backbone of this recovery is Europe's macroeconomic shift towards domestic reflation and investment. This is most visible in the earnings of sectors that are at the heart of the shift and that have room to catch up after deflation suppressed earnings in the decade after the European sovereign debt crisis.

The recovery remains modest, but it is increasingly difficult to argue that Europe is sliding into recession. Therefore, higher yields are more a reflection of improving growth prospects in a reflationary environment than a sign of economic or political stress. These rising yields have also coincided with stronger equity performance and positive earnings revisions.

Rising yields may point towards an attractive long-term backdrop

Higher yields can reflect stronger economic growth, higher inflation, or investors demanding additional compensation for the risk that government debt becomes less sustainable. This distinction matters in determining how we construct portfolios and identify alpha opportunities.

Today's rising yields are not simply a story of fiscal risk or imported market pressures. They are also a reflection of an economy that is more resilient than many expected. That may keep upward pressure on yields in the near term, but it is also creating a more attractive backdrop for long-term fixed income investors. Higher yields mean higher income, stronger carry and greater scope to benefit from curve roll-down. After years of searching for yield, investors are once again being paid to own bonds. The question is not whether to own fixed income but how to own fixed income to take advantage of the higher-for-longer yield environment.

Seeking opportunities with an active, multi-strategy approach

We continue to favour an active approach, with tactical and country-relative value opportunities in core rates over large directional duration positions.

Within European rates, our positioning currently reflects two key themes. First, having already delivered an initial rate hike and with markets now pricing more than 50 basis points of additional tightening, the ECB stands out as aggressively priced relative to other major central banks. Second, Germany is embarking on a path of substantially increased debt issuance to finance its large-scale fiscal package. Against this backdrop, we see value in shorter-dated euro government bonds versus US Treasuries. At the same time, the relative issuance dynamics lead us to hold an underweight in ultra-long German Bunds relative to UK Gilts and bonds issued by the European Union.

For strategic allocations, we favour high-quality European investment grade credit, offering attractive all-in yields, where carry continues to provide both a compelling source of income and a cushion against market volatility.

Beyond Europe, we continue to see merit in a global multi-strategy fixed income approach that seeks resilience and alpha across sectors, regions and risk premia. Diversification remains a valuable shock absorber, particularly during periods of elevated uncertainty.

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