When markets disagree

Over the past few weeks, equity markets have continued to push higher. Both the S&P 500 and Nasdaq have recently reached new all-time highs, supported by strong corporate earnings, continued enthusiasm around AI and persistent investor optimism.

At the same time, bond markets have been moving in the opposite direction.

Government bond yields in both the US and UK have risen back towards levels not seen consistently since before the Global Financial Crisis, despite widespread expectations earlier this year that central banks would gradually begin easing monetary policy.

Rising bond yields are often associated with concerns around inflation, government borrowing, stronger economic activity or the possibility that interest rates may need to remain elevated for longer than investors had previously expected.

This creates an increasingly interesting divergence between the messages being sent by different parts of

the market.

Equity investors appear focused on strong earnings, resilient economic data and the transformational potential of AI-led investment. Bond markets, however, seem to be signalling greater caution around inflation, fiscal deficits, energy prices and the longer-term path for interest rates.

In the UK, rising gilt yields have also been influenced by growing concerns around fiscal pressures, political uncertainty and leadership stability, reinforcing how quickly bond markets can react when investor confidence begins to weaken.

Oil prices have also remained elevated amid ongoing tensions involving Iran and the wider Middle East. While markets have so far largely treated these events as manageable geopolitical risks, higher energy prices have historically had broader consequences for inflation expectations, consumer spending and economic growth.

At the same time, enthusiasm around AI-related investment continues to accelerate. Semiconductor companies, data centre infrastructure providers and large-cap technology firms have led much of the recent rally, while some of the largest IPOs in years are now expected to come to market.

There is clearly genuine innovation taking place. AI is already beginning to reshape industries, business models and capital spending decisions. However, periods of genuine innovation can also create stretches of market optimism where investors become increasingly willing to overlook broader macroeconomic risks.

In many ways, bond markets may now be questioning whether the ultra-low interest rate environment of the past decade was the exception rather than the norm.

What makes the current environment particularly unusual is that both narratives may contain elements of truth.

The global economy has remained more resilient than many expected, corporate earnings have generally been strong and AI-related investment is creating a powerful new cycle of capital expenditure and infrastructure development.

At the same time, inflation risks have not fully disappeared. Government debt levels remain high, energy markets remain sensitive to geopolitical disruption and higher interest rates continue to affect both consumers and businesses.

Higher yields are changing the opportunity set again.

This is also one reason why investors are increasingly reassessing the balance between risk, income and duration exposure within portfolios.

From a portfolio perspective, this reinforces the importance of balance and diversification.

While we continue to participate in equity markets and recognise the long-term significance of AI and technological innovation, we also remain mindful of concentration risk and the broader macroeconomic backdrop.

Within fixed income, we continue to maintain a broadly neutral duration stance. In practical terms, this reflects a balanced approach to interest rate sensitivity rather than making aggressive directional calls on the path of yields.

Should bond yields rise further, longer-duration bonds would likely remain more sensitive to price declines, while shorter-duration holdings may prove relatively more resilient.

Higher yields have also improved the attractiveness of shorter-duration fixed income and cash-management strategies, where investors can now achieve more meaningful levels of income without taking excessive duration risk.

This has also increased interest in solutions such as our Cash Plus portfolios, which aim to provide enhanced cash-like returns through exposure to shorter-dated bonds and money market instruments, while seeking to limit sensitivity to rising yields.

More broadly, we continue to believe that portfolios should be positioned to navigate a range of possible outcomes rather than relying too heavily on any single market narrative.

Markets do not always agree with each other. At times like this, that disagreement can often be more informative than the headlines themselves.

As always, we would be very happy to discuss these themes, portfolio positioning and current market conditions with advisers and their clients.

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