# MACRO OUTLOOK

## October 2026:
## Many threads to the story

By Philip Brown, Head of Research, FIIG Securities

FIIG | The fixed income experts
an NRI company

# Introduction:
# Many threads to the story

The world is not a happy place at present. Explaining what is happening in the economy and in the markets requires an understanding that the current story of markets is not one story, but multiple threads all vying for attention in a tapestry. The geopolitical risk is an important element, but only one part of the overall story. Inflation is in the picture too, both as background and as a response to the wars in the Middle East and in Ukraine. The weakening of the Australian economy is another thread that is clear when one looks at unemployment, though also one that is at odds with the AI boom that is so clearly taking place and so clearly sucking up much of the world's capital.

The geopolitical risks are manifesting as higher transport prices in Australia, which is then adding to an already high inflation rate and creating a very uncomfortable situation (as consumer confidence attests to). The RBA is responding to inflation by raising rates, even though signs of cracks are starting to emerge in the economy. Labour markets continue to weaken, while the property price falls are becoming substantial. The Governments (Federal and State) have a big decision to make in the coming months as we approach mid-year budget updates. They'll need to decide between spending money they don't really have to string along the economy for a short while longer or letting the current cycle run its natural course. Letting the cycle run its course will result in an economic slowdown coming comparatively soon.

Our first section will look at the traditional economic measures the RBA targets: inflation and employment. While inflation is too high, the unemployment rate is starting to rise fairly consistently. At the very least, the rising unemployment rate ought to convince the RBA that the current settings of monetary policy are relatively restrictive, even if the inflation rate is proving sticky. That doesn't mean the RBA won't raise rates again this year, but it does mean that the interest rate cycle can't extend too much more before something really starts to give.

Our second section will look at the risks inherent in government bonds, globally, at present. While there is growing risk in this sector which is being captured by higher yields, Australian government bonds appear comparatively more resilient than those of many international peers. The risks inherent in the situation are being seen in rising credit spreads, too. But these threads are not independent of the first set of concerns, either. As shown in France, the economic reality of life is causing demands on the Government, but the Government doesn't have full freedom to act. Their hands are bound by the reality of borrowing money as a highly-indebted government. Many governments around the world may be forced to stand by and allow the slowdown to impact consumers because they don't really have any other option.

Bond yields are not preparing for a slowdown just yet, however. They are responding to the global balance of capital. Between government borrowing (globally) and AI-related infrastructure spending, there is an imbalance at present. The demand for capital is very strong, while the supply of capital in many markets is smaller as Asian money gets repatriated home. This overall situation feels terrible for consumers who are essentially crushed between the irresistible force of AI investment spending and the immovable object of government borrowing.

There has been a strong sell-off in bond prices in recent months, which raises the yields and causes losses for existing fixed-rate bonds. However, it also materially affects the prospects of new bonds in a positive way. Yes, the bonds have higher yields, which is a benefit, but it is easy to underestimate how much of a benefit that is. There are two important features of bonds - specifically that conventional bonds earn interest as compound interest and that bonds have a duration that is affected by their yield - which combined mean that higher yields benefit bonds in a non-linear way. The near-term prospects for a bond improve as the yield rises, but this improvement is much greater than a simple linear interpretation might have you believe. Our third section will explain the beneficial impact of higher yields on bonds, specifically on the holding period breakeven for bond investments. Our final section will offer some concluding thoughts and some possible ideas for bonds in the current environment.

# Contents


| | | |
|---|---|---|
| Section 1: | The RBA's traditional concerns of inflation and unemployment require near-term hawkishness, but the case for rate cuts in 2027 is growing quickly | 6 |
| Section 2: | The largest sources of credit risk are government indebtedness and AI concentration | 10 |
| Section 3: | The impact of higher yields on bond returns and bond portfolio selection | 16 |
| Section 4: | The bonds FIIG suggests are appropriate for this juncture | 19 |

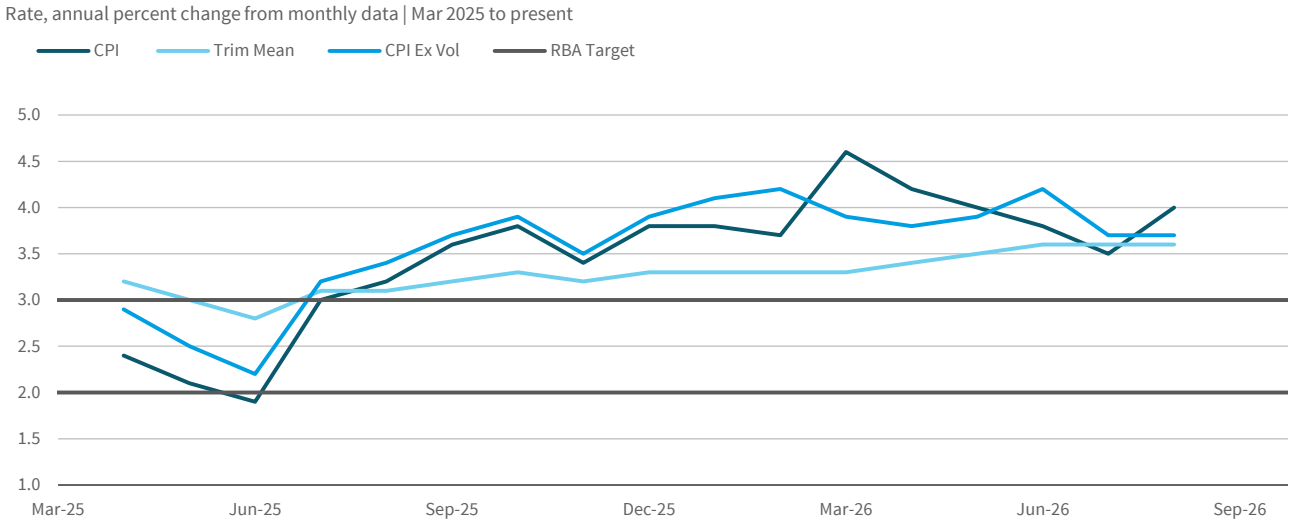
# Section 1: The RBA's traditional concerns of inflation and unemployment require near-term hawkishness, but the case for rate cuts in 2027 is growing quickly

It's no secret that inflation remains too high. The RBA has made repeated references to it. The war in Iran has been a significant contributor to the rise in inflation, as it caused crude oil prices to rise and impacted refining capacity.

Meanwhile, the war between Russia and Ukraine has also contributed to the cost of refining, so that's not helping either. However, it would be wrong to conclude that the wars are the only drivers of our current inflation problem and, as we covered at length in our quarterly outlook released in July, Australia already had an inflation problem before the war started. The first RBA rate rise was in February, remember, before the start of the Iran war.

The inflation data since our last Macro Outlook has been reasonably close to expectations. The expectations were that inflation would be too high, though, so being near expectations is cold comfort. It could have been worse, though. The headline inflation rate has risen to 4.0% year-on-year while the trimmed mean inflation has been consistently at 3.6%.

**Figure 1: Australian inflation**




Source: ABS, FIIG Securities

The RBA gave a number of risks in their assessment of the economy in the August meeting minutes. The risks identified as potentially causing inflation to exceed forecasts included:

1. Global oil prices could move higher if the conflict in the Middle East persists or escalates.
2. Domestic capacity pressures could prove higher than expected, particularly if AI-related investment were to prove larger.
3. Growth in domestic supply capacity could prove even weaker than assumed.

The RBA is very rarely one-sided, however, and they did identify potential downside risks to inflation in the August minutes too. These were:

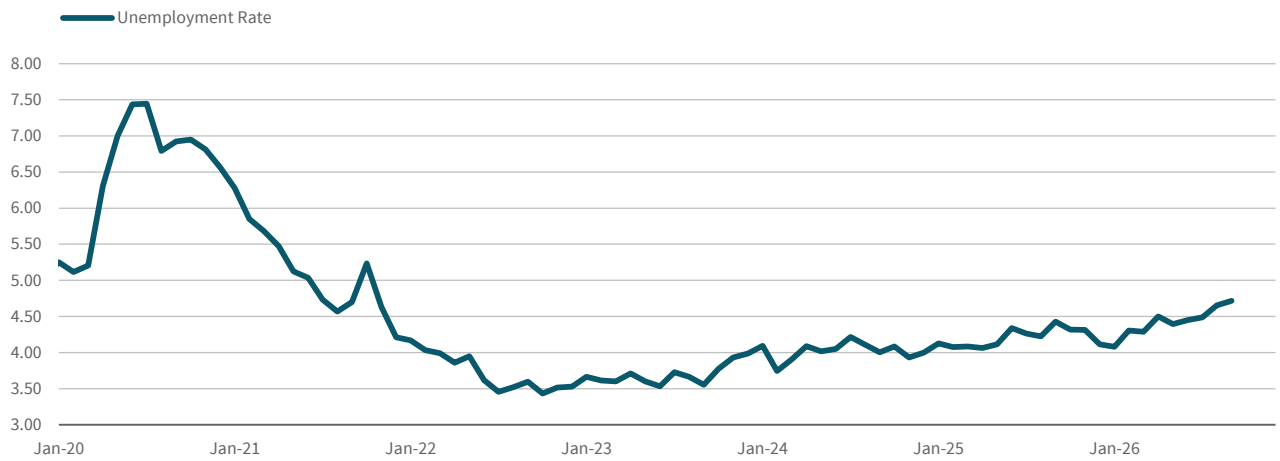
1. The labour market may be easing more quickly than assessed.
2. Activity could slow more quickly than assumed (perhaps in response to the housing market downturn).
3. There could be adverse changes to global trade policy.
4. Expected returns from the AI boom could be revised down sharply.

In August, the RBA explicitly said that they judged the balance of risks to be to the upside. Then, in September, many of these upside risks either had come to pass or appeared very likely to come to pass. In particular, the Iran war was worsening and the RBA liaison had discovered many firms intended to pass on costs now that higher input costs were assumed to be more long-lasting. These observations caused the RBA to raise rates further at the September meeting.

However, that was September. Now, from the vantage point of October, the risks to the downside appear to be materialising too. Specifically, the unemployment rate is rising much more quickly than the RBA had anticipated. Figure 2 shows the unemployment rate calculated to multiple decimals from the ABS seasonally adjusted data. We are using the calculated result, rather than simply the ABS quoted figure rounded to one decimal place, because we feel it better highlights an important and underappreciated feature in this data. Namely, the unemployment rate is moving higher and doing so consistently. However, when you look at the data as it is usually presented, which is rounded to one decimal place, the movement looks far more lumpy and seems to stop and start more.

**Figure 2: Australian Unemployment rate, calculated to multiple decimals**

Rate, % | Jan 2020 to present




Source: ABS, FIIG Securities

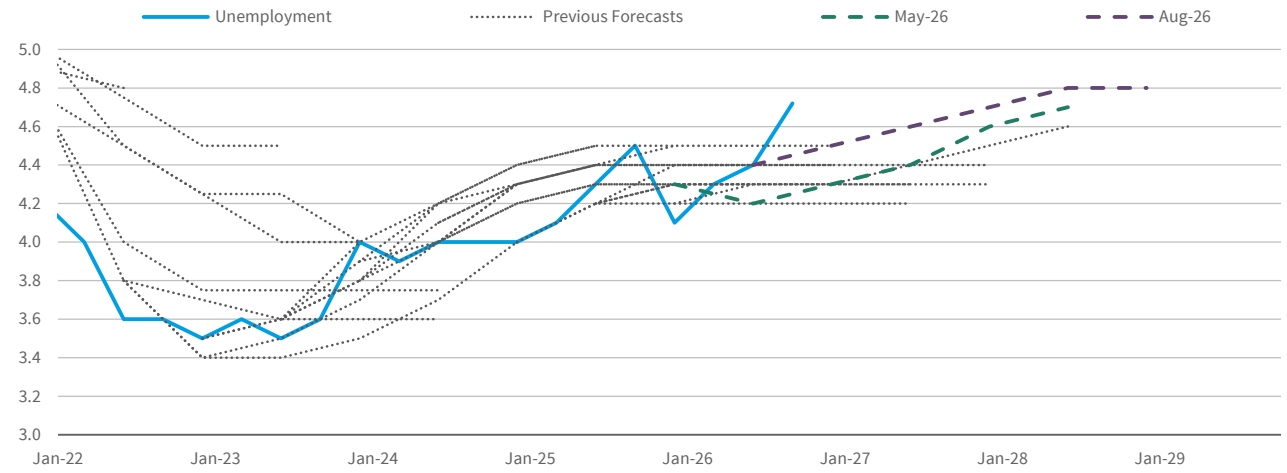
We also can't help but observe that since January the unemployment rate has risen from 4.08% to 4.72%, a rise of 0.64 percentage points in eight months. That is slightly cherry-picking the data for the low in the unemployment rate, but given that the first rate rise was in February, it does make January not an unreasonable starting point to choose. The signs are very clear that the unemployment rate has been rising consistently since the RBA began raising rates. In a way, this is good news, since it does mean that the movements in the cash rate are having the desired effect of slowing the economy. The medicine is working the way it is supposed to. The issue here, though, is that higher RBA rates are unable to affect higher oil prices or the international capital that is driving data centre growth.

The RBA has sometimes prevaricated about whether they think the setting of monetary policy is fully restrictive. That was somewhat justified at the time, but is now much less justified. The fact that unemployment is rising consistently suggests that policy is clearly restrictive.

As part of the standard Monetary Policy process, when the RBA meets at the November board meeting, there will also be a new set of forecasts created. These new forecasts will very likely include a higher forecast for the unemployment rate. The previous forecast was that the unemployment rate would slowly rise from 4.4% to 4.8% by end of 2028. The reality is that we've gone from 4.4% to 4.7% in only three months.

### Figure 3: RBA forecasts for the unemployment rate and historical data

Rate, % | Jan 2022 to Dec 2028

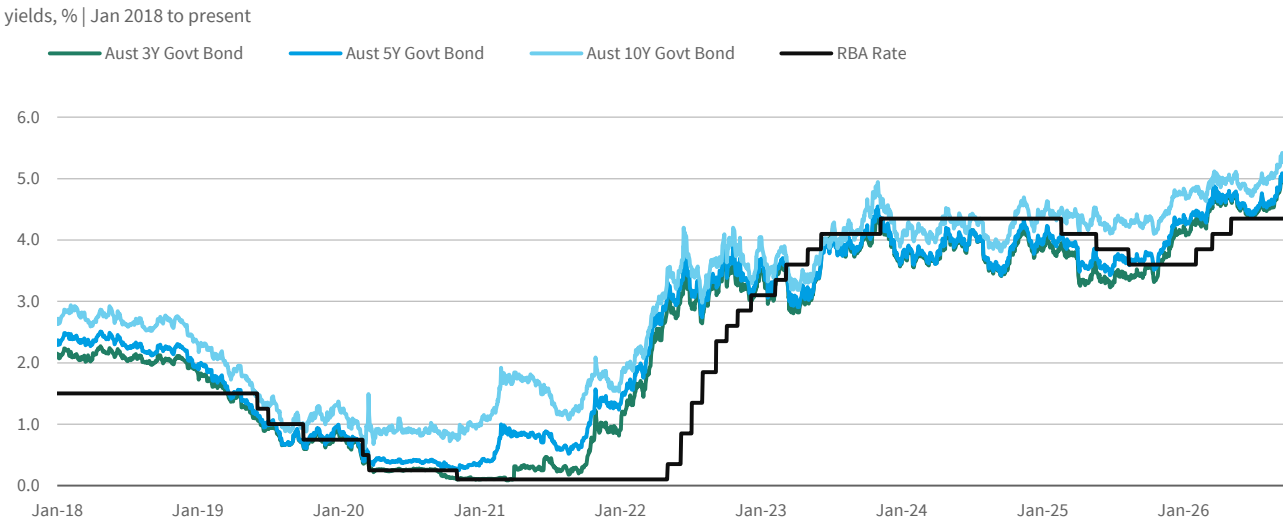



Source: ABS, RBA, FIIG Securities

For bond markets, this means that the risk of an elongated Australian rate rise cycle is dropping. While the near-term may yet see a further RBA rate move, the previous expectations had been for a cash rate as high as 5.06% at the peak (pricing on 28 September for the cash rate to be 5.06% in August 2027). Now, following the unemployment data, the cash rate peak is expected to be 4.88% in May 2027. Importantly, this is still higher than the current cash rate of 4.60%. If there were to be a continuation of the current run of weak data then the market might come to the conclusion that the RBA will be actively cutting rates in 2027, rather than simply not raising them. In such a circumstance, there is plenty of scope for bond yields to fall much further from here.

There has been some movement lower in recent weeks, but yields remain very elevated on a longer-term view. Australian Government bond yields remain above the cash rate, which is unusual for this time in the cycle (assuming we are nearing the end). As we highlighted in our last macro update in July, when there is a last RBA cash rate move higher that occurs unexpectedly late in the cycle, there is usually an accompanying move higher in term yields. However, the movement higher in term yields is normally short-lived. The spike in yields which accompanied the RBA's final move of the cycle in November 2023 proved to be an excellent time to buy fixed-rate bonds. The signs are building that the same pattern is playing out now. We've had a delayed extra rate rise already that has wrong-footed markets who had expected the cycle to be finished and has triggered a move higher in term yields. But it's not clear whether this move higher now is a full cycle or a temporary peak. When discussing the future trajectory of rates, nothing is guaranteed, of course, but the case is building that this might be a temporary excursion higher in yields and that the medium-term cyclical elements are pointing to lower yields. There are risks around the behaviour of the very long bonds, however, so choosing where to take duration is key.

### Figure 4: Australian Government Bonds




Source: Bloomberg, FIIG Securities

The domestic threads are suggesting that the economy has an inflation problem, but that the RBA rate rises are largely working to slow the economy. Inflation hasn't yet started to fall, but the changes in the labour market are clear. If this keeps up, the RBA might have to raise rates more, depending on the inflation data, but the chance of an elongated peak in the cash rate is falling. If the RBA does move to a cash rate of 4.85%, from the current 4.60%, then the trend of weakening in the labour market is only likely to intensify.

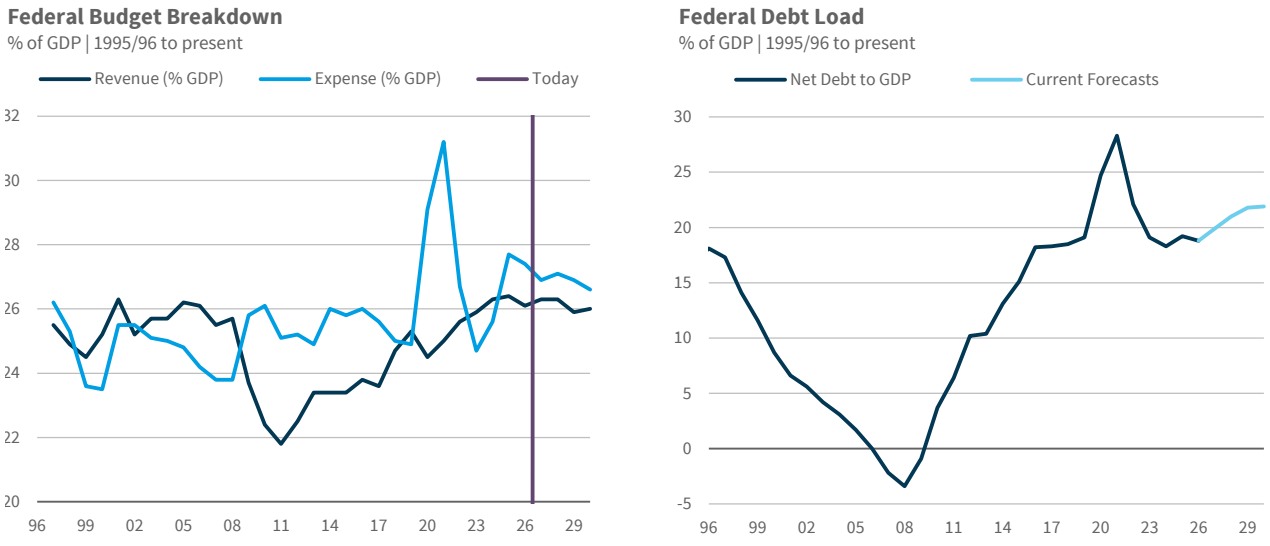
# Section 2: The largest sources of credit risk are government indebtedness and AI concentration

One reason bond yields are so volatile of late is that there are multiple key storylines, each pulling in a different direction. We've looked at the domestic economic elements in Section 1. The other two threads that we see as being highly material are credit risk related, but from either ends of the credit spectrum.

There are numerous headlines and stories about rising credit risk in government debt, but it's not always easy to disentangle what is credit risk from what is simply supply and demand moving yields higher. For the moment, we believe that the moves higher in the US yields are mostly about supply and demand for capital, rather than a true market reaction to increasing sovereign default risk. In FIIG Research's assessment, fiscal pressures have increased the vulnerability of some sovereign borrowers to adverse market developments.

Since the GFC, it's only become easier for governments to spend money. The previous collective desire to keep debt low has ebbed as COVID and the war in the Middle East have encouraged governments to spend. However, as the old adage says, you must make hay while the sun shines. The sun has been shining, economically speaking, for the last few years. Australia has significantly reduced our deficit and now sits with only a minor deficit and with Commonwealth net debt relative to GDP not far from pre-pandemic levels. That isn't to say that the Federal Government couldn't have done better (and the states definitely could have), but let's not be churlish either. There has been a material reduction in the Federal deficit and a material fall in the total indebtedness since the COVID peaks.

**Figure 5: Federal Budget Breakdown and Debt Load**

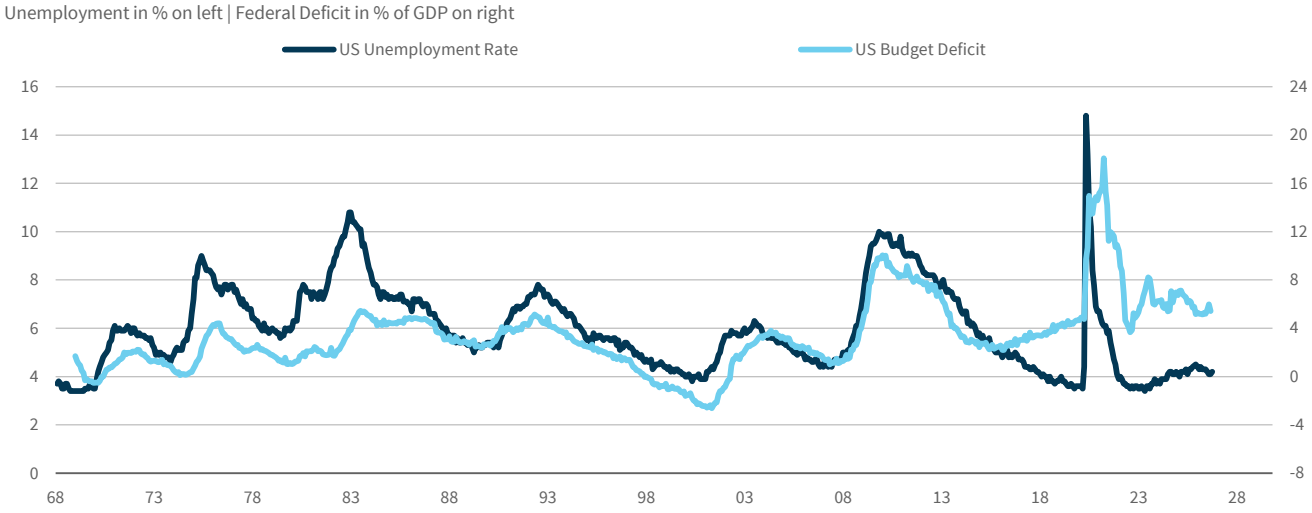



Source: Federal Budget Papers, FIIG Securities

The forecast rise in net debt to GDP is something of a concern, but should also be understood in the context of Australian budget practice. Unusually compared to other parts of the globe, Australia's budget forecasts tend to be conservative, with low commodity prices and strong reversion to the mean. A result of that conservatism is that the net debt forecasts almost always have a slight upward tilt. Every Budget since 2019/20 has forecast rising net debt to GDP either as steep, or steeper, than the current predictions and, as the chart shows, it hasn't risen.

Not all countries have been so frugal. The United States, in particular, continues to run a deficit which is more associated with a global calamity like the GFC or COVID than with an economy that is really firing on most cylinders at the present moment. Figure 6 shows the US deficit and the US unemployment rate. There is an incredibly strong relationship between the two, and this is not a coincidence. The unemployment rate is an excellent catch-all for the strength of the economy, and the overall strength of the economy goes a long way to predicting the deficit or surplus position of the government. Obviously, when more people have jobs, more people are paying taxes, and fewer people are collecting welfare, leading to a better budget position. So there's a direct linkage, but the linkage is broader than that, since when the unemployment rate is low, the economy is generally strong too. A stronger economy means stronger growth and stronger tax revenues from all sources.

## Figure 6: US Structural Budget Position



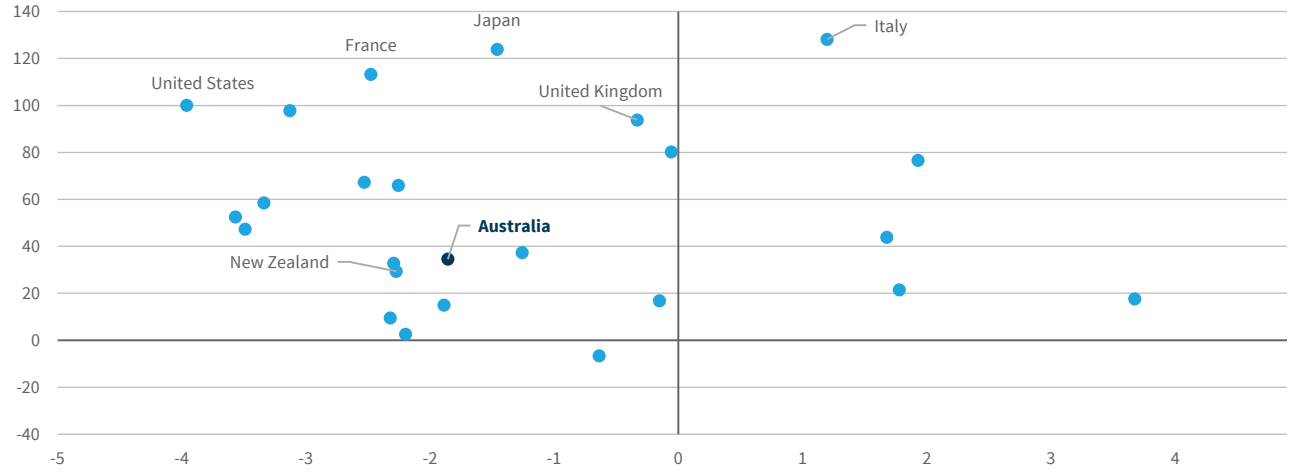

Source: Bloomberg, FIIG Securities.

At least, that's the theory. Over time, the correlation is strong, but the current deficit is larger than it was at any point other than the GFC and COVID, while the unemployment rate is only marginally up from the 60-year low reached in 2023. Previously, when the unemployment rate had been this low, the US had a government surplus, or very close to it. At present, the rolling 12-month deficit is around 5.5% of GDP and likely to trend higher in coming years as military assets are restocked following the war against Iran. The higher cost of borrowing debt due to elevated Treasury yields is also adding further pressure to the US fiscal position.

The US also compares unfavourably to other sovereign borrowers on standard metrics like net debt and budget deficit. Figure 7 shows the scatter plot produced using the IMF WEO data (which uses the international definitions and so doesn't quite tally with the Australian data shown above). In Figure 7, the top left is the naughty corner, where both deficits and stock of debt are high. At present, Australia is in the middle of the pack, but the troublesome names are the US, France, Japan and the UK.

## Figure 7: Indebtedness by country

Govt Net Lending/Borrowing % of GDP (horizontal) | Govt Net Debt % of GDP (vertical) | IMF WEO data, October 2026

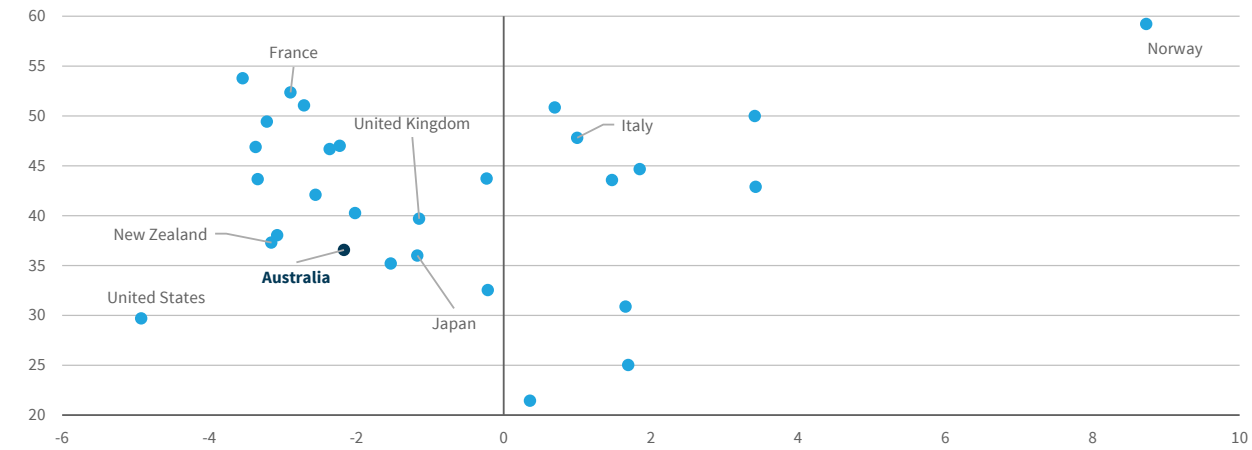



Source: IMF World Economic Outlook, FIIG Securities

The US has the nasty combination of running a large deficit whilst also having a large stock of debt – but the problem is arguably even worse for the US than that. The US has a relatively small government compared to the size of the economy. So while no nation would find it easy to move their government deficit by 4% of GDP, it would be easier for a country like France, where the government is a very large proportion of the economy and takes 55% of GDP as revenue, than for the US, where the revenue is only 30% of GDP.

## Figure 8: Revenue vs Deficit

Govt Revenue % of GDP (horizontal) | Govt Deficit % of GDP (vertical) | IMF WEO data, October 2026

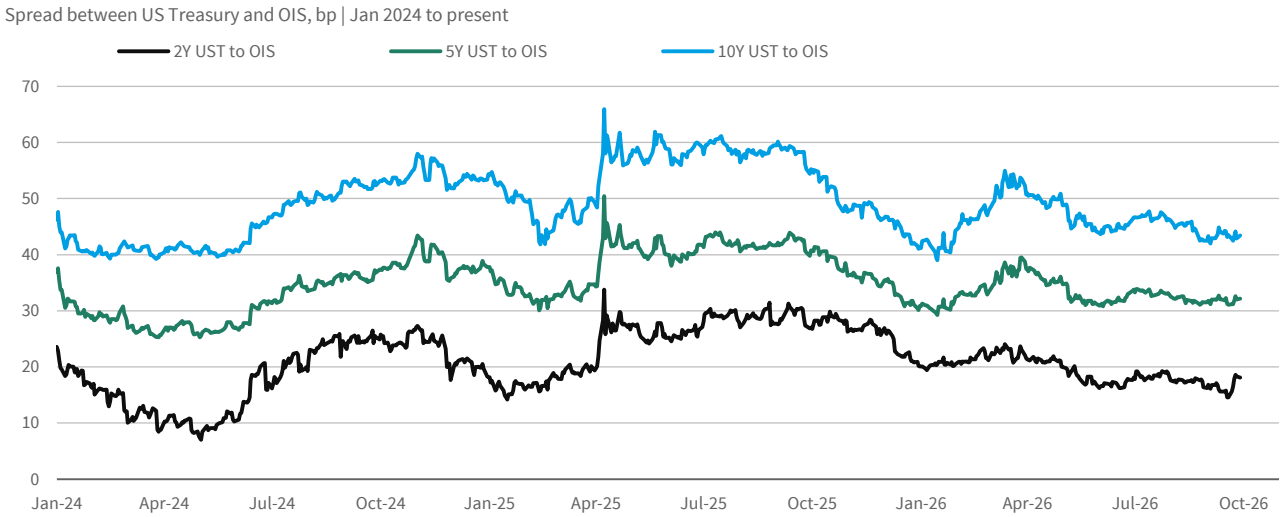



Source: IMF World Economic Outlook, FIIG Securities

While there are many reasons to fear that bond markets might be starting to withdraw support for the US as a sovereign borrower, the data does not actually support that interpretation, despite the rise in US yields. The spread between the US Treasury Bond and the OIS rate (a swap rate that reflects a near risk-free benchmark) has mostly been moving slowly lower in recent weeks.

There have been spikes in this spread when the US does something unexpected, like in April 2025 (better known as Liberation Day), or when the war in Iran began in February 2026. Those spikes may partly reflect changes in perceptions of US sovereign risk, alongside other market and liquidity factors. But of late, this measure is not suggesting alarm.

## Figure 9: US Government Sovereign Risk

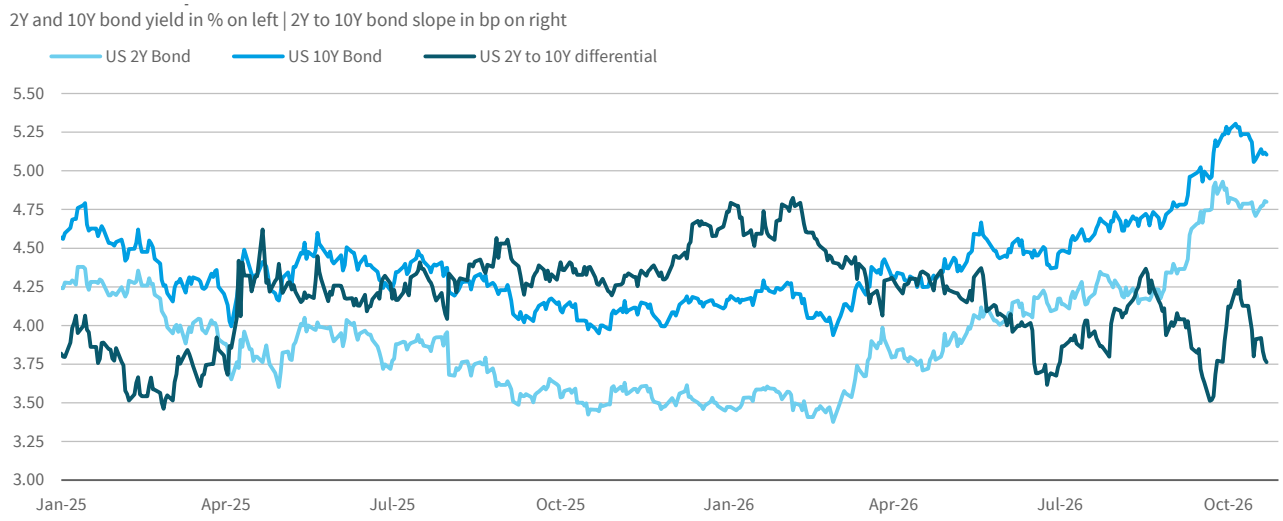



Source: Bloomberg, FIIG Securities

That doesn't mean that US yields haven't been rising; they most certainly have. Though they have been caught between multiple storylines in recent months. When the US credit issues are to the fore, the yields rise and steepen (long yields rise faster than short yields). When US inflation/oil prices are to the fore, US yields rise and flatten (short yields rise faster than long yields). When AI bubble fears are to the fore, the curve rallies and steepens (short yields fall faster than long yields).

Although each of these lines of argument is important, their relative importance differs over time. Which is why despite the US yields rising substantially in recent months, the slope of the US curve (the difference between 2Y and 10Y yields) has been highly volatile.

## Figure 10: US Yields and Slope

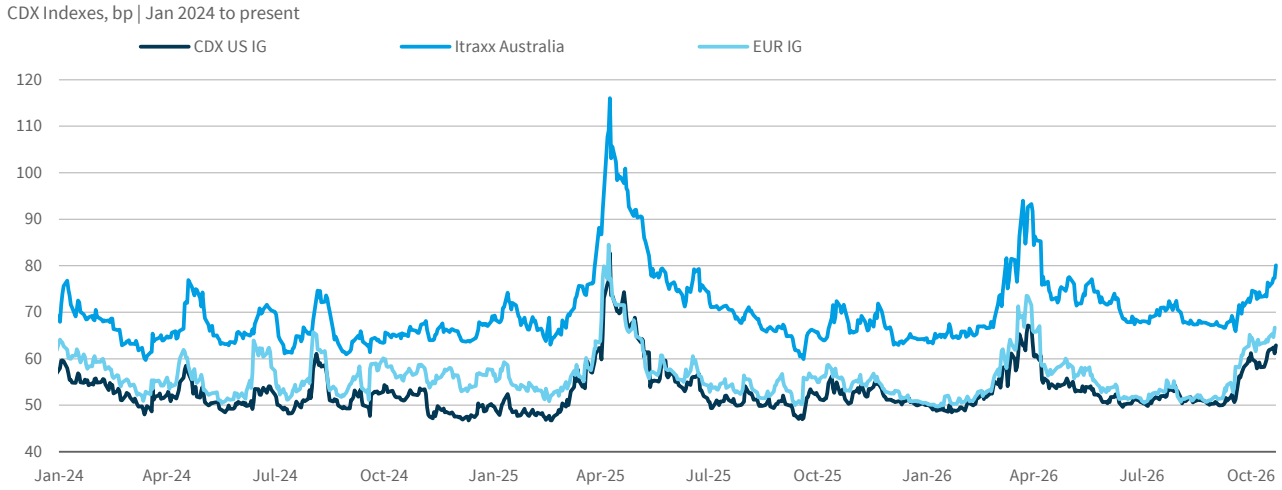



Source: Bloomberg, FIIG Securities

The credit risk in the US sovereign has been reasonably stable in the last few months, given the risks floating about the scene. The other end of the spectrum, US corporate debt, has seen a material and concerning widening in spreads of late. The movement is not particularly large so far. What is more concerning is that the widening has occurred without any real driver, as best we can tell. Widening in spreads around Liberation Day, or around the start of the Iran war are easy to explain. The most recent widening appears much more about the market's assessment of the credits themselves, rather than any other external driver.

The movements have been clear in both the US and Europe. There has been a mild widening in Australian spreads, too, but so far, the movements are not particularly large here (though that may change over time). Also note that because of the way the averaging works, the change in the spread is more of an indicator of risk than the outright level. Please do not interpret the wider Australian measure as suggesting that Australian credit is riskier than the US or Europe.

### Figure 11: Credit Spreads




Source: Bloomberg, FIIG Securities

We are watching developments in the high yield space too, but at this stage it's not clear where the greater risk lies. The basic problem is that high interest rates can put pressure on a broad range of borrowers simultaneously. Although the precise impact differs with refinancing needs, leverage and debt structure; there is pressure in every segment of borrowers. That's governments, AI and "old industry" alike. However, the AI infrastructure borrowing is triggering particularly large issuance at present and is, to a large extent, taking the very high-risk option. Whichever AI company or companies achieve a dominant position will become immensely valuable, but it is very unlikely that all the current companies will make it. As such, they spend incredible sums and take very large risks to attempt to ensure they have the strongest position if the speculated correction comes. Markets had readily provided debt to these companies for much of the year, but sentiment has started to turn as investors reassess the sheer scale of borrowing across the data centre and AI sector.

The cancellation of IPOs in the AI space in Australia has been one manifestation of the risk that the AI boom is overdone, but it's not the only one. The equity prices of some of the larger companies in the US have been falling too.

We want to reinforce to clients a view that we've held for a while. It is important to differentiate between AI as a technology and the current AI technology leaders. It is entirely possible that AI as a technology succeeds and changes our lives just as the internet did 30 odd years ago. But that doesn't mean that every AI company will succeed. Companies like Alta Vista, MySpace, AOL and Netscape were early juggernauts in the internet age, but they were not the long-term successes.

That's because while it is clear that the internet then and AI now are both phenomenal tools, it is far from clear how best to use that tool in a commercial and profitable way. The companies that figure that out, and the AI providers that provide the AI best tailored to that end, will be the final successes.

There was a major tech-industry share price collapse in 2001 – but that doesn't mean that the internet didn't "succeed". Similarly, AI can succeed even if some, or even many, of the current AI leaders eventually fail. We do fear that the current pricing and assumptions around AI will prove unfounded and there will be another bust coming. It's very hard to know when that bust will start, but the fact that we appear to be approaching the top of the interest rate cycle, with US equity markets both incredibly high in price and incredibly concentrated in a few companies, creates exactly the preconditions for a credit cycle taking hold.

While we think the problems will be concentrated in the AI-linked spaces, there will be spillovers everywhere in the event of a large credit spread widening. But at the same time, it can be hard to know when that cycle will start. If you hunker down too early, you can miss a lot of extra yield by holding too conservative a position too early. Investment is not usually about the complete avoidance of risk; it is about taking considered and appropriate levels of risk in an informed way.

For that reason, we are suggesting that clients shorten their credit exposures, while still actively taking credit risk. We suspect that, slightly counterintuitively, taking lower-rated, but shorter, credit exposures is the most likely path to success against the current backdrop. Although we expect a widening in credit spreads in coming months, we do not expect there will be a widespread rash of defaults. In this circumstance, shorter credit duration may mitigate price sensitivity, although issuer credit quality remains critical.

A longer bond that experiences a widening in credit spreads may remain below its previous price for an extended period. A shorter bond that offers the same initial yield will both fall by a smaller amount in a credit widening and be pulled back to par more quickly over time. Australian-based credits which are not particularly exposed to AI risk, but are of shorter tenor and floating rate, appear to be the best credit options, at present.

We have so far discussed credit risk in the US sovereign because that is a key part of global markets. There are also risks in other sovereigns, like the UK and France, which will be the subject of other works. One key observation, however, is that because of the Euro as a currency, banks in the Eurozone have multiple options outside their national borders, both for business and for investment. This makes French banks, for example, less reliant solely on the health of the French sovereign than might be true of banks in other, non-European, jurisdictions.

# Section 3: The impact of higher yields on bond returns and bond portfolio selection

The recent sell-off in bonds has taken bond yields much higher. Unusually, this sell-off has been led by the longer end of the curve at times. Overall, this has seen the longer end of the curve rise by more than it normally would at this stage of a cycle. This is particularly true of the longer bonds in the 7Y sector and longer.

For bond owners, higher yields can improve prospective returns, particularly for new purchases. More return is always better, all else equal. But in bonds, there are a few unusual and complicated features that mean some bond investors don't appreciate just how beneficial higher yields are. Longer bonds have unusual mathematical properties relating to the interaction of yield and price. If there is a change in interest rate away from the issuance rate, the change in yield is reflected in the price of the bond, assuming a compounding interest structure over the remaining life of the bond. This means that higher yields are not better than lower yields in a linear way; higher yields are better than lower yields in an exponential way.

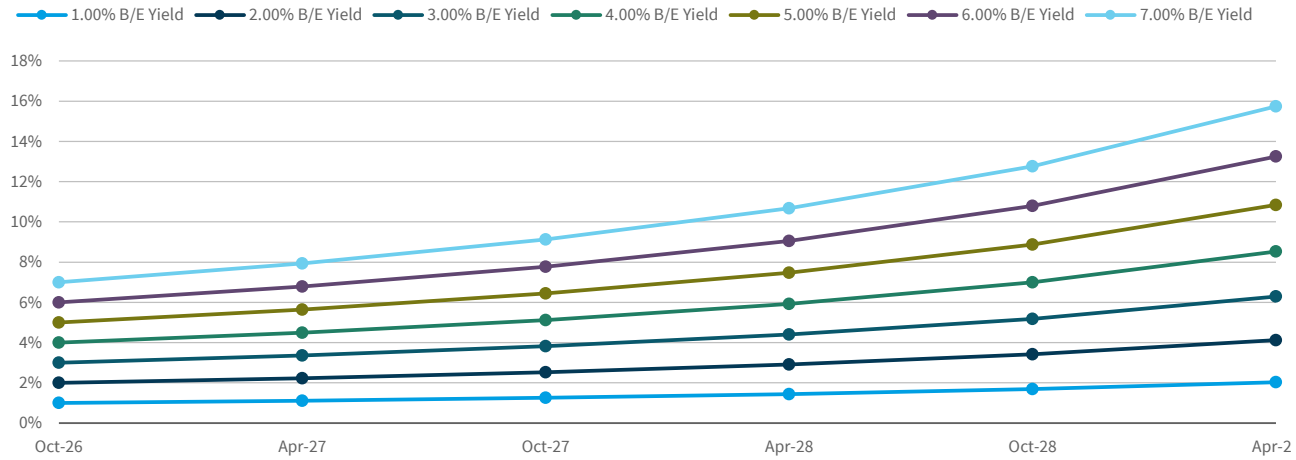
In particular, there is a concept known as the Breakeven Yield, which is the future yield of the bond such that the return to the owner over the holding period is zero. This is a form of risk measure and is designed to check how much protection a bond owner has should rates move in an unfavourable direction (i.e. for the owner of the bond, that is rates moving higher). Obviously, given the recent rise in yields, the question of "How much protection do I have if yields move even further upwards?" is at the forefront in many investors' minds at present.

Figure 12 below shows the example breakeven behaviour of 5Y bonds with yields between 1% and 7% at purchase. These lines represent what yields would need to do over time in order for a bond investor to have zero return. That line is the breakeven line. If the yield is higher than that, the investor has made a loss over the holding period, but if the yield is lower than the line, the investor has made a profit.

Starting with the base of the structure, notice that if the original 5Y bond yield is 1%, the investor needs the yield to be less than 2.03% after two and a half years to break even. That makes intuitive sense. The two and a half year holding period is half the length of the bond, so the breakeven line is approximately double the original yield. The extra 0.03% is a result of a compounding effect and convexity in the bond's price/yield relationship. Notice that the compounding effect for the 1% bond is very small. Now let's look further up Figure 12. As the starting yield rises, the breakeven lines get higher overall, which is to be expected. The lines also become much more curved. The 1% starting yield had to effectively double to only break even, while the 3% starting yield needs to move to 6.29%. The compounding is starting to kick in now. The 6% starting yield needs to rise to 13.25% for break-even, and the 7% starting yield needs to rise to 15.74% for investors to break even. The compounding and other non-linearity effects were worth 0.03% at a 1% yield, but are worth 1.74% at a 7% yield. This is the extra benefit that bond owners don't always realise they are receiving as yields rise.

## Figure 12: Breakeven Yield for 5Y bond, various starting yields

yield, % | Oct 2026 to Apr 2029



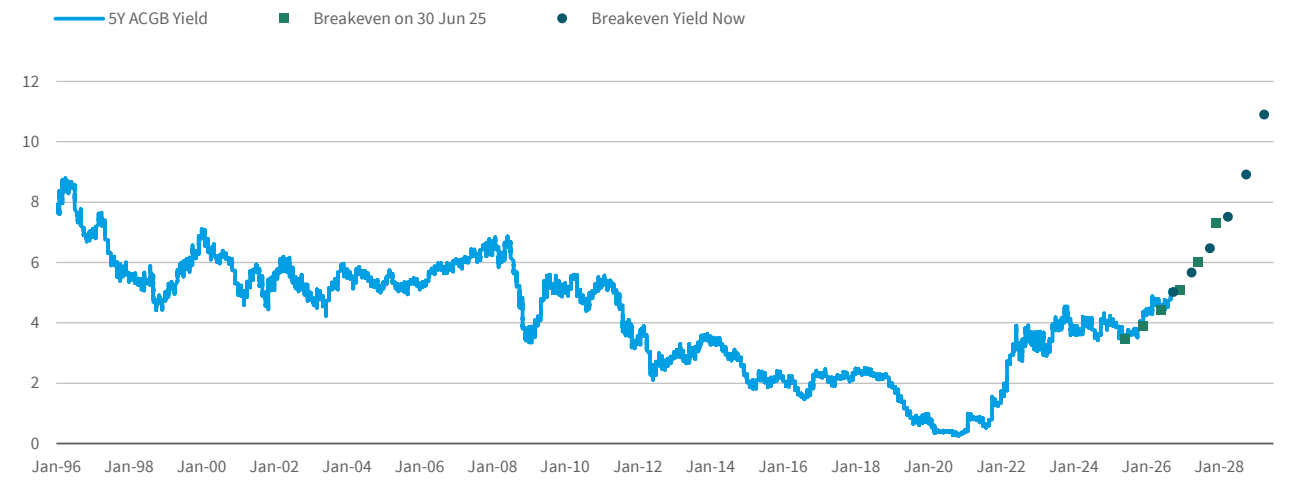

Source: Bloomberg, FIIG Securities. The figures shown are modelled and depend on the assumptions specified for the illustration; the decomposition into compounding and convexity effects is illustrative.

This breakeven line is also proportionate, though still non-linear. The further the yield is below (or above) the breakeven yield, the larger the profit (or loss) will be.

We also need to consider how these breakeven lines compare to the actual history of yields. For a 5Y ACGB, the sell-off required is quite extreme.

## Figure 13: Breakeven Yield for 5Y ACGB, historical comparison

yield, % | Jan 1996 to Apr 2029




Source: Bloomberg, FIIG Securities

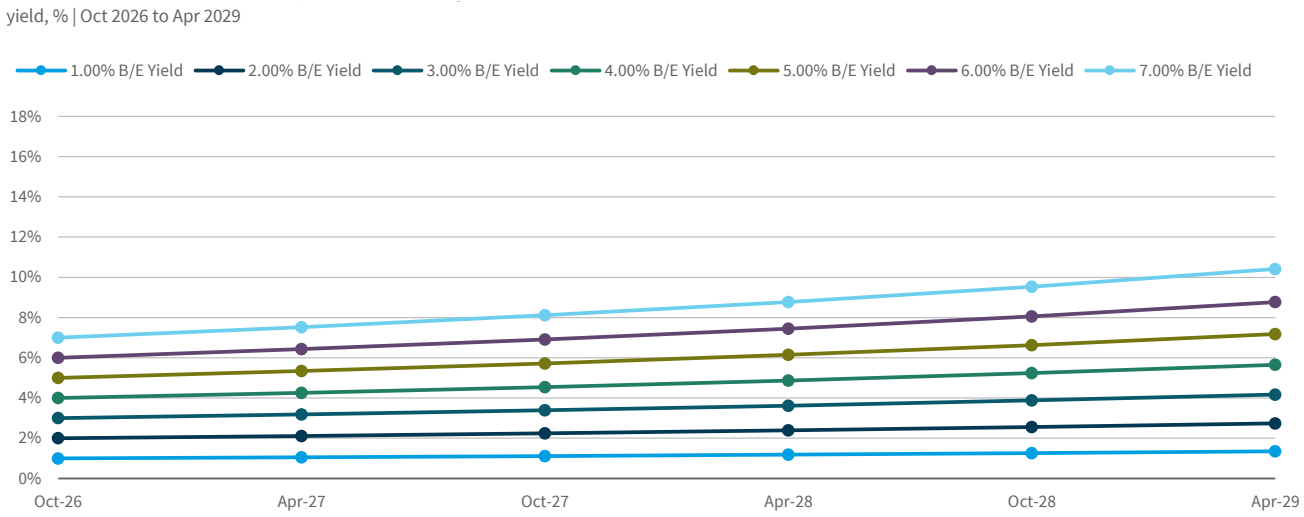
Notice that even amidst one of the sharpest sell-offs of the last 30 years, a 5Y bond has actually not lost money. Moreover, the breakeven lines also show that a 5Y bond purchased now would, under the illustrated assumptions, generate a positive holding-period return unless the 5Y yield rises to over 9% in the next two years. While we understand that some clients feel burned by recent price performance, the idea that the 5Y yield could be in excess of 9% in two years is just not really credible. Too many other things would break in the economy on the way to that point for that movement to arise under our central outlook, or even as a plausible risk case. It is, technically, a possible adverse outcome, but it would be incredibly unlikely to occur.

The highest the 5Y ACGB has been during the RBA era is 7.03%, when the cash rate was 7.25%. A 5Y bond rate of 9%, even allowing for a widening of the credit margin, would require a cash rate something in the order of 9.50-10.00%. The Australian economy would likely crater well before the RBA delivered another 20 rate rises. It's already showing signs of strain after only four rate rises. It's hard to know whether zero, one, or two more rate rises are coming, but we can probably discount the prospect of another 20 rate rises.

When there has been an abrupt mark-to-market loss because of a sell-off it's important to understand what the new higher yields actually mean, both for outright yield and for breakeven performance in coming months. Thanks to compounding, the sell-off needs to worsen over time for bonds to continue to lose money.

This conclusion is dependent on the length of the bond, however. We have displayed the 5Y bond in this section so far. The same conclusions and effects apply to longer bonds, but the effects are smaller. This is because the passing of time is, proportionately, less important for a longer bond. A 2-year holding period for a 5Y bond is an appreciable fraction of the bond's life. A 2-year holding period for a 20Y bond is much less important. Figure 14 shows the same results as Figure 12, and deliberately on the same axes, but for 10Y bonds, not 5Y bonds.

### Figure 14: Breakeven Yield for 10Y bond, various starting yields




Source: Bloomberg, FIIG Securities

The same patterns of upwards lines and more curvature on the higher lines is still present, but not as visually obvious.

This behaviour of bonds should help clients decide what length of duration they want to take.

Those who are more confident that yields are about to turn lower, and those who have longer investment horizons might want to consider bonds in the 10Y zone. Those who are a little more cautious should probably consider shorter bonds in the 5Y-7Y range. This observation should help clients understand where to take duration that most suits their understanding of the economy.

# Section 4: The bonds FIIG suggests are appropriate for this juncture

Overall, FIIG Research believes we are approaching the end of the current cycle and the time is right to start thinking about what bond positions will be best for when the cycle actually turns. A turn in the cycle likely comes with a reduction in overall yields, but a widening in credit spreads. Notably, we don't anticipate widespread defaults; we expect it is more likely that there will be widening in spreads without a material run of losses.

With that in mind, and using technical definitions, FIIG Research recommends reducing credit duration, but increasing outright duration at this point. That's a complicated phrase, so let us tease it out a bit. Duration is the length of time for which your yields are locked in. Credit duration is the length of time for which your credit spreads are locked in. A long FRN will have a very short duration, since the outright yield is not locked in, but will have a very long credit duration, since the spread above BBSW (i.e. the credit spread) is locked in for the entirety of the FRN.

Our recommendation to have lower credit duration but longer outright duration means selecting credit bonds that are comparatively short, but comparatively high yielding and then pairing these with longer, safer bonds. We are also looking to manage our exposure to the AI industry. While we do not see a problem with any of the AI-related bonds on our books at present (names like NextDC and CDC), we are also cognisant of not growing the exposure too much without thought.

For the moment, these names provide higher yields and are an excellent element to a portfolio, but with a correction in the air we do not wish to be overly exposed to them.

In line with our original strategy from the RISE publication in January, we continue to strongly advocate taking inflation-linked exposure as protection against an unexpected rise in inflation. The risk of a material rise in the inflation rate, even amongst a general economic slowdown, remains high. We also recommend clients pay attention to their diversification.

The specific bonds we wish to highlight are:

| Issuer | Maturity / Call | Coupon | Type | Rationale | Current Yield |
|---|---|---|---|---|---|
| Sydney Airport (R) | Nov-30 | CPI + 3.12% | Inflation Linked | Strong yield and inflation protection | CPI + 3.70% |
| Transgrid (W) | Sep-36 | 6.7040% | Fixed Rate | Safer infrastructure name (regulated income), senior position. Longer duration won't suit all. | 6.47% |
| Boral (W) | Oct-33 | 6.7630% | Fixed Rate | Shorter, less duration, but still carries yield | 6.44% |
| Dominion (W) | Feb-29 c | BBSW + 3.20% | Floating Rate | Higher credit risk, low credit duration, aligns with our preferred strategy | BBSW + 2.44% |
| Macquarie (W) | Mar-32 c | 6.5780% | Fixed to Call | Some duration without excessive duration, good yield for maturity point | 6.11% |
| Santander USD (W) | Dec-35 c | 7.2500% | Fixed to Call | Higher risk, higher yield, USD exposure with only moderate direct US exposure | 7.57% |
| Coles (W) | Sep-34 | 6.1980% | Fixed Rate | Like the maturity / yield combination. Potentially resilient in a downturn | 6.21% |
| WBC (W) | Jun-35 c | 5.82% | Fixed to Call | Best Tier 2 major bank on our RV measures | 6.39% |

Source: FIIG Securities. Pricing correct as at 20 October 2026. (W) means wholesale available. (R) means a bond is retail eligible.

Please understand that these bonds are bonds we consider appropriate as a general matter and appropriate for the strategy we have outlined in this publication. That does not mean the strategy outlined here is appropriate for all clients or that that these notes are necessarily suitable for every investor. Investors should consider both the characteristics of any new bond they contemplate purchasing and also how that new bond would alter their overall portfolio characteristics.

# Find out more

InvestmentStrategy@fiig.com.au
1800 01 01 81
fiig.com.au

FIIG Securities Limited ('FIIG') provides general advice only. As a result, this document, and any information or advice, has been provided by FIIG without considering one or more of your objectives, financial situation and needs. Because of this, you should, before acting on any advice from FIIG, consider the appropriateness of the advice having regard to your objectives, financial situation and needs. If this document, or any advice, relates to the acquisition, or possible acquisition, of a particular financial product, you should obtain a product disclosure statement relating to the product and consider the statement before making any decision about whether to acquire the product. Neither FIIG, nor any of its directors, authorised representatives, employees, or agents, make any representation or warranty as to the reliability, accuracy, or completeness, of this document or any advice. Nor do they accept any liability or responsibility arising in any way (including negligence) for errors in, or omissions from, this document or advice. FIIG, its employees and related parties earn fees and revenue from dealing in the securities as principal or otherwise and may have an interest in any securities mentioned in this document. Any reference to credit ratings of companies, entities or financial products must only be relied upon by a 'wholesale client' as that term is defined in section 761G of the Corporations Act 2001 (Cth). FIIG strongly recommends that you seek independent accounting, financial, taxation and legal advice, tailored to your specific objectives, financial situation and needs, prior to making any investment decision. FIIG does not provide tax advice and is not a registered tax agent or tax or financial advisor, nor are any of FIIG's employees or authorised representatives. A copy of FIIG's current Financial Services Guide is available at www.fiig.com.au/fsg.

An investment in notes, bonds or securities should not be compared to a bank deposit. Notes, bonds and securities have a greater risk of loss of some or all of an investor's capital when compared to bank deposits. Past performance of any product described in any communication from FIIG is not a reliable indication of future performance. Forecasts contained in this document are predictive in character and based on assumptions, such as a 2.5% p.a. assumed rate of inflation (unless otherwise specified), foreign exchange rates, or forward interest rate curves generally available at the time, and no reliance should be placed on the accuracy of any forecast information. The actual results may differ substantially from the forecasts and are subject to change without further notice. FIIG may quote to you an estimated yield when you purchase a bond. This yield may be calculated by FIIG on either A) a yield to maturity date basis; or B) a yield to early redemption date basis. Some bond issuances include multiple early redemption dates and prices, therefore the realised yield earned by you on the bond may differ from the yield estimated or quoted by FIIG at the time of your purchase. The information in this document is strictly confidential. If you are not the intended recipient of the information contained in this document, you may not disclose or use the information in any way. No liability is accepted for any unauthorised use of the information contained in this document. FIIG is the owner of the copyright material in this document unless otherwise specified.

FIIG | The fixed income experts
an NRI company