CHARLOTTE SQUARE
INVESTMENT MANAGERS

A VIEW FROM THE SQUARE September 2026

Rising bond yields – does it really matter?

Recent weeks have seen the seasonal softness often seen at this time of year in equity markets, though this should be viewed in the context of strong returns over the first seven months of the year. This comes on the back of inflation figures remaining stubbornly high, oil prices rising notably again to above $100 per barrel and the US government 10 year bond yield crossing 5% for the first time since 2007. The latter is notable as investors have been hard-wired to think that 5% is the level on which the equity cycle breaks. So, why have equity markets largely shrugged this off so far?

Ultimately, earnings remain the most important driver of long-term equity returns. Despite concerns over valuations, particularly in US technology stocks, corporate profitability has been exceptionally strong. The most recent US earnings season demonstrated not only robust growth from the largest technology companies but also improving profit trends across a much broader range of businesses. For all the attention given to the "Magnificent Seven", one of the more encouraging developments of 2026 has been the improvement in earnings growth across sectors such as industrials, healthcare, materials and financials. Market leadership is gradually broadening.

We are not in 2007

One of the key distinctions between today's market and the environment that preceded the Global Financial Crisis is where leverage sits within the financial system. With yields rising to a level not seen since then, investors are understandably comparing the two time periods.

In 2007, leverage was embedded at the heart of the banking sector. In short, complex mortgage-backed securities, off-balance-sheet vehicles and opaque derivative exposures created a system where a relatively small decline in asset values could threaten the solvency of major institutions. When confidence evaporated, the result was a systemic crisis that spread rapidly through the global banking network.

Today, the banking system is significantly better capitalised, more liquid and subject to much stricter regulation. Higher capital requirements, regular stress testing, tighter liquidity rules and greater transparency have all helped improve the resilience of the financial system.

That is not to say leverage has disappeared. Rather, it has migrated. Today's leverage is increasingly found within capital markets rather than within the core banking system. One of the fastest-growing examples has been the rise of leveraged ETFs (Exchange-Traded Funds), which allow investors to gain two or three times the daily return of an index, sector or even an individual stock. Products offering leveraged exposure to areas such as semiconductors, artificial intelligence and individual technology companies have attracted substantial inflows from retail investors.

Importantly, while these products can amplify gains during rising markets, they can equally magnify losses when sentiment turns. The growth of leveraged ETFs is therefore a reminder that although systemic leverage may be lower than it was in 2007, pockets of speculative leverage still exist. We expect that some individuals that invest this way will get their fingers burnt and while risks undoubtedly remain, the likelihood of a repeat of the widespread banking failures seen during 2008 is considerably lower than it was two decades ago.

Something to watch out for

An important development to monitor going forward is the increasingly active role that Treasury Secretary Scott Bessent has taken in supporting financial markets in recent weeks. Early in the month, US policymakers worked alongside Japan as the Yen weakened to multi-decade lows, helping to stabilise both the currency and US Treasury markets. Why? The significance lies in Japan's status as the largest overseas holder of US government debt. By easing pressure on the Yen, the need for Japanese investors to sell Treasuries to raise dollars and buy Yen was reduced, therefore reducing the upward pressure on US yields (as a reminder bond prices and yields have an inverse relationship, thus selling pressure pushes prices lower and yields higher).

The developments have also revived discussion around the so-called "debasement trade", something we have been positioning softly for a while now. Concerns over persistent fiscal deficits, rising government debt and intervention in bond markets have encouraged some investors to seek alternative stores of value by selling the US dollar. As a result, assets such as gold, industrial metals and bitcoin have once again attracted attention as investors look for protection against the perceived erosion of fiat currency purchasing power. As we have highlighted before, with such a large percentage of equity markets in US stocks, investors often forget that also creates a large exposure to the US dollar. By hedging some of the currency back to sterling at the point of investment, this reduces the overall exposure to the US dollar should this trend continue over the coming years.

Liam Goodbrand
Investment Director

22 September 2026

43 Charlotte Square
Edinburgh EH2 4HQ

T. 0131 624 7709
investments@csmanagers.com