

Global Wealth Research

Higher sovereign bond yields are reshaping return prospects. Investors more discerning about AI capex, with flows highlighting a barbell of risk appetite.

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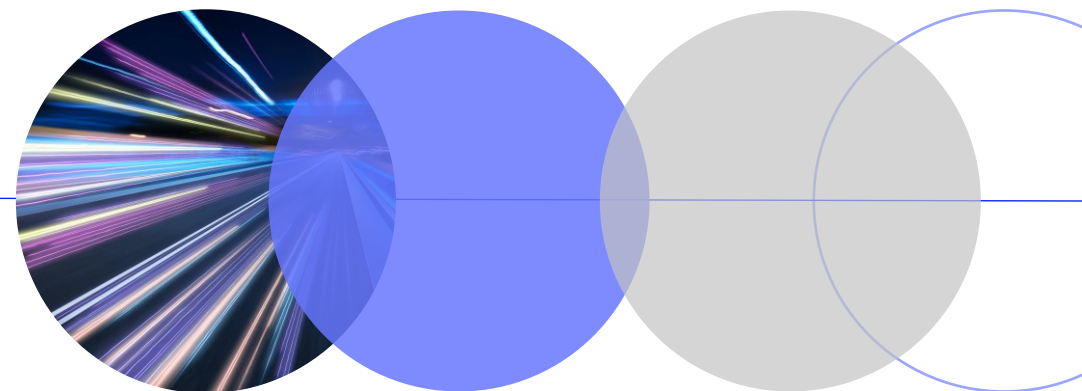
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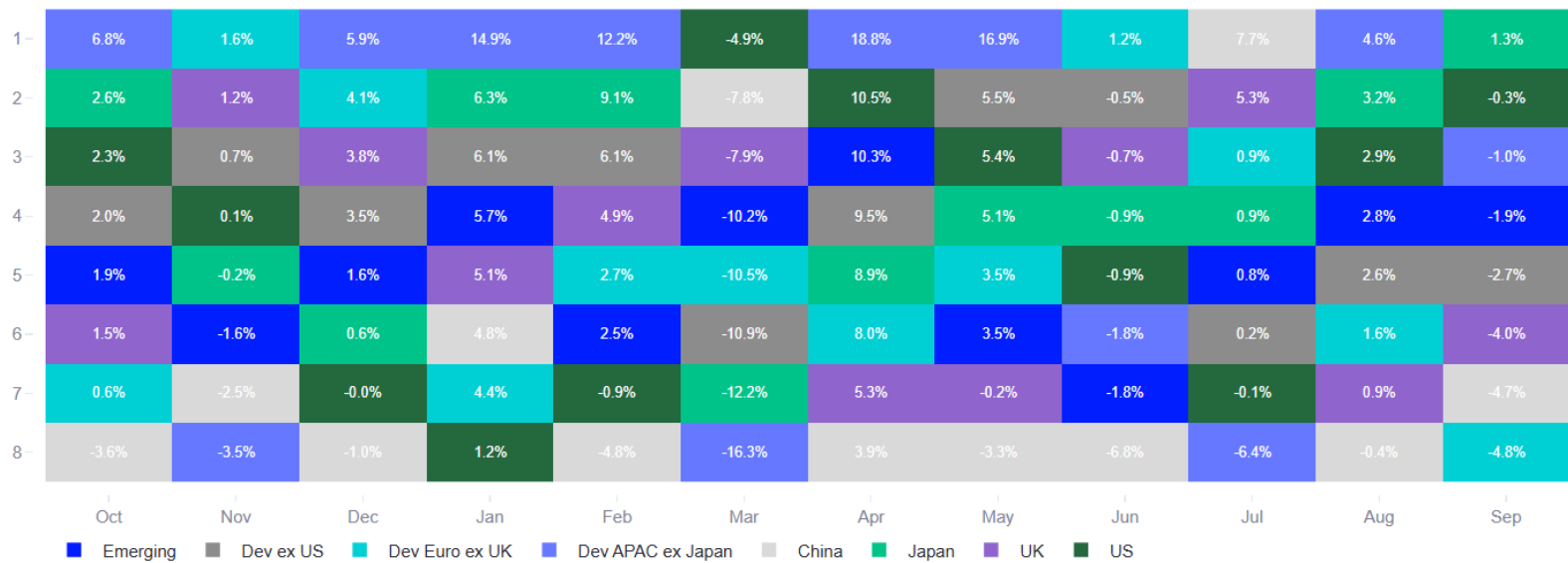


Regional returns taking a random walk supports global diversification

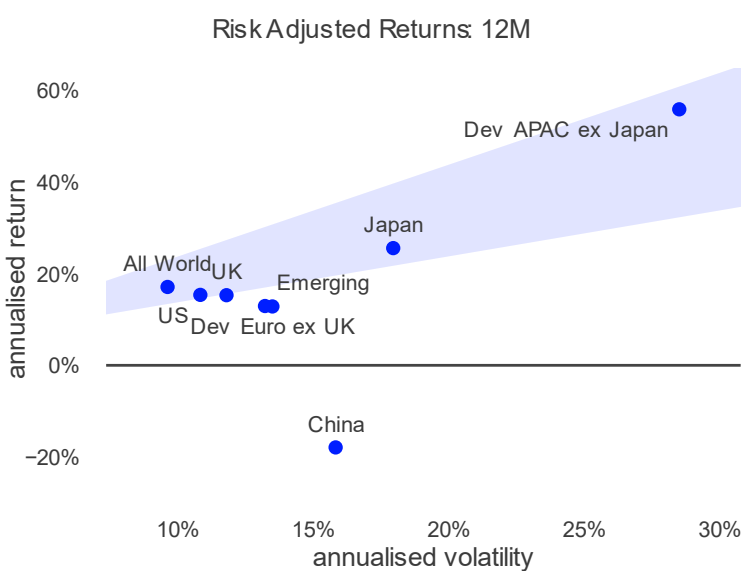
- Over the last 12M, Developed APAC ex Japan was the top-performing market in seven months and the worst-performing in three; two of those bottom rankings coming immediately after a month in which it ranked top. China, meanwhile, was generally the weakest-performing market, although it ranked second at the onset of the Middle-East conflict and top in the AI sell off in July.
- Volatile markets, like South Korea, have had return distributions over the last 12M exhibiting fatter (leptokurtic) tails. Gaping in markets makes timing more difficult. As an example, the FTSE Korea index returned around -25% in March, but rallied c. 37% in April 2026. However, a large proportion of the monthly return was generated over two trading sessions: +11.7% on the 1st and +9.8% on the 8th April.
- Single market concentration risk is also elevated. The FTSE USA Technology weight is now 46.3%, which for context is a larger weight than the weights of: Real Estate, Utilities, Telecoms, Consumer Staples, Energy, Healthcare, Financials and Industrials combined. Concentration is even higher in Taiwan and Korea: TSMC is >50% of the FTSE Taiwan Index and the largest name in the FTSE Emerging Index (17.8%); in Korea Samsung Electronics and SK Hynix are c. 65% of the FTSE Korea Index.
- These dynamics highlight the risk, particularly in markets like the US, where the headline index may not provide the diversification benefits investors were anticipating – potentially leading to unintended, concentrated bets, on Technology and AI and sensitivity to a single market risk factor.
- The case for global equities hasn’t fundamentally changed. What has shifted is the speed and magnitude of market rotations. The speed makes it harder to time market shifts, whilst the magnitude of daily moves makes the risk of being uninvested on a particular day higher which favours remaining invested.

In the chart below we rank major markets by monthly returns over 12M where a rank of 1 is the top performing index in that month, and 7 had the lowest returns. Over 12M, FTSE Developed APAC ex Japan was the top performing market seven times but also bottom three times, highlighting the whipsawing of sentiment.

Ranked monthly returns: Key FTSE GEIS indices



Over 12M, the FTSE All World achieved strong risk-adjusted returns relative to other major equity markets. The blue funnel shows a Sharpe ratio of 1-2x.



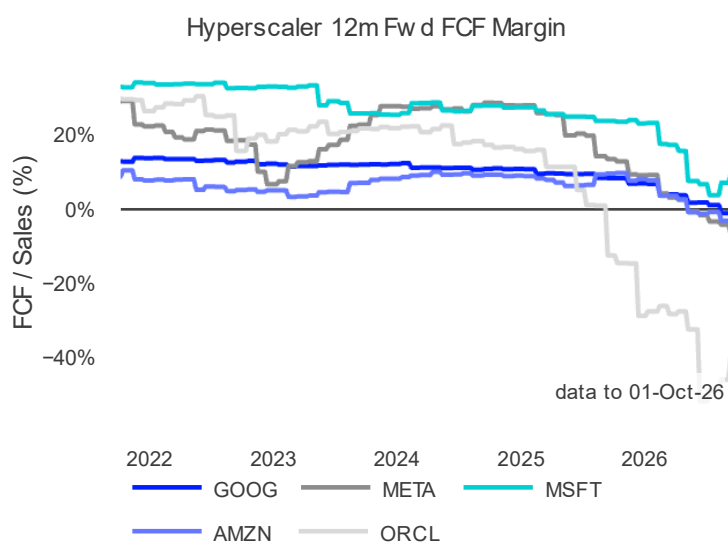
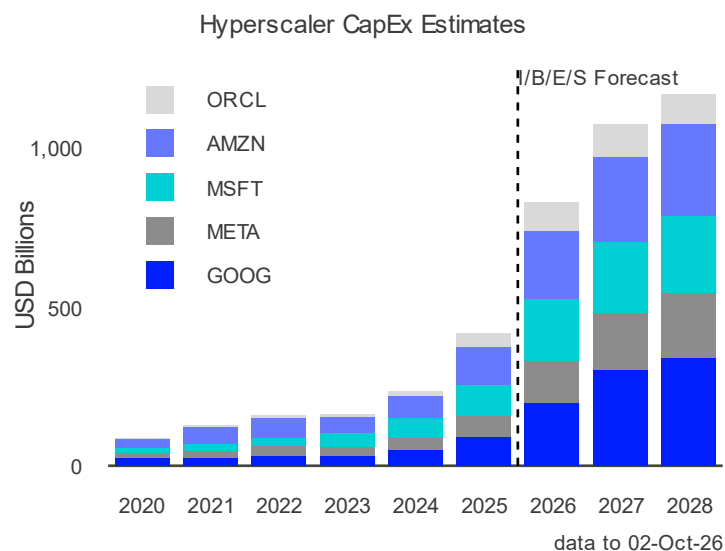
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a. Is AI capex in a bubble?

- AI capex expectations continue to grow, with I/B/E/S estimates for the Big 5 hyperscalers now more than \$1 trillion in 2027, with continued growth into 2028. Analyst estimates were supported by Nvidia, which at its Q2 earnings announcement revised up estimates of YoY revenue growth of 70% for FY28.
- Uptake of AI usage has also been exponential. Data from OpenRouter, a model aggregator, shows weekly token consumption going from c. 500 billion tokens per week in March 2025 to over 120 trillion in September. The fastest-growing segment is agentic workflows, which now make up >1/3 of token throughput.
- But AI capex comes at a cost, and investors have become more discerning about seeing the link between capex and earnings. The cost can be observed in the free cash flow of the hyperscalers, which as a group have broadly gone from double-digit forward FCF margins to being negative in four out of the five.
- In order to fund AI investment, companies are also issuing a significant amount of debt, often with long duration. As an example, YTD, Alphabet and Amazon have issued more than \$175 billion of debt combined with a weighted average maturity of roughly 15 years.

I/B/E/S estimates of hyperscaler capex spending continue to grow, with the Big 5 names expected to spend more than \$1 trillion on AI capex in 2027.

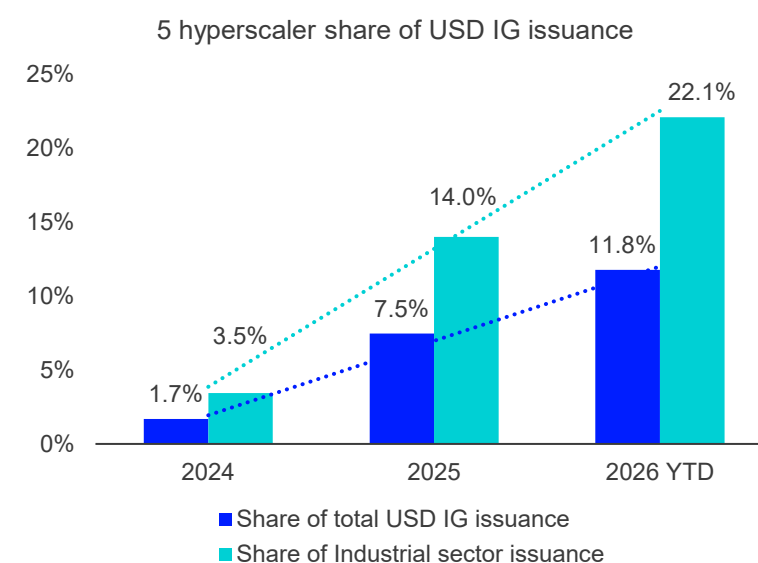
AI capex is impacting the free cash flow of companies. Estimates of forward FCF margins have gone from strongly positive to negative in four of the Big 5.



b. AI capex is reshaping IG supply

- Hyperscalers accounted for 11.8% of USD IG issuance in 2026 YTD, rising to 22% within Industrials, as greater capex and lower free cash flow drive debt financing.
- AI-related investment extends beyond hyperscalers. Utilities are also expanding issuance to fund AI-related power and infrastructure demand, contributing to a broader 27% YoY rise in USD IG supply alongside Industrials (hyperscalers are IG-rated and classified as Industrial by FTSE).
- If these trends persist, greater supply concentration could gradually reshape sector and issuer weights across IG benchmarks and portfolios.

Financing implications are increasingly visible in credit markets. Hyperscaler borrowing has surged with AI capex, reaching ~12% of USD IG issuance.



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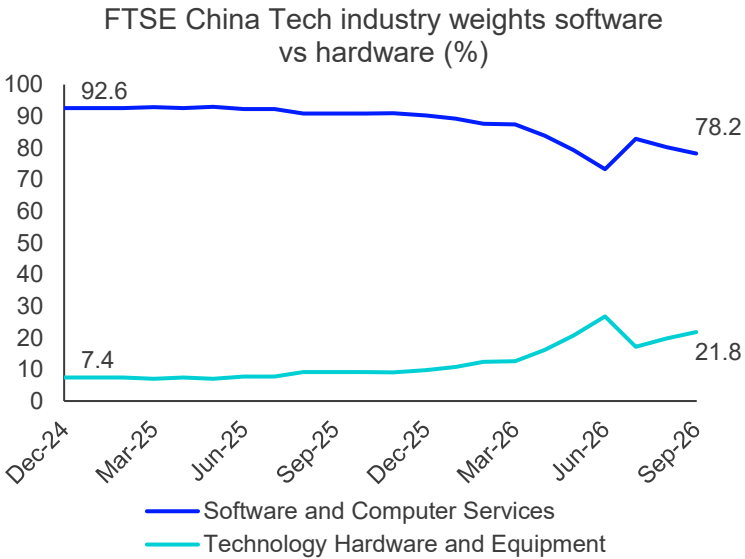
Physical AI in Asia: supply-chain beneficiaries and China’s hardware shift

- AI investment is broadening from the digital to the physical layer. Rising hyperscaler capex requires not only chips, but memory, semiconductor equipment, data centres, power infrastructure, electronic components and upstream materials, areas where Asian markets have significant exposure. These physical enablers can benefit relatively early in the AI investment cycle as demand for compute capacity and supporting infrastructure expands.
- Asia’s exposure spans distinct parts of the AI supply chain rather than a single technology trade. Taiwan is concentrated in leading-edge foundry manufacturing, advanced packaging and AI servers; Korea in memory chips, particularly HBM; Japan in semiconductor equipment and specialty materials; and China increasingly in data centres, power infrastructure and domestic semiconductor development. YTD performance has been strongest in semiconductors and related equipment, consistent with rising AI capex.
- Tech self-reliance is accelerating China’s push into strategic industries, with semiconductors and high-end chips a key focus. While China’s technology industry remains software-dominated, hardware exposure has increased materially from 7% to around 22% since the end of 2024. Market performance has been consistent with the push towards chip-making localisation: hardware (+104%) outperformed software (-11.7%) from December 2024 to September 2026 and returned +26.8% YTD, in USD terms, compared with software YTD returns of -30%.
- CXMT provides a case study of how China’s tech self-reliance strategy is translating from policy ambition into industrial and capital-market scale. Strategic support for semiconductors and high-end chips has helped build domestic DRAM capacity and reduce reliance on overseas supply. CXMT’s growing commercial scale and reported profitability in conventional memory point to improving competitiveness, while its July IPO illustrates how domestic capital markets can support further capacity expansion, technology upgrades and R&D.

Asia’s physical AI opportunity extends across markets, with semiconductor returns reaching 73% in Taiwan, 191% in Korea and 138% in Japan YTD. APAC equipment-related equities and specialty chemicals outperformed their All-World counterparts.

YTD total return (USD)		Taiwan	Korea	Japan	China	Thailand	Malaysia	HK	India	Singapore	APAC	All-World
Technology	Semiconductors	73%	191%	138%	16%						88%	52%
	Electronic Components	87%	256%	110%	29%	40%		1%	-18%	13%	94%	63%
	Production Technology Equipment	132%	115%	67%	66%			107%			75%	77%
	Computer Hardware	59%	-25%	1%	33%			275%			52%	35%
Telecom	Telecommunications Equipment	45%	139%		-17%			-11%			103%	71%
Industrials	Electronic Equipment: Gauges and Meters	174%		34%	-11%						45%	31%
	Electronic Equipment: Other	-16%			-14%						-19%	16%
Basic Materials	Chemicals: Diversified	253%	-1%	32%	14%	124%	17%		1%		41%	21%
	Aluminum				-26%		5%		1%		-12%	-8%
	General Mining				-16%				-59%		30%	26%
	Nonferrous Metals		-13%	55%	-16%				-12%		14%	15%
	Copper				-10%			-2%			-1%	27%
Energy	Renewable Energy Equipment		41%		-31%				-26%		-25%	1%
Utilities	Conventional Electricity		-31%	13%	11%	35%	-2%	13%	1%		6%	-1%
	Multi-utilities				-14%		48%	17%		11%	12%	3%
	Alternative Electricity				5%				2%		2%	13%

China’s technology industry remains software-dominated, but hardware exposure has risen materially from 7% to around 22% since the end of 2024.

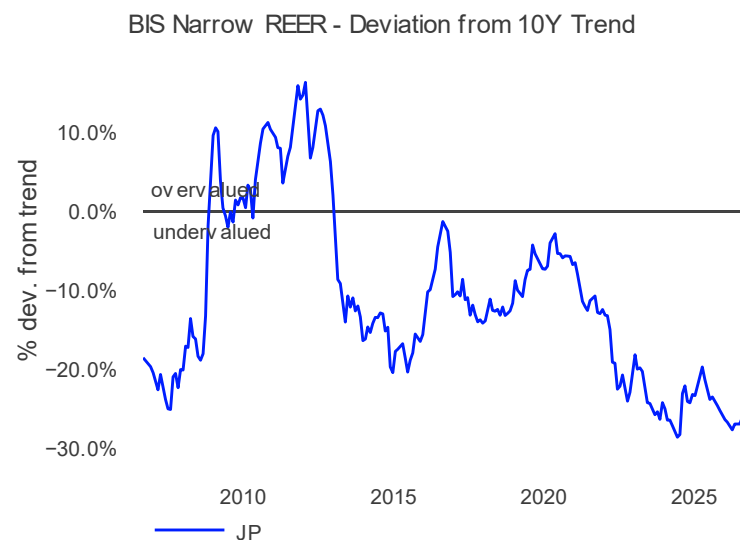


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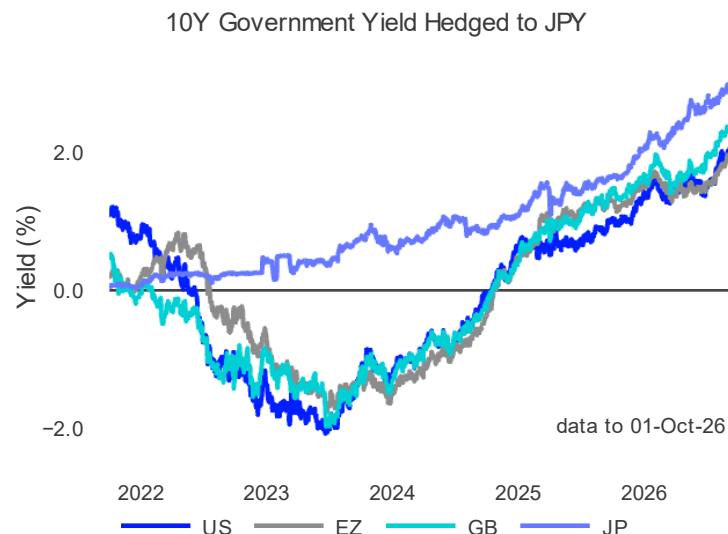
a. Global implications of Japanese yen intervention

- At the end of July, Japanese and US authorities engaged in a coordinated FX intervention which led to a sharp appreciation in the yen, equivalent to a five-standard-deviation move based on the past 10 years. The yen is the third-most-traded currency over-the-counter globally (BIS, 2025), meaning it is too deep for continuous intervention – but what they did was to weaponize volatility.
- Fundamentally the yen is battling two opposing forces. Expansionary fiscal policy and relative interest rate differentials would typically augur for depreciation in the yen; extremely cheap valuations and government intervention are pushing the yen stronger. Volatility in the yen has increased and it is important for investors to have an explicit view on the direction of the currency.
- A weakening yen would continue to favour holding hedged Japanese positions - over 12M, the FTSE Japan 100% Hedged Index has outperformed the FTSE Japan Index by c. 12ppts, returning 37.6% versus 25.6% in USD.
- A stronger yen has wider implications for global markets. Increased yen volatility could lead to an unwinding of the yen carry trade or repatriation of Japanese foreign direct investment. This may reduce demand for higher-yielding assets and push yields up on G7 government bonds and credits, putting pressure on EM and growth equity.

JPY is extremely undervalued on a cross-section of valuation metrics like Purchasing Power Parity (PPP) or Real Effective Exchange Rates (REER).



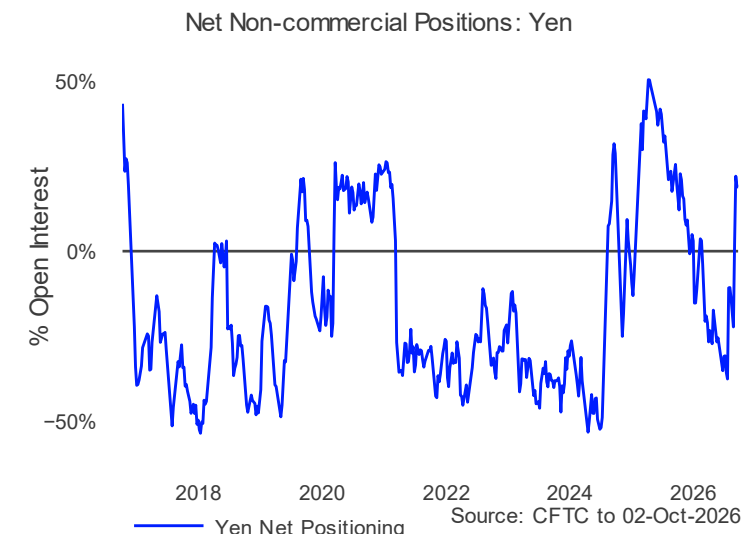
For a Japanese domestic investor, JGB yields are above G7 peers when hedged back to yen, which may encourage repatriation of capital to Japan.



b. Could Japanese investors repatriate capital?

- On a hedged basis, JGBs have a more attractive yield than G7 peers. The gap first opened in 2022 but Japanese investors resisted repatriation because the weakening yen still meant they were better off holding offshore bonds unhedged.
- A change in currency regime could trigger repatriation. The Government Pension Investment Fund (GPIF) Q2 asset allocation showed the fund was overweight domestic bonds and equities in its portfolio.
- Speculative futures positioning has turned net positive on the yen, implying traders are betting on appreciation. Typically, the net speculative positioning is negative, indicative of the synthetic funding of yen carry trades.

Typically open interest in yen futures is net short, consistent with synthetic carry trade funding. But currently traders are net long, betting on appreciation.

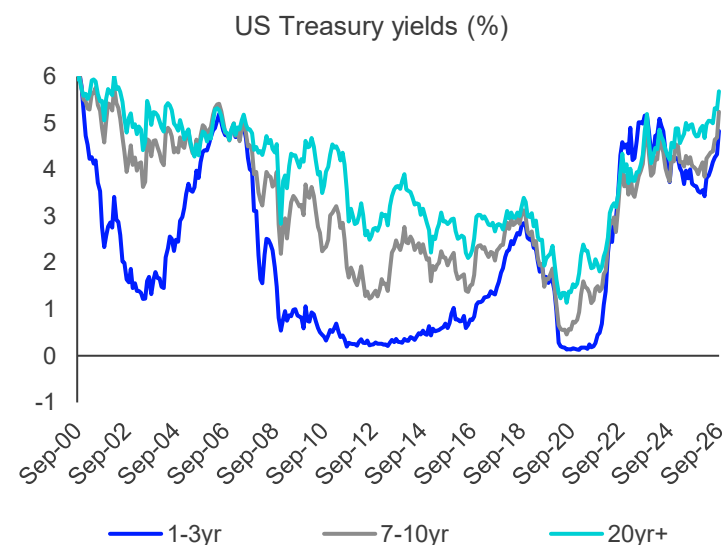


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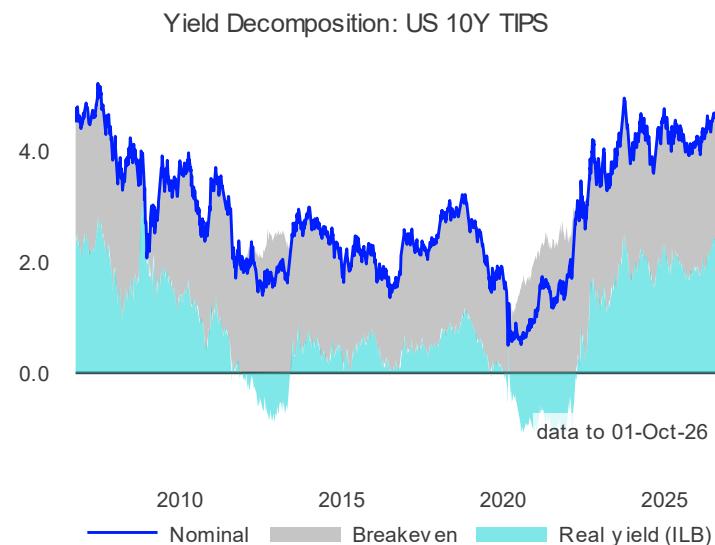
a. What is driving the long end of Treasury curve

- US Treasury yields have normalised to a structurally higher post-Covid regime, with yields rising sharply across the curve in September and longer-dated yields reaching post-GFC highs (7-10Y yields at 5.2%, 20Y+ yields at 5.7%). This marks a significant departure from the exceptionally low-rate environment that followed the GFC.
- The rise in 7-10Y Treasury yields in 2026 YTD has been driven more by real yields (+104 bps) than inflation expectations (+16 bps), reinforcing the shift towards higher real rates. The repricing reflects broader structural changes in the interest-rate environment rather than simply a reassessment of the inflation outlook.
- Stronger investment and financing demand may be lifting equilibrium real rates. Wider fiscal deficits and investment in AI, infrastructure, defence and the energy transition may shift the savings-investment balance towards greater demand for capital; stronger productivity expectations could also support higher real rates.
- Higher Treasury supply and greater rate uncertainty are rebuilding the term premium. Fiscal expansion, larger government borrowing and the unwind of QE may require greater compensation for holding duration, putting persistent upward pressure on longer yields.

Treasury yields surged across the curve in September, pushing longer yields to post-GFC highs and reinforcing the shift to a higher-yield regime.



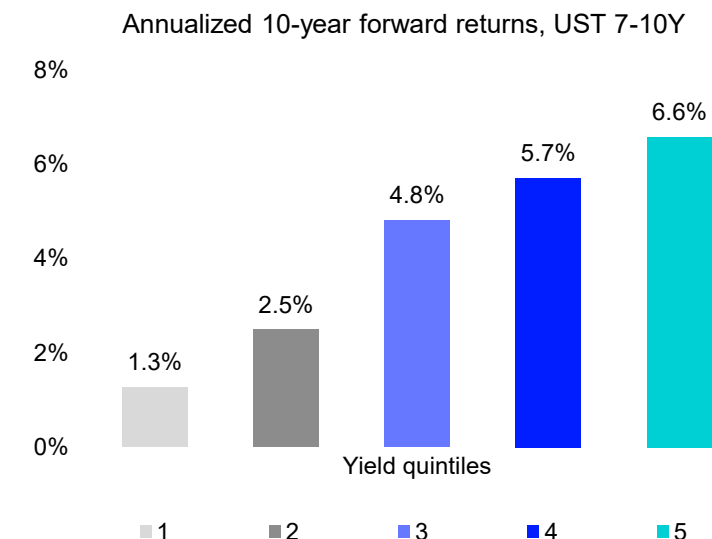
Decomposing the US 10Y yield into real yields and inflation expectations shows how the YTD rise in longer yields has primarily been driven by real borrowing costs.



b. Implications for future returns*

- Higher starting yields have historically been associated with higher subsequent Treasury returns, based on FTSE US Treasury index data since 2000.
- The relationship is strongest when bond maturity broadly matches the investment horizon, i.e., the highest correlations of 7-10Y index starting yields are with 10Y forward returns, as short-term duration effects diminish over time.
- Over longer horizons, carry and roll-down become increasingly important as duration effects tend to diminish over time as yields mean revert; higher starting yields can therefore support returns over a longer horizon even during some rising-yield regimes.

Since 2000, higher starting-yield quintiles (Q5) have been associated with higher average subsequent returns (6.6%), while Q1 has the lowest (1.3%).

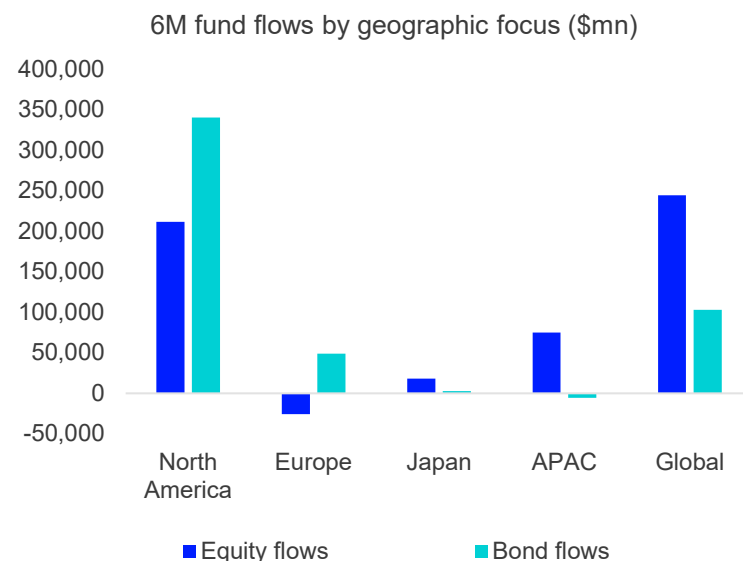


Source: FTSE Russell/LSEG. [*What a carry-on: starting yields as a valuation tool for sovereign bonds | LSEG](#). All data as of September 30, 2026 unless otherwise stated. Past performance is no guarantee of future results. All returns are in USD unless noted otherwise. This report should not be considered "research" for the purposes of MIFID II. Please see the end for important legal disclosures. Results in this report are for research / illustrative purposes and do not represent the official performance of the indices.

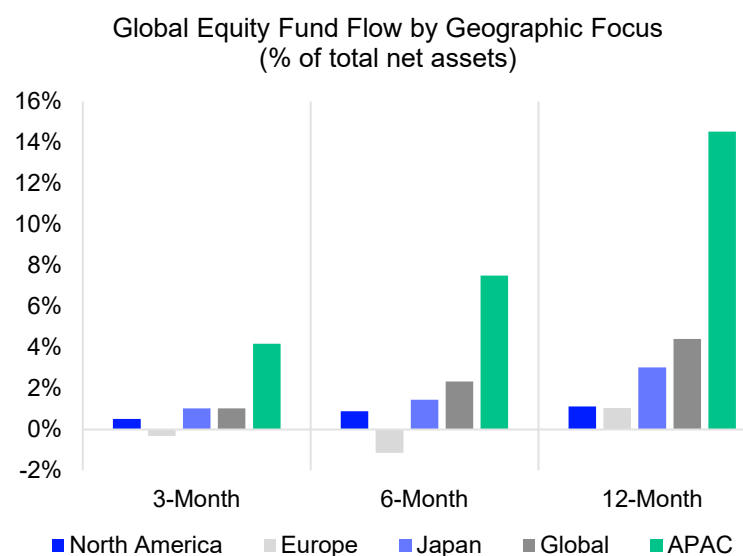
Fund flows: a barbell between growth and fixed income, with selective equity allocation

- Global fund flows (by August 31, 2026) show the coexistence of growth-seeking and defensive flows. Over the past six months, investors have added to both equities and bonds, with especially strong bond inflows in North America and continued equity demand in North America and globally. Instead of a straightforward risk-on/risk-off rotation, investors are maintaining participation in risk assets (technology, AI-related growth) while also taking advantage of relatively attractive fixed-income yields.
- Equity flows were highly differentiated by geography. North American equities continued to attract inflows, while Europe moved into outflows over 6M despite remaining positive over the longer 12M period. This US/Europe reversal likely reflected concerns about the potential re-escalation in the Middle East and its strong inflationary impact on oil-importing Europe. APAC stood out with substantially stronger inflows relative to total net assets, reaching around 7% over 6M and 14% over 12M.
- Strong APAC aggregate flows mask considerable dispersion across individual markets. Allocations remain selective, with markets such as Taiwan, Korea, Japan and India attracting stronger interest, while China saw weaker equity flows. This suggests investors differentiate within Asia based on earnings drivers and domestic fundamentals rather than treating the region as a single allocation. In fixed income, however, China stands out, attracting around \$171 billion over 6M and far exceeding other APAC markets.
- US fixed income is the other side of the barbell. IG corporates and government bonds recorded the strongest inflows, while high yield saw modest 12M inflows and turned negative over 6M. Strong demand for higher-quality bonds has helped absorb heavy IG issuance, allowing investors to capture attractive yields without moving further down the credit spectrum or taking additional equity risk.

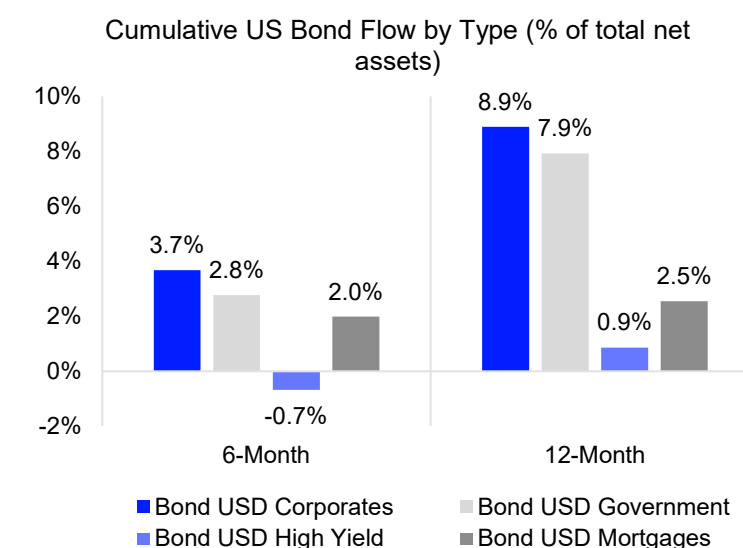
Recent 6M and 3M fund flows reveal a barbell between growth (US, APAC and global equities, technology stocks) and defensive assets (US bonds).



US equities continued to attract inflows over 6M, while Europe reversed its 1Y trend with outflows. Asian flows remained notably strong but selective.



USD bond demand remained strong, led by IG corporates and government bonds, as attractive yields drew investors despite heavy IG supply.

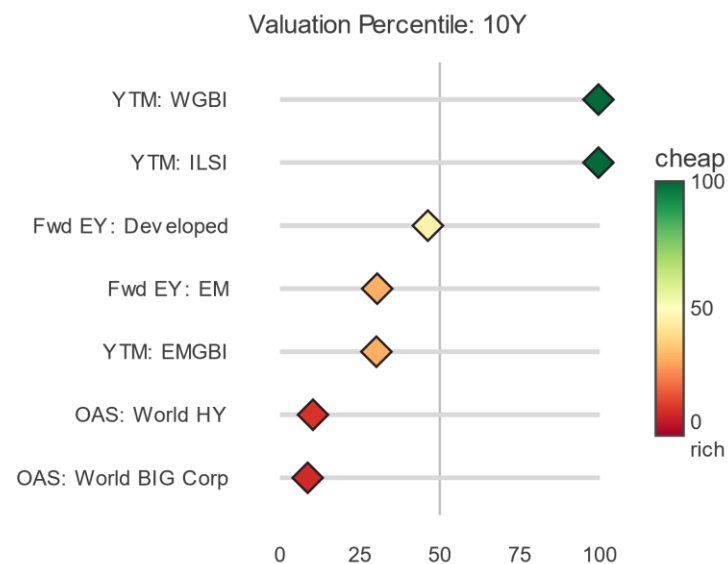


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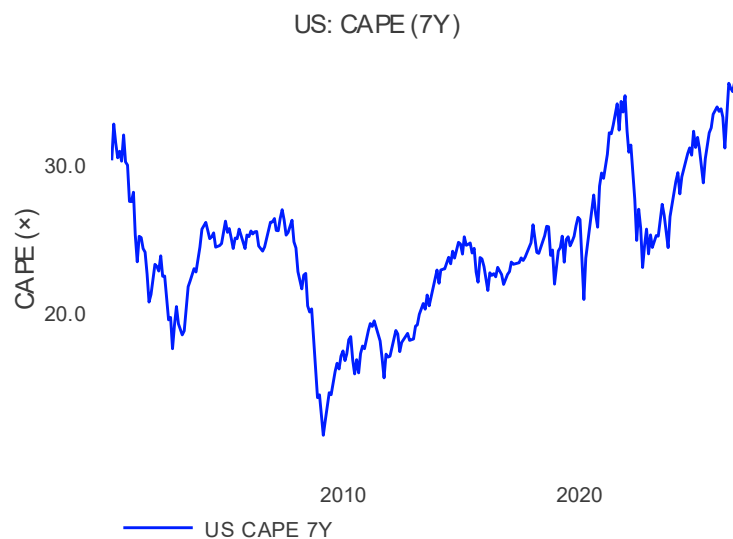
a. Where are investors being compensated for risk?

- Considering yield-based measures relative to an asset class's own history: nominal and inflation-linked government bonds look cheap, developed market equities are close to long-term trends and credit is extremely rich.
- Nominal bond yields in most of the G7 are at post-GFC highs; 10Y JGB yields are the highest they have been since 1996, which as we note on page six is primarily a function of wider real yields, making the yields on inflation-linked bonds also attractive on a historical basis. Are investors being compensated? In *What a carry-on*, we show how starting yields are highly correlated to prospective returns, so the question of attractiveness is dependent on time horizon.
- Credit valuations are tight. The all-in yields continue to appear attractive but that is primarily because of sovereign yields, whilst the spreads, or the risk premium on top of risk-free rate, are close to decade tights in Investment Grade (14th percentile) and still expensive in High Yield (25th percentile).
- Credit faces an additional risk from material issuance related to AI enablement. As of August 2026, debt issuance from hyperscalers has increased to 11.8% of USD IG issuance from 1.7% in 2024. Currently there is no evidence of the market being unable to absorb additional issuance, but the additional supply is a potential headwind for the asset class.

Looking at asset-class yields relative to their own 10Y history, government bonds look cheap, credit looks expensive and equities are close to trend.



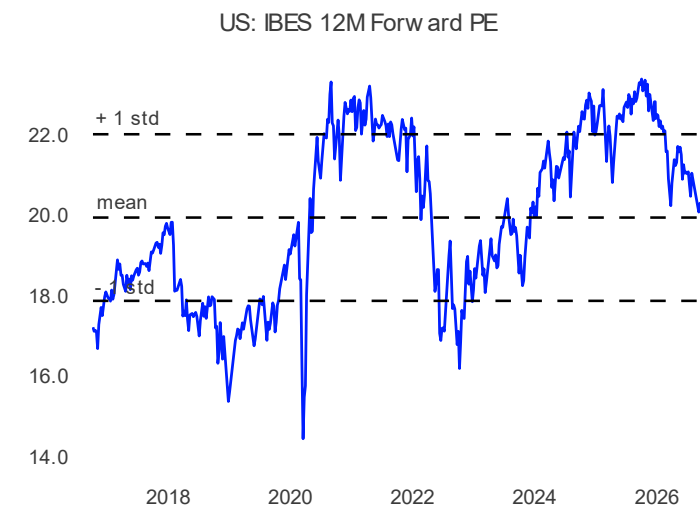
Cyclically adjusted price earnings (7Y average with a CPI deflator) for the FTSE USA is now more expensive than during the dot-com bubble.



b. How are equities rich & cheap simultaneously?

- The forward PE ratio for Developed markets is c. 15.9x and close to its 10-year trend, with the FTSE USA at the 54th percentile. Typically, equity valuations aren't a signal unless at extremes.
- However, the CAPE ratio tells a different story, and on a cyclically adjusted basis the FTSE USA is now more expensive than during the dot-com bubble.
- The answer is that forward earnings expectations are doing the heavy lifting. EPS upgrades have been very strong, anticipating good economic growth and tailwinds from AI.
- Whether equities are cheap or expensive ultimately depends on investors' conviction that earnings expectations will be realised.

The Forward PE ratio for Developed markets has de-rated substantially, from c. the 90th percentile in Q4 2025 to around the 53rd percentile now.



Appendix: List of indices used in report

Name	Mnemonic/Code	Name	Mnemonic/Code
US Treasury 1-3yr	US_TSY1-3	FTSE Emerging Index	AWALLE
US Treasury 7-10yr	US_TSY7-10	FTSE Developed Index	AWD
US Treasury 20yr+	US_TSY20+	FTSE Japan	WIJPN
FTSE World Government Bond Index	WGBI	FTSE China	WICHN
FTSE World Inflation-Linked Securities Index	ILSI	FTSE Korea	WIKOR
FTSE Emerging Markets Government Bond Index	EMGBI	FTSE Taiwan	WITWN
FTSE World Broad Investment-Grade Bond Index	WBIG	FTSE Thailand	WITHA
World Broad Investment-Grade Bond Index Corporate	WBIG_CORP	FTSE Malaysia	WIMAL
US Broad Investment-Grade Bond Index Corporate	BIG_CORP	FTSE Hong Kong	WIHKG
USBIG – Corp Industrial	BIG_INDU	FTSE India	WIIND
FTSE World High-Yield Bond Index	WHYM	FTSE Singapore	WISGP
		FTSE Asia Pacific	AWPACS
		FTSE All-World	AWORLDS

For more details regarding Index Construction for these and related FTSE Russell indices, and for ETFs and Mutual Funds linked to these FTSE Russell Indices, please reach out to your FTSE Russell Sales contact.

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