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Prescient

INVESTMENT MANAGEMENT



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Higher yields, harder choices: navigating the global bond turbulence

A NOTE FROM OUR CEO

by CHEREE DYERS
Chief Executive Officer

Higher bond yields are creating fresh income opportunities, while demanding a closer look at risk and what each portfolio needs to achieve.

Bond markets are no longer the calmer corner of the portfolio. In the third quarter, they became the main event, and that matters for investors because their movements shape financing costs, the economic growth outlook, and the choices available to investors. Whether an infrastructure project proceeds or a business can afford to expand depends, in part, on the price of borrowing.

Income is back, at a price

Not long ago, exceptionally low interest rates across major developed economies made borrowing cheap and meaningful investment income hard to find. Investors often had to accept more risk to earn the returns they needed. The third quarter showed how different the picture now looks. Official US Treasury data show that the 10-year government bond yield rose from 4.44% at the end of June to 5.29% at the end of September, an increase of 85 basis points. The 30-year yield climbed from 4.91% to 5.64%.

Higher yields increase the income available for distribution on new investments. Falling bond prices, however, have hurt existing portfolios, and the adjustment has been painful for those holding bonds issued at lower yields. That brings us to an important question: how much risk do we now need to take to achieve our goals? More attractive income from quality bonds gives investors an opportunity to reconsider the balance between income and growth, and to ask whether additional risk elsewhere in a portfolio is adequately rewarded.

A lower-inflation anchor at home

In South Africa, another change deserves attention. The inflation target adopted in November 2025 is 3%, with a tolerance band of one percentage point on either side, replacing the previous 3% to 6% range. If achieved and sustained, this should change how we think about investment returns. Investors accustomed to higher nominal yields may need to recalibrate: earning less in percentage terms can still leave them better off if inflation takes a smaller share.

Over time, lower inflation could also support lower nominal financing costs and foster greater confidence in long-term investment decisions. But the transition will not be smooth simply because the target has changed. South Africa remains exposed to global energy prices, currency movements and international financing conditions. A structural improvement at home can coexist with considerable market volatility.

Growth is not the same as comfort

The US economy shows why the outlook remains hard to read. The Federal Reserve's Beige Book, released on 2 September, reported growth in ten of its twelve districts and the sentiment is re-iterated in the latest release on 14 October. Yet overall employment rose only slightly, and businesses continued to face elevated input costs. Some were also finding it harder to pass those costs on to increasingly price-sensitive customers.

Continuing growth does not mean everyone is comfortable. Strong investment spending can sit alongside stretched household budgets and pressure on company margins. Inflation may remain persistent even as parts of the economy weaken, complicating interest-rate decisions and the outlook for both bonds and equities.

Judgement over prediction

> For advisers and allocators, the response must go beyond predicting the next central bank move. Higher bond yields raise the hurdle for other investments. Equities still offer long-term growth potential, but valuations and earnings resilience matter more when investors have competitive income alternatives. Within fixed income, the additional yield must justify the interest rate, credit and liquidity risks being accepted.

And the client's circumstances will remain the deciding factor. An investor funding near-term withdrawals has different choices from a pension fund meeting liabilities decades ahead. Attractive income is useful only when the investment also fits the time horizon and capacity for loss.

> This is where we believe investment managers must add value. Clients need help interpreting conflicting evidence, understanding why an allocation makes sense, what could undermine it, and how it supports their objectives. At Prescient, our evidence-based approach means we must make those trade-offs clear.

In this edition of On Point, our teams examine the risks and opportunities emerging from the global bond sell-off. We believe higher yields warrant a fresh assessment of portfolios. Recent losses can obscure improving opportunities, while attractive headline income can obscure risk. The judgement lies in recognising both, and in putting capital to work where the potential reward serves the client's needs.





Calm equities, loud bonds

A LOOKBACK ON THE PAST QUARTER

by BASTIAN TEICHGREEBER
Chief Investment Officer

Equity markets remained calm as bonds sold off sharply, revealing a widening gap in how markets price risk and opportunity.

The VIX sat near 16 for most of September and closed the quarter at 16.3, which again describes a quiet market. The bond market was anything but. The MOVE index, the bond market's version of the VIX, rose about 35% in September and closed above 100. The ten-year US Treasury yield went from around 4.44% at the end of June to 5.29% on 30 September, its highest close since 2007, and the thirty-year reached levels last seen in 2004. Brent went from $72 a barrel on 1 July to $109 in mid-September as the Middle East conflict returned to the oil price. Equity index volatility barely registered any of it. The gap between what the volatility indices say and what prices actually do is the complacency signal we flagged in June, and in the third quarter it widened rather than closed.

Equities looked through the noise. The S&P 500 returned 2.3% for the quarter and set a record high in August, the MSCI All Country World Index returned around 1.6%, and emerging markets gave back 0.2% in dollars after the semiconductor-led rally of the first half paused in July. Beneath the US headline the market was narrower, with the Russell 2000 down about 7%. As in the second quarter, it was earnings doing the work. Third-quarter S&P 500 earnings growth is tracking around 29%, and the forward multiple ended September at 19.0 times against a five-year average of 19.8. The market got cheaper while it rose.

On 16 September, at Kevin Warsh's third meeting as Chair, the FOMC raised the target range by 25 basis points to 3.75% to 4.00%. The vote was 12 to 0 and it was the first hike since 2023. The driver was not the oil price. It was a US economy that strengthened against most expectations: second-quarter growth was revised up to 2.2% annualised, the first quarter to 2.5%, the September flash composite PMI reached a five-year high, and Warsh's own summary was that the economy is strengthening. An economy that keeps growing through a supply shock and restrictive policy is telling you it needs higher real rates for longer, and that is what a unanimous committee acted on. In June we said the market had very lightly priced a change in monetary regime. It has now priced it, and then some: at quarter-end money markets were pricing roughly three further hikes over the next nine months, against the committee's own median of one more this year. We expect the Fed to deliver less than the market has priced, perhaps one more hike, because September already closed most of the gap between the policy rate and what the growth data require.

> It is the long end of the curve where we think consensus has the story wrong. The common reading is that a ten-year yield above 5% is the bond market worrying about fiscal deficits and the financing of the AI build-out. If that were the driver we would see it in the inflation risk premium, and we do not. The five-year, five-year forward inflation expectation, the cleanest market measure of long-run inflation, was 2.36% on 30 September, essentially where it stood in June, and ten-year breakevens held near 2.4% through the sell-off. The nominal ten-year rose about 85 basis points in the quarter and almost all of it was real yield. That is the market repricing the real rate the US economy can bear, not the market losing confidence in US paper. It also means that, despite the headlines, investors are not pricing the Iranian crisis as a source of higher inflation for longer. Long-term expectations stayed anchored through a quarter in which US headline CPI rose back to 3.7%. Term premium has returned, but it is a real-rate premium, and that is a very different thing to own than a fiscal one.

Index concentration drew more commentary than any other topic this quarter, so it is worth setting out where we stand, because it is not where most of the commentary stands. The ten largest stocks were roughly 39% of the S&P 500 at the end of September, against 22.8% in September 2019, and the largest single name was above 8% of the index. The MSCI Emerging Markets Index is more extreme, with its three largest stocks, all semiconductor companies, at 29.1% of the index at the end of September. The common reading is that this is a warning in itself. Our reading is that concentration is a description, not a signal. The largest-weight episodes of the past fifty years, the Nifty Fifty, Japan in the 1980s, the Magnificent

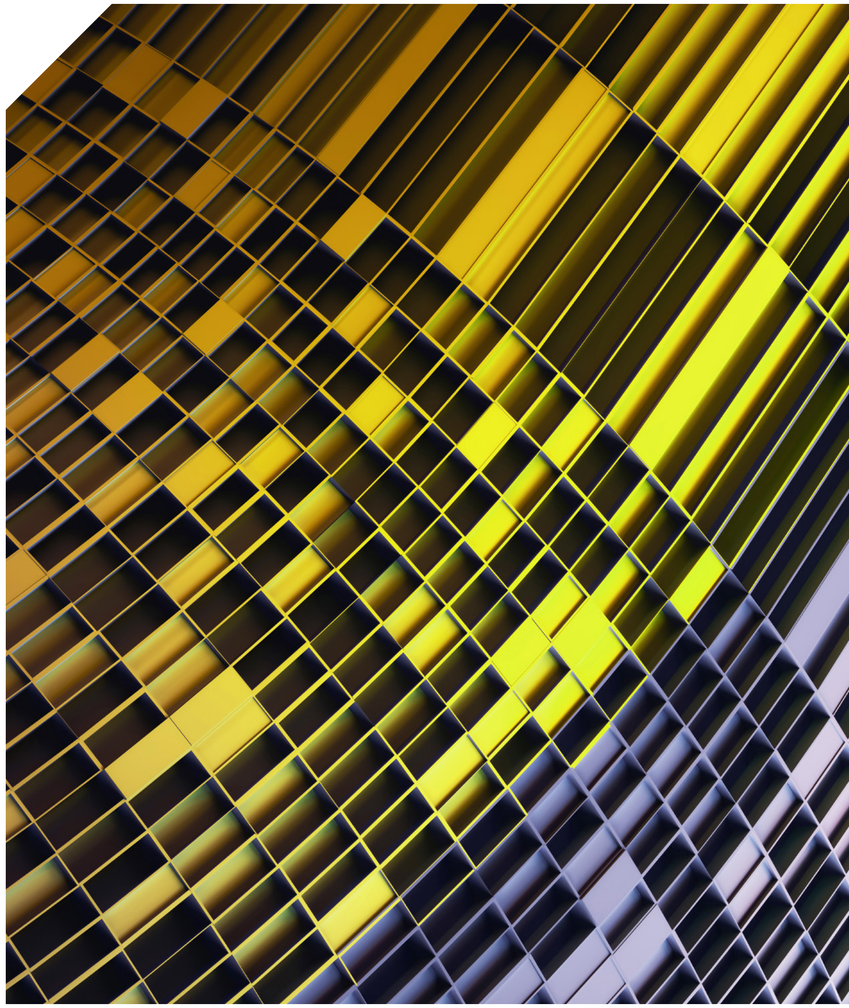
Seven from 2015, all rewarded index holders for years before they reversed. What separates the episodes that end badly is whether earnings carry the weight or positioning does. The third quarter gave us both cases: in the US the top of the index delivered the earnings and the multiple did not expand; in Korea, where two memory stocks are more than half the index, the earnings revisions paused in July and the crowd left in two days. We trimmed that crowd last quarter on positioning data, not on index weight. Our enhanced indexation and portable alpha structures exist precisely so that we can own the benchmark's concentration where earnings justify it and take active risk somewhere else.

South Africa was again a bad headline on top of a better quarter. The Capped All Share lost 0.3% for the quarter and is down 3.1% for the year, with the JSE Resources index up 16.6% and the JSE Industrial index down 10.4%, the widest dispersion we have seen in some time. GDP contracted 0.2% in the second quarter after six quarters of growth, and the SARB cut its 2026 growth forecast to 1.2%. Set against that, the All Bond Index lost only 0.7% in a quarter where the FTSE World Government Bond Index lost 2.4% in rand and US Treasuries fell sharply, and the rand closed at R16.42 against the dollar, almost exactly where it started the quarter at R16.39. The Reserve Bank itself noted in September that South Africa's macro fundamentals have become a differentiating factor that helped protect it from the global bond sell-off. We agree. With all three rating agencies at BB or Ba2 and two on positive outlook, the local market is being paid a real yield for a credit that is improving.

On inflation we said in June that the 5.0% print was the peak rather than the trend. So far it has been. Headline CPI fell to 4.3% in July and 4.4% in August, fuel inflation came down from 34.3% in June to 20.0%, and food inflation is at its lowest since 2010. The SARB held at 7.0% in July and then raised by 25 basis points to 7.25% on 23 September, unanimously, citing fuel and elevated services inflation. We read the hike as insurance against second-round effects rather than a response to the data in hand. The Bank's own model has the repo rate broadly stable through year-end and cutting later, and its forecast has headline inflation above 5% around the turn of the year before returning to around 3% by the end of 2027, with the overshoot attributed to fuel rather than core. The energy base effect we described in June is running the other way for a few months. The reversal is delayed, not cancelled, and the real yield on South African bonds remains among the highest in any market we track.

> On our own calls: the front end of the local curve did what we said it would. For the fourth quarter we are positioned as always in line with our systematic framework. Where equity volatility is priced for calm and rate volatility is not, we would rather own protection than assume the gap closes in equities' favour. Where prices moved without the facts changing, which still describes domestic-facing South African shares and local bonds, we hold our additions. Where the US curve now pays a real-rate premium with inflation expectations anchored, we see value returning to US duration that was not there in June. Income remains concentrated at the front of the local curve.

None of the above is a forecast for the rest of the year. It is a description of where we think the odds sit at the end of September, based on what we can measure, and we fully expect parts of it to change. The long end of the US curve and the oil price have our full attention, but the point is the same as last quarter: cut through the noise, look deeper than the headlines, and position the funds so they can benefit from where risk is mispriced.







Why multi-asset funds welcome harder choices

by RUPERT HARE
Head of Multi-Asset

and KELLY VLUG
Quantitative Analyst

Higher bond yields are broadening the opportunities for multi-asset portfolios, as equity prices build in growth expectations that economic data has yet to support.

The global bond selloff, led by the US, has had a hidden benefit for multi-asset portfolios. The theme of this quarter's Prescient on Point is Higher Yields, Harder Choices – but for a multi-asset manager, harder choices are better choices. After a decade with few real alternatives to equities, we are now spoilt for choice.

Prescient's Bonds team has decomposed the US bond market selloff and attributes the lion's share to the market pricing in higher short-term real rates, rather than higher inflation compensation (whether expected inflation or the inflation risk premium). That distinction matters for equities too, because real rates feed directly into the discount rate for both asset classes.

In the multi-asset world, our primary job is weighing asset classes up against one another. For more than a decade, the low yields on offer from global fixed income made equities the go-to asset class for return generation. The bond selloff, coupled with the headwinds now facing global equities, has shifted that trade. The S&P 500 now offers a dividend yield of only about 1%, a price that rests on the assumption that earnings will keep growing well ahead of trend for the foreseeable future. Ten-year US Treasuries, by contrast, offer 5.3%. The question is whether a 1% dividend yield and roughly 1% in share buybacks, plus whatever growth the market is banking on, is enough compensation over a 5.3% Treasury – at current prices, an equity risk premium (ERP) of only around 1–2%. The answer hinges on the shorter-term growth rate.

Investors often fall back on how they were taught at university, where equity valuation and fixed income were separate courses, and mentally ring-fence the two asset classes. In reality, the same valuation framework applies to both.

Start in fixed income, the world of relative certainty: a fixed term (say ten years) of known coupon payments and a principal repayment at maturity, each discounted back at a discount rate.

$$\text{Bond value} = \sum_{t=1}^{10} \frac{\text{Coupon}}{(1+\text{discount rate})^t} + \frac{\text{Principal}}{(1+\text{discount rate})^{10}}$$

$$\begin{aligned}\text{Discount rate}_{\text{bond}} = {} & \text{expected real short rate} \\ & + \text{expected inflation} \\ & + \text{inflation risk premium} \\ & + \text{term premium}\end{aligned}$$

Now step into equities: an indefinite stream of dividend payments (read "coupons"), a terminal value (read "principal repayment"), and assumed short- and long-term growth rates. In essence, equities are fixed income instruments with growing, uncertain coupons and no maturity, and the only additional term in the discount rate is the equity risk premium.

$$\begin{aligned}\text{Equity value} = {} & \sum_{t=1}^{10} \frac{\text{Dividend}_{t=0}\,(1+\text{growth rate})^t}{(1+\text{discount rate})^t} \\ & + \frac{\text{Dividend}_{t=0}\,(1+\text{growth rate})^{10}\,(1+\text{trend growth})}{\text{discount rate} - \text{trend growth}} \\ & \qquad\qquad (1+\text{discount rate})^{10}\end{aligned}$$

$$\begin{aligned}\text{Discount rate}_{\text{equity}} = {} & \text{expected real short rate} \\ & + \text{expected inflation} \\ & + \text{inflation risk premium} \\ & + \text{term premium} \\ & + \text{equity risk premium}\end{aligned}$$

If the components common to both discount rates are held equal, then the fact that equities rallied 2% while bonds sold off must be explained by a change in the market's assumptions on either the ERP or the shorter-term growth rate. Had neither changed, the rise in yields alone implies that equities should have fallen by around 25%.

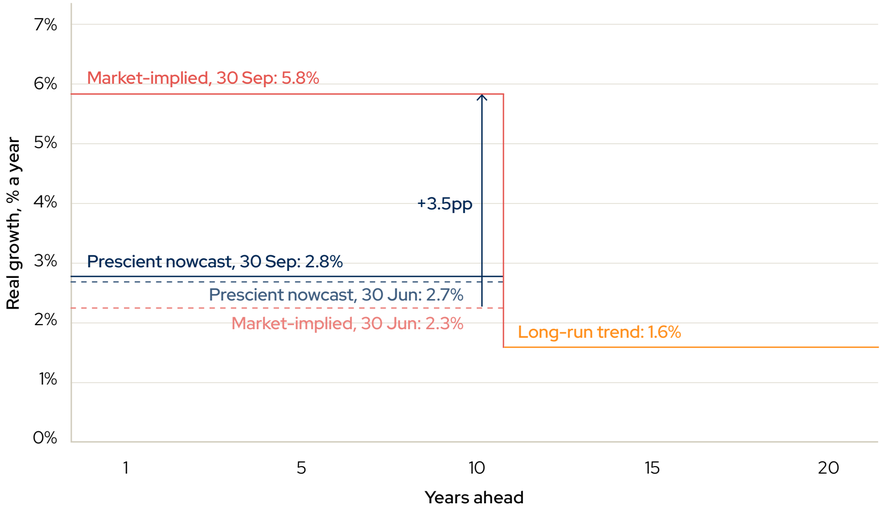
To close that gap, either expected short-term growth was revised up by roughly 3.5 percentage points a year, or the ERP was revised down by roughly 1 percentage point. To test the latter, changes in the ERP can be proxied by a combination of option-implied volatility and the high-yield credit spread. In Q3, implied volatility (the VIX) fell while the credit spread widened, so the two signals offset each other and point to no significant change in the ERP. That leaves a higher growth assumption as the only remaining driver.

What the economy is telling us

Prescient tracks real economic growth with its own GDP nowcast: a Bayesian model that reads a broad set of US economic indicators, from payrolls and retail sales to factory surveys and housing starts, and estimates growth for the current quarter.

> At the end of June, the market and our model told a similar story. Stripping out inflation expectations, which rose only marginally over the quarter, the S&P 500 was priced for real growth of about 2.3% a year over the next decade, against our current-quarter nowcast of 2.7%. Three months later, the market-implied rate had jumped to 5.8%, while our nowcast stood at 2.8%.

Figure 1. The market's growth assumption jumped; ours didn't

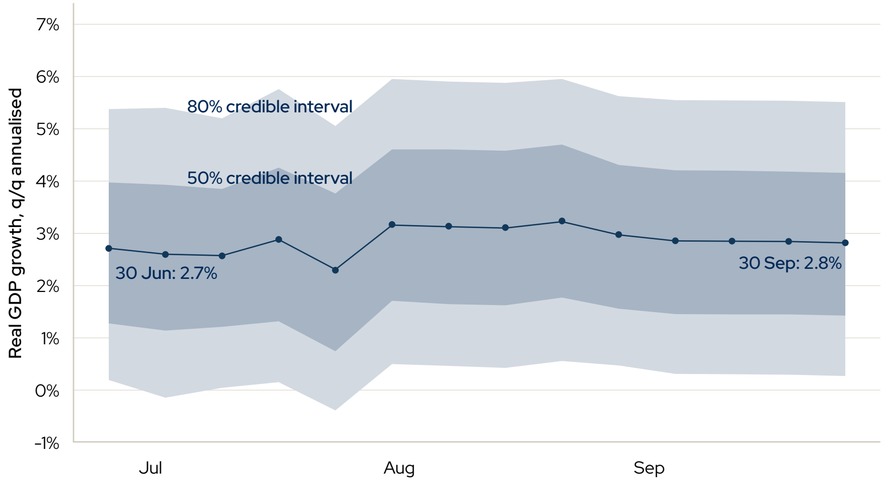


Real growth, % a year. Market: growth implied by the S&P 500 price (years 1–10, then trend), less 10-year breakeven inflation. Prescient: our nowcast for the current quarter, drawn flat for comparison only; it is not a ten-year forecast.
Source: Bloomberg, Prescient Investment Management as at 30 Sept 2026.

That is a rise of about 3.5 percentage points in the growth the market expects every year for ten years. For context, US real GDP has not grown by much more than 5% a year over any ten-year period since the Second World War.

Our nowcast updates as new data comes in. It moved during the quarter but ended close to where it started, with no sign of the acceleration the market is pricing.

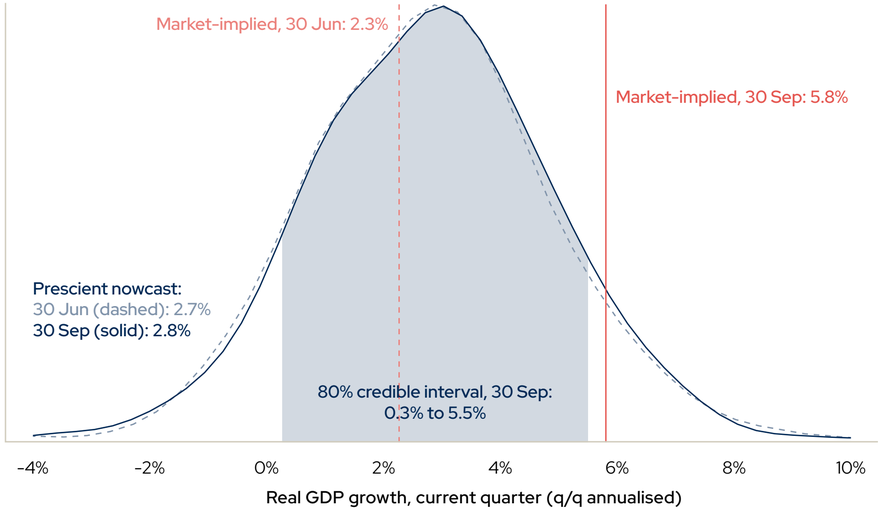
Figure 2. Our weekly nowcast through the quarter



Real GDP growth, quarter on quarter, annualised. Shaded areas show the 50% and 80% credible intervals.
Source: Bloomberg, Prescient Investment Management as at 30 Sept 2026.

Because the model is Bayesian, it produces a probability distribution for growth rather than a single point estimate, with credible intervals that show how confident it is. Our June and September distributions are almost identical, and the market's new implied growth rate sits outside our 80% credible interval (0.3% to 5.5%).

Figure 3. How confident our model is



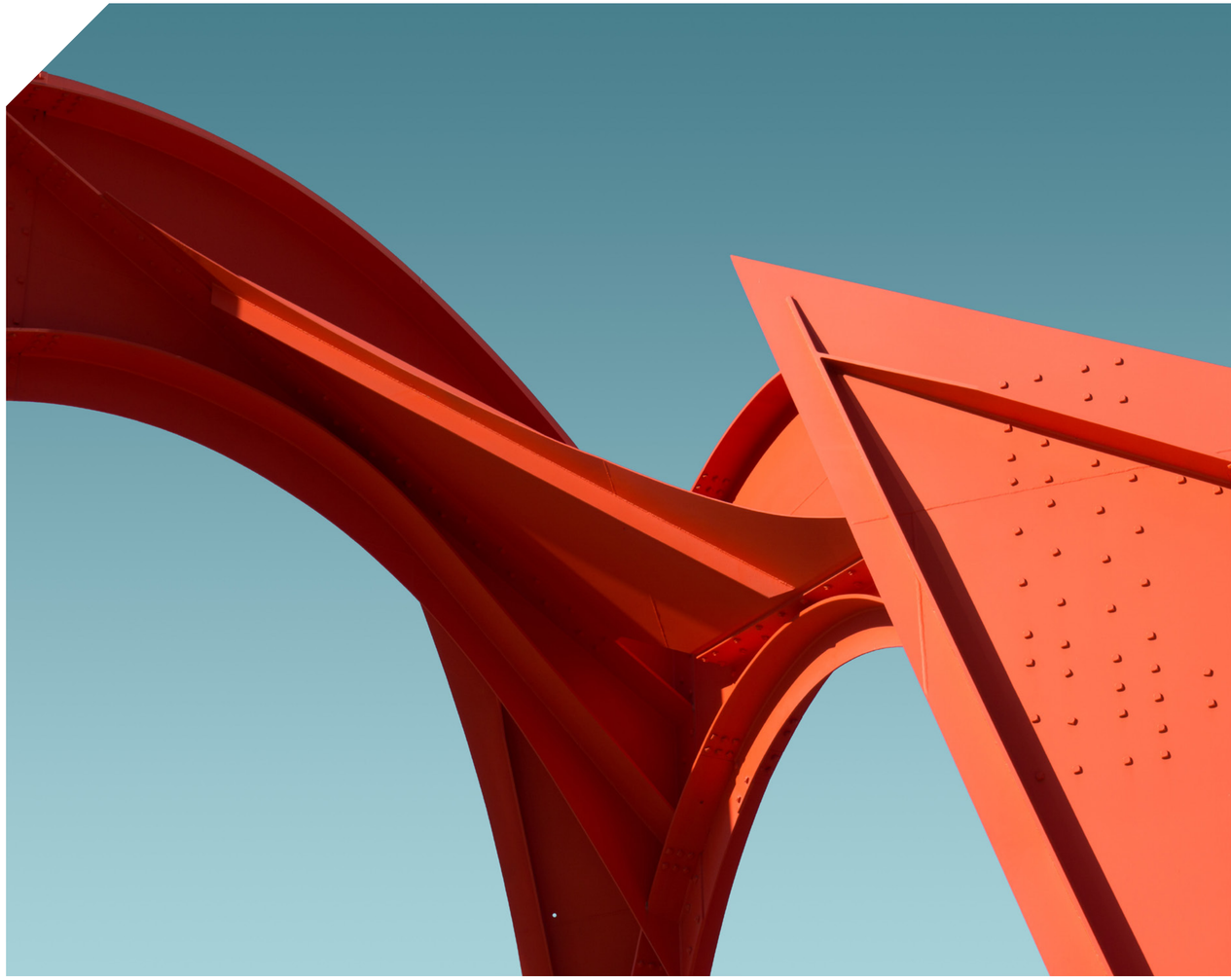
Probability distribution of our nowcast of current-quarter real GDP growth on 30 June (dashed) and 30 September (solid). Red lines: market-implied real growth.

Source: Bloomberg, Prescient Investment Management as at 30 Sept 2026.

A one-quarter nowcast is not a ten-year forecast, so this is not a like-for-like comparison. But a decade of growth at that pace would have to start somewhere, and nothing in the data we track shows it starting.

What it means for portfolios

It is no coincidence, then, that Prescient's house view has US equities firmly in negative territory and US Treasuries in positive territory. This logic, and more, drives our asset models in real time, allowing us to take advantage of market disconnects and avoid areas of heightened risk in stretched markets. Higher yields have made the choices harder, but they have also made them better.







Rising yields don't hit every equity sector the same way

by SEEISO MATLANYANE
Head of Equities

and NICHOLAS DE CLERCQ
Quantitative Analyst

Two decades of South African data reveal which equity sectors are most sensitive to rising yields, challenging some familiar investment assumptions.

Interest rates have turned. The South African Reserve Bank cut the repo rate by 1.5 percentage points between September 2024 and November 2025, then raised it in May and September this year to 7.25%. The bond market moved first: the two-year government bond yield is up more than a percentage point since February, and in September the US 10-year Treasury yield closed above 5% for the first time since 2007.

None of this makes equities unattractive. South African investors have never had a free alternative, since local bonds have paid a real return throughout the past two decades, and cash for most of it. What has changed is the direction of travel, and that much of the pressure now comes from abroad. The rules of thumb say higher rates squeeze the consumer, weigh on property and help the banks. We tested them against two decades of data, and only some survive.

Why rising yields matter

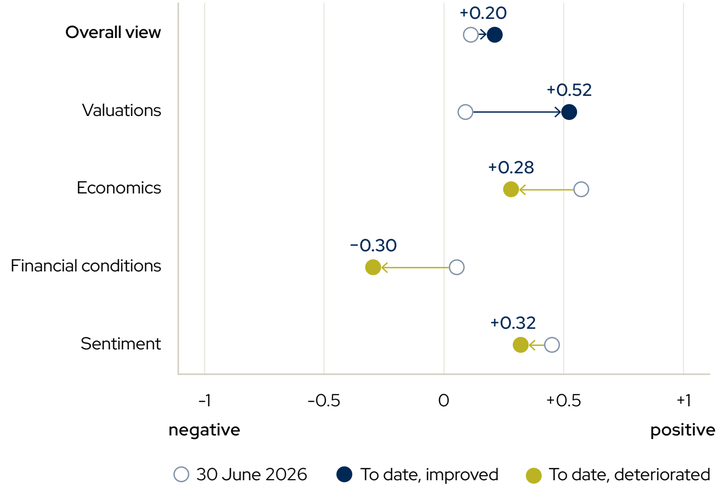
When rates climb because economies are growing strongly, equities usually cope, since earnings rise alongside them. This year's move has a different source: an energy shock, rooted in the conflict in the Middle East, that has lifted inflation while eroding real incomes. Central banks from the US Federal Reserve to the SARB have tightened, the SARB above all to stop a one-off price shock from becoming a lasting inflation problem, and at home that tightening has come while the economy shrank in the second quarter. In the US, the 10-year yield is up more than a percentage point against a single quarter-point hike, pointing to a higher term premium and heavy government borrowing.

The bar has moved, but less than it looks

On the face of it, the hurdle has risen sharply: the 10-year government bond now yields close to 9%, more than the All Share's earnings yield of about 8.2%. But earnings grow with inflation and coupons do not, so the fairer comparison is with the real yield on inflation-linked bonds, around 4.3%. That still leaves an equity premium of roughly four percentage points before any growth in earnings, even allowing for the fact that strong resource earnings flatter the All Share's earnings yield somewhat.

> Our models register the shift all the same. Their read of financial conditions moved from mildly supportive at the end of June to negative by mid-October, yet the overall view on the market improved slightly, because valuations moved far enough to compensate: dividends rose while the index went nowhere. The hurdle rises, but so does the reward for paying the right price.

Figure 1. The bar went up, and valuations moved to meet it



Prescient model view on SA equities (All Share) and its four lenses, scored from -1 to +1

Source: Prescient Investment Management sector and asset-class models. Scores are model outputs, not return forecasts.

What happens when yields jump

We measured how each of the 13 sectors in our investment process performed against the FTSE/JSE All Share Index in every month since January 2005, and isolated the 55 months, roughly one in five, in which the 10-year government bond yield rose by 0.25 percentage points or more.

> The sectors that lagged most all depend on the local economy: retailers, banks, telecommunications and local property. Retailers, by which we mean the clothing and general merchandise chains, did worst, trailing the All Share by 3.4% on average and beating it in only one month in four, and all four sectors lagged on average in each of the three periods we examined (2005 to 2012, 2013 to 2019 and 2020 to 2026).

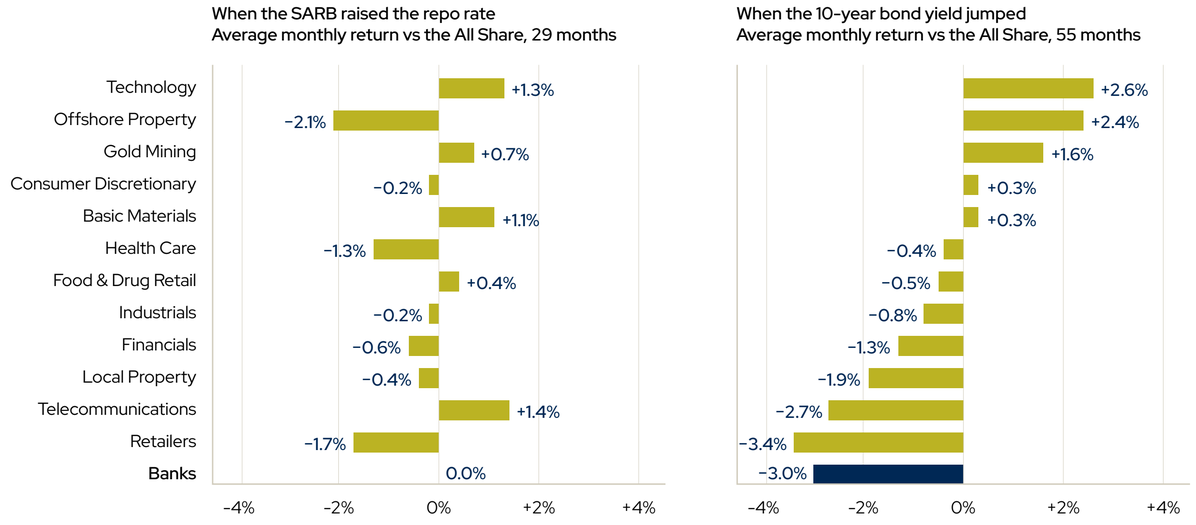
Offshore property, technology and gold miners beat the market, but less reliably. For gold miners that is largely the rand: South African yield spikes usually come with a weaker rand, and when the rand held steady, gold miners did no better than the market, while retailers and banks lagged regardless.

Banks: it matters which rate is rising

Higher rates are usually described as good news for banks, whose loans reprice with the prime rate while much of their funding pays little or no interest. Over full hiking cycles the record is mixed: banks lagged the All Share by about 40% in 2006 to 2008, beat it comfortably in 2014 to 2016 and roughly matched it in 2021 to 2023. Month to month, the picture is clearer: bank shares have tracked the 10-year yield, which reflects what investors demand for holding South African risk, far more than the repo rate. In the 21 months since 2005 when the SARB raised rates without a jump in the 10-year yield, banks beat the market by 1.9% on average; in the eight months when a hike came with a jump, they lagged every time, by 4.9% on average.

Hikes are usually expected well before they happen, whereas a jump in the 10-year yield tends to come with a broader sell-off in South African assets, and bank shares have tended to fall with it.

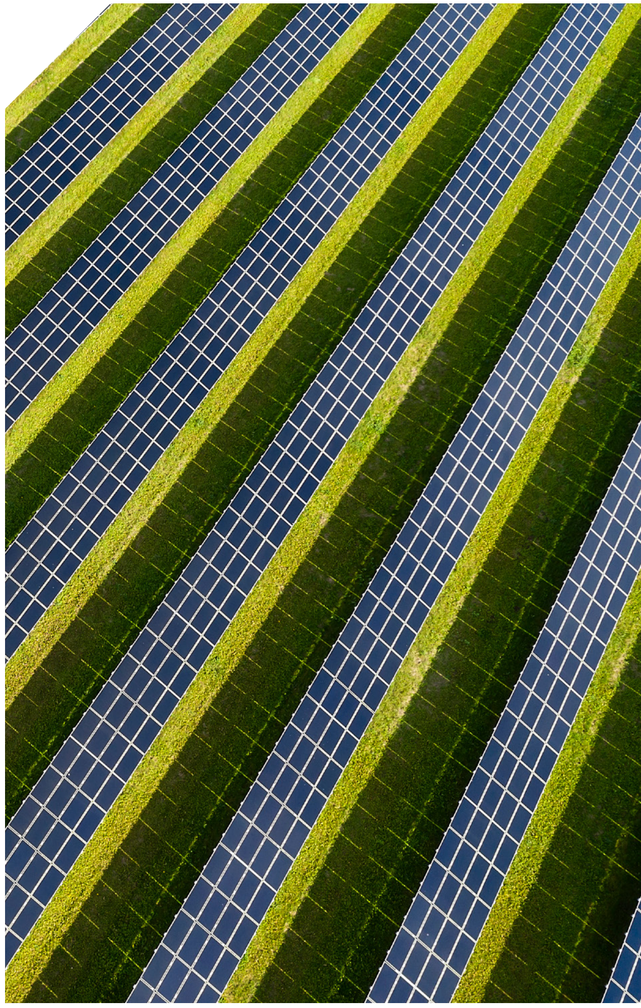
Figure 2. The banks paradox: it matters which rate is rising



Banks fared far worse when the 10-year yield jumped than when the SARB hiked. January 2005 to September 2026

Note: Retailers comprises clothing and general merchandise retailers (Mr Price, TFG, Truworths, Woolworths). Food & Drug Retail comprises food, pharmacy and consumer staples names (including Shoprite, Pick n Pay, Boxer, Clicks, Dis-Chem and Spar).

Source: Prescient Investment Management, Bloomberg (as at 6 October 2026). Total returns, Prescient sector groupings. A jump is a rise of 0.25 percentage points or more in the 10-year government bond yield over the month. Offshore Property history starts in 2015. Past performance is not necessarily indicative of future performance.



This year is different

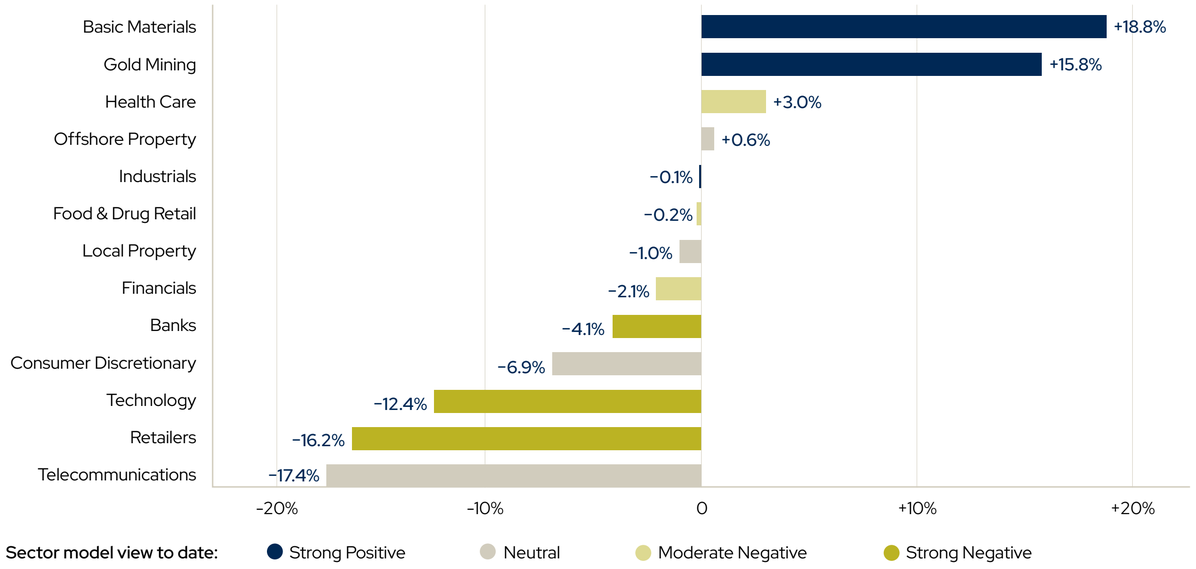
That distinction matters now, because 2026 breaks the pattern. Over the past year the two-year yield has risen while the 10-year yield has edged about a quarter of a percentage point lower, a sign that the market is pricing the SARB rather than South African risk. The rand is roughly where it started the year, and the gap between South African and US 10-year yields has narrowed by about 1.4 percentage points. So far, the pressure has been imported from US Treasuries while South Africa's own risk premium has fallen, a backdrop in which banks have historically held up. Our models' negative view on banks is in any case not about rates: on book value and sales, banks already sit near the expensive end of their history. The textbook case is in the price.

Where the models lean

The third quarter was more a commodity story than a rates story: basic materials rose 19% and gold miners almost 16%, while retailers fell 16%, technology 12% and telecommunications 17%, with the All Share roughly flat. Retailers fell mostly before the September hike, on results and the strain of fuel prices on household budgets.

Looking ahead, our sector models lean towards basic materials, gold miners and industrials, and away from banks, retailers and technology. For retailers, the quarter's fall was about earnings, but the models read forward-looking conditions, and there the bond market's reach is clearest: rate and inflation inputs drove more than half of our view on the sector over the past year, and since June it has swung from strongly positive to strongly negative. The drivers were US bond volatility, rising inflation expectations and the Federal Reserve's balance sheet, a key gauge of global liquidity, and they reach a domestic retailer through emerging-market flows, the rand and the risk premium on South African consumer shares. Retailers still screen as inexpensive, but cheap is not the same as ready. Local property is the mirror image: it has repriced enough for our models to move from strongly negative to neutral.

Figure 3. Commodity producers won the quarter; domestic consumer names lost it



Total return by sector, 30 June to 30 September 2026 (All Share −0.3%), coloured by our sector models' view to date

Source: Prescient Investment Management, Bloomberg. Total returns, Prescient sector groupings. Colour shows the current model view, not a forecast made at the start of the quarter. Past performance is not necessarily indicative of future performance.

The harder choice

History offers no single rule for which sectors suffer when yields rise. The local sectors that lagged when bond yields jumped did so in every period we examined, while the winners were less dependable, and what lies behind a move in yields matters. That is why our sector process reads valuations, economics, financial conditions and sentiment for each of the 13 sectors every day, with the weights set by the data. Four things will tell us whether the bar keeps rising: the oil price; services inflation and wage settlements at home; the term premium on US Treasuries; and the rand, read together with the gap between South African and US bond yields, which is the clearest sign of whether the pressure is imported or home-grown. The harder choice lies between the parts of the equity market that the new arithmetic punishes and those it leaves untouched, or even rewards.



Real rates, real reasons: the 2026 treasury market sell-off and its three closest precedents

by REZA ISMAIL
Head of Bonds

Three historical precedents help explain what is driving the US Treasury sell-off, which pressures could ease and which may persist.

Introduction

US Treasury bonds (treasuries) have had two periods of conspicuous weakness in 2026. The first episode, between March and May, was examined in the July 2026 edition of Prescient on Point and, upon econometric decomposition, the US yield sell-off during this period ran mainly through the real term premium, as a component of the overall 10-year nominal bond yield. The second began at the end of June - between 30 June and 30 September, which saw the 10-year yield rising 82 bps to 5.3%, its highest close since June 2007.

> The two sell-offs differ with regards their underlying drivers. The real term premium led the first sell-off; average expected short-term real rates led the second, which was essentially a repricing of the (real) central bank policy path. This component reflects what investors are pricing with regards to the conduct of monetary policy by the US Federal Reserve in respect of real rates over the next decade.

This article sets out the decomposition, explains the economics behind each component and compares the move with its three closest historical precedents: the US Federal Reserve hiking cycle of 2022, the tightening cycle of 2017-18 and the Taper Tantrum of 2013. Those precedents suggest that the late-September rise in the real term premium is the most reactive part of the 2026 move (most prone to retrace), and that the larger part, carried by average expected short-term real rates, should last for as long as core inflation (the measure of inflation that excludes the volatile food and energy components) remains elevated.

Four components

Conceptually, the yield on a 10-year nominal bond can be split into four parts:

10-year nominal yield =

Average expected short-term real rates + Real term premium + Average expected inflation + Inflation risk premium

Average expected short-term real rates and average expected inflation are both measured over the bond's 10-year life, and together they make up average expected short-term nominal rates.

The two remaining premia are the extra compensation investors demand for bearing risk:

The real term premium is the extra return investors demand for holding a long-dated real bond rather than rolling over a series of shorter-term ones. What determines its value is not only how much the bond's price can move but, above all, when its yield tends to change. A bond that gains value (yield compression) in "bad times", when jobs and profits are falling and every extra dollar matters most, works like insurance, and investors will hold it for little or no premium, or even a negative one. In contrast, a bond that loses value (yield sells-off) in "bad times" adds to losses exactly when they hurt most, and investors therefore demand compensation to be paid for holding it.

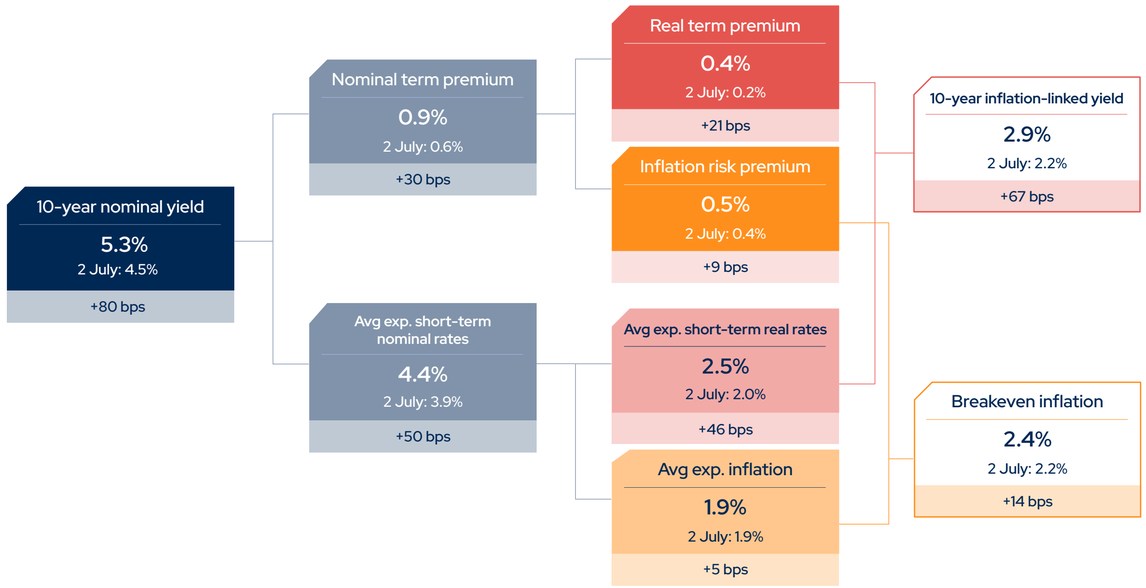
The inflation risk premium applies the same logic to inflation: it is the yield compensation for the risk that inflation surprises on the upside in weak states of the economy. A nominal bond pays a fixed amount of dollars, so inflation above what was expected erodes what those payments will buy. If inflation tends to rise in "bad times", as it does after an oil or other supply shock that lifts prices while weakening growth, nominal bonds lose real value exactly when it hurts most, and investors demand a larger premium to hold them. If inflation instead tends to fall in "bad times", as in a demand-led downturn when spending, jobs and inflation soften together, nominal bonds act as a hedge and the premium is small, or even negative.

The first two components (in the equation on the previous page) sum to the yield on a 10-year inflation-linked bond, and the last two to breakeven inflation. Breakeven inflation therefore contains two things (leaving aside a small premium for liquidity): the inflation investors expect, and this premium for the risk around it. A rise in breakeven inflation need not mean that investors expect more inflation; it can mean that they are charging more for the risk.

The Bond team at Prescient Investment Management builds the decomposition chiefly from the econometric routine detailed in Adrian, Crump and Moench (2013). The nominal and real term premia are calculated following the process outlined by the authors, average expected inflation is breakeven inflation less the inflation risk premium, and average expected short-term real rates are the remainder of the identity.

> Figure 1 sets out the key result. From early July 2026, where the decomposition starts, to 30 September the 10-year yield rose 80 bps. Average expected short-term real rates supplied 56.8% of the rise and the real term premium 26.2%, so that 83.0% came through the real yield related channels. Breakeven inflation supplied only 17.0%, and most of that was the inflation risk premium rather than average expected inflation.

Figure 1. The decomposition of the US 10-year yield between 2 July and 30 September 2026



Each box gives the level on 30 September, the level on 2 July beneath it and the change between the two. The 10-year inflation-linked yield is the sum of average expected short-term real rates and the real term premium; breakeven inflation is the sum of average expected inflation and the inflation risk premium.

Source: Prescient Investment Management, October 2026.

The composition says what the market pricing essentially revised: its view of the path of average real rates, whether through the Federal Reserve's response to inflation, or through the neutral rate, much more than its view of where inflation will settle. The market also demanded a higher inflation risk premium.

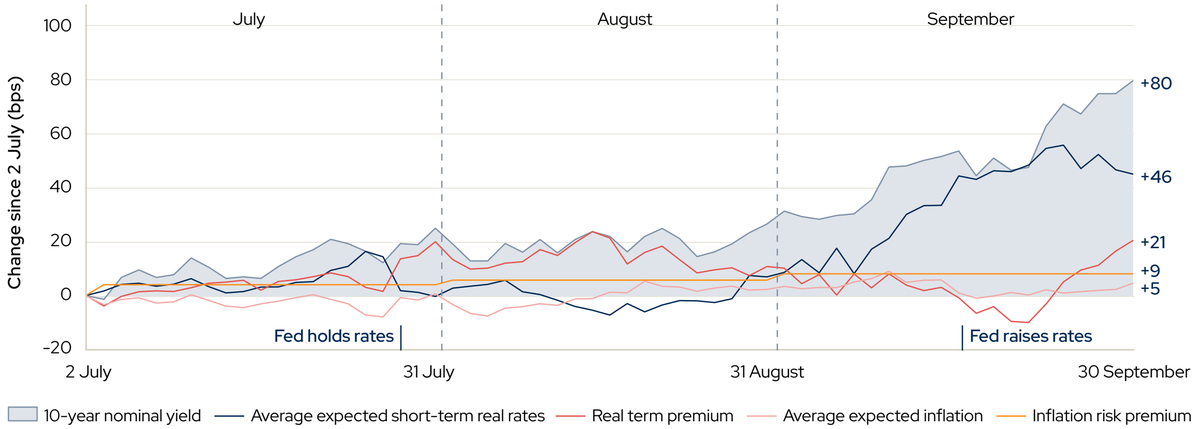
How the repricing unfolded

The third quarter of 2026 falls into three phases, with the sell-off "culprits" passing between the real term premium (Figure 2, red line) and average expected short-term real rates (Figure 2, navy line).

The real term premium led in July. From early July to the end of the month the yield (Figure 2, grey shaded area) rose 25 bps, four-fifths of it from the real term premium, while average expected short-term real rates were essentially unchanged.

The real term premium's largest one-day rise of the month, 12 bps, came on 29 July, when the FOMC left its policy rate unchanged; breakeven inflation rose that day too, and average expected short-term real rates fell. That is the pattern of a market digesting the policy rate hold, with inflation above target and oil prices rising, as tolerance of inflation.

Figure 2. The cumulative change in the US 10-year yield and its four components



The cumulative change in the US 10-year yield and its four components from 2 July to 30 September 2026, in bps, with each value at the end of the window. The shaded area is the change in the yield and the lines are its components. Dotted lines mark the month ends; the short lines at the foot of the chart mark the Federal Reserve's decisions of 29 July and 16 September.

Source: Prescient Investment Management, October 2026.

The real term premium had peaked in mid August, 24 bps above its opening level, and it fell 34 bps over the following five weeks. Both tightening precedents discussed below show the same pattern: average expected short-term real rates build steadily, while the real term premium overshoots and retraces.

September produced 53 bps of the 80 bps, most of it in average expected short-term real rates. Three days account for 75.9% of the month's net rise in that component: a strong payroll report in early September, followed by a firm consumer price report and the FOMC's quarter-point increase in mid-September.

On each of those days average expected short-term real rates rose by about 10 bps, yet the 10-year yield hardly moved, because the real term premium fell at the same time and, on the consumer price and FOMC days, breakeven inflation fell too. That is the pattern to expect if the news persuaded investors that the Federal Reserve would lean against inflation. The two FOMC decisions of the quarter thus moved the components in opposite directions, the hold of 29 July one way and the increase of 16 September the other, as a market pricing the central bank's reaction to inflation would.

The economics of the repricing

Average expected short-term real rates are the decomposition's estimate of where real policy rates will sit over the next decade, and they rise chiefly for two kinds of reasons: The first is the central bank's response to inflation as perceived, and therefore priced, by market participants in aggregate.

Not primarily to bring current inflation down, but much more to keep inflation expectations in kilter, central banks typically need to raise their policy rate by more than current inflation has risen, so that the real cost of borrowing climbs and spending cools; investors who expect that response raise the average real rates they expect over the life of the bond.

The second is the neutral rate (sometimes referred to as "r-star"), the real rate at which the economy neither overheats nor stalls. When the demand for borrowing rises relative to the supply of savings, through stronger investment or larger government deficits, the level around which policy settles rises too. Both forces were at work in 2026. The FOMC's own longer-run estimate of the federal funds rate rose from 3.1% in June to 3.2% in September, a sign that the neutral rate itself is being revised up.

> The core inflation data gave the market reason to expect a firmer response as well. Core PCE inflation stood at 3.0% in August, and it has been above the 2.0% objective in every month since April 2021, never lower than 2.6% in that time. Against that backdrop, the 46 bps rise in average expected short-term real rates is the market pricing a central bank that will keep real rates high for longer.

Furthermore, the US labour market tightened, partly because labour supply shrank. Unemployment fell from 4.3% in May to 4.1% in July and August, below the FOMC's longer-run estimate of 4.2%, while participation fell from 61.8% in May to 61.4% in July, and payroll growth stalled in July. Over the same quarter Brent crude rose some 40% to $104 a barrel. With core inflation above the objective for more than five years, a reasonable case (on the part of market participants) could be made for a more hawkish policy path lest the developments above begin leaking into longer term inflationary expectations.

A simple policy rule of the kind proposed by Taylor (1993) gives a sense of scale. In the stylized version used here, the prescribed policy rate is the neutral real rate plus core inflation, plus half the gap between core inflation and the objective, plus half the output gap, where the output gap is taken as twice the amount by which unemployment falls short of its full-employment level:

Prescribed policy rate

=

Neutral real rate + Core inflation + ½ × (core inflation − 2.0%) + ½ × output gap

With a neutral real rate of 1.2%, the FOMC's September longer-run estimate of 3.2% less the inflation objective, and full employment at 4.2% unemployment, the rule prescribed a nominal policy rate of 4.8% in June, 1.1 percentage points above the mid-point of the federal funds target range. After the September increase, and on August data, the gap was 0.9 percentage points.

Three precedents

To find the closest historical precedents to the current sell-off, 20 named episodes since 2004, most dated from one turning point of the 10-year yield to the next, were decomposed in the same way, and the composition of each was compared with that of 2026.

The comparison has three steps. First, each component's move is expressed as a share of the episode's total movement: the sum of the four moves, each counted as positive whatever its direction.

A component that fell keeps a negative sign on its share. These four shares describe the anatomy of an episode independently of its size.

Second, the two episodes' shares are compared component by component. Third, the sizes of the four differences, each counted as positive, are added, and half of the total is subtracted from 100.0%:

$$\text{Similarity} = 100\% - \tfrac{1}{2} \times \text{sum of absolute differences across the four component shares}$$

The halving keeps the score between 0.0% and 100.0%. Two episodes with identical shares score 100.0%; two with exactly opposite shares, whose differences add to 200.0 pp, score 0.0%. Size and length play no part. As an example, the 2026 window splits its total movement 56.8%, 26.2%, 6.2% and 10.8% across average expected short-term real rates, the real term premium, average expected inflation and the inflation risk premium, and the 2022 hiking cycle 76.0%, 17.3%, −0.6% and 6.2%.

The sizes of the four differences add to 39.5 pp, half of which is 19.8 pp, so the similarity is 100.0% less 19.8 pp, or 80.2%. The 2022 shares differ slightly from those in Table 1, which are shares of the net change in the yield; for 2026, in which every component rose, the two coincide.

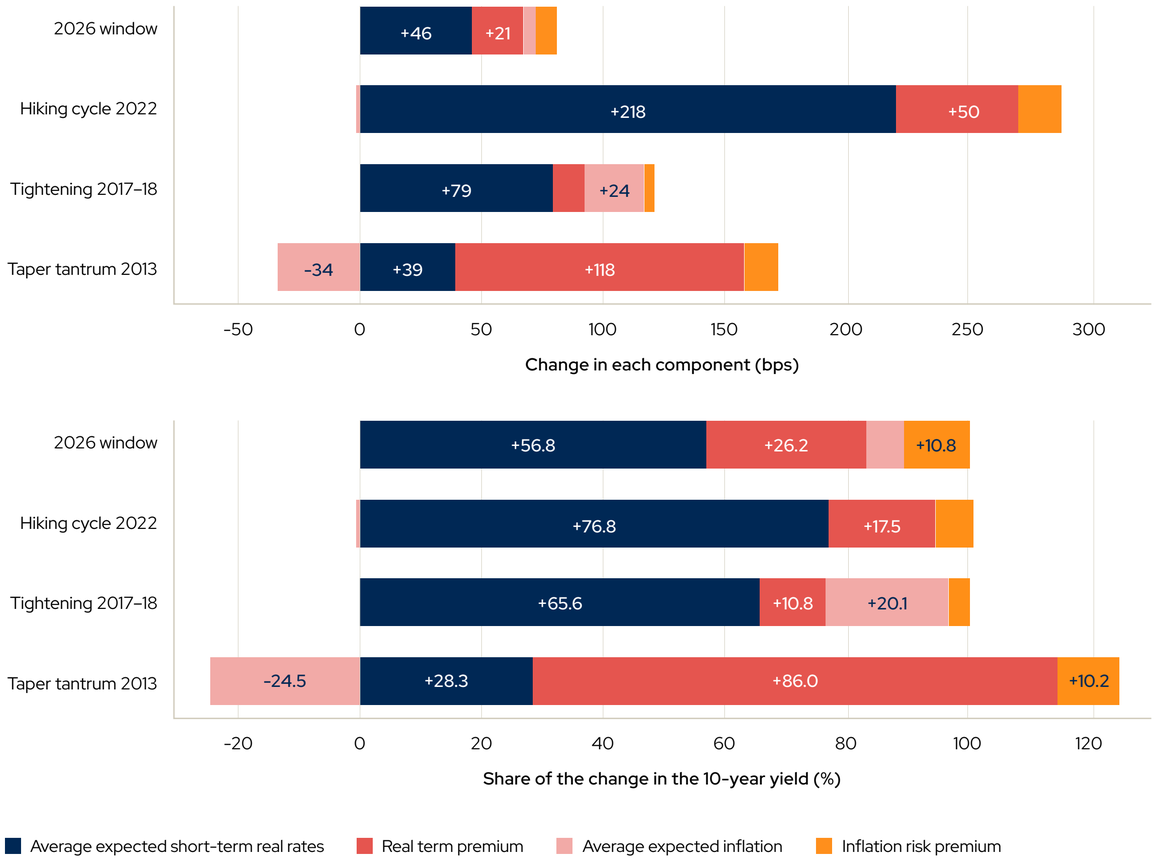
Table 1 and Figure 3 report the three closest episodes.

	Days	10-year yield	Average expected short-term real rates	Real term premium	Average expected inflation	Inflation risk premium	Similarity
Panel A: changes, bps (similarity in %)							
2026 window	**62**	**+80**	**+46**	**+21**	**+5**	**+9**	
2 Jul 2026 to 30 Sep 2026							
Hiking cycle 2022	212	+284	+218	+50	−2	+18	80.2
17 Dec 2021 to 24 Oct 2022							
Tightening 2017–18	294	+120	+79	+13	+24	+4	77.3
7 Sep 2017 to 8 Nov 2018							
Taper tantrum 2013	87	+137	+39	+118	−34	+14	52.1
2 May 2013 to 5 Sep 2013							
Panel B: shares of the change in the 10-year yield, %							
2026 window		**100.0**	**56.8**	**26.2**	**6.2**	**10.8**	
Hiking cycle 2022		100.0	76.8	17.5	−0.6	6.2	
Tightening 2017–18		100.0	65.6	10.8	20.1	3.5	
Taper tantrum 2013		100.0	28.3	86.0	−24.5	10.2	

Table 1: *The 2026 window and its three closest precedents. Panel A gives the change in each component in bps and the similarity score in %; Panel B gives each component's share of the change in the 10-year yield, in %, so that each row sums to 100.0%. Components may not add up to totals because of rounding. Days are business days.*



Figure 3. The 2026 window and its three closest precedents



The 2026 window and its three closest precedents, as in Table 1. Top: the change in each component, in bps. Bottom: each component's share of the change in the 10-year yield, in %. Segments to the left of zero are components that fell.

Source: Prescient Investment Management, October 2026.

The hiking cycle of 2022 is the closest match. Over 212 business days the yield rose 284 bps, and average expected short-term real rates supplied 218 bps of it. Between March and September 2022 the Federal Reserve raised its target range by 3.0 pp and began to shrink its balance sheet. Average expected inflation fell over the episode although consumer price inflation reached its highest rate in four decades: the long-run anchor held, and the adjustment ran through real rates, as it has in 2026. The episode also contains a pause (like August 2026), between 14 June and 1 August 2022, when the yield fell 90 bps and the real term premium accounted for 70 bps of the fall.

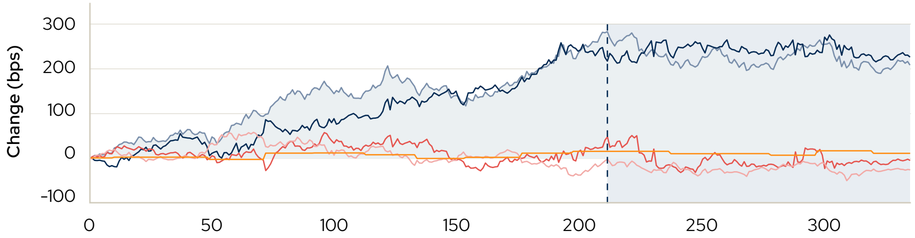
The tightening of 2017–18 ranks second. The yield rose 120 bps over 294 business days, with average expected short-term real rates supplying 79 bps. The Federal Reserve raised its target range in four steps, began to run off its balance sheet in October 2017 and faced a fiscal expansion after the tax legislation of December 2017, while core PCE inflation rose from 1.5% to 2.0%. Average expected inflation added 24 bps, a recovery from below-target levels that has no counterpart in 2026.

The taper tantrum of 2013 ranks third and is a different kind of episode. The yield rose 137 bps in 87 business days, and the real term premium supplied 118 bps. Chairman Bernanke's testimony in May 2013 indicated that asset purchases could be slowed within a few meetings. Average expected short-term nominal rates barely moved. The purchases had absorbed duration risk, and the prospect of their withdrawal handed it back to private investors. The episode is among the closest three only because of the late-September rise in the 2026 real term premium: for the window ending 22 September it ranked eighth.

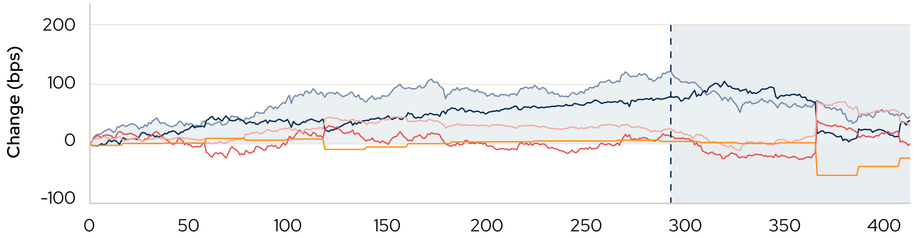
In size the 2026 move is still small. It has risen at about the same daily pace as 2022, but for 62 business days rather than 212. Figure 4 traces each precedent's components through the episode and the six months after it.

Figure 4. The three closest precedents

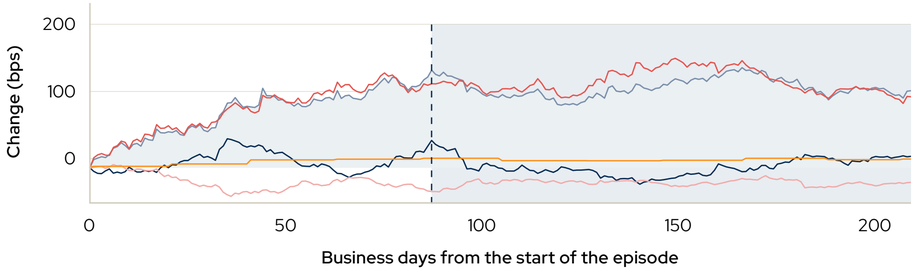
4.1. Hiking cycle 2022: 17 December 2021 to 24 October 2022, then six months



4.2. Tightening 2017–18: 7 September 2017 to 8 November 2018, then six months



4.3. Taper tantrum 2013: 2 May 2013 to 5 September 2013, then six months



10-year nominal yield — Average expected short-term real rates — Real term premium — Average expected inflation — Inflation risk premium

The three closest precedents: the cumulative change in the 10-year yield and its components from the start of each episode, in bps. The dashed line marks the end of the episode and the shaded band the six months that followed; each panel has its own scale. The step in the middle panel in March 2019 is a one-off move in the inflation risk premium estimate, noted under Table 2.

Source: Prescient Investment Management, October 2026.

What the precedents imply

Each precedent ends at a local peak of the yield by construction, and the yield was lower three and six months later in all three.

In the three months after both tightening episodes, the real term premium fell furthest.

Panel A: the backdrop at the end of each episode

Episode	Month	Core PCE inflation, %	Unemployment, %	Taylor gap, pp
Hiking cycle 2022	October 2022	5.3	3.7	+5.6
Tightening 2017–18	November 2018	2.0	3.8	+1.4
Taper tantrum 2013	September 2013	1.6	7.2	−0.6
2026 window	**August 2026**	**3.0**	**4.1**	**+0.9**

Panel B: changes after the end of each episode, bps

Episode	Months after	10-year yield	Average expected short-term real rates	Real term premium	Average expected inflation	Inflation risk premium	Average expected short-term nominal rates
Hiking cycle 2022 from 24 Oct 2022	3	−79	+25	−75	−28	−1	−3
	6	−75	+14	−59	−29	0	−15
Tightening 2017–18 from 8 Nov 2018	3	−60	−1	−35	−20	−4	−21
	6	−75	−43	−11	+9	−30	−34
Taper tantrum 2013 from 5 Sep 2013	3	−12	−52	+34	+7	−2	−45
	6	−29	−21	−20	+12	0	−9

Table 2: *What followed each precedent. Panel A: the backdrop in the month each episode ended. The Taylor gap is the rule's prescribed rate less the mid-point of the target range, positive when policy is below the rule, with a neutral real rate of 1.2% and full employment at 4.2% unemployment for every episode; the 2026 row uses August 2026 data and the target range after the September increase. Panel B: changes in bps over the three and six months after each episode ended.*

Note: Panel B decomposes each period afresh from the end of the episode, so its figures can differ by up to 5 bps from the paths in Figure 4; components may not add up to totals because of rounding. The inflation risk premium estimate fell from 0.4% in February 2019 to −0.1% in March, its largest one-month change since 1990, and recovered over the following months; the six-month row for 2017–18 carries that step.

Figure 5. What followed each precedent

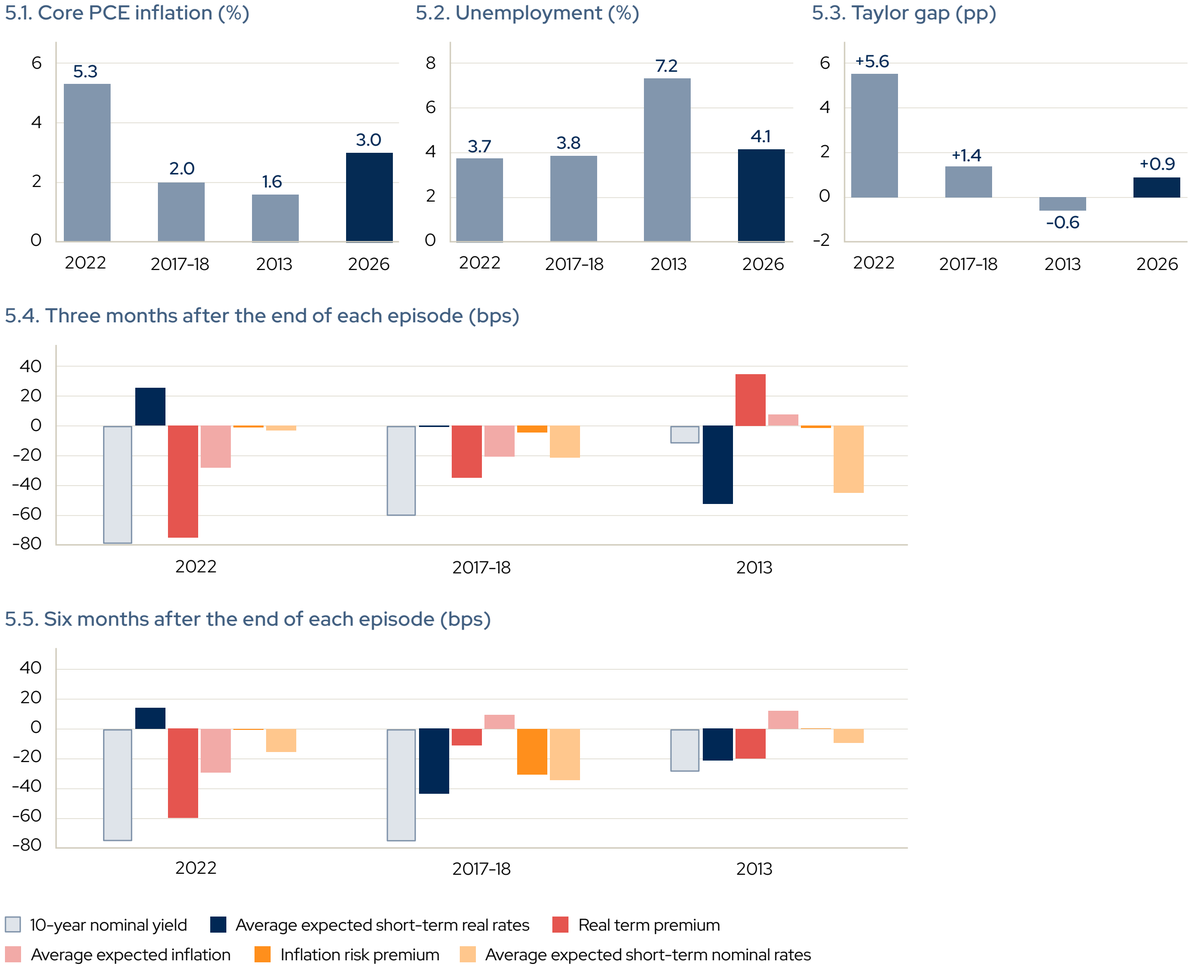


Figure 5: *What followed each precedent, as in Table 2. Top: core PCE inflation, unemployment and the Taylor gap in the month each episode ended, with the 2026 window for comparison. Middle and bottom: the change in the 10-year yield and its components over the three and the six months after each episode ended, in bps.*

Source: Prescient Investment Management, October 2026.

The 2026 backdrop lacks the conditions that produced the quick falls in average expected short-term nominal rates after 2013 and 2018. Core PCE inflation of 3.0% is 1.0 pp above the objective, and unemployment of 4.1% offers no slack.

Average expected short-term real rates, which carry 56.8% of the move, should therefore hold for as long as core inflation stays elevated near 3.0%. The 2022 record shows that they can keep rising after the yield has turned, but the Federal Reserve is not as far behind as it was then: the policy rate stands 0.9 percentage points below a stylized Taylor rule, against 5.6 percentage points in October 2022, leaving less room for further rises.

The real term premium, and above all its rise of 31 bps after 22 September, is the component most exposed to reversal once the end of tightening is in view. Average expected inflation could also fall, as it did in the three months after both tightening episodes, and a fall in oil prices could work through it, as in late 2018, and through the inflation risk premium, which carried more of the 2026 rise.

Concluding observations

The second Treasury sell-off of 2026 is a repricing of monetary policy. Average expected short-term real rates carry most of the rise, forward rates rose most one to four years ahead, and average expected inflation barely moved through a 42.0% rise in the price of oil. The responses to the two FOMC decisions of the quarter fit a market pricing the Federal Reserve's reaction to inflation.

In the current episode and based on the supplied decompositions, average expected inflation barely moved because investors appear to believe (as extracted from market pricing) that the Federal Reserve will do what is required to keep expectations in kilter, so the adjustment ran through the real components of bond yields rather than through the inflation anchor. Supply shocks push near term inflation up while simultaneously also threatening growth, so long bonds lose value in the states in which investors are most protective of wealth. Investors therefore demanded a higher real term premium, and, relatedly, a higher inflation risk premium, to hold them, more so once the end point of policy tightening came into doubt. The 10-year yield rose because both the expected path of real rates and the price of bearing real duration increased.

> The tightening episodes of 2022 and 2017-18 suggest that the real term premium falls furthest once the end of tightening is in view, so its late-September rise is the part of the move most likely to reverse. Average expected short-term real rates, which carry the larger part, are tied to the core inflation process: they should hold while core inflation stays elevated and give way only as it shows sustained evidence of moderating.

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Lessons from South Africa for an expensive-money world

by CONWAY WILLIAMS
Head of Private Markets

South Africa's experience shows how private capital can help governments keep building when borrowing is expensive, and what investors should demand in return.

This year's global bond sell-off is usually discussed in terms of what it does to bond portfolios. I want to look at a different consequence: what governments do when borrowing becomes expensive, and what that means for the investors they turn to.

Long-dated yields in the US, the UK, Germany and Japan are at their highest levels in more than a decade. Inflation has played a part, but heavy government borrowing is a large part of the story. There is a great deal of government debt to absorb and more is on the way.

> Expensive funding does not have to mean governments stop building. One response is to move the building off the balance sheet: offer guarantees, sign long-term contracts and invite private capital to fund what the state would otherwise fund directly. South Africa has relied on this approach for years, most visibly through the Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) since 2011. If borrowing costs stay high, governments elsewhere may return to similar tools, as the UK did with its Private Finance Initiative from 1992 to 2018. The question for every allocator is whether they are being paid for the project and sovereign risks these structures carry and for giving up liquidity.

A constraint South Africa knows well

In its April 2026 Fiscal Monitor the IMF put global public debt at nearly 94% of GDP and projected it to reach 100% by 2029. Rising interest bills put long-term investment under pressure.

South Africa starts from a different place. The fiscus has largely stabilised. In the 2026 Budget Review National Treasury projected gross debt to peak at 78.9% of GDP in 2025/26 and then decline. S&P upgraded the country in November 2025, and Fitch followed in June 2026. That progress is real but it has not created room to spend. Debt service was budgeted at R420.6 billion for 2025/26, about 21% of revenue. Meanwhile the transmission plan alone calls for about 14,500km of new lines by 2034 at a cost of roughly R440 billion. That gap between what the country needs and what the fiscus can carry is where private capital comes in.

How South Africa learnt to build off balance sheet

Under REIPPPP, private sponsors and lenders funded construction, and Eskom bought the power under long-term agreements. Government stood behind Eskom's obligation to pay through an implementation agreement with each project. According to the IPP Office's latest published figures, by June 2024 renewable projects that had reached financial close had attracted R272.5 billion of investment, more than four-fifths of it from domestic investors.

The next phase builds on that model. National Treasury is establishing a Credit Guarantee Vehicle, designed as an independently governed insurer that will guarantee payments to infrastructure projects and cover them if contracts are terminated early. It is set to start with about $500 million of capital, $350 million of it from the World Bank, and aims to mobilise up to $10 billion of investment over time. Its first guarantees are aimed at independent transmission projects. Separately, amendments to Regulation 28 that took effect in January 2023 allow retirement funds to hold up to 45% in infrastructure across asset classes. The plumbing for local savings to fund the build is theoretically in place.

What investors are really buying

In these structures private capital takes on construction and operating risk. The state, or a vehicle it seeds, keeps much of the tail risk: the rare but severe outcomes. National Treasury put its exposure to signed independent power projects at R244.3 billion as at 31 March 2026, carried as a contingent liability.

A senior loan to a renewable energy project with a state-backed offtake agreement is two exposures in one. The first is project risk: construction, performance and the grid. The second is the state standing behind

the offtaker. Investors who treat it purely as private credit understate the second. Investors who treat it as a government bond proxy ignore the first. A fair price pays for both, plus a premium for not being able to sell.

Measuring against the right yardstick

It is tempting to read high government bond yields as a hurdle every private asset must beat. The benchmark South African ten-year government bond yielded about 9% in early October 2026, a real return of roughly 4.6% against August inflation of 4.4%. That looks like a hard number to argue with. But the comparison mixes up two different decisions.

The first is whether to hold real infrastructure assets at all. That choice is made when an investor selects a mandate, and it is the right place to weigh the liquid alternative. A government bond cannot offer direct exposure to real assets, contracted cash flows from those assets or a hand in building what the country needs. Investors who want those things are not choosing between a solar loan and a bond. They have already chosen.

The second decision is whether a particular loan belongs in that mandate. Here the government bond is the wrong yardstick. Measuring a twenty-year senior project loan against a listed instrument of similar duration compares it with an exposure the investor has not asked for. The questions that matter are whether the loan clears the mandate's real-return objective after the risks identified, and whether it is priced in line with comparable assets: senior against senior, construction against construction, on a like-for-like real basis. For floating-rate debt, rising rates lift the headline yield without making the deal any better.

Converting the margin into a real spread is the proper test. Because private assets are valued using models rather than traded prices, their returns look smoother, and less risky, than they really are.

What could go wrong

The model has limits that investors should price in. Guarantees are contingent liabilities, so if the fiscus came under pressure again, government bonds and state-supported infrastructure debt would likely weaken together. And retirement savings directed towards national priorities still have to earn their place on merit. If pricing discipline slips, the risk is an informal version of prescribed assets, which serves neither members nor the projects. Both are reasons to demand a fuller premium.

The answer for allocators

So what do governments do when borrowing becomes expensive? On South Africa's evidence they can keep building by changing who pays. Investors here should expect more guarantees, more long-term contracts and more invitations to private capital. For South Africa this is a developmental necessity. For long-term savers it is a real opportunity.

> What should those investors expect to be paid? Enough for each risk they carry, measured against the right yardstick. High sovereign yields rightly raise the bar when an investor chooses a mandate. They should not become the test for each asset within it. That test is the mandate's objective and comparable private assets.





Spread thin: is credit still paying for risk?

by THEA DE WET
Head of Listed Credit

Spreads have tightened for years. But is the market still paying investors for the credit risk they take? To answer this, we decompose each bond's spread into the credit expected loss, the credit market premium and the excess spread.

The question behind the squeeze

The story of South African corporate credit over the past few years is well known. There is more cash looking for a home than there is paper to hold it, state-owned enterprises have largely stayed away from the primary market, and corporate auctions are routinely oversubscribed, often clearing well below their pricing guidance. Spreads have followed: the average spread at issue tightened from 196bp in 2022 to 119bp in 2026 (year to date).

> Tighter spreads on their own do not mean investors are being inadequately compensated. If the probability of default (PD) decreased by as much, a lower spread could still be a fair price. So the real question is not whether spreads are low, but whether they still pay for the risk being taken. To answer it we need a way to separate the price of risk from the amount of risk.

A price tag for default risk

Holding a corporate bond is akin to selling insurance on the issuer. Part of the spread covers the losses you expect on average, given the issuer's PD. Were expected loss the only component, credit spreads would be considerably lower. But defaults are not independent events: they cluster in recessions and around sovereign downgrades, precisely when losses are most costly, so investors require compensation above the expected loss.

The market price of risk, lambda (λ), is the size of that extra compensation per unit of risk. The idea comes from the Merton model of corporate debt[1] and its one-factor extension by Vasicek[2]. Two features make it useful:

- λ moves with risk appetite. When risk aversion is high, investors require greater compensation per unit of risk; when risk appetite is strong or liquidity is abundant, they accept less.
- Only systematic risk is paid for. Issuer-specific (idiosyncratic) risk can be diversified away in a portfolio; systematic risk, arising from economy-wide shocks that affect all issuers simultaneously, cannot. Each bond's premium is therefore scaled by how closely it moves with the economy, which we measure with the Basel IRB correlation.[3]

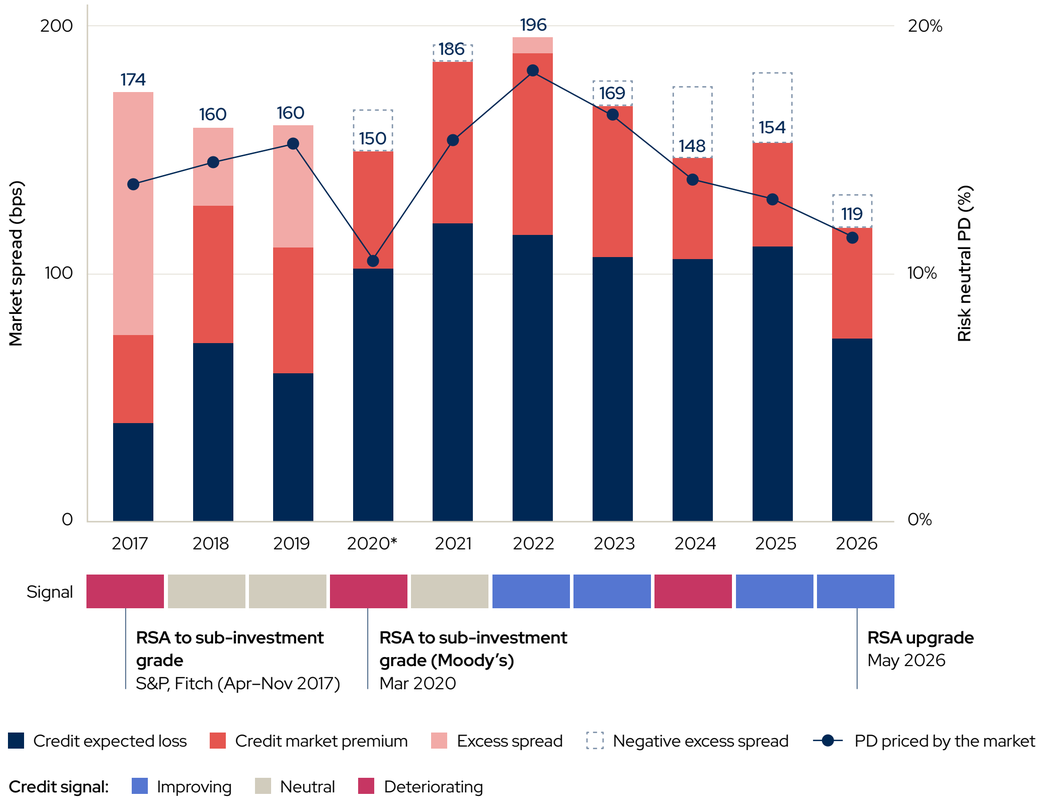
Across 454 senior non-financial corporate bonds issued since 2017, the long-run λ is estimated to be 0.26. In simple terms, a five-year bond whose PD is 5% is priced as if its PD were 8.3%: the spread pays 51bp for expected losses and a further 34bp for bearing the risk. The portion of the spread remaining after the credit expected loss and the credit market premium is defined as the excess spread.

Compensation for credit risk

Figure 1 splits the average spread at issue for each year into its three parts and overlays the PD priced by the market: the cumulative default probability that each year's spreads imply. Our credit signal for each year, compiled from news, is displayed below the graph.

Figure 1. In a tight spot: less risk, or more cash chasing paper?

Volume-weighted spread over ZARONIA at issue (bars) and cumulative PD priced by the market (line)



What each year's spread paid for. Solid bar and number = market spread at issue (bp); dashed box = shortfall against the full premium (negative excess spread).

JIBAR-referenced spreads are converted to a spread over ZARONIA by adding the 16.19bp credit adjustment spread (CAS).

**After the COVID-19 onset in March 2020, 78% of corporate issuance by value was from offshore-guaranteed issuers, explaining the lower spread and PD.*

Source: Prescient Investment Management, Standard Bank auction history

Negative sentiment around the sovereign's loss of investment grade kept spreads wide in 2017–2019 (Figure 1). The key observation since 2022 is that credit risk has decreased, with the PD priced by the market falling from 18.3% to 11.5%, but spreads have tightened alongside it, from 196bp to 119bp, so that the excess spread has been negative on average in every year since 2023. Spreads have covered the expected credit loss in every year, but since 2020 they have, in all but one year, fallen short of the full credit market premium, leaving the excess spread negative. Although 2021 and 2026 were priced at very different levels, 186bp and 119bp respectively, the outcome for investors is similar: in both years the spread fully covered the credit expected loss (122bp and 75bp) but fell short of the full credit market premium, recovering about 89% of it in 2021 and 77% in 2026.

The premium: cheaper risk, or less of it?

Think of λ as a price: the spread investors accept, divided by the risk they carry. Like any price it can change because the numerator moves or because the denominator does. We calculate λ for every bond and split it into a spread term, which rises when spreads widen, and a risk term, which rises when PDs decrease. Averaging across each year's issues by size, the change from one year to the next splits exactly into the two:

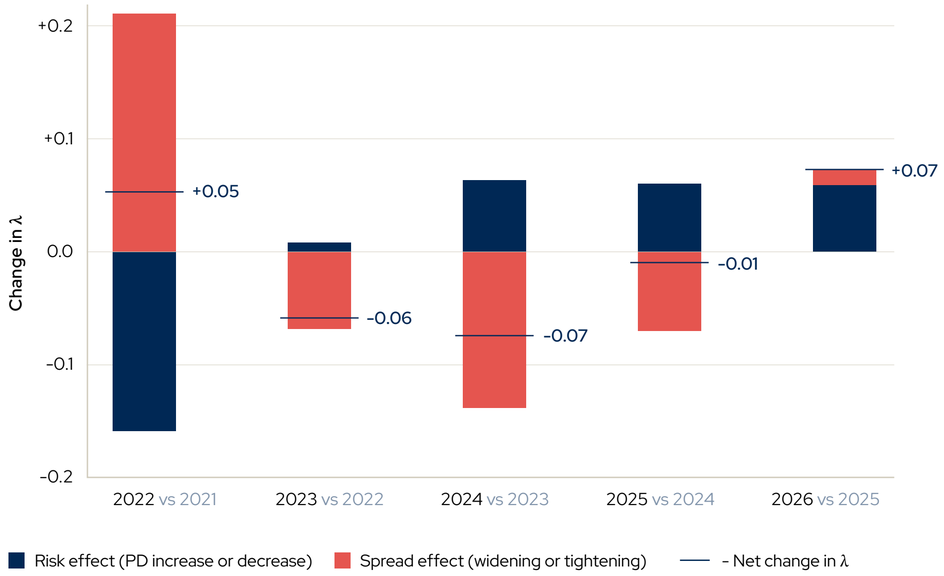
$$\Delta\lambda = \underbrace{\Delta(\text{spread term})}_{\text{spread effect}} + \underbrace{\Delta(\text{risk term})}_{\text{risk effect}}$$

The spread effect is the price of risk changing: tighter spreads for the same risk mean investors are accepting less compensation per unit of risk. The risk effect is the amount of risk changing: if PDs decrease while spreads hold, more of the spread becomes premium and λ rises.

Figure 2 shows, for each issue year, the change in λ from the year before: the navy bar is the risk effect (positive when PDs decrease), the red bar is the spread effect (positive when spreads widen), and the dark line is the net change, the sum of the two. In 2022 spreads widened by more than PDs increased, so λ rose by 0.05. From 2023 to 2025 spreads tightened faster than PDs decreased, so λ drifted down to 0.20. In 2026 spreads tightened while PDs decreased and λ rose only slightly, by 0.07, almost all of it from the PD decrease. The market is still paying for risk, but less generously than the long run.

Figure 2. Spread it out: what really moves the price of risk

Change in volume-weighted λ from the prior issue year, split into risk and spread effects



Year-on-year change in the volume-weighted market price of risk, split into spread and risk effects. Label beside each dark line = net change in λ. Both effects include term-mix shifts.

Source: Prescient Investment Management

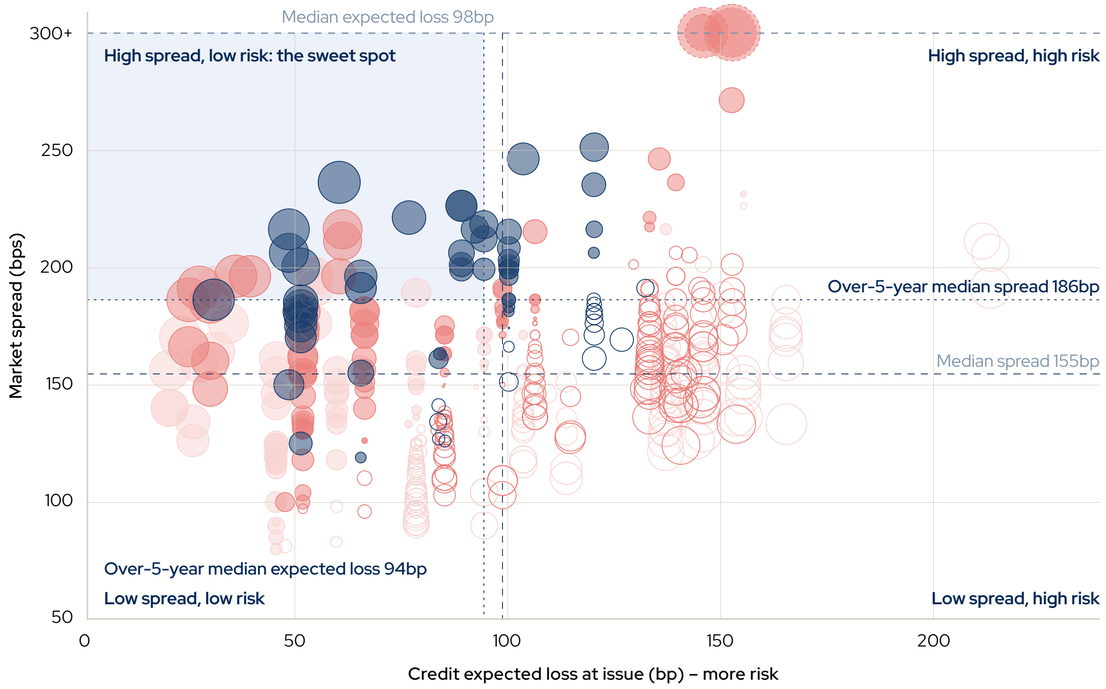
Where the premium still pays

Applied at bond level, the decomposition can assist with identifying relative value. Figure 3 places each bond by the spread it was issued at and the expected loss its PD implies. The top-left corner is where investors want to be: bonds that pay more than the median spread while carrying less than the median expected loss.



Figure 3. Terms of endearment: longer-dated bonds earn a positive alpha

One bubble per bond at issue; bubble area = alpha (solid positive, hollow negative); colour = term at issue



Every senior unsecured bond at issue by spread and credit expected loss, 2017–2026; bubble size = alpha. Spread axis capped at 300bp; bonds above it (max 441bp) are drawn dashed on the 300bp line. Medians use all bonds. Alpha = spread at issue less CAS, credit expected loss and credit market premium at the long-run λ of 0.26.

Source: Prescient Investment Management

Bonds issued for more than five years have a median spread of 186bp against a median expected loss of 94bp (the dotted lines in Figure 3). By comparison, bonds of three to five years have a median spread of 161bp against 106bp. Longer-dated paper therefore carries less expected loss per year, reflecting stronger issuers, yet pays a higher spread. This is consistent with a market that has traditionally extended term only to high-quality issuers.

In the high-spread, low-risk corner of Figure 3, term is the common thread: longer-dated bonds are over-represented, and most bonds issued for more than five years earn a positive alpha. Investors require a term premium for longer-dated paper, yet a high-quality issuer's PD increases only gradually with maturity. Its PD term structure is flat, so the extra years add little expected loss while market spreads keep widening with term. The premium is therefore best captured by extending credit tenor with high-quality issuers.

Sector patterns point the same way. Autos, backed by their offshore parents, sit almost entirely in the low-spread, low-risk corner. Mining sits mostly in the high-spread, high-risk corner. Both price broadly in line with expectations. The opportunities in the high-spread, low-risk corner are less about sector and more about issuer selection: identifying issuers with strong balance sheets and flat PD term structures.

The bottom line

> The credit market is still paying for default risk, but at a lower price than history suggests. The squeeze has come mostly from investors accepting less compensation per unit of risk. That makes blanket exposure to the market a weaker trade than it was. The premium has not disappeared; it has concentrated in longer-dated paper from good-quality issuers, and finding it is a matter of considered credit selection rather than chasing yield.

Pricing also appears anchored: spreads follow recent clearing levels rather than changes in PD, resulting in the price of risk drifting away from fundamentals as the cycle turns. A systematic process that measures the premium bond by bond, rather than relying on where spreads have recently traded, can extract value at each stage of the credit cycle.

Data: senior unsecured floating rate notes from non-financial corporates and property companies, 2017–2026, with more than one year to maturity at issue (454 bonds, R263bn), using spreads at issue converted to a spread over ZARONIA. Spreads and auction data from the Standard Bank auction history.

References

[1] Merton, R.C. (1974). On the Pricing of Corporate Debt: The Risk Structure of Interest Rates. Journal of Finance 29(2), 449–470.

[2] Vasicek, O. (2002). The Distribution of Loan Portfolio Value. Risk 15(12), 160–162.

[3] Basel Committee on Banking Supervision (2005). An Explanatory Note on the Basel II IRB Risk Weight Functions. Bank for International Settlements.



Hedged to hold: why a wider toolkit matters when yields rise

by HENK KOTZE
Head of Cash & Income

A wider investment toolkit helps capture the income on offer from higher bond yields while managing the risks that come with them.

> Higher yields are only worth having if you can hold on to them through the volatility that comes with them. In the Prescient Income Provider Fund, a wide toolkit, including US Treasuries and a rand hedge, lets us earn more yield while keeping risk in check.

The rout

At the start of 2026 the market was pricing rate cuts. By the end of the third quarter, it was pricing hikes.

In September the Fed raised rates for the first time since 2023, taking the fed funds range to 3.75–4.00%, and most FOMC members expect one more hike before year end. The market isn't expecting much relief further out either, our Central Bank Monitor shows Fed funds futures implying a policy rate of about 5% three years from now. The US 10-year moved above 5% for the first time in roughly 19 years. Closer to home, the SARB hiked for the second time this year, taking the repo rate to 7.25% as the conflict in the Middle East continues to put pressure on energy prices.

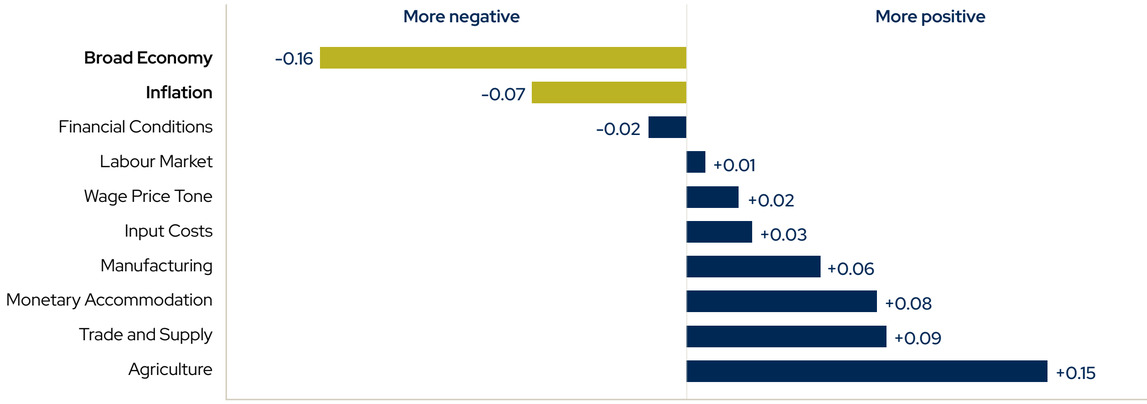
The tailwinds for fixed income from 2025 no longer exist. Income investors now have to think harder about how much risk they are willing to take for the extra yield on offer.

What the Beige Book is telling us

The Fed's September Beige Book goes some way to explaining why the sell-off has had legs. In our Central Bank Monitor we score every sentence of every Beige Book back to 1970 using a set of language models (FinBERT, RoBERTa models fine-tuned on FOMC language, and GPT-based scores for growth, inflation and monetary policy). We then group the more than 80 resulting sentiment series into ten economic themes.

Figure 1. Broad economy and inflation tone weakened most in the September Beige Book

Change in theme sentiment score, 15 July to 2 September 2026 (higher = more positive)



Source: Prescient Investment Management, Central Bank Monitor (Fed Sentiment AI: theme change, 15 Jul – 2 Sep 2026), read 11 Oct 2026

At face value the September release looked fairly balanced, with about half of all sentences positive and 45% negative, broadly unchanged from July. Underneath, though, the mix has shifted. Sentiment on the broad economy fell more than on any other theme since July, and the tone around inflation weakened as well. Softer growth alongside stickier prices leaves the Fed very little room to cut, and once the market takes cuts off the table, it wants more term premium for holding longer-dated bonds.

The same dynamic is weighing on equities. A higher risk-free rate raises the hurdle for every other asset, and with cash and bonds now offering decent real yields, equities have to work harder to justify their volatility.

Yield versus risk

Higher yields look attractive on paper, but you only earn them if you can stay invested through the drawdowns along the way. SA bonds were a good reminder of this in March, when the All-Bond Index lost close to 7% in a single month.

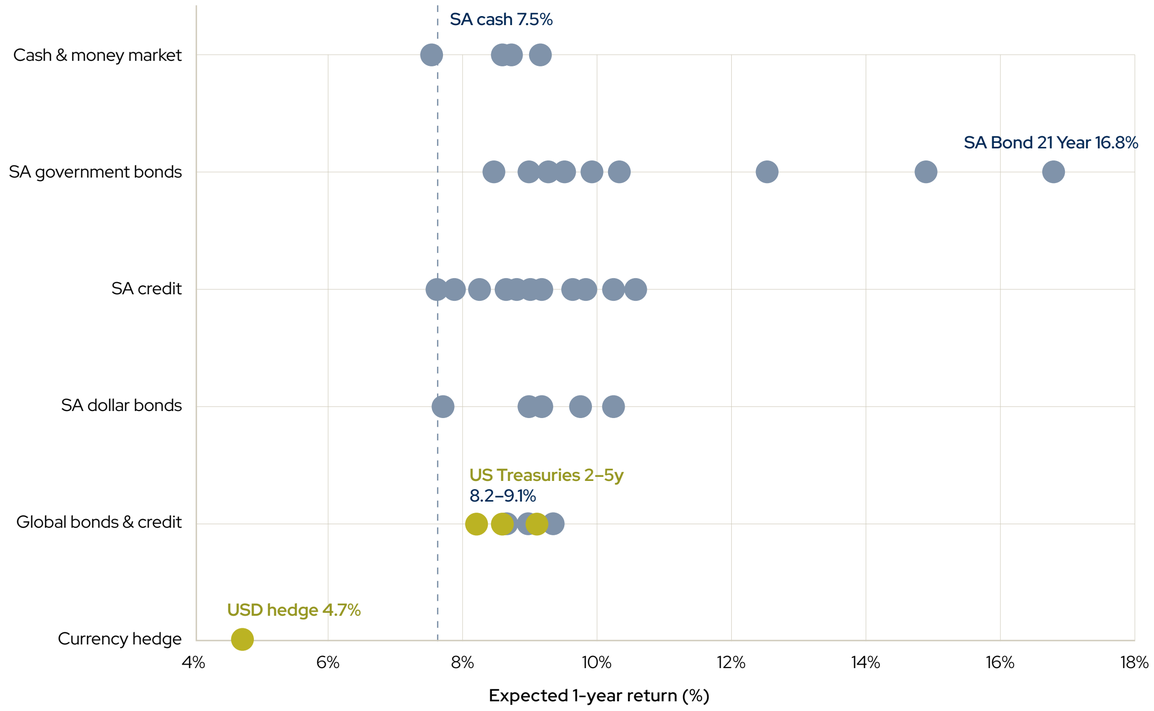
That is why we start with risk in the Prescient Income Provider Fund. For every position we look for the most efficient way to own the return we want, and the most efficient way to hedge the risk we don't. Having a wide toolkit gives us more than one option on both fronts.

Putting the toolkit to work

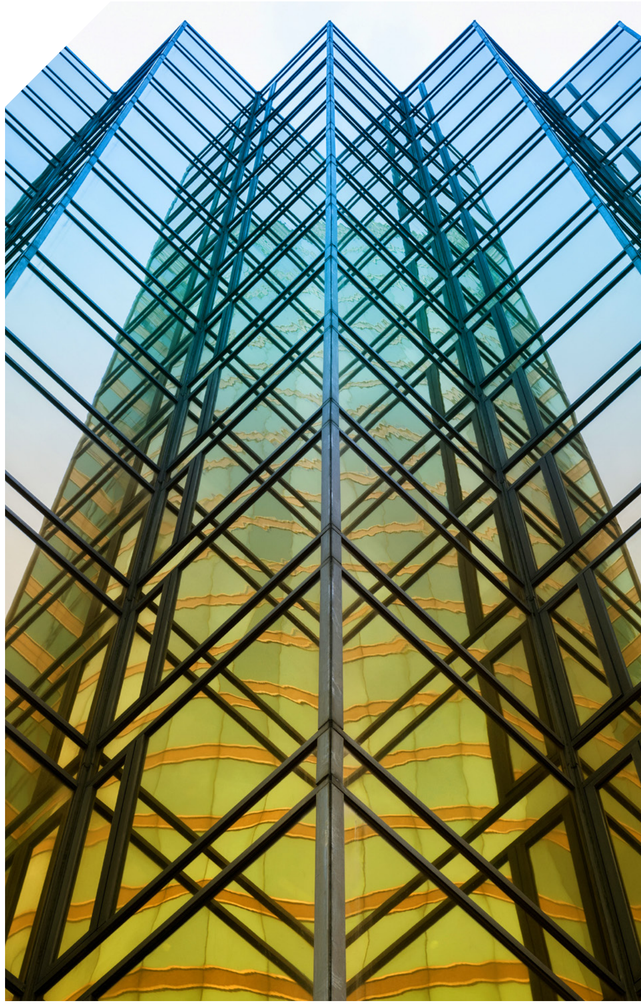
Our portfolio optimiser works across a wide universe of instruments for the Fund, from cash and SA government bonds through to credit, offshore bonds and currency hedges. The chart shows the return we expect from each of them over the next year.

Figure 2. US Treasuries (2–5y) are expected to return 8.2–9.1%, above SA cash at 7.5%

Expected 1-year return in rand for each instrument in the Fund's universe (offshore assets hedged back to rand)



Source: Prescient Investment Management, Portfolio Optimiser (Income – Income Provider – STRATEGY, Asset Universe: total expected returns), stored run of 9 Oct 2026



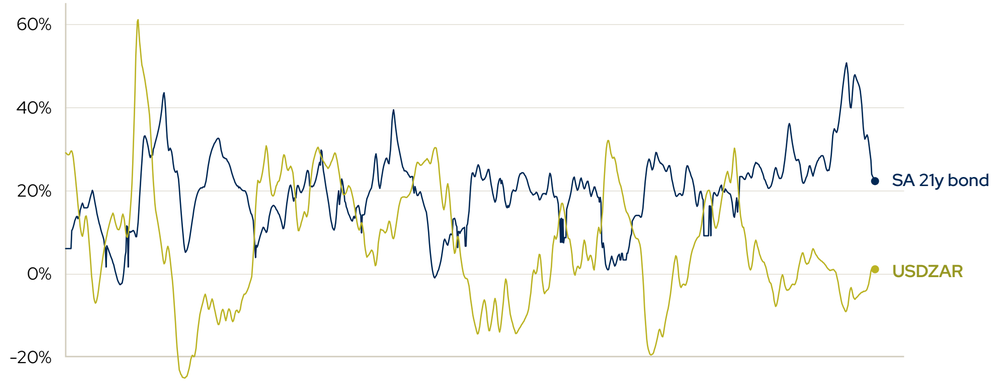
US Treasuries. With US yields back at levels last seen before the global financial crisis, the world's deepest bond market is paying investors to hold duration again. We have used the Fund's offshore capacity to build a 10% allocation to US Treasuries, focused on the 2- to 5-year part of the curve. This captures the yield on offer from the Fed's hiking cycle while keeping duration risk contained. We started the position in March and have added to it over time, rather than trying to pick the top in yields.

> The ZAR hedge. When risk appetite fades, the rand and SA bond yields tend to move together, with the rand weakening as yields rise. A long USDZAR position therefore tends to make money just as the domestic bond book comes under pressure. We hold this hedge through currency futures at 7% of the Fund and put it on in March alongside the extra SA duration we bought after the sell-off. The additional yield came with its own protection.

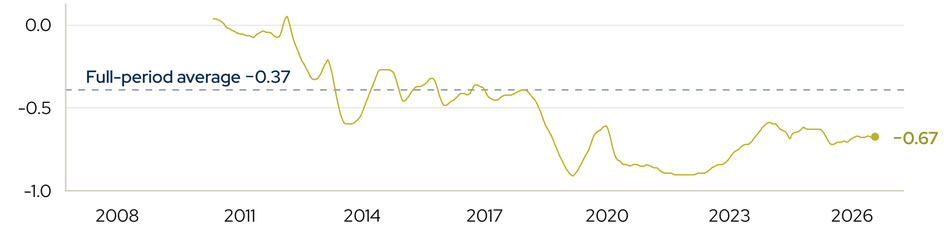
Our own data bears this out. Since 2007 the correlation between rolling one-year returns on USDZAR and the SA 21-year government bond has been about –0.4, and it has been stronger in recent years, at about –0.7 over the past three years.

Figure 3. The dollar tends to rally when SA long bonds struggle

Rolling 1-year returns (%), USDZAR and SA 21-year government bond, month-end, Jan 2007 to Oct 2026



Correlation of the two, rolling 3-year window



Source: Prescient Investment Management, Portfolio Optimiser

The hedge isn't free. Currency futures price in the interest rate gap between the two countries, and with 3-month JIBAR currently about 2.4% above US 3-month rates, holding it costs roughly that much a year on the hedged amount, or about 17 basis points a year for the Fund as a whole. We think that is a fair price for the protection, and our optimiser also assumes the rand weakens by about 4.7% against the dollar over the next year. On our numbers the hedge should more than pay for itself, on top of protecting the bond book. The relationship is also not perfect: in parts of March the rand held up better than SA bonds, which is why we size the hedge to the risk rather than treat it as a guarantee.

What comes next

Nobody knows exactly when this cycle will peak, us included. What we do know is that today's yields lock in a starting income well above what investors earned for most of the past decade, and starting yield remains one of the better guides to future Income returns.

For us, the question is how to hold higher yields without being forced out at the wrong time. Diversifying where our yield comes from, sizing hedges to the risk and building positions over time is how the Prescient Income Provider Fund aims to turn a global bond rout into an opportunity rather than a loss.





Has the economy been here before? Looking to history to explain today

by TIMOTHY TERBLANCHE
Head of Data Science

and CHLOE TOWNSEND
Data Scientist

By analysing more than fifty years of economic commentary, Prescient's Regime Radar identifies historical parallels that help put today's conditions into perspective.

We taught a machine to read more than fifty years of the Federal Reserve's Beige Book and to measure which chapters of history today's economy most resembles.

> "This feels like 2008." Markets love an analogy, but the comparison that gets made is usually the one that fits the speaker's story: the optimist reaches for 1995, the pessimist for 2007. History may rhyme, but the rhyme has always been a feeling rather than a measurement, so we set out to measure it.

From words to a picture of the economy

To understand what is happening in the economy, we turn to the US Federal Reserve's Beige Book, a qualitative account of conditions across the American economy compiled eight times a year from businesses and other contacts in all twelve Federal Reserve districts. Using natural language processing, we score the tone of each report across ten themes, from growth and inflation to the labour market, costs and credit, and compare every reading with that theme's own history.

Once each theme carries a reading, a month stops being a headline and becomes a shape, a characterisation of the economy at that moment. Inflation running hot and the labour market tight, but growth cooling: that is a distinctive silhouette. Arrange those readings around a dial and the silhouette becomes literal. This is what we call the Regime Radar. By comparing today's shape with every reading since 1970, we can see which periods it most resembles.

What is the radar saying amid the bond rout?

Before we look at the figures, some context. An oil-price shock tied to conflict in the Middle East is pushing up short-term inflation, and bond markets have taken notice. In early October, investors sold government bonds around the world, and as bond prices fell, yields rose. The US 10-year Treasury yield climbed above 5.3%, its highest level since 2002. The Fed raised rates in September for the first time since 2023 and has signalled more to come. Longer-term inflation expectations, however, remain broadly anchored.

That leaves the Fed with a delicate task: cooling demand enough to stop a temporary price shock from becoming a lasting one, without tipping the economy into a downturn. So what happened the last time the economy looked like this, and how did it play out for the Fed?

To answer them, we turn to the Regime Radar (Figure 1).

Figure 1. Regime Radar: Today's economy compared with June 2022

How far each Beige Book theme sits from its own 1970–2026 average, in standard deviations.



Further out = unusually high for that theme. For Monetary Accommodation and Financial Conditions, that means looser; for Trade & Supply, more strained.
Source: Prescient Investment Management, Federal Reserve Beige Book as on 14 October 2026.

In Figure 1, the dark blue line shows the economy according to the latest Beige Book (14 October 2026). The further out a point sits, the higher that theme reads compared to its own history. Our algorithm compares today's shape with every Beige Book since 1970, and June 2022 is one of the closest matches at 81% (shown in red). That was a period of very high inflation, driven by soaring energy, gasoline and housing costs, with US consumer prices up 9.1% on a year earlier. The two shapes are very similar on inflation, input costs and manufacturing, which all read well above average, and on monetary accommodation, which reads well below average as the Fed tightens. There are two clear differences. In 2022 the labour market was very tight and supply chains were under strain. Today the labour market reads close to average and the FED reads less concerned about supply chain. The bond market also looks familiar. June 2022 was in the middle of one of the worst bond sell-offs in decades, and that month the Fed raised rates by 0.75 percentage points, its largest single increase since 1994.

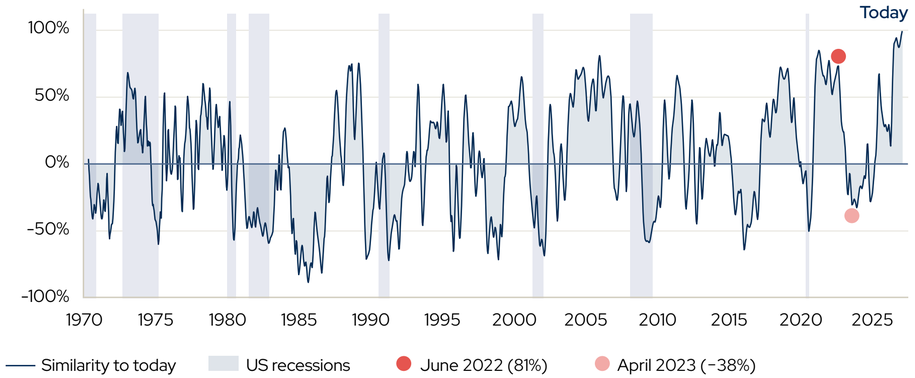
What happened next

To understand what came next, Figure 2 tracks how closely every Beige Book since 1970 resembles today's.

The higher the line, the more a period resembled today; below zero, the economy's shape was the opposite of today's. The shaded bands mark US recessions.

Figure 2. Similarity through history: How closely each Beige Book since 1970 resembles today

Shape match to the October 2026 reading.
100% = identical shape; below zero, the economy's shape was the opposite of today's.



Source: Prescient Investment Management, Federal Reserve Beige Book as on 14 October 2026.

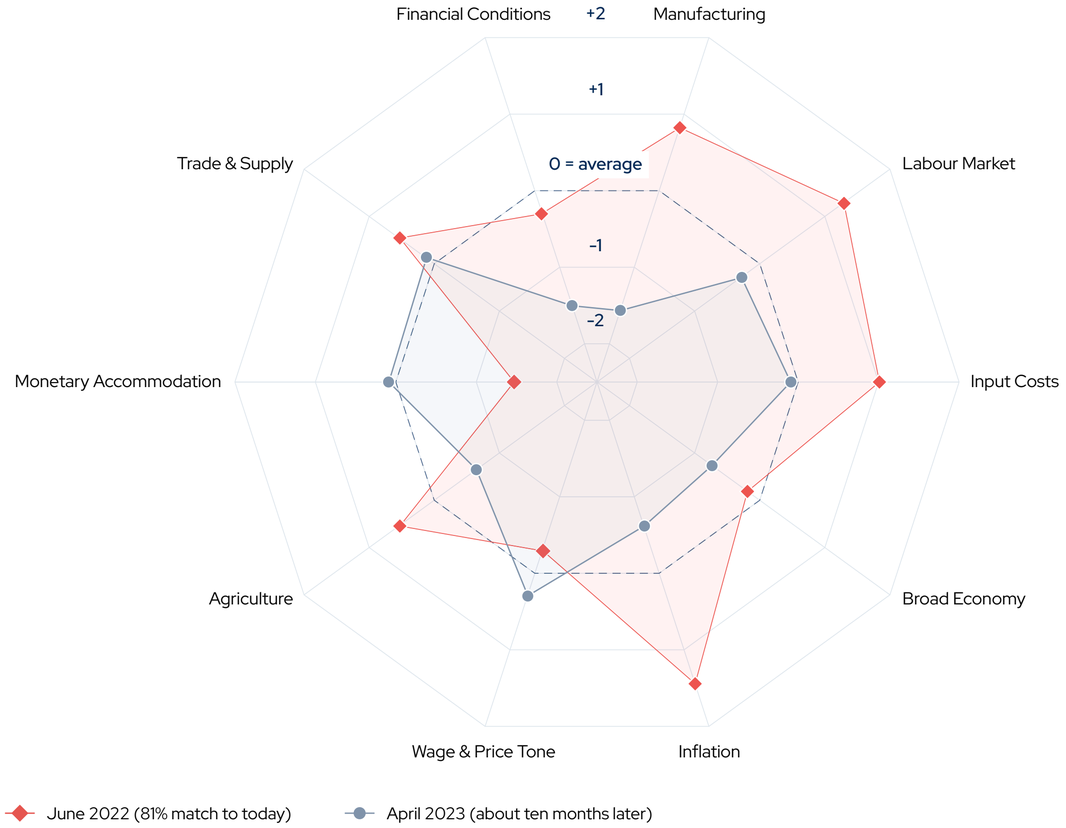
Several periods have looked a lot like today. The strongest matches are January 2021, October 2005, September 1988 and June 2022 which we have been investigating. None of these periods lasted. Each time, the resemblance faded and sometimes even inverted as the economy moved into a different shape.

Some of these matches were also followed by a US recession. The late-1980s and mid-2000s matches both came about two years before a downturn, while 2021 and 2022 were not followed by one. Across the full history, readings of 70% similarity or higher were followed by a recession within three years 57% of the time, compared with 39% for all readings. That is a modest difference based on only a handful of episodes, and our own testing has found that past matches are not a reliable guide to what comes next. We read this as history, not a forecast.

So periods like this one rarely last, and history is mixed on what follows them. Does the economy contract, expand or simply change shape in some other way? Again, we look to the past for guidance: what happened after June 2022?

Figure 3. What happened next: June 2022 compared with April 2023

How far each Beige Book theme sits from its own 1970–2026 average, in standard deviations. April 2023 came about ten months after June 2022.



Further out = unusually high for that theme. For Monetary Accommodation and Financial Conditions, that means looser; for Trade & Supply, more strained.
Source: Prescient Investment Management, Federal Reserve Beige Book as on 14 October 2026.

Figure 3 compares June 2022 (red) with April 2023 (blue-grey), about ten months later. The shape changed a lot. Inflation, manufacturing and the labour market all fell back to or below average, and financial conditions came under strain after the collapse of Silicon Valley Bank. By then the Fed had raised rates by four percentage points. The Beige Book's own summary described overall activity as "little changed", and our Broad Economy theme had slipped slightly further below average. On Figure 2, April 2023 scores −38%, meaning the economy's shape had swung to the opposite side of today's. The economy cooled without contracting, and inflation was falling (4.9%, down from its 9.1% peak), though still well above the Fed's 2% target.

What now?

> No model can tell us what comes next, and the Regime Radar does not try to. What it offers is a measurement in place of a feeling: today's economy looks a lot like mid-2022, and periods like this have not tended to last. Last time, tighter policy cooled inflation without a recession. Whether this cycle follows the same path, and what that means for today's higher yields, is what we will be watching with each new Beige Book. Keep an eye out for more in-depth analysis.

Prescient flagship funds



Prescient Money Market Fund

Invests in cash and high-quality capital market instruments.

FIND OUT MORE

Real: CPI + 1% p.a.
Horizon: 3+ months

Prescient Income Provider Fund

Income producing with downside risk managed while offering inflation protection.

FIND OUT MORE

Real: CPI + 1% p.a.
Horizon: 3+ months

Prescient Income Plus Fund

High yield via credit exposure with inflation protection.

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Real: CPI + 3% p.a.
Horizon: 1+ year

Prescient Flexible Bond Fund

Savings for retirement, offering systematic exposure to local bonds, enhanced with high-performing yield assets

FIND OUT MORE

Real: CPI + 3% p.a.
Horizon: 3+ years

Prescient Defensive Fund

Savings for retirement and other goals offering a more conservative asset allocation including equities and offshore assets.

FIND OUT MORE

Real: CPI + 4% p.a.
Horizon: 3+ years

Prescient Balanced Fund

Long term savings for retirement offering an aggressive asset allocation to mostly equities and offshore assets.

FIND OUT MORE

Real: CPI + 6% p.a.
Horizon: 5+ years

Prescient Equity Fund

Long term savings aiming to consistently outperform peers.

FIND OUT MORE

Real: CPI + 7% p.a.
Horizon: 7+ years

Prescient offshore flagship funds*



Prescient Global Income Provider Fund

Diversified Global Income exposure within a well maintained risk framework.

FIND OUT MORE

Real: CPI + 1% p.a.
Horizon: 3+ months

Prescient Global Balanced Fund

Diversified exposure to a mix of offshore assets with an aim to achieve long term capital growth appreciation.

FIND OUT MORE

Real: CPI + 5% p.a.
Horizon: 5+ years

Prescient Core Global Equity Fund

Cost-effective access to diversified global equity markets.

FIND OUT MORE

Real: US CPI + 6% p.a.
Horizon: 7+ years

*The funds are approved under section 65 of CISCA.

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A Money Market portfolio is not a bank deposit account and the price is targeted at a constant value. The total return is made up of interest received and any gain or loss made on any particular instrument; and in most cases the return will have the effect of increasing or decreasing the daily yield, but in the case of abnormal losses it can have the effect of reducing the capital value of the portfolio. The yield is calculated as a weighted average yield of each underlying instrument in the portfolio. Excessive withdrawals from the portfolio may place the portfolio under liquidity pressures and a process of ring-fencing of withdrawal instructions and managed pay-outs over time may be followed.

Where a current yield has been included for Funds that derive its income primarily from interest bearing income, the yield is a weighted average yield of all underlying interest-bearing instruments as at the last day of the month. This yield is subject to change as market rates and underlying investments change.

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