Higher yields: is it really term premium this time?



Francis Banzon, CFA · Portfolio Manager

PRODUCED BY tam ASSET MANAGEMENT

Five per cent on a ten-year Treasury has not been seen for a while; this autumn it came back. The US 10-year reached about 5.36% on 7 October, its highest since 2002, while in the UK the 10-year gilt sits around 5.35% and the 30-year near 5.75%, close to its highest level since the late 1990s.

Much of the commentary has blamed government borrowing, with heavy deficits, relentless issuance and a fiscal risk premium all pushing yields higher. The fiscal story is compelling and not entirely wrong, but on the evidence so far it explains only a small part of the move.

A government bond yield has two building blocks

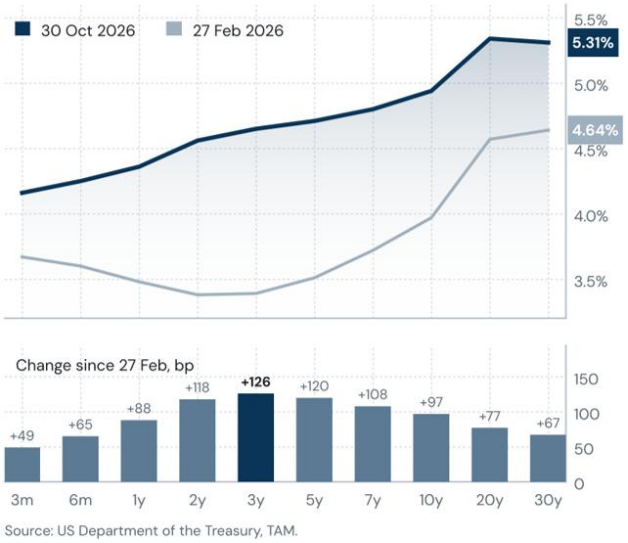
- **Expected policy rates**, what investors think short-term interest rates will average over the life of the bond.
- **The term premium**[1], the extra return investors demand for the risk that rates move unexpectedly while their money is tied up.

Split this year's rise into its parts and most of it reflects markets pricing a higher path for policy rates, after an energy shock pushed inflation up and turned central banks back towards hiking. The distinction is important because the two unwind on different triggers. One depends on oil and central banks, while the other depends on deficits, issuance and who is left to buy long-dated debt.

For a multi-asset investor, telling them apart is the difference between a duration call based on headlines and one based on what is actually driving yields.

Exhibit 1

US Treasury yields are higher across the curve



Source: US Department of the Treasury, TAM.

Key takeaways

- Most of this year's rise in yields reflects higher expected policy rates after the energy shock, not a loss of faith in government finances.
- The term premium is positive again and the forces behind it are slow-moving, but on current estimates it explains the smaller share of the move.
- Bonds once again offer meaningful carry and roll, and in our view the risk-return on duration looks relatively attractive.

"Five per cent is not, on the evidence so far, a sign that investors have lost faith in government finances."

The value of investments can fall as well as rise and you may get back less than you invested.

What's happening?

The sell-off has been global, steep and, until the last fortnight, almost entirely one-way. Since late February, just before the conflict with Iran began, 10-year yields have risen by about 125bp in the US, 113bp in the UK, 96bp in Japan and 81bp in Germany, while France stands out at about 160bp after a poorly received budget widened the gap between French and German yields to its highest since 2011.

At the long end, the US 30-year moved above 5.6% by the end of September and still sits near 5.37%, while the UK 30-year is close to 5.75%, around half a percentage point higher than a year ago. The trigger has been energy rather than a broad pickup in underlying inflation. Brent crude remains above $110 a barrel, and while US headline inflation rose to 3.7% in September, core held at 2.6%. The UK has followed a similar path, with inflation rising to 3.5% from 3.1%, ahead of expectations.

Persistent inflation has left the Federal Reserve raising rates in September for the first time in three years and, although it held in late October, two policymakers voted for a further hike and the statement left the door open to more. Then came last week's US midterm elections, in which Democrats won control of both the House and the Senate, and Treasuries edged higher as investors judged that a divided government would make further tax cuts and spending harder to pass.

Across the Atlantic, the Bank of England raised Bank Rate from 3.75% to 4% on 5 November, its first increase since 2023, as it now expects inflation to approach 5% by mid-2027. The Budget on 28 October, meanwhile, barely moved gilts despite a smaller fiscal buffer, leaving the 10-year at about 5.32%, the highest since 2007.

Bonds have still shown they can do their job, though, as on 22 October, when technology shares sold off on worries about AI spending and investors moved into government bonds, pushing the US 10-year yield down by about 19bp, its largest one-day drop since March 2023, before it settled back around 5%.

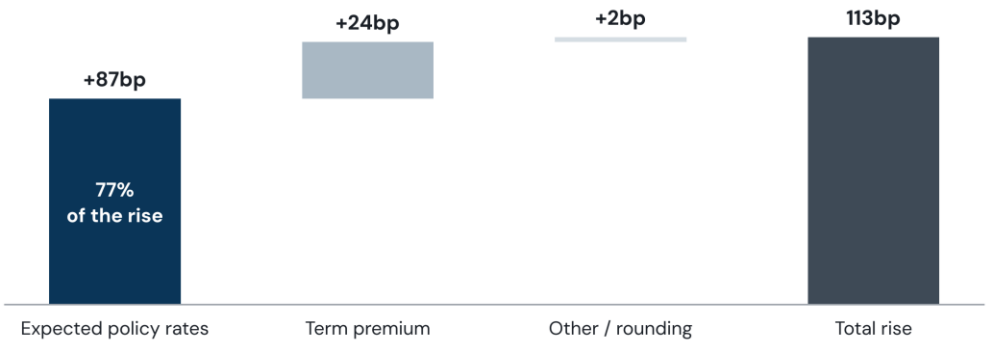
What's really driving yields?

Strip the yield into its parts and the fiscal story shrinks, with most of this year's rise reflecting the market pricing a higher path for policy rates.

Breaking down this year's rise in gilt yields shows what has actually pushed them higher. Of the roughly 113bp rise in the 10-year yield since late February, estimates put around 87bp down to markets expecting the Bank of England to hold rates higher for longer. Just 24bp or so comes from the term premium, the extra return investors ask for to lock their money up for longer. A good part of the move also traces back to the conflict with Iran and the jump in energy prices, so some of it could reverse if the fighting ends.

Exhibit 2

Most of this year's rise in gilt yields reflects rate expectations



Source: NIESR model estimates, TAM. Term premium is a model-based estimate and cannot be observed directly.

There is also a simple way to check this without relying on a model. If investors were demanding much more to lend long, longer-dated yields would have risen faster than shorter ones. Instead, the gap between 10-year and 2-year gilt yields narrowed by around 15bp.

Treasuries point the same way, with most of this year's rise in the 10-year yield explained by expectations of higher policy rates rather than a bigger term premium. Though, the latest leg briefly looked different. Between early September and early October, the term premium accounted for more than half of the move, before easing back as investors sought safety later in the month. Even so, the forces that pushed it higher are slow-moving and harder to reverse than a change in rate expectations. In the US, the government is running a deficit of around 5.5% of GDP, overseas investors hold only about 30% of Treasuries in public hands compared with nearly half in the early 2010s, and technology companies have more than doubled their bond issuance this year to over $200bn to fund AI investment, before counting a growing pile of private credit and leasing deals. More debt is now chasing a smaller pool of committed buyers. The midterm result may ease that pressure at the margin, as a divided Congress makes further fiscal expansion less likely, though it does little to shrink the deficits already in place.

Long-dated gilts have lost some of their most dependable buyers, with domestic demand weakening, the Bank of England's balance sheet run-off adding an estimated 20-30bp to 10-year yields, and the investors stepping in tending to be more price-sensitive and quicker to sell.

Although the UK term premium has climbed from below zero in early 2021 to around 140bp, the increase in the US has been at least as large, which points to a global repricing of duration rather than a verdict on UK public finances.

Partly in response, the Bank of England's revised plan for running down its gilt holdings, set out in September, took around 10bp off 30-year yields on the day. The Budget on 28 October pushed in the same direction, nudging total gilt issuance higher while shifting the mix away from the longest maturities towards shorter-dated gilts and Treasury bills, easing pressure where it has been greatest.

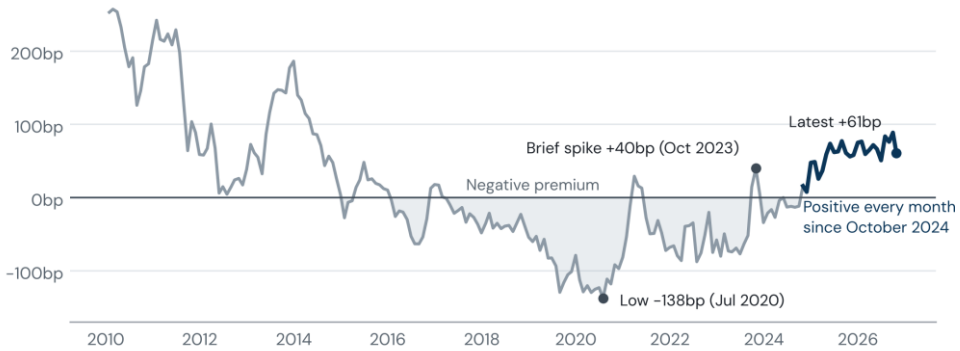
Had a fiscal risk premium been driving yields, the Budget should have hurt gilts, given that the government's headroom against its main borrowing rule, which requires day-to-day spending to be covered by tax revenues, fell to around £15bn from £23.6bn in March. Gilts barely moved, and with the Budget uneventful by design, the market's calm response suggests investors are not, for now, pricing a UK-specific fiscal premium.

Is a positive term premium so unusual?

For most of the last decade, investors were effectively paying for the privilege of lending long. On widely used US estimates, the term premium was negative in all but a handful of months between 2016 and 2024, falling as low as -138bp in mid-2020, and the brief spells when it turned positive, including a spike in autumn 2023, soon reversed. That era appears to be over. The premium has been positive every month since October 2024 and now sits at around 60bp.

Exhibit 3

Investors are being paid to lend long again



US 10-year Treasury term premium, model estimate, basis points, month-end, January 2010 to 27 October 2026. Source: Federal Reserve Bank of New York (Adrian, Crump and Moench model), TAM. Past trends are not a guide to the future.

The UK shows the same shift over a longer horizon. Since February 2022, 10-year gilt yields have risen by about 450bp, and estimates suggest close to half of that reflects a higher term premium. The 30-year gilt now yields more than at any point since the late 1990s.

This can look alarming, but history suggests otherwise, because through much of the 1990s and before, investors routinely demanded extra compensation to hold long-dated bonds, and a positive term premium was the norm rather than the exception. The anomaly was the decade of ultra-low rates and central bank bond buying, when that compensation was squeezed out. The UK's 2022 pension fund crisis was a different kind of event, a sudden liquidity squeeze rather than a gradual repricing, and not the conditions today.

What does this mean for portfolios?

The split between rate expectations and the term premium matters because each responds to different levers, and that shapes how we think about duration.

If most of this year's rise reflects expectations of higher policy rates linked to the energy shock, then the main route to lower yields runs through oil and central banks rather than through budgets. A durable easing in the Middle East, or signs that higher prices are weighing on demand, would matter more for bond markets than any fiscal announcement. Until then, rate expectations are likely to stay sensitive to each inflation release and central bank meeting.

With 10-year yields around 5% in both the US and the UK, and a term premium that is positive once again, starting yields look very different from the past decade, and bonds now offer meaningful carry, the income earned simply from holding them, which acts as a cushion against further volatility. While that does not tell us where yields go next, it does change the balance between risk and reward in holding duration.

With yield curves sloping gently upwards, bonds also benefit from a modest roll, the gain that comes as a bond moves closer to maturity and is valued at the lower yield of a shorter-dated bond, provided the curve does not shift. Together, carry and roll mean bonds can add to returns even if yields stay where they are. Where along the curve that duration sits still matters, though. With the UK shifting issuance away from the longest maturities and the term premium the slower-moving part of the yield, the very long end may remain more exposed to swings in supply and investor appetite than intermediate maturities.

In September, bonds and equities fell together as the oil shock pushed up inflation expectations. Yet in October, when technology shares sold off on concerns about AI spending, government bonds rallied. The difference lies in the type of shock. Bonds have tended to cushion growth scares but have offered less protection when inflation is the problem, which is why a broader mix of diversifiers matters in the current environment.

Higher long-term yields also matter beyond fixed income, because they raise the discount rate applied to future earnings, which tends to weigh most on companies whose value rests on profits far in the future. Meanwhile, record corporate bond issuance, much of it tied to AI investment, competes for the same pool of investors as government debt.

For our traditional active portfolios, this is an environment that rewards flexibility rather than fixed views. Active management allows us to adjust duration as the balance between rate expectations and the term premium shifts, to be selective about where on the curve and in which markets we take interest rate risk, and to look beyond government bonds for diversification when inflation, rather than growth, is the main risk. In recent months, we have moderately added to duration in our gilt exposure, reflecting higher starting yields and the income they now provide, while keeping the overall position measured given the uncertain path of inflation and policy. Above all, active management means distinguishing between what is driving yields and what the headlines say is driving them.

What could change the picture?

None of this means yields have peaked. It means the route lower runs through oil and central banks before it runs through finance ministries. The table below sets out four broad scenarios and how each could affect the two parts of the yield.

Exhibit 4

Four ways the picture could change

Scenario	What could trigger it	Rate expectations	Term premium	What it could mean for portfolios
Energy shock fades	A settlement in the Middle East, or higher prices weighing on demand	↓ Fall as rate hikes are priced out	→ Little changed	Bonds likely to benefit, particularly intermediate maturities
Energy shock persists	Continued supply disruption keeps oil prices high	↑ Rise as central banks tighten further	↑ Edges higher	Yields stay elevated and bonds and equities more likely to fall together, so real assets and other diversifiers matter more
Supply concerns return	Heavier government borrowing, weak demand at auctions or more AI-related corporate issuance	→ Little changed	↑ Rises	Longest maturities most exposed and yield curves steepen
Growth scare	A pullback in AI investment or a broader equity sell-off	↓ Fall	↓ Falls as investors seek safety	Government bonds act as a diversifier, as they did briefly in October

Illustrative scenarios only, not forecasts. Source: TAM.

There is a reasonable counter-argument to our reading. The most recent leg of the US sell-off was driven more by the term premium, and deficits remain high on both sides of the Atlantic. We accept that structural pressures are building, but on the evidence so far, they explain the smaller share of this year's move. Estimates of the term premium also vary between models, which is why simpler cross-checks, such as the narrowing gap between 10-year and 2-year gilt yields, carry weight.

In the near term, how far the Bank of England goes after November's hike, the Federal Reserve's December meeting, the policy agenda of a newly divided Congress and the next round of inflation data will be the key tests of which path markets follow.

The bottom line

Five per cent is not, on the evidence so far, a sign that investors have lost faith in government finances. The term premium has played a smaller part in driving yields higher, and its brief surge in early autumn has since eased.

This does not mean the fiscal story should be ignored, but the forces behind the term premium, from heavy government borrowing to a smaller pool of committed buyers, are slow-moving and unlikely to reverse quickly. A positive term premium also looks less like a warning sign and more like a return to normal after a decade in which investors were barely paid to lend long.

For investors, the practical upshot is that bonds once again offer meaningful carry and roll, while their value as a diversifier depends on whether the next shock comes from inflation or growth. In our view, the risk-return on duration now looks relatively attractive, and we have begun adding to it in our portfolios. Today, a good approach argues for flexibility over fixed views, a measured approach to duration and a clear eye on what is actually driving yields rather than what the headlines suggest.

[1] The term premium cannot be observed directly. Figures in this note are third-party model estimates, and different models produce different results.

Sources

Note: term premium and yield decomposition figures are model-based estimates from the third-party sources listed below, not TAM calculations.

- US Department of the Treasury: Daily Treasury par yield curve rates
- Federal Reserve Bank of New York: Treasury term premia, ACM model data
- NIESR: Market Anatomy, why have gilt yields risen so much this year?
- Bank of England: Dave Ramsden, Quantitative tightening: the next chapter
- UHERO: The 2026 global bond sell-off
- Oxford Economics: Why higher term premia will slow the fall in gilt yields
- Kiplinger: October Fed meeting live updates
- Top1Markets: 10-year Treasury biggest drop since 2023
- Parallax: ACM 10-year term premium at +92bp
- HomeOwners Alliance: BoE rate predictions and Reuters poll
- Newsquawk: UK Budget 28 October preview; UK Budget 2026 market analysis; DMO gross gilt issuance £250.6bn
- 24/7 Wall St: AI pushes corporate bond sales to a record
- Portfolio Adviser: fiscal headroom falls by £8.6bn; gilts steady after Budget
- MarketScreener: gilt yields ease, sterling slightly lower
- Reuters: Analysts react to US midterm election results
- FinancialJuice: Stocks and dollar slide as Treasuries rally on election result
- Trading Economics: Treasury yield edges higher ahead of midterm election results
- Trading Economics: UK 10-year and 30-year gilt yields; 30-year gilt at 27-year high

Important information. © 2026 TAM Asset Management Ltd. This document is intended for investment professionals only. Its contents should not be distributed to, or relied on by, retail clients. This document on its own is not intended as an offer, solicitation or recommendation to use or invest in any of the services or products mentioned in it. The investments and services referred to in this document may not be suitable for all investors and TAM Asset Management Ltd (TAM) does not give any guarantee as to the performance or suitability of an investment for a retail client. Past performance is not a guide to future returns. The value of an investment and the income from it, may go down as well as up and may fall below the amount initially invested. Any opinions, expectations and projections within this document are those of TAM and do not constitute investment advice or guaranteed returns. TAM is authorised and regulated by the Financial Conduct Authority, No. 208243. Registered in England, No. 04077709. Registered Office: One Leadenhall Floor 23, 1 Leadenhall Street, London, EC3V 1AB