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An Invidious Choice? Towards Bond Market Crisis or Yield Curve Control

The yields on long bonds have risen to multi-decade highs. Debt sustainability fears have festered for years but to no tangible effect—either on investment portfolios or political debate. The most likely route is that the “can is kicked” on both debates; after all, >2% real yields will be tempting to many investors.

Nevertheless, in this note we think about the possible next stage. The political stance on deficits is just not serious on either side of the Atlantic. Politicians inhabit a land of make-believe. The demands of retirement savings and the coming rebalancing of pension assets away from nominal duration implies that a change will come.

We take the unpopular stance that a bond-market crisis would be a good thing, as probably the sole route to engender change and avoid worse intergenerational tension later. However, in practice politicians might balk and stop yields from rising by fiat, thereby triggering inflation and currency implications.

How bad would higher yields be for equities? So far, this rise has been masked by AI-led upward revisions to expectations, but we think that techno-optimism is naïve. Still, we think a strategic pro-equity position is still warranted.

This is a global problem, though the specifics vary. The US has growth (at least for some) but short debt maturity, European countries lack growth and are worryingly dependent that pension plans want to buy their bonds. Investors have not learned, despite 2022’s experience and the UK’s Liz Truss moment. They still believe in the myth of “risk-free assets.” Any current calm is not an equilibrium.

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The rise in bond yields in 2026 raises questions for investors and governments about what comes next. After six decades of climbing government debt and at least a decade of fretting about what level would be unsustainable, is this a sign that markets are taking a firmer line? Does US Treasury Secretary Scott Bessent's double intervention during August— in the yen and US long-bond markets—imply a more overt, fiscally led, approach to this issue? In the longer sweep of history, today's yields are not exceptional, but they raise strategic questions about asset allocation and government funding against a cavalier approach to deficits in many major economies and an inexorable tilt in the allocations of pension systems away from bonds.

In this note, we consider options for the way forward in the longer term. We are explicitly not going to opine on what this means for near-term Fed policy, as we keep the focus strategic. Some have suggested that, because it is real yields and not inflation expectations that have risen, this is at most a benign sign of future abundant growth. We are not so sanguine. This is a theoretical argument based on equilibria of recent decades that may not apply any longer. Growth is indeed very strong in the near term. Yes, there is an artificial intelligence (AI) reason why it could be high long term as well. However, equally other aspects of that could go wrong (political backlash and rising inequality, for example), so it seems equally likely that higher yields reflect a term premium of long-run distrust in fiscal policy and a questioning of the demand for nominal assets. One could also suggest that higher long rates are purely a function of investors wishing to price in higher near-term rates, but that notion sits uneasily with a yield curve that is as steep as it has been in years.

Another potentially significant change has been the proposal by Norges Bank, in its September 2026 submission to Norway's Ministry of Finance,¹ to reduce government bonds from 70% to 50% of its fixed income benchmark, while not making an overall change to the fixed income exposure or to its geographic footprint. This recognizes that long-horizon investors do not need such a large allocation to sovereign duration for liquidity and diversification. It also shows that such views are not necessarily fixed income negative in general; they are more about the role of nominal duration, particularly in a strategic asset allocation (SAA) context, and the desire to allocate to other areas—be it inflation-protected bonds, active allocation in credit or potentially private debt.

There are a few options for the way forward. Very broadly, either: things can stay as they are, “crisis deferred;” yields could continue rising to levels that are painful for governments and investors; or governments could become more proactive in stopping yields from rising.

Given how long these issues have been discussed, one should never underplay the option that the most likely way forward is what we have seen before, i.e. a “muddling through.” This is a more likely near-term route than the other possible outcomes discussed here. Institutional inertia is a powerful force, in this case the inertia of policy formation by politicians and inertia in the governance of global pension systems, with the lazy perpetuation of the idea that government bonds are “risk free” and a source of necessary liquidity. This amounts to a fetishization of the role of government bonds in SAA. Even when the (thankfully ditched) Mar-a-Lago accords were causing alarm among bond investors in early 2025, in the end there was no net outflow. Likewise, the parallel fall of equities and bonds in tandem in 2022 didn't cause a strategic rebalancing. The way that global institutional investors function meant that demand for liquidity swamped other concerns. Yet, there have been tests to this calm. Perhaps most obviously, this happened recently in gilt markets in response to the “Liz Truss moment” and a little longer ago in the eurozone debt crisis. Moreover, for the US at least, this is happening with the increased questioning of the US dollar's reserve status. We have made the point before that changes in reserve-currency status are very slow, so let's not hold our breath, but there are geopolitical reasons in addition to economic ones to question it.

We suggest that the calm will not last indefinitely and that no amount of institutional inertia can stop a pull upward in yields, because of a combination of demographic pressure (at both ends of the age distribution), an unsustainable balance of promises vs. the ability to tax, and a shift from defined benefit (DB) to defined contribution (DC) pensions and what that means for the need for real returns. The only force big enough to change this upward pull in theory is AI, but we don't buy it. The supposed techno-optimist utopia of superabundance and growth is, we think, naive. Indeed, if AI really is that effective, then we have a far worse set of problems on our hands than mere government funding and SAA.

So, ultimately, albeit with highly uncertain timing, there are two options: either a bond market crisis or a government intervention in bond markets, i.e. yield curve control (YCC) or something akin to it. Of these, we would prefer a bond market crisis, however painful, as probably the only way to bring about meaningful change. We do not think the current raft of politicians in the US,

¹ Please see: "The Government Pension Fund Global – analyses and assessments of the investment strategy for bonds" <https://www.nbim.no/en/news-and-insights/submissions-to-ministry/2026/the-government-pension-fund-global--analyses-and-assessments-of-the-investment-strategy-for-bonds/>

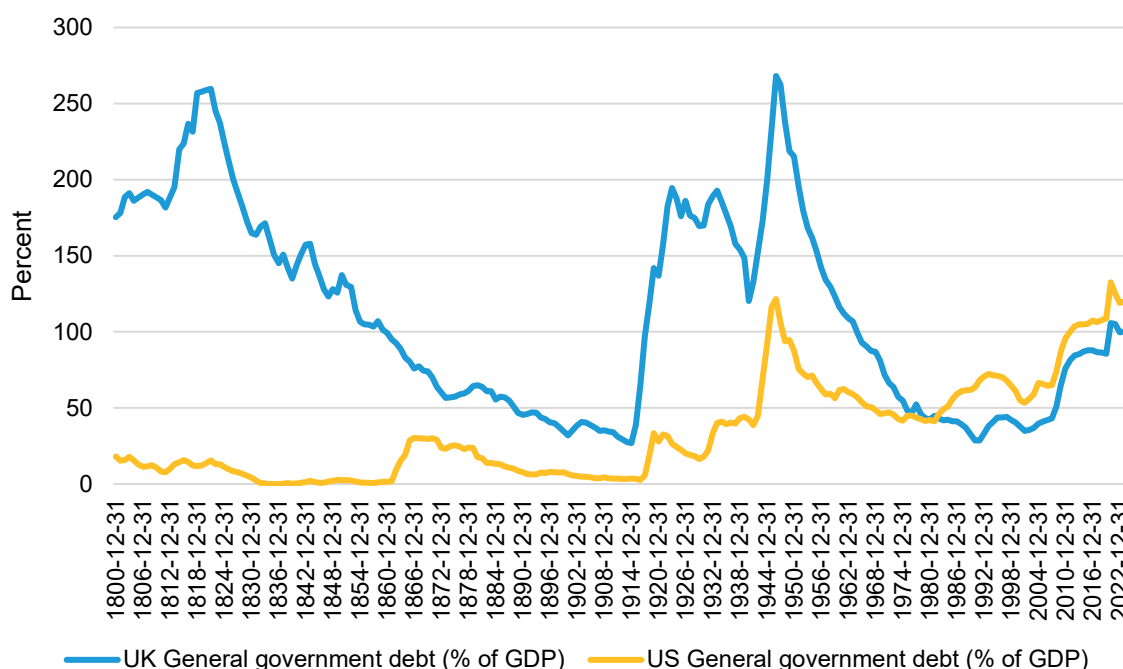
Europe or Japan are capable of bringing about change; it's not even on their agendas. The bond market could give them an excuse. What might be more likely in practice is that if a bond market crisis looks probable, then a policy shift toward YCC might become more appealing.

Politicians in the land of make-believe

Lots of ink has been spilled over the shift upward in US 30-year Treasury yields to two-decade highs. Equally, both of Bessent's August interventions sparked related questioning. Was the intervention in the yen more about trying to prevent yen instability from turning into Japanese selling of US Treasuries? Likewise, is the increased buying of long-maturity debt the start of a bigger program of intervention in curbing the cost of debt?

But debt levels have been rising since Richard Nixon took the US off the gold standard in 1971 – so why worry? Today's levels of government debt/gross domestic product (GDP) have only been experienced before in the US and UK in times of existential conflict, e.g., the Napoleonic wars, WWI and WWII (*Display 1*). We have reached a similar level today, thankfully with no existential conflict, but seemingly just to keep consumers happy. The funds were not consistently invested to raise productivity (the recent hope that AI might lift productivity is different and we cover it below).

DISPLAY 1: TODAY'S DEBT LEVELS HAVE ONLY BEEN SURPASSED IN THE US AND THE UK DURING TIMES OF EXISTENTIAL CONFLICT



Historical analysis does not guarantee future results.

As of December 30, 2025

Source: Anansi Data Analytics and AllianceBernstein (AB)

However, so what? Japan has shown us that debt levels can rise to very high levels without causing an investor exodus. We have discussed in previous notes² how debt service as a share of government expenditure is probably a harder constraint. Niall Ferguson suggested that once a great power spends more on debt service than defense, then it is no longer a great power, citing the UK, Ottoman and Austro-Hungarian Empires as examples.³ The US passed this worrying milestone in 2024. Yet

² [The Dollar: Half Awake in a Fake Empire?](#)

³ Niall Ferguson "Ferguson's Law: Debt Service, Military Spending, and the Fiscal Limits of Power," Hoover Institution History Working Papers, Stanford University, Stanford, CA, February 21, 2025, <https://www.hoover.org/sites/default/files/research/docs/HAHWGWorkingPaper-212502-Ferguson%27s%20Law-Final.pdf>.

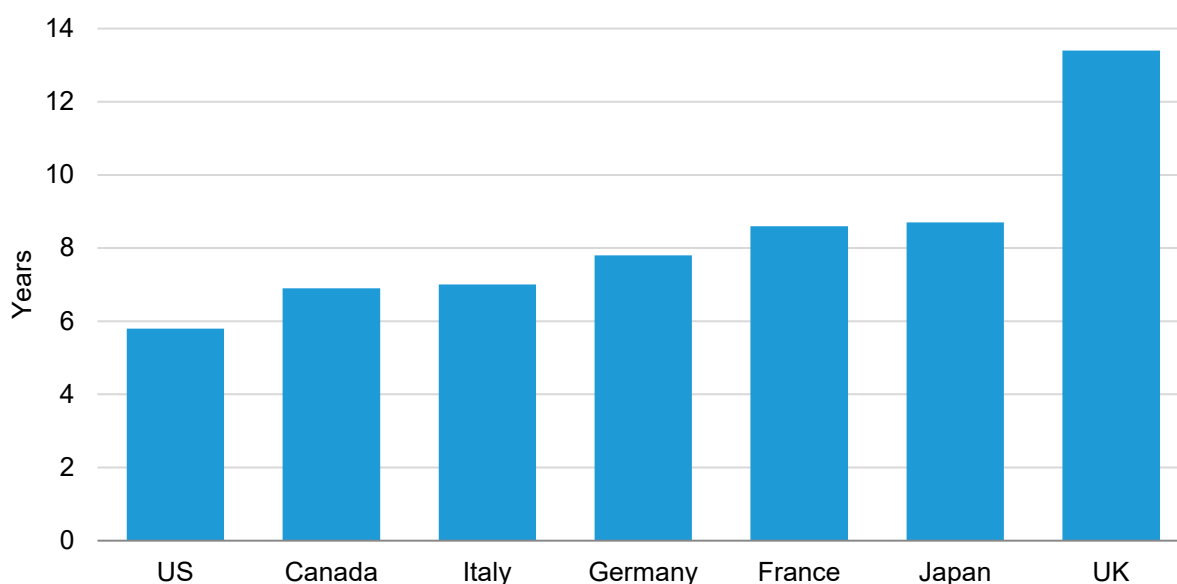
maybe even this is not enough to prompt change. Take the UK as a case in point. Despite the largest war in Europe since WWII, a capricious US administration causing existential doubt over the reliability of NATO promises, a shocking absence of ballistic missile defenses and a promise to raise defense spending, the new chancellor (who had previously been secretary of defense and resigned specifically over lack of funding) declined to try to shift the balance. The fiscal box is too tight. If even defense threats haven't galvanized people, it's hard to imagine what would.

We think the pattern is similar, albeit with different details, in most major economies. The debt/GDP ratio has risen for decades without causing crises. Yet, we would argue that the 1980–2020 period was unusually special given a demographic boost, globalization, high starting yields and no need to price climate externalities. None of that applies today. Yet politicians have not begun to seriously explain this to voters. Going into the last US election, both Democrats and Republicans were happy to be deeply unserious about fiscal commitments. The same applies in Europe. The degree to which the UK government is fiscally boxed in appears to lead to an inability to bring about change, to invest or to meet urgent defense needs. In France, the early positioning of candidates for the next presidential election has, on the one hand, Mélenchon calling for French government debt to be “thrown into the fire” and, on the other, Le Pen making far-reaching fiscal promises including lowering (!) the retirement age. One can only conclude that politics is operating in a world of make-believe.

The exact nature of the problem varies by country. The US, at least, has growth and a reserve currency for now. Growth is not in plentiful supply in Europe, the UK or Japan. Moreover, pension funds' high ownership share of debt in markets like the UK used to be an advantage, as it gave a handy buyer for local debt. However, the shift to DC, less efficacy in bonds' ability to hedge equity risk, and greater willingness to question the assumed risk-free nature of government debt can turn this high concentration of institutional ownership into a liability.

The problem in the US is different; it is that the shortening of maturity increases vulnerability. This issue has been helped in the short term by the jump in demand for short-term debt from issuers of stablecoins and hedge funds, but that extra demand presumably will not persist indefinitely. Other countries are starting to move in this shorter maturity direction, too, given the shift in yields. Notably, the Bank of England recently announced a shift in this regard.

DISPLAY 2: DEBT MATURITY FOR MAJOR ECONOMIES



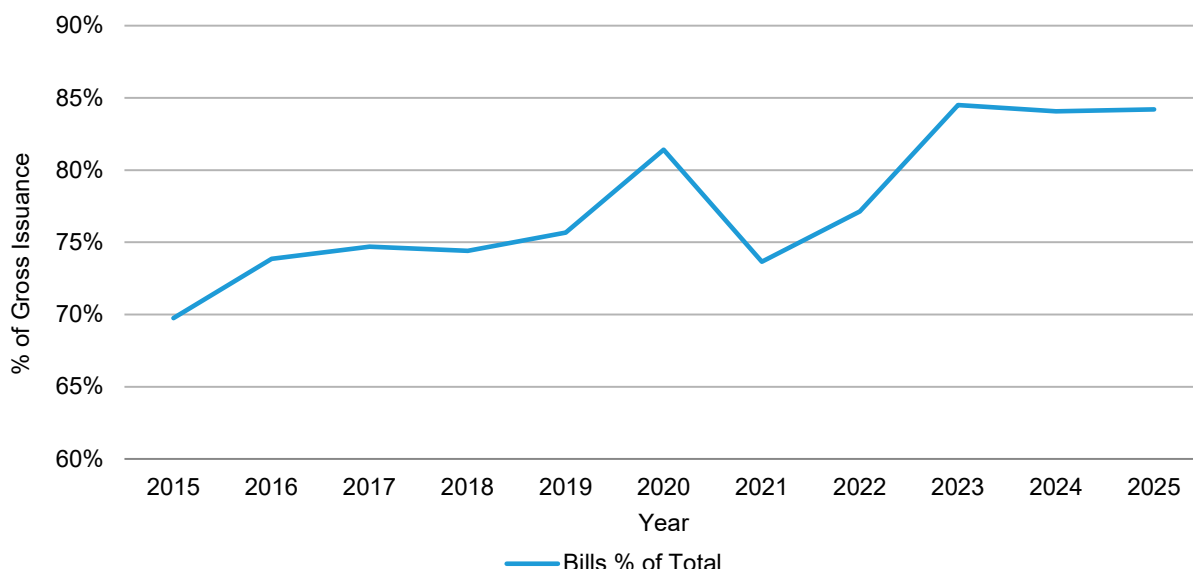
Historical analysis does not guarantee future results.

As of December 30, 2025

Source: Bank of England and HM Treasury calculations; reproduced from HM Treasury, Debt Management Report 2026-27 (Annex A, Chart A.5, p.24), Bloomberg L.P. and AB

At close to five years, the weighted-average maturity of US debt is low compared to other countries and has been this way for some time, but this belies a bigger problem with the issuance of new debt: a shift to shorter-term issuance has taken place that is unusual outside of recessions, Display 3.

DISPLAY 3: SHORTENING OF US DEBT MATURITY—T-BILLS FORM AN UNUSUALLY HIGHER SHARE OF US DEBT ISSUANCE



Historical analysis does not guarantee future results.

As of September 15, 2026

Source: SIFMA and AB

This all ends up being about politics rather than economics or finance, which have always been downstream of politics anyway; it's just that some people thought it might be convenient to forget this fact. This points to extra difficulties. The splintering of political consensus and the rise of parties on the far left and far right seem here to stay, and they pose a problem for long-term investors in government bond markets because it becomes hard to see beyond multiple elections. This is especially a problem in countries like the UK, where its first-past-the-post system is ill suited to a future with many political parties as opposed to two and a half.

At the same time, the shattering of the US-led rules-based order and threats to the existence of NATO and other defense pacts imply that defense spending has to rise significantly for the largest economies. This hasn't yet happened to the required degree.

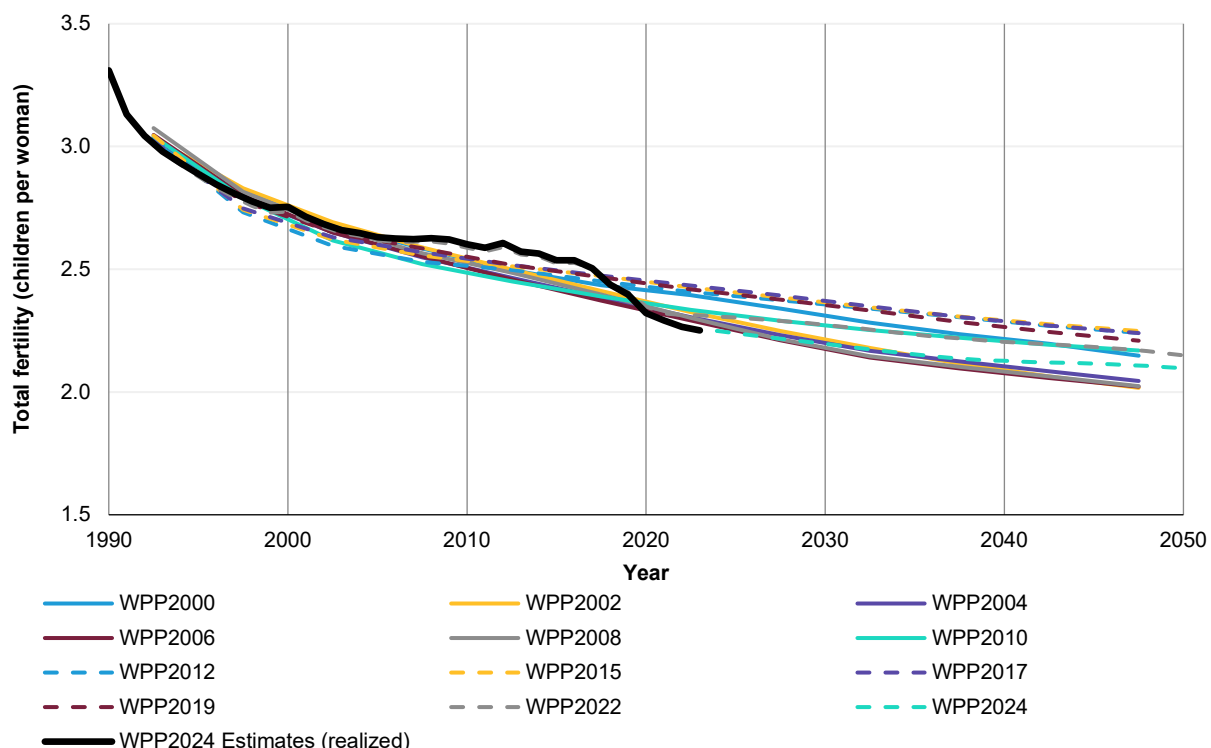
The retirement problem... and demand for bonds

It's tempting to say that the status quo can continue; after all, that is usually the default position. However, we think it cannot for two reasons linked to what we view as the contemporary retirement problem: the ability of people (voters!) to have a retirement and the kinds of assets that retirement systems need. The concept of retirement was mainly an invention of the early twentieth century but has not been updated for contemporary reality. We would cite this retirement problem as a combination of:

- **Demographics problem I:** Greater longevity. This is a very nice problem to have, of course, but it means that either far more needs to be saved in funded systems, or that in unfunded systems, taxpayers in future generations have to pay a lot more. Which leads us to:
- **Demographics problem II:** Fewer babies. The birth rate has been declining for decades, but in the last decade there has been an exceptionally rapid decline, noteworthy in how it has affected rich and poor countries. The Mexican fertility rate is now the same as the US fertility rate, for example. A revision is needed in the demographic assumptions that underpin much long-term planning, as we are now closer to the low end rather than the medium level of the

widely used United Nations population forecasts; this will put downward pressure on expected GDP growth rates. Granted, this creates a long-horizon problem, but that is exactly the point in any discussion of fiscal policy that kicks the problem onto the next generation (*Display 4*).

DISPLAY 4: COMMON DEMOGRAPHIC ASSUMPTIONS WILL LIKELY HAVE TO BE REVISED LOWER
WORLD FERTILITY FORECASTS ACROSS UN WORLD POPULATION PROSPECTS VINTAGES (MEDIUM VARIANT)



Historical analysis does not guarantee future results.

As of September 14, 2026

Source: Macrobond, UN Population Division and AB

As an aside, it's probably a controversial view, but we think that fewer babies is actually a good thing. It is too late to curtail a warming of the planet by two degrees, but declining birth rates have broader implications for reducing the wider human impact on the planet and ameliorating the "Anthropocene." We are also scathing of ethical arguments that more babies are a "good," see our review of *After the Spike* in our Book Review Summer 2026.⁴ We will also deal with this topic at length in a forthcoming note on demographics.

To continue the list of sources for the retirement problem:

- **Higher equilibrium inflation:** We won't rehash the argument here,⁵ but we think that equilibrium inflation will be higher than in recent decades. Let's call it 3% rather than 2%. This further increases the cost of retirement.
- **Political impossibility of immigration:** A possible answer to the demographic problem would be to increase immigration, but the political path to that option seems impossible in most large economies.
- **Low future returns:** Something that made retirement goals seem possible was that cross-asset valuations on equities and bonds had been lower historically. We are not claiming that there must be a reversion to long-run valuation means (such a view would be incredibly bearish). However, at the same time it is not possible to claim that

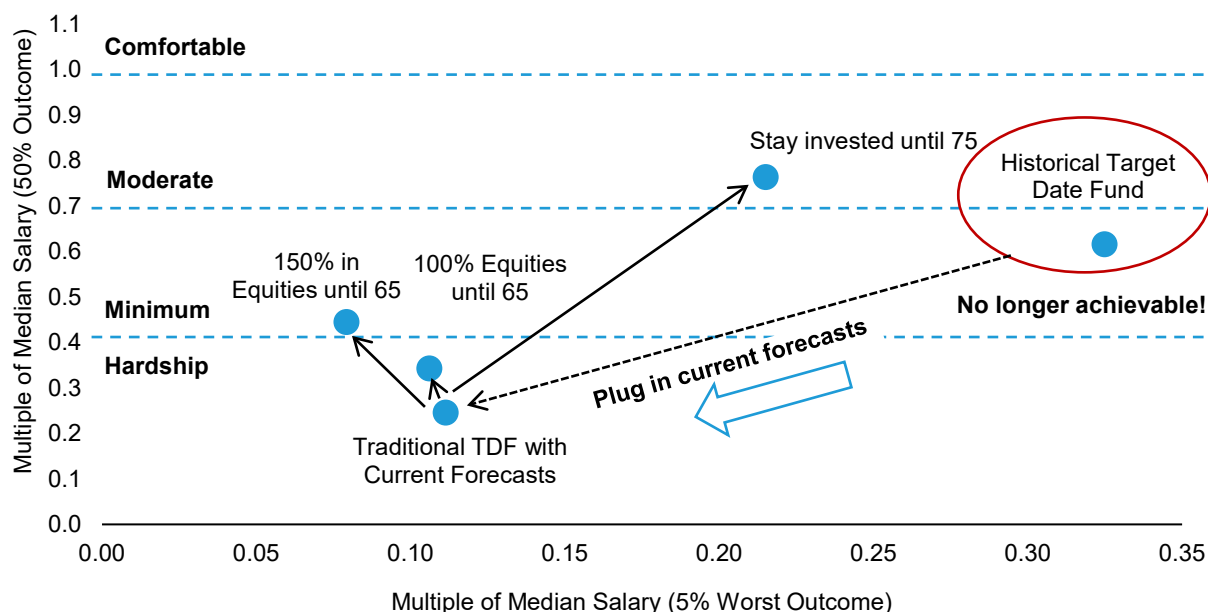
⁴ <https://www.alliancebernstein.com/content/dam/global/insights/insights-whitepapers/book-review-summer-2026.pdf>

⁵ See [US Exceptionalism, AI and Towards the Total Portfolio](#).

there is a plausible path of upward re-rating of major assets. This contributes, *inter alia*, to the likelihood that future returns will be lower. Hence, in situations where pensions are funded, the required savings amount is even higher.

We show in *Display 5* the expected annual income in retirement as a proportion of national median income for someone who starts saving in their early 20s and retires at 65, contributing 8% of their salary each year into a retirement savings plan. The horizontal axis is the outcome that would be achieved in the worst 5% of cases. So, one can think of this as expected retirement income vs. the lower-range risk to that income. Using the historical return of target date funds and historical inflation, then retiring at 65 is a possibility with an acceptable level of retirement. However, substituting our forecasts for lower returns, less equity-bond diversification and higher inflation implies that the current model is broken. Even investing entirely in equities on a levered basis over the whole life cycle isn't enough (and carries unacceptable risks). The only way to achieve the required quantum of increase in the savings pool is to work for an extra decade, and with this we also assume staying invested in risk assets far longer.

DISPLAY 5: THE SOCIAL ROLE OF OUR INDUSTRY: IS RETIREMENT STILL POSSIBLE? MAYBE, BUT WE NEED TO TAKE RISK FOR LONGER, AND BONDS ARE NOT LOW RISK!



Past performance does not guarantee future results.

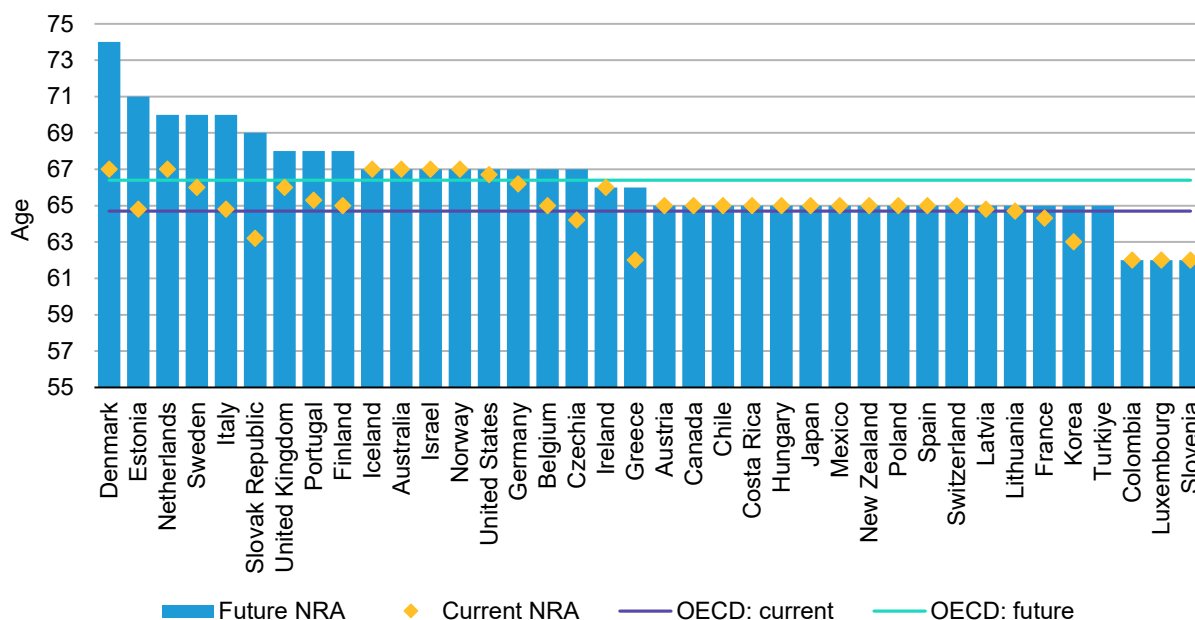
Display shows the expected median income in retirement (annuity rate) plotted against the likely worst fifth percentile of retirement outcomes. We overlay lines showing how these outcomes relate to different levels of comfort in retirement using the PLSA definitions of retirement needs as a percentage of national median income. The baseline TDF strategy simply invests 100% in equities until the age of 45, then has a linear reallocation over 10 years to become 100% bonds by age 55. The examples shown are as follows: (1) the historical TDF strategy shows the median outcome of returns from such a strategy over complete lifetime savings cycles since 1970, while the distribution of returns uses a longer lookback period to all outcomes since 1941. (2) The same target-date structure applying our forecast of lower return and positive stock-bond correlation. (3) A simple approach to taking more risk with 100% equities through the entire career. (4) 150% equities through the entire career. (5) 100% equities until age 65 and then a linear reallocation to 100% bonds at age 75 and retire at 75.

As of May 31, 2024.

Source: Anansi Data Analytics, Macrobond, PLSA and AB

The only way to solve the retirement problem is by working longer. There are signs in some economies that this has started to happen, but in most cases the expected increases in retirement age are minimal (*Display 6*). Messing around with one-year increments to retirement age is not going to cut it.

DISPLAY 6: SOME COUNTRIES ARE SEEING AN INCREASE IN EXPECTED RETIREMENT AGE, BUT OVERALL, THIS CHANGE HAS SO FAR BEEN MINIMAL



Historical analysis does not guarantee future results.

As of November 27, 2025

Note: The chart shows current and future retirement age for a man with a full career starting from age 22

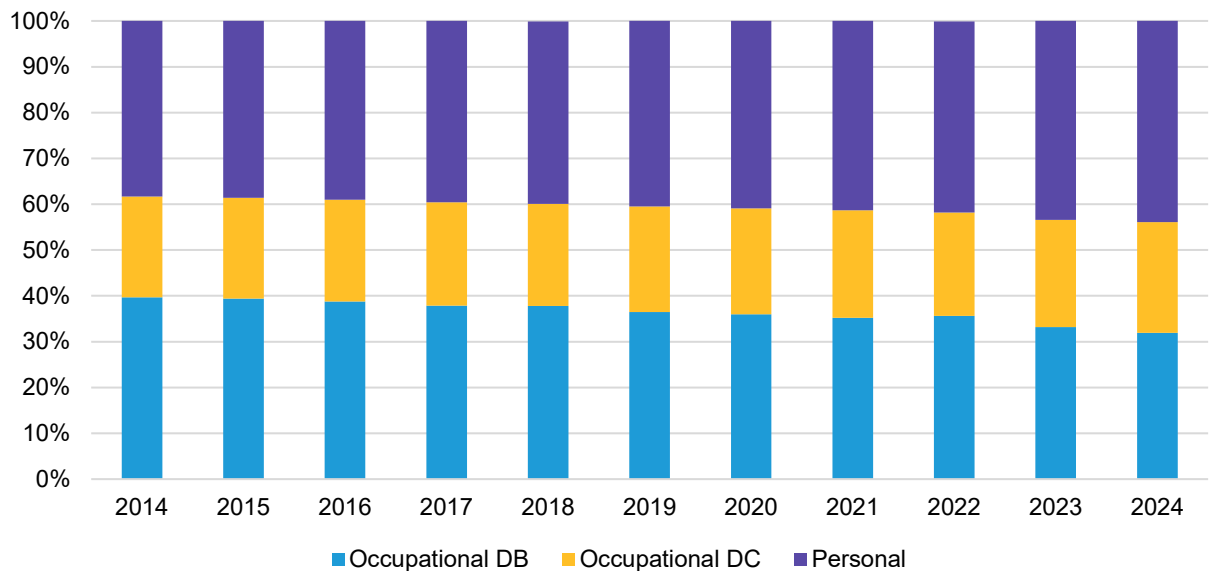
Source: OECD (2025), Pensions at a Glance 2025: OECD and G20 Indicators, OECD Publishing, Paris. and AB

Could several huge shifts in health data counteract this? We would point to two that are particularly significant in this regard: 1) There has been a material decline in dementia rates over the last decade. The cause seems not well understood, but what had served as a potentially huge limit to working life and an extra driver of hard-to-automate care costs seems to be less bad than had been assumed before. 2) The second significant issue here is the rise of GLP-1 drugs. Their long-term direct impact on health notwithstanding, the indirect help to potential working lifetime via obesity and related conditions is significant. Having said that, the role of AI in disrupting the workforce is significant here. These improved health dynamics lessen the retirement problem by allowing a much larger proportion of the 65–75-year-old cohort to continue to work. Of course, this presumes that the AI economy creates demand for jobs that this cohort can perform. The largest increase in employment for the 65+ cohort in recent years has been in service sectors highly exposed to AI.

The other problem is political. Attempts at even very modest increases in retirement ages have met with a huge backlash, showing that politicians haven't begun to properly prepare the ground. In systems where there are usually savings to cover retirement, such as the US, UK and Holland, there is sometimes an assumption that it is not the problem of the government. We reject such a view; it only takes one election to put any shortfall onto the government's balance sheet. However, the situation for unfunded systems is clearly worse, as they don't even have the savings cushion to get through first.

The other side of the "retirement problem" is what the "output" of the retirement-saving system means for demand for different kinds of assets. There has been a shift taking place for years from DB to DC plans. This is now well advanced and, as *Display 7* shows, DB share in the OECD nations will be 29% by 2030 and the combined Occupational DC and Personal share will be 71%, assuming that growth continues at the last 10-year average rate.

DISPLAY 7: DC ASSETS ARE INEXORABLY BECOMING A LARGER SHARE OF RETIREMENT ASSETS



Historical analysis does not guarantee future results.

DC assets as a percentage of total assets in OECD countries. From OECD (2025), Pension Markets in Focus 2025, OECD Publishing, Paris

As of September 15, 2026

Source: OECD and AB

This shift has profound implications for asset allocation. DB plans have an incentive to match a large part of liabilities with nominal assets, especially in the case of closed DB plans, where the end-game is to de-risk by selling to insurance companies, who in turn are incentivized to hold nominal bonds. For DC plans, by contrast, it is not clear that they should hold a significant allocation to nominal bonds at all. They might have them as part of longevity insurance bought late in the glide path, say from about age 70 onwards, but those bonds will be of significantly shorter duration than traditional pension fund bond allocations. The old model of “de-risking” by rebalancing from equities to bonds just as the pension pot starts to become large at some point in the saver’s midlife phase looks like a decidedly risky option in a high-inflation and greater-longevity world.

This is a much bigger problem for smaller economies without sizable pension systems such as the UK, Japan and Holland. In these markets, the pension and insurance sector accounts for a third to a half of bond ownership (*Display 8*), so a trend decline in this position raises questions about who else would want to step in to buy these assets.

This is part of a bigger issue, whereby in recent years price-sensitive investors have ended up owning a larger share of government bonds, as central banks have stepped back and issuance has grown.

DISPLAY 8: SHARE OF LONG-DURATION GOVERNMENT DEBT OWNED BY PENSIONS AND INSURERS

Country	Long-Duration Definition as Residual Maturity	Investor Definition	Est. Share of Long-Duration Gov't Debt Held	Date	Comment
UK	>15 years	DB pensions + insurers/LDI	~35–45%	2025/26	Estimate from BoE/ONS/DMO data. DB pensions remain highly exposed to the long end, although this is falling. BoE estimates weighted-average maturity of pension/LDI gilt purchases has fallen from ~25yrs in 2018 to ~14yrs in 2026. Bank of England
US	>10 years	Private + public pensions + life insurers	~8–12%	2025/26	Approximation. Fed Financial Accounts give sector Treasury holdings but don't cross them by maturity, so this applies maturity profiles to sector holdings. Unlike UK/NL/Japan, US pensions have relatively little structural need to own ultra-long government bonds. Federal Reserve
Netherlands	≥20 years	Pension funds + insurers	~45–55%	2025	Estimate from DNB security-level holdings. Dutch P&I demand concentrated at the long end because of liability matching; DNB research explicitly documents large P&I positions around 20yrs and beyond. OECD
France	≥20 years	Pension funds + insurers	~20–25%	Q3/Q4 2025	Estimate from Banque de France/ECB security holdings. Insurance dominates this number, but much is spread across euro-area sovereigns rather than exclusively OATs. Banque de France
Japan	≥20 years	Public/private pensions + life/non-life insurers	~35–45%	Dec. 2025	Estimate combining MoF/BoJ holder and maturity data. Insurers are particularly concentrated in long JGBs. Across all JGBs, insurers own 14.0% and pensions 8.7%, but their combined share of 20yr+ bonds is materially higher

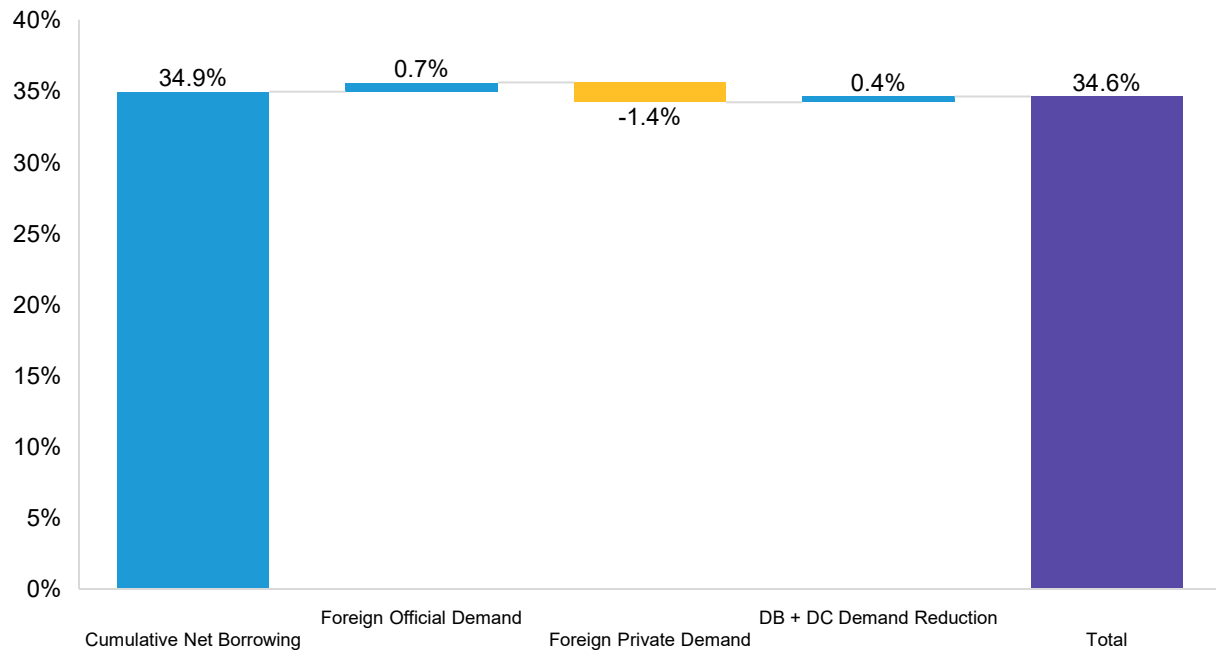
Historical analysis does not guarantee future results.

As of 2026

Source: UK: UK Debt Management Office (DMO); Bank of England; ONS; OBR, Federal Reserve Financial Accounts (Z.1), De Nederlandsche Bank (DNB), Banque de France; ECB Securities Holdings Statistics Japan Ministry of Finance, Bank of Japan and AB

Current deficit levels imply a high level of issuance in the future. If we zoom out, there is a bigger story here. After decades of public equity markets getting smaller as buybacks exceeded issuance, the AI-driven jump in capital demand means that looks much closer to being a balance of issuance and buybacks, and a risk of outright net issuance. So, this excess of issuance is a cross-asset problem. The issue, however, is that with equities there is a more obvious need for investors seeking real returns to buy them. The same holds for parts of fixed income, e.g., private debt. It's less clear for nominal government bonds. In *(Display 9)* we lay out assumptions for what the supply and demand for treasuries might look like. The increase in supply reflects both the primary budget deficit and the need to finance a growing debt service cost Foreign official demand for treasuries has been static for over a decade, we assume a slight decrease in this in coming years reflecting attempts to lessen US exposure. We assume a slight decline in global pension fund demand as part of the rebalance from DB to DC. The biggest unknown is the evolution of foreign private sector demand. This source of demand has increased significantly since 2020 but is also price and risk-sensitive. We assume this continues, but at the average run rate since 2000 rather than the very high rates of recent years. The bottom line is that would appear to be a significant cap between natural supply vs demand.

DISPLAY 9: US TREASURY DEMAND VS SUPPLY (2026–2030)



Historical analysis does not guarantee future results.

We assume debt issuance in line with CBO projections, a slight decline in foreign official sector demand in an attempt to move away from US exposure. We assume a 10% decline in global pension system exposure as part of the move from DB to DC. We assume foreign private sector demand continues to grow by 1.5 percentage points per annum. The numbers are expressed as % of total outstanding Treasuries as of Q1 2026. As of 29 September, 2026

Source: CBO, Federal Reserve, Macrobond and AB

The net issuance and demand for equities and bonds don't really enter their pricing equations, but we think they do imply greater volatility going forward. In the case of government bonds, it means there is a risk that assuming that low-volatility levels of recent decades can continue is complacent.

The naivety of techno-optimism

AI could, in theory, solve all of these problems via higher growth. According to CBO analysis, if total factor productivity growth in the nonfarm business sector was structurally 0.5 percentage points higher than its estimated baseline of 1% then even with the current budget deficits the debt/GDP level would stabilize at 113%. For example, if one buys Musk's superabundance view then deficits don't really matter—well, apart from kickstarting higher inflation, that is. We think this is primarily a strategic issue, but there are near-term tactical implications, too. As has been widely discussed, it is the AI boom that has kept the US out of recession, and AI's demand for capital that has attracted global cross-asset flows, making it increasingly hard to hedge any tactical disappointment in the AI trade.⁶ In theory, an upending of the AI trade could prompt tactical flows into bonds, but such an eventuality might raise risks as well, e.g., if it drew calls for fiscal support, and also possibly raise fears of the de-grossing of hedge funds that own large positions in Treasuries.

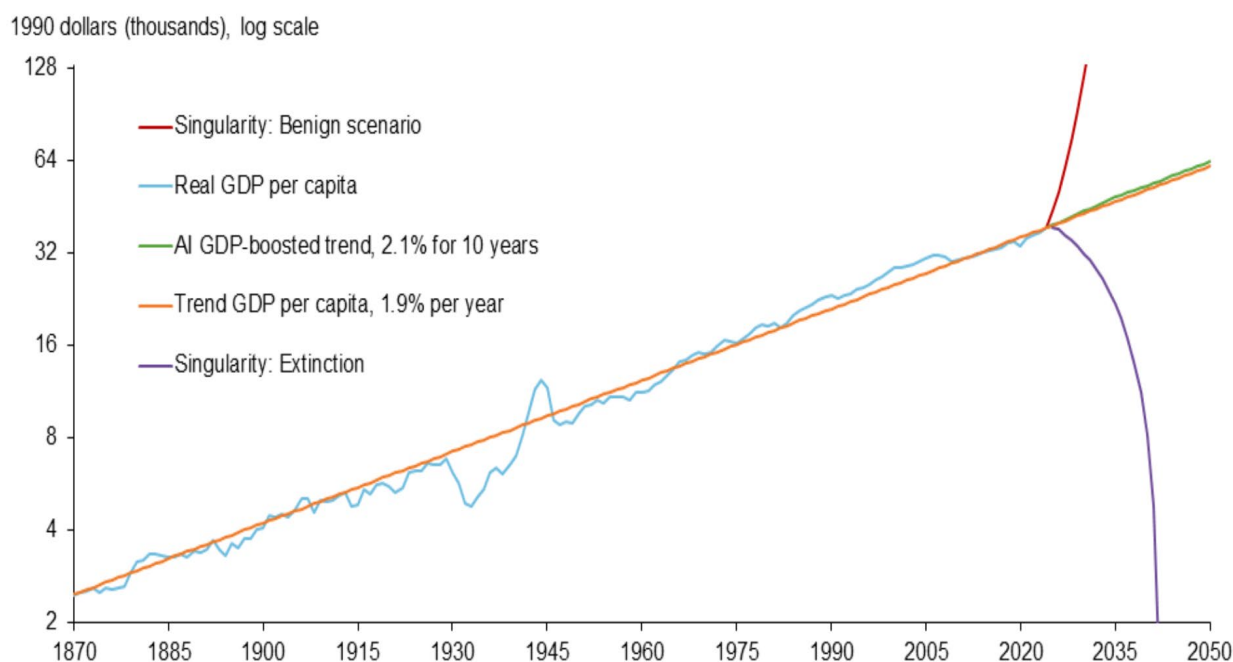
We strongly reject Musk's recently articulated assertion of superabundance. Such statements about human labor becoming irrelevant because of plentiful productivity from machines have occurred before and are as old as the Industrial Revolution. For example, in *Two Memorials on behalf of the working classes*, Robert Owen in 1818 declared that scientific advances would

⁶ [The Everything Trade](#)

“soon render human labor of little avail in the creation of wealth.”⁷ We would not want to besmirch the memory of Robert Owen by putting him in the same camp with someone as divisive as Musk, but the point is that such hope has been expressed before. Nevertheless, however great the technical breakthrough, the time of superabundance never⁸ comes. This is for two reasons: First, the benefits are not shared equally, likely leading to a society-challenging level of inequality given unequal ownership of capital (a point that makes Musk’s claim look particularly disingenuous). Second, demand for an increased standard of living drives up required growth. The same points undermined Keynes’ forecast of a radically shorter workweek by the year 2030, a forecast he made in 1930.⁹ Separately, the superabundance view ignores the extractive aspect of AI and the way that aspect raises risks for inflation and challenges planetary limits.

We prefer the view expressed by the Dallas Federal Reserve in a pithy chart about the possible future paths of per-capita growth rates. Despite all the brouhaha, the most likely route is a continuation of the trend increase in per-capita growth rates that the US has achieved for over a century. Two other possibilities present themselves: the Musk-ian path of superabundance and also a collapse to zero consistent with human extinction (*Display 10*). But it is the central path that is most likely here. In our previous work on this, we made the point that, in the US at least, it is plausible that a productivity gain from AI could broadly offset the downward forces on growth stemming from demographics, deglobalization and climate. But that is compensating for lost growth, not raising growth to a new aggregate level.

DISPLAY 10: THREE VIEWS ON GROWTH IN AN AI WORLD



Historical analysis does not guarantee future results.

The blue line is real gross domestic product (GDP) per capita in 1990 dollars. The orange line is a trend line fitted to the data for 1870–2024 with a trend growth rate of 1.9% per year. The red, green and purple lines are hypothetical paths for per-capita GDP based on different scenarios.

As of June 24, 2025

Source: Bureau of Economic Analysis, Haver Analytics, Macrohistory.net, United Nations, <https://www.dallasfed.org/research/economics/2025/0624> and AllianceBernstein (AB)

⁷ Robert Owen, 1818. *Two Memorials on Behalf of the Working Classes*.

⁸ [US Exceptionalism, AI and Towards the Total Portfolio](#)

⁹ Keynes. 1963. “Economic Possibilities for Our Grandchildren.” In *Essays in Persuasion*. W.W. Norton & Co., 358-373.

Suppose AI actually worked, in the sense that the techno-optimists mean. By making human labor unnecessary. The social dislocation would be enormous. In the near term, one would expect a sharp rise in unemployment, presumably crashing economies predicated on consumption. There would be a massive backlash from voters and a huge increase in inequality due to the transfer of power to a small group of plutocrats while others lost their livelihoods. As Luke Kemp's recent magnum opus, *Goliath's Curse*, elegantly showed, such a set of unequal circumstances has, over the long sweep of human history, been predictive of societal collapse, not superabundance.¹⁰

As we have pointed out before,¹¹ we do not think that universal basic income (UBI) is an answer, in practical terms because of the starting level of debt, the core theme of this note, and more fundamentally because UBI fails to address the way that work gives meaning to people's lives. There are also profound questions about the functioning of democracy and notions of what constitutes truth that would also be raised by such a path.

The invidious choice: crisis... or YCC?

So, what is the way forward?

One way change could come is a bond market crisis of some form. The phrase is not well defined, and we grant that its usage is often hyperbole, but we think it is a useful phrase nonetheless, because when it is invoked it can have policy-changing implications. Let's say, for the purposes of argument, that it involves a shift upward at the long end of the curve by at least 200bps from today's levels. This is the magnitude of the change that happened to the UK during Liz Truss' catastrophic tenure, and it is similar to the shift upward in Italian yields during the eurozone debt crisis. A change of this order of magnitude, on top of today's starting levels, would probably create a level that would start to have a political impact—not just in the short term but, critically, on the long-term assumptions about fiscal sustainability. Another possible way of defining a “crisis” is if there were suddenly no buyers. We will discuss what this might mean for investors in the next section, but what kind of policy response would this lead to?

A shift of this order of magnitude, potentially in several highly indebted large economies, could be enough to force a political change. One can imagine politicians declaring *force majeure* and admitting that past policies were not sustainable. They could even declare that it is a global phenomenon, always a useful fallback. Yes, it would be painful, but we think it would probably be a good thing; deferring it would just make the problem worse and create even larger questions of intergenerational fairness.

While a crisis might be cathartic, it might also not be allowed to happen. One can well imagine that if it looked likely that a crisis of some form were taking place, that a policy change would be implemented to forestall it. Fiscal adjustment is politically painful, currency devaluations and inflation less so.

Arguably, we saw a test of this with the increased buying of long-duration debt in the US in August. Ultimately, such a course of action could lead to yield curve control (YCC). That possibility has occasionally come up in client meetings. In the past, it was usually raised as a distant or fringe possibility. Now, the idea is not so outlandish. It has, of course, happened before, initiated in the US in 1942 and in Japan from 2016. In the case of the US, long-term bond yields were capped at 2.5% with the Federal Reserve agreeing to buy whatever was needed to sustain that rate. In Japan, the Bank of Japan targeted a bond yield of close to zero. In the US case, the objective was fiscal, in the latter monetary. The rationale to do it again would be fiscal, but it is clearly very hard to compare today's implications to the 1940s, especially trying to put it in any international perspective.

What would this mean in practice? A key objective would presumably be to keep the cost of debt below or close to the nominal growth rate of the economy, potentially through buying debt in such a way as to cap yields. For it to happen in the US, say, it would presumably require the administration to be happy to sacrifice the dollar and be tolerant of inflation. It is imaginable that the risks to the dollar would be manageable, given the dollar is arguably strong anyway and benefitting from the scale of global inflows to fund AI. Moreover, the scale of the impact on the dollar might be mitigated by the observation that, in the face of a bond crisis triggered by a worry about fiscal sustainability, “everyone” else is also in the same boat. Well, most major economies at least. There can be a long discussion as to the relative roles of central banks vs. Treasury departments in undertaking any such action. We think that, by whatever path, there is a high probability that it would be inflationary. The impact on currencies vs.

¹⁰ See our recent book review of this in [Book Review Summer '26](#)

¹¹ [The Everything Trade](#)

each other (as opposed to vs. gold) would depend on whether one country was acting unilaterally or countries were doing it in concert. However, the ability to pull off international coordination today is probably very difficult. For this to work in keeping yield levels below the nominal growth rate of the economy, whatever the composition between central bank and treasury department in any highly indebted country, the commitment would have to be at scale. i.e., much larger than Bessent's intervention in the long end of the US debt market this summer.

People will have different views on the merits and risks of allowing yields to rise vs. intervening, depending on their prior preferences. It might sound, a priori, that the bond-market crisis leading to smaller government spending would be something that appeals to those on the right of the political spectrum. But we are not sure that is necessarily the case, given the need it would create to increase retirement ages significantly and also the way it probably implies a steep increase in effective tax rates on firms and individuals. So, a crisis might be better for the longer-term sustainability of the system, but as we get closer to it maybe YCC is more likely?

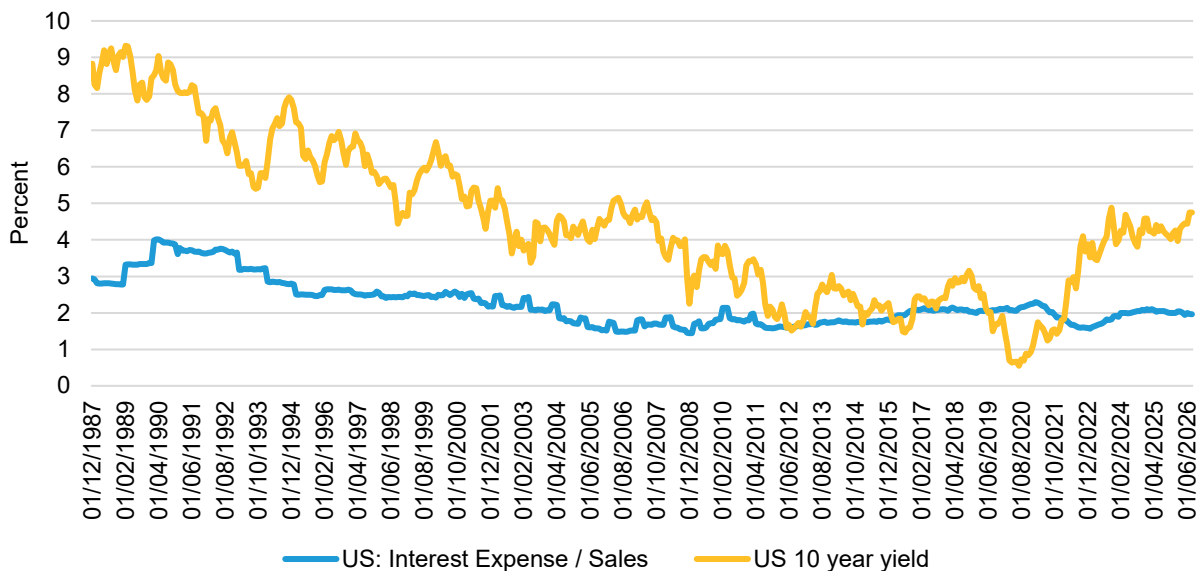
And investors suffer what they must?

What would this mean for investors? This is intended as an essay rather than an SAA note, so we thankfully do not feel ourselves constrained to come up with a suggested allocation at the end. Nevertheless, we can think through the consequences. 2026 has seen a significant increase in the cost of capital for two separate reasons. First, there is the increase in bond yields discussed here, and at the same time the return of the physical economy and surge in demanded capital has driven up the cost of capital. Meanwhile, the unprecedented increase in earnings expectations has swamped other concerns.

One of the questions that is often asked is “what level of the 10-year yield is bearish for equities?” It's one of those questions that one might have thought would have an easy answer, but it doesn't. An increase in the cost of capital reduces the fair-value multiple of an asset today in theory, but equity markets have not exactly been driven by valuation in recent years. A more likely mechanism is what it means in terms of dampening growth expectations. The US consumer may, in relative terms, be less sensitive to such an increase than, say, the UK, given the longer term of mortgages. But an increase in bond yields that was sufficient to raise the question of fiscal discipline would presumably take an axe to growth expectations.

On the positive side, AI capex expectations are still being revised up, which is likely to be supportive of equities, though that process will not last indefinitely. More pertinent to the topic of this note, we would point to the currently subdued interest costs of US corporates. As *Display 11* shows, as corporates refinanced and termed out a large portion of their debt during the post-COVID period of low interest rates, their interest cost remained roughly flat over the last four years and did not follow the rise in government bond yields. Essentially, corporations responded rationally to low rates and termed out their debt; governments did not. Also, despite the recent Fed rate move, broader metrics of financial conditions are loose.

DISPLAY 11: US CORPORATE INTEREST COSTS REMAIN LOW, AS DEBT HAS BEEN TERMED OUT



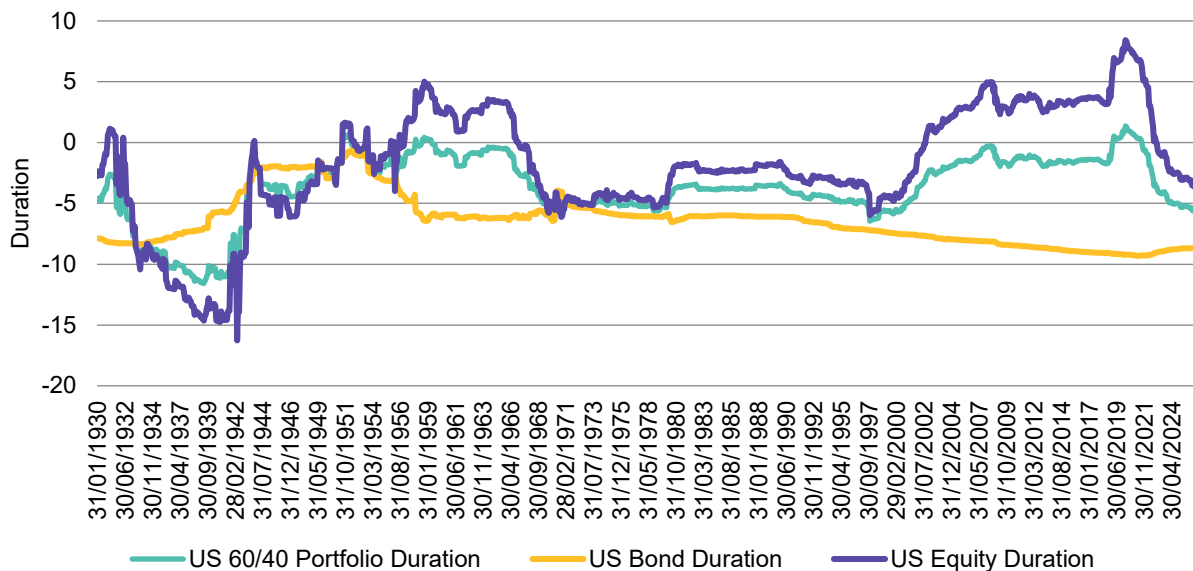
Historical analysis does not guarantee future results.

As of August 30, 2026

Source: FactSet, Macrobond and AB

Set against this, the strong performance of growth names does mean that the duration of the equity market has plausibly increased, making it more vulnerable to changes in long rates, particularly shifts in real rates as we have seen recently. We see this change in a shift of the empirical duration of the equity market. In *Display 12*, we plot the empirical duration of US stocks, bonds and the 60:40 as the simple regression beta of price changes on shifts in interest rates, so a positive sign implies negative duration in the traditional sense. On this measure, the equity market has moved from very negative duration to closer to zero.

DISPLAY 12: 10-YEAR ROLLING DURATION OF US STOCKS, BONDS AND 60/40



Historical analysis does not guarantee future results.

As of August 31, 2026

Source: Macrobond and AB

Moreover, if the net present value of an equity asset is driven by the gap between its return on capital and its cost of capital, then an increase in the cost of capital raises the bar in a way that presumably increases dispersion within the equity market.

We have seen it suggested that because the yield increase is driven by real rates and not inflation it is not a problem for equities. The argument is that such a shift must be driven by assumptions about long-term growth rates increasing rather than about inflation risk that merits a monetary policy response. We are not so sure. This thought process assumes that the equilibria of the last 75 years still apply. What if they don't? We think it is more likely that the increase in real yields as opposed to inflation expectations reflects investors being uncertain about long-term policy and long-term demand for bonds.

In a model where there is such a thing as a risk-free rate, then it is usual to think about equity risk premia and term premia for bonds being nested on top of this underlying rate. We have never believed that there is such a thing as a risk-free asset, and the debate about bond yields implies that more people seem inclined to think along the same lines. This also points to a market system in which equity risk premia and term premia might not sit on top of each other but be different things, albeit with links between them.

The adoption of some form of YCC would presumably be a less painful path for equity investors by capping the nominal cost of capital, and at least a moderate increase in inflation is something that equities can weather. The big open questions are really around what an implementation of YCC would mean for inflation, which presumably moves higher. The impact on the dollar vs. other major currencies is less clear to us. A policy of YCC would presumably be very dollar-negative, but if other economies are in the same boat, do they need to consider similar moves? Can they?

These risks suggest that there is a greater role to be played by non-fiat zero-duration assets, i.e., primarily gold, which would likely be the real winner in such a scenario. The role in a bond-yield-crisis scenario seems clear, but under YCC, while nominal yields might be underpinned the negative impact on the dollar and inflation would increase demand.

We note that in the very recent increase in yields, gold has fallen. Some might read into this that it is an attempt by investors to reassert the pre-Ukraine war relationship, whereby higher Treasury Inflation Protected Security (TIPS) yields were negative for gold as the opportunity cost of foregoing a real income stream becomes greater. We are not so sure about that. We think that the breakdown of that relationship reflects a new geopolitical reality, which we think is here to stay.

This brings us to TIPS inflation-linked bonds. Given the uncertainties in long-term policy generated by high debt levels crashing into demographics and geopolitical narratives, we think there is an upward risk to inflation expectations. We have to admit to being surprised that more of the upward move in yields so far has been in real yields, rather than in inflation break-even rates. But from today's level, we would prefer TIPS over nominal duration, given the choice. We find it frankly bizarre that they remain regarded in some quarters as still being somewhat exotic and not even in everyone's benchmarks. In a deglobalizing and high-debt world, they are core assets within a fixed-income universe!

As we mentioned up front, it is also not a view that is necessarily negative to fixed income in general, just the role of nominal duration, in particular. Hence, the potentially useful roles for active fixed income if the passive long-only allocation is less effective, as an example.

Despite our view that the dollar's reserve status is (very slowly) under threat, we have been nervous about translating this into a directionally negative view on the dollar, in part because there is no credible alternative to the dollar and in part, as mentioned earlier, because most other major economies are in the same fiscal boat. However, the linkages discussed here, plus the parallel trend by which the dollar has been more likened to the AI trade through cross-asset global flows,¹² mean that the dollar is more risky. This underlines a conclusion that we have voiced before: non-dollar investors should be increasing their hedging of USD exposure.

There are other aspects of investing that are not simply a directional implication for a given asset but more methodological in nature. These are potentially even more significant than a given view on an asset. For example, our suggestion that a bond market crisis leads to a more sustainable solution implies that taxes will go up. We think this increase has to happen at some point anyway, regardless of what the current crop of politicians might claim, but this would accelerate this change. This scenario would strengthen our conclusion that tax planning will make up a larger portion of any investor's net post-tax income.

Whatever the outcome on a policy response to higher yields, the fact of fiscal sustainability being a more prominent issue poses a governance question for many investors. If they are not already focused on a real return target, it likely pushes them in that direction. Meanwhile, all these issues imply that a shakeup may be needed in the return, volatility and covariance values in many capital-market assumptions, which all too often treat the last 30 years as the default, rather than a special and unusual period.

¹² [The Everything Trade](#)

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