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Editorial

For whom the bell tolls

John Donne's famous line, later borrowed by Hemingway, is usually remembered as a meditation on death. What is often forgotten is that it was also a meditation on attention.

Historically, church bells functioned as a mass-communication system to announce any form of breaking news. Whether it was a birth, death, emergency or new arrivals, the bell rang because something had happened that the community needed to know. Recently, it has felt as though bells have been sounding from every quarter.

Nvidia, now down 25% over the past month, has prompted a different set of questions than investors have become accustomed to asking. At the same time, political developments in the United States suggest that public enthusiasm for an AI-driven future may be less unanimous than markets have assumed.

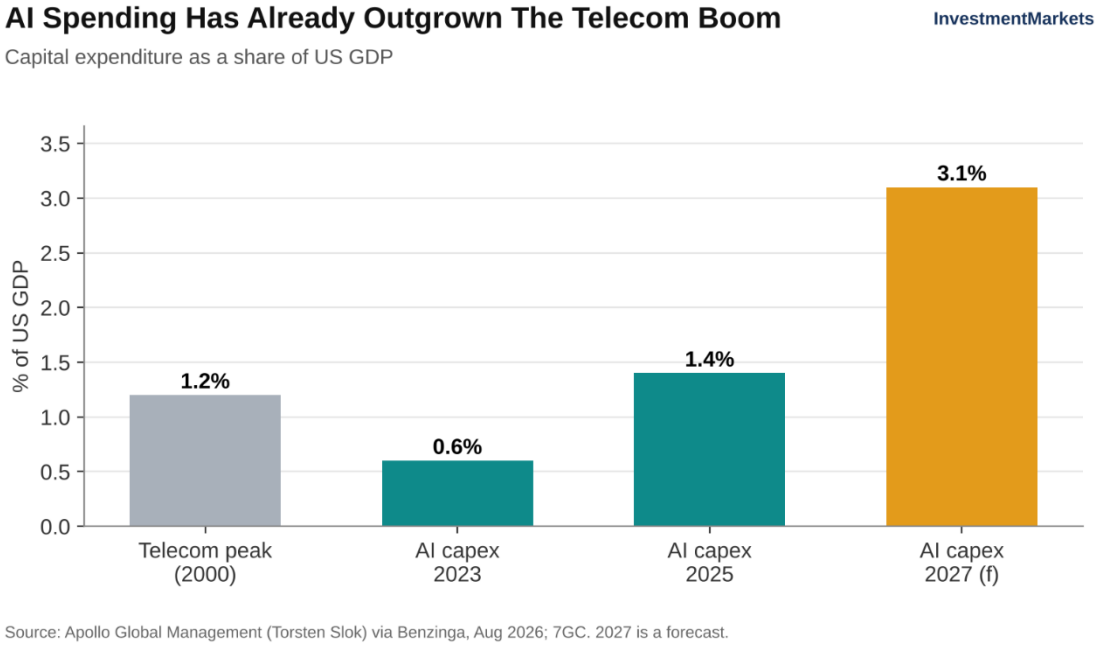
Markets have always produced enough controversies to fill a newsroom and to no one's surprise, politics remains an endless theatre of ambition and disappointment. However, there are moments when seemingly unrelated stories start to appear like fragments of a larger one.

The mood of the past few years in markets has been one of confidence, gradually morphing into a sense of inevitability. Investors will know the prevailing narrative well. AI will transform the economy, Nvidia will supply the picks and shovels and the hyperscalers are willing to spend whatever necessary to secure their advantage. Eventually, these immense expenses will all be justified by significant productivity gains. Investors may disagree on valuations, timelines and beneficiaries, but far fewer question the direction itself. The trouble often begins when a hypothesis ceases to be questioned.

None of this is to suggest that artificial intelligence is a passing fad. I find that history offers very little support for that conclusion. The internet transformed modern life so completely that I often struggle to imagine a world in which accessing information required patience.

In this sense, the technology itself was rarely the source of the misunderstanding. Rather, investors consistently struggled to distinguish between a revolutionary innovation and a sound investment. The former is usually much more obvious.

What strikes me as most interesting is not the technology itself, but the behaviour surrounding it. One of the more curious developments has been the increasingly frantic search for capital across the AI ecosystem. Though funding remains abundant, the appetite for capital simply continues to expand.



ai-1-capex-share-of-gdp.png

Against that backdrop, the growing enthusiasm around public listings feels noteworthy.

Such events are often treated as milestones of ambition and the natural progression of successful companies. Often they are. Yet I cannot help wondering whether some of the recent manoeuvring in the industry reflects confidence or concern. Things are not always as romantic as they seem. Public markets have also historically functioned as a liquidity event for early investors seeking an exit.

None of these developments constitutes a crisis or entire collapse of conviction. I prefer to make observations rather than predictions. However, what these events collectively suggest is that the extraordinary confidence which has characterised recent years may no longer be quite as secure.

Ultimately, that may be what the bells are signalling.

Donne understood that uncertainty has always been a communal experience. Investors (despite their frequent attempts to convince themselves otherwise) remain part of a similar community.

Simonelle Mody

Also in this week's edition...

Retirees can be reluctant to draw on their savings due to fear of running out. **David Bell** and **Geoff Warren** propose an additional retirement savings account that Australia should have.

The Democrats have regained control of Congress and shifted the equation in Washington. **Shane Oliver** returns to discuss the implications of the US midterm results for investors.

A reader's query about the recent CGT reforms has raised a bigger issue. **Tony Dillions** asks whether policymakers are forgetting to reward investors for taking on risk.

Rising yields have made bonds attractive again, but the team at **Fidelity Australia** argue that the role they play in a portfolio has become more complicated.

Signs of a recovery are emerging for dividend investors. **Marc Jocum** explores the important trade-off that investors face when seeking yield and building reliable income.

The market has delivered some of the strongest returns have arrived when the outlook seemed least attractive. **Jason Teh** explains why 'overvalued' has been such an expensive word for portfolios.

Investor obsession with AI is attracting unprecedented amounts of capital and confidence. **Satyajit Das** questions whether the enthusiasm is a good kind of bubble or simply a bubble.

Curated by Simonelle Mody and Leisa Bell

The retirement account that Australia should have

David Bell, Geoff Warren

Retirement savings are currently invested via account-based pensions (ABPs) that perform multiple functions including funding income and acting as a store of wealth to draw on if needed. One problem is that retirees can be reluctant to draw on their savings due to fear their savings might run out. We think dividing retirement savings into two pots – accounts to generate income and 'contingency' or 'rainy day' accounts – might help retirees to better utilise their savings while providing peace of mind through knowing that they have something set aside 'just in case'. Contingency accounts would also cater for low balance members who prefer to use their super as savings they can access when needed while relying on the Age Pension for income, rather than for generating a small amount of income.

In effect, a two-account structure would amount to a form of bucketing. Income accounts would be directed at generating income. Contingency accounts would provide a pot of funds that retirees may draw upon to meet occasional spending needs such as holidays or renovations, while providing a backstop in times of need, i.e. as 'precautionary savings'. Two accounts can simplify matters over having one account to cover everything.

We explored the idea of contingency accounts in a recent paper (available here). In essence, they would involve a retirement account that retirees can draw from as and when they desire which is not subject to the minimum drawdown rules (MDRs) applied to ABPs. While determining the maximum contingency account size requires further work, we notionally suggested and modelled $100,000 as an amount that provides a meaningful backstop with an eye on the type of expenditure envisaged.

The mechanics of how contingency accounts could operate

Super funds might offer contingency accounts within retirement solutions as a way of providing members with 'flexible access to funds' as required under the Retirement Income Covenant. Contingency accounts could be set up a few different ways:

(A) **Virtual accounts sitting within an ABP under existing rules** – The super fund notionally divides the ABP into income and contingency accounts. Regular income is reported to the member as being drawn from the income account, while irregular drawdowns are taken from the contingency account. This structure could become messy, as the MDRs would still apply to the overall ABP balance.

(B) **Functionally separate options within an ABP** – The MDR schedule is adjusted so that minimum drawdown requirements apply only above a certain threshold, which in turn equates to the maximum contingency account size. This allows super funds to create contingency accounts sitting within an ABP structure that are quarantined from the MDR. The remainder is allocated to an income account to which the MDRs directly apply.

(C) **Functionally separate products** – A new retirement product is created to which MDRs do not apply. Retirees could allocate between an ABP as their income account and the new product as a contingency account up to a certain limit.

Structures B and C both require policy change, which would probably involve resetting the MDRs applying to income accounts at a higher level to ensure an appropriate overall level of drawdowns. Both these structures bring additional complexity. So the net benefits need to be worthwhile.

Identified benefits for retirees

We believe there are a range of benefits including:

- *Provide confidence to draw income and spend* – Retirees may have more confidence to spend income and to draw down from other assets knowing that they have something set aside 'just in case'. Indeed, carving out some assets that are available when needed may help overcome any reluctance retirees may have to draw down from other savings (including non-super savings).
- *Provide confidence to take an appropriate level of investment risk* – Generally, more investment risk creates an expectation of higher outcomes (in this case income) with some risk of a poor outcome (lower income or in the worst-case exhausting retirement savings). Having savings set aside through a contingency account may provide retirees comfort to take an appropriate level of investment risk.
- *Accommodating retirees with low balances* – Our understanding is that some retirees with low balances prefer to treat their super as a resource they can draw on if required (i.e. a type of savings account), rather than use it to generate regular income (which may primarily come from the Age Pension). A contingency account would accommodate these preferences. Currently, low-balance retirees are required by the MDRs to take what might be a minimal amount of income. Super funds tell us this requirement contributes to some retirees remaining in accumulation to avoid being forced to draw down, and therefore continuing to pay tax on investment earnings.
- *Understandable for retirees* – Retirees might find it more intuitive to have separate asset pools to address income and precautionary savings. This might better align with how households run their finances.

- *Simplifying retirement solution design* – Initially carving out some assets into a contingency account to address flexible access to funds and directing the remaining assets towards providing retirement income enables addressing differing objectives through distinct mechanisms. It would reduce the need to worry about whether sufficient accessible funds are being left in place within ABPs.

There are some downsides

Nearly every policy idea comes with shortcomings.

1. *The size of unintended bequests could be boosted* – This outcome would be inconsistent with the government's policy intent for superannuation as a tax-incentivised savings vehicle designed to fund retirement income. Bequests might be boosted and less spent in retirement if retirees fail to access their contingency account. However, this is far from a foregone conclusion and partly depends on the implementation and level of MDRs (if reviewed).

2. *Cost and complexity may increase* – Managing contingency accounts and their inclusion within retirement solutions could add governance and operational cost and complexity to super funds, depending on how these accounts are structured. Some of these costs may flow back to retirees. It would be important for funds to present and communicate effectively to their members, otherwise it also adds more complexity for retirees.

What value do contingency accounts offer retirees?

We're interested in your thoughts.

Our experience is that whenever the concept of contingency accounts is raised during discussion, a typical response is 'that makes a lot of sense'. It is not a new idea. Treasury proposed the idea in their Retirement phase of super discussion paper (2023). Some major super funds, including Cbus and Rest, have been strong advocates.

We'd like to hear from you. To what degree:

- would you view the availability of contingency accounts as a welcome development?
- would a formalised account structure with different buckets for income and unexpected expenses change how you structure your retirement finances?
- would the existence of a contingency account impact on your willingness to draw income?
- would the existence of a contingency account impact on your willingness to invest more aggressively to grow your income-producing asset pool?
- if you have a lower level of retirement savings and are receiving a full Age Pension, would a contingency account better suit your needs than an ABP that 'pushes' income out to you?

Please provide any thoughts either in the comments section or privately to David.Bell@TheConexusInstitute.org.au.

David Bell is the Executive Director of the Conexus Institute. Geoff Warren is a Research Fellow at the Conexus Institute and an Honorary Associate Professor at the Australian National University. This article is based on Conexus Institute research linked here.

What the US midterm results mean for investors

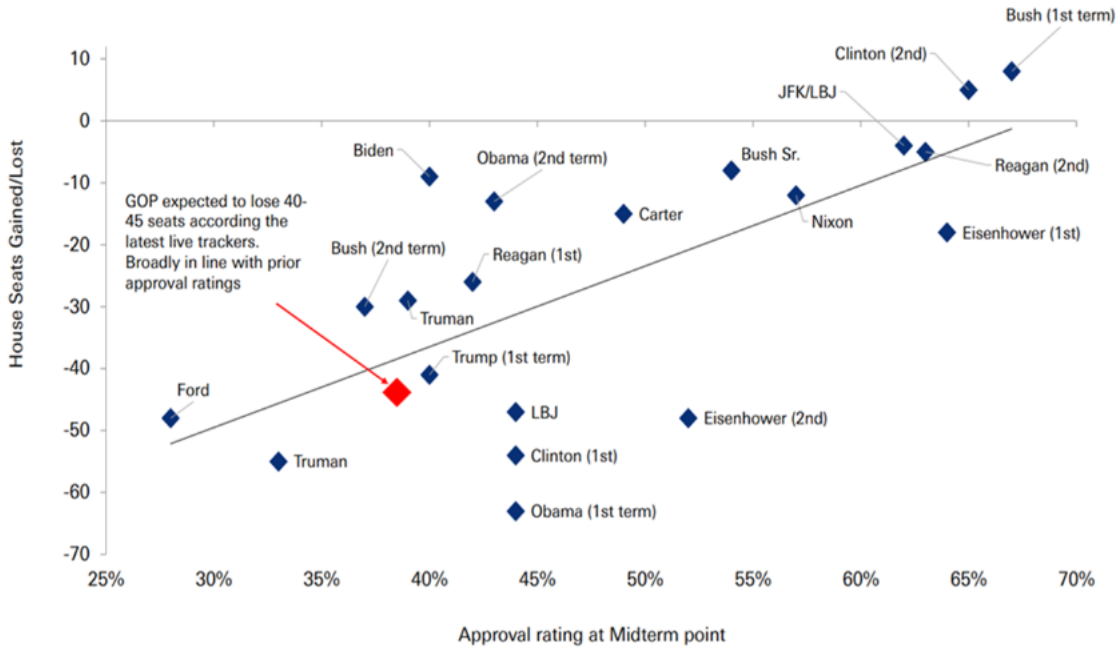
Shane Oliver

The US midterms saw a resounding rebuke of President Trump's policies. Democrats took control of the House and the Senate, with big wins and various governorships in Republican states.

Trump won in 2024 after "cost of living" pressures turned people against the Democrats. However, his tariff and War policies made those pressures worse, causing many who had swung to him to swing back to the Democrats. This was probably compounded by controversies surrounding immigration enforcement, the Epstein files and concerns about governance.

Of course, there is a danger in reading too much into the results, as presidents often lose Congress in midterms. In the chart below from Deutsche Bank, the Republican losses in the House look normal. Both Clinton and Obama lost more seats in their first term midterms and both went on to win second terms.

Presidential approval rate versus House seats lost in Midterms



Source : USPollingData, Deutsche Bank
Note: Approval ratings: Gallup historical data. "Midterm point" defined as the approval average during the 6th-8th month of the 2nd year in office (typically June-August of the midterm year), or the best available Gallup reading closest to Election Day.

Source: Deutsche Bank

Implications for US economic policy

The result is likely to have several important implications for economic policy, markets and Australia.

Congress will now be a check on Trump. In particular, there are now likely to be significant inquiries into his and the Administration's actions, including possible attempts at impeachment. Democrat control of the Senate also means Fed independence will be protected. At a high level, this highlights that US governance and democracy remains strong. Some surveys showed democracy as just as important an issue for voters as the economy.

More scrutiny and regulation of AI may emerge, particularly on data centres in states where Democrats won the governorships (Texas, Ohio, Iowa and Georgia). However, there is a danger in exaggerating this. Trump is able to veto regulations from Congress, but the states may matter more. That said, there are also still plenty of states that may welcome data centres.

There will likely be a return to brinkmanship over raising the debt ceiling (necessary by around June quarter next year) and funding the US Government (which currently expires on 11th December). In some ways this may be a good thing if it leads to a smaller budget deficit. However, hopes for lower budget deficits may prove in vain as Trump may agree with Democrats to increase some social benefits if they support more defence spending, and he is likely to veto tax hikes.

So far, markets seem relaxed. Oil prices are down on hopes Congress will bring an end to the War. VP JD Vance and other Republicans are blaming the conflict for the election loss. Meanwhile, reports suggest that the US and Iran may be edging closer to a deal again. Trump himself added that further significant strikes on Iran were "highly unlikely". Both tariffs and the War are self-evidently not popular, although there is a chance he could double down, so another spike in tariffs and/or oil prices remains a high risk.

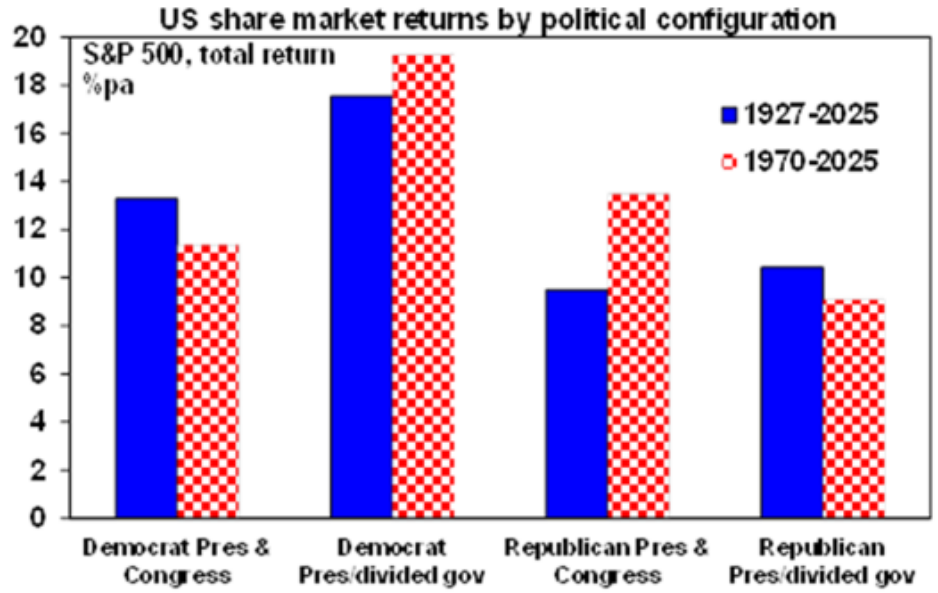
Implications for major asset classes

Bonds - negative

Bond yields have fallen since the midterms on the fall in oil prices and hope political gridlock will lead to a lower budget deficit.

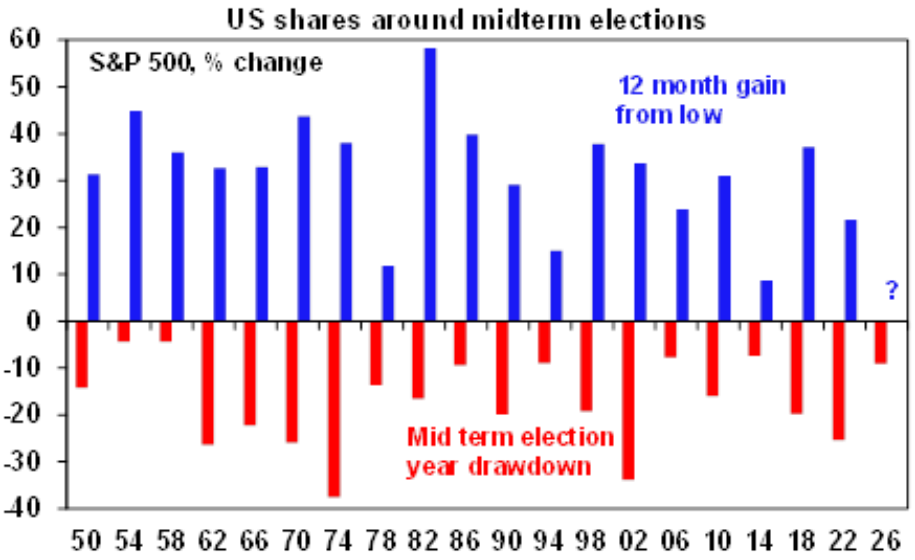
Shares - ambiguous

The bad news is that the combination of a Republican president and Democrat control of one or both houses of Congress has been the worst outcome for US share returns on average since 1970, with an average return of 9.1% p.a., compared to 13.5% p.a. when there is a Republican president and Congress. Of course, 9.1% is still okay!



Source: Bloomberg, AMP

The good news is that US shares have risen following all midterm elections since 1950 given the removal of a source of uncertainty.



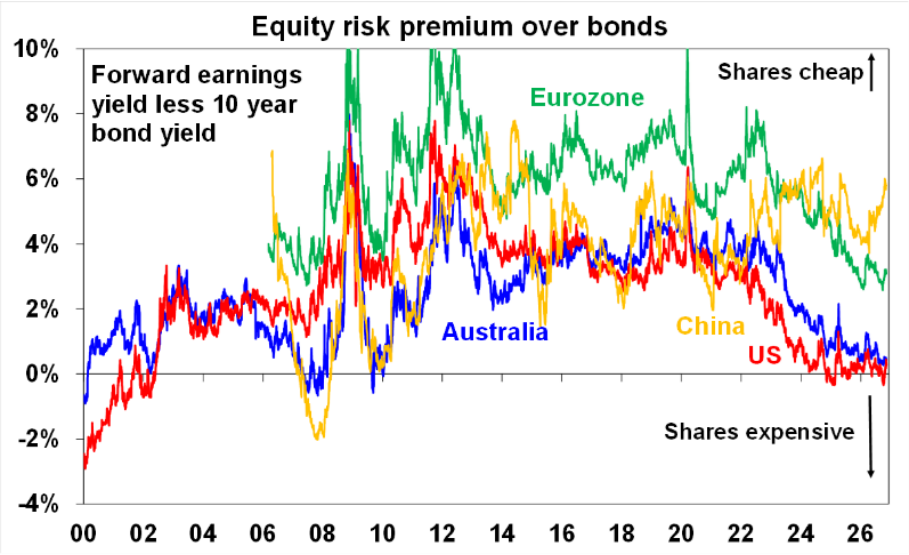
However, there may be more uncertainty this time around given the importance of the AI trade to both the US share market and recent economic growth.

So far, the US share market has had a roller-coaster reaction - initially up 1.6%, then down 4.4% on Thursday. Data centre shares sold off heavily on Thursday on fears that Democrat wins will constrain them, but earlier they had been selling off on fears that hyperscaler AI capex was excessive and uneconomic. In any case, it is unlikely to fundamentally stop their build out.

Since Thursday, there has been a recovery in US shares leaving them around where they were before the midterms.

Overall, the risk of a further correction in shares remains high, given the threats from high and sticky inflation, ongoing rate hikes, excessive public debt driving bond yields, the risk of one last spike in oil prices, the AI bubble and data centre worries, and slowing growth and rising rates in Australia.

Despite some fall in price-to-earnings ratios and more recently, a pullback in bond yields, both US and Australian shares remain expensive relative to bonds as measured by the gap between forward earnings yields and bond yields (which is a proxy for the risk premium shares offer over bonds). Of course, the risk premium has been low for years now, so it is not a great timing guide for shares.



However, at this stage, strong US earnings growth (even outside tech) and no indications of a US recession suggest that any pullback in shares is more likely to be a correction, rather than a new bear market. So, we continue to see shares providing okay returns on a 6-12 month horizon.

Cryptocurrencies - negative

With Democrats likely to look closely at the Trump family's links to the sector, the tide may be turning back towards tougher crypto regulation. Bitcoin could plausibly retain support though as an inflation hedge.

Gold and the Australian dollar - ambiguous

Much will depend on oil prices and how much further the Fed has to hike, but the midterms are ambiguous here.

Implications for Australia

While the fall in oil prices may mean less pressure on the RBA for another hike, it's uncertain as to whether this will stick in the short term and we see no reason to alter our assessment that the RBA will leave rates on hold out to late next year.

Further weakness in both consumer and business confidence in the latest Westpac/MI and NAB surveys support our view that the RBA has likely already raised rates enough to slow demand in order to cool inflation.

At a broader level, a risk for Australia is a renewed Trump focus on disruptive foreign policy in the near term, but this should recede as Trump's power wanes over the next two years.

Dr Shane Oliver is Head of Investment Strategy and Chief Economist at AMP. This article has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs.

Should the capital gains tax reward risk?

Tony Dillon

A long-time Firstlinks reader lamented recently that investors with assets held since the early 1990s will be disadvantaged by the new CGT rules. The changes will see the 50% discount on nominal capital gains replaced by indexation of the asset's cost base for inflation. He argues that freezing indexation as at 30 September 1999 fails to recognise the erosion of purchasing power over long holding periods.

He also has a broader concern about whether the new regime effectively taxes real gains and recognises the economic cost of long-term saving and investing.

The good news for our reader is that the new legislation doesn't force all pre-1999 assets back onto the old frozen indexation method. The existing rules permit eligible holders of pre-September 1999 assets to choose between the 50% discount and frozen indexation methods and continue to apply that to gains

accrued up to 1 July 2027. From that date, the cost base is reset to the asset's value at 1 July 2027, with gains accruing from that date indexed for inflation.

The Budget reforms do not retrospectively tax the entire historical gain under the new system.

The 50% discount may reward risk as well as inflation

But the reader's question raises a broader issue.

Do the new CGT arrangements reflect a fundamental shift away from recognising investment risk? Is indexation of the cost base for inflation enough? Should we also make some sort of allowance for risk? And how would that work?

Many view the shift from taxing discounted nominal gains to taxing real gains as simply a more precise adjustment for inflation. Yet the 50% discount may also contain an implicit allowance for risk.

Theory tells us that the expected return on investment should increase with risk. Assume that a risky asset purchased for $100 is held for a period and then sold for $150. A less risky asset is purchased at the same time for $100 and sold for $130 at the time of sale of the riskier asset.

Inflation was such that the cost base for both assets was indexed to $120. The real gain on the risky asset being $30, while the gain on the less risky asset is $10. The nominal gains were $50 and $30 respectively. The risky asset will therefore be taxable on 60% of its nominal gain ($30 real gain out of $50 nominal), with the less risky at just 33% ($10 real gain out of $30 nominal).

Yet under the 50% discount approach, both assets have 50% of their nominal gain taxable. It can preserve a greater share of the return as gains increase than indexation does.
The marginal after-tax reward from an additional dollar of gain adds only 50 cents to the taxable gain. Whereas with a fixed indexed cost base, each extra dollar adds a dollar to the taxable gain.

This is exactly the concern that tech start-ups and the like have with the move to an indexation CGT system.

Why indexation changes the incentive structure

The example shows that when taxing real capital gains by removing inflation from the calculation, the proportion of the taxable nominal gain can rise as the investment return rises relative to inflation.

But taxing discounted nominal gains leaves a fixed proportion of the gain taxable, with the investor retaining a constant proportion of each additional dollar of nominal gain. This can provide greater compensation for risk-taking than taxing real gains.

Therefore, while indexation may measure real gains more accurately, it may not encourage risk-taking as effectively as the existing discount system, particularly when the tax treatment of marginal gains is considered. Noting this doesn't imply that the discount method necessarily produces superior after-tax results, because that will depend on actual inflation, return, and term of investment.

By delivering better marginal results, the 50% discount may encourage risk-taking more effectively than indexation. But in the end, it is a blunt instrument. It doesn't explicitly distinguish between inflation, compensation for risk, or the length of time that capital is committed. Nor does it differentiate between

levels of risk because low-risk investments receive the same discount on gains as speculative investments.

A case for indexing the cost base beyond inflation

The CGT debate should go beyond discussion around inflation adjustment, or whether the 50% discount is too generous. It should also consider how the system affects the reward for taking on investment risk. How should CGT policy recognise the return required to commit capital, and the risks involved?

Now that cost-base indexation is the preferred CGT mechanism, albeit only to account for inflation, here's a radical idea: could we index for risk?

At a minimum, that might look like indexing the cost base at a risk-free rate like a government bond yield, to at least compensate for tying money up. But then why not go all the way and compensate for putting the capital at risk? This would require indexation at an appropriate risk-adjusted rate.

Three ways to define a taxable gain

Essentially therefore, three different levels of cost base adjustment would be possible:

- Inflation: leaves just the real capital gain taxable (the new method from 1 July 2027).
- A risk-free return: exempts a return that could have been earned without taking investment risk. Compensates for committing capital over time.
- A risk-adjusted return: exempts a return that could have been earned taking investment risk. Compensates for committing risk capital over time.

The third level of adjustment may accommodate investors who require an expected return to justify taking on risk. Without it, the after-tax reward may be insufficient to compensate for the risk involved, and investment may not go ahead.

We are seeing that presently with reports of property developers pulling projects post the May Budget. Large Sydney developer Bathla Group left thousands of homes under construction or in the pipeline with an uncertain future, as it was placed into voluntary administration in August. Management attributed the failure to a "perfect storm" of rising construction costs and the May Federal Budget.

Higher expected returns are the reward for risk, but they are never guaranteed. Allowing investors to retain more of any gains may encourage capital to flow into riskier, potentially more productive investments.

The challenge of measuring risk

What might a return that includes compensation for risk look like? Should it vary with risk, and how would losses be treated?

Implementing a risk-adjusted rate depending on the investment would be problematic. How would the system determine how much risk allowance a particular investment deserves? It shouldn't be so high that it encourages investing in ostrich eggs, for example.

Perhaps a prescribed rate might be appropriate to encourage investment and entrepreneurship.

Returning to the numerical example with the risky investment of $100 selling for $150. The inflation-adjusted cost base of $120 yielded a $30 taxable gain. But suppose a risk-adjusted cost base of $135 instead produces a taxable gain of $15.

In that case, the investor would retain more of the gain from a successful investment. And the prospect of better after-tax gains might see more projects proceed in general.

Importantly though, an incentive-based tax system doesn't remove the risk of a loss. Nor does it necessarily mean less aggregate tax revenue if it encourages more investment and flow-on economic activity. And if productive capacity is lifted more broadly, then all the better for the economy.

Such a prescribed rate could be set at a risk-free rate plus a balanced margin. In effect, only taxing gains in excess of a reasonable benchmark return would be taxed, as opposed to real gains under the new regime. It would effectively be a system with a deduction for a 'deemed' return on capital, that could improve the attractiveness of investment.

What about losses?

Careful consideration would need to be given as to how capital losses are handled. I have been an advocate for the symmetric treatment of losses under the new CGT regime such that real losses should be allowed against gains or carried forward in the absence of gains. The new system, however, only allows nominal losses into the equation.

So should a tax system that gives investors more upside on investment be symmetric in its treatment of losses?

Enlarging the loss on an underperformed investment might be too generous and could encourage excessive risk-taking behaviour. In any case, a taxable loss larger than the actual economic loss would not be desirable. Measuring losses against a cost base indexed for inflation only, might be a suitable compromise, but that would require two different indexed cost bases, depending on whether the investment made a gain or a loss. It is a complication that requires further thinking.

A radical idea, but not unprecedented

A risk adjustment allowance to CGT may not be as radical as people think. After all, it wouldn't even be the most generous capital gains concession among developed nations. For example, New Zealand and Singapore generally do not tax capital gains, providing an even greater incentive to invest than any form of indexed cost-base system.

Whether policymakers have any appetite for such an approach is another matter. Our reader's concern may therefore extend beyond inflation to the shift from a regime that provided some implicit allowance for the risk taken to generate gains, to one that allows only for inflation.

Tony Dillon is a freelance writer and former actuary. This article is general information and does not consider the circumstances of any investor.

Bonds: The income and diversification trade-off

Salman Ahmed, Stefan Rusev, Conor Parle

Government bond markets today look very different from the low-yield environment that followed the global financial crisis. Across developed markets, for example, 10-year yields have returned to levels not seen for much of the past two decades.

Stronger nominal growth, persistent inflation and tighter monetary policy have driven much of the shift, while term premia have recovered from unusually compressed levels. Investors can once again earn income from high-quality government bonds, with higher starting yields providing some protection against further increases in interest rates.

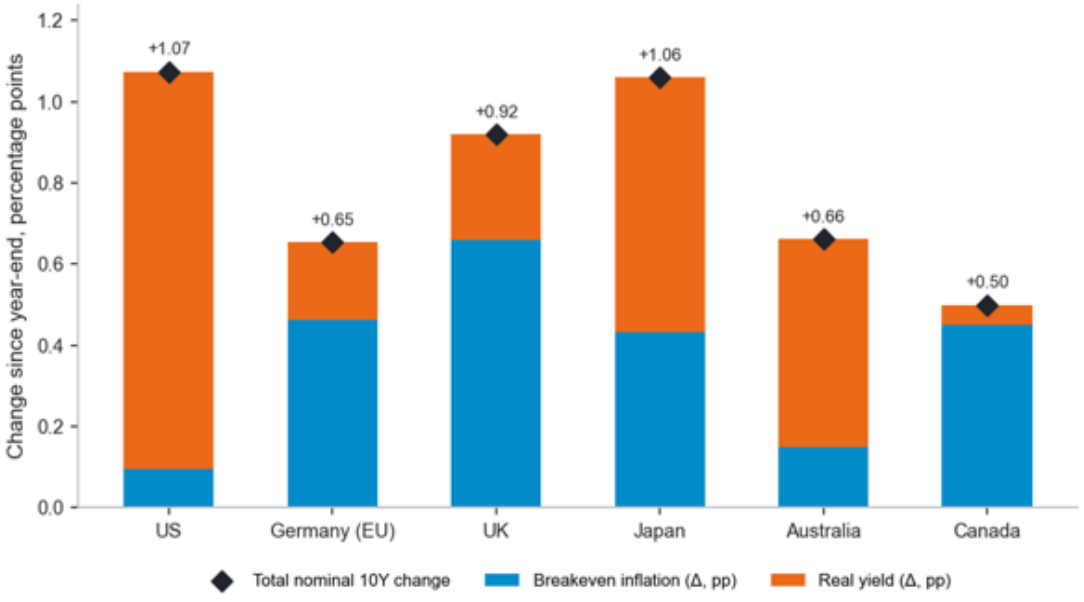
Yet relatively high levels of income are also available from shorter-dated bonds. With market volatility high and bond-equity correlations positive, government bonds currently add to, rather than offset, equity risk. Geopolitical tensions leave markets exposed to further energy shocks, while fiscal pressure could push term premia higher.

The case for duration therefore depends on how much of the repricing is complete, what could push yields higher and whether weaker growth could turn the bond-equity correlation negative.

How much of the repricing is behind us?

In the US, most of this year's increase in 10-year nominal yields has come through higher real rates, rather than breakeven inflation. Oil supply shocks have added to near-term inflation pressure, while growth has remained resilient. With longer-term inflation expectations anchored, markets have responded by pricing a higher expected path for policy rates, in turn pushing up real yields. Elsewhere, the split between real rates and breakeven inflation has depended on domestic growth and inflation dynamics.

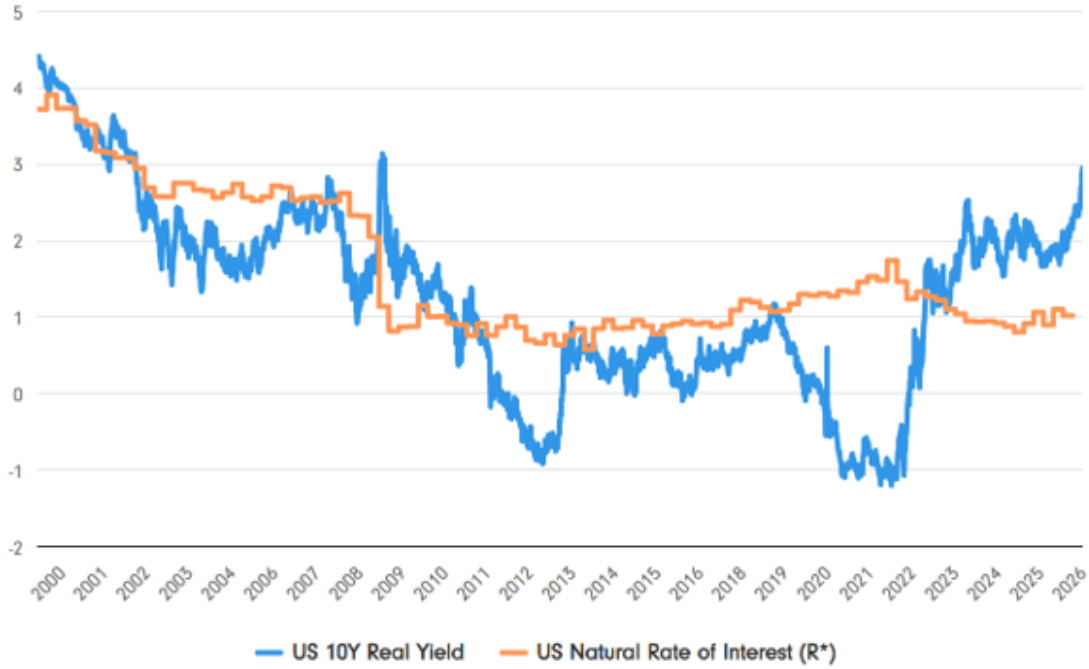
Figure 1: Real rates have been the key factor behind the recent rise in bond yields



Source: Fidelity International, Bloomberg, October 2026. For illustrative purposes only.
Note: Year-to-date change in generic 10-year nominal government bond yields decomposed into changes in 10-year real yields and breakeven inflation. Breakeven inflation calculated as nominal less inflation-linked yields.

US 10-year real yields are now close to 3%, around their highest levels in 25 years and well above typical R* (the neutral real rate of interest that equilibrates the economy in the long run) estimates of around 1%. That is consistent with monetary conditions that may already be restrictive. From these levels, a further large rise in real yields would likely require stronger growth or more persistent inflation than markets are currently expecting.

Figure 2: Real yields are well above estimates of the neutral real rate

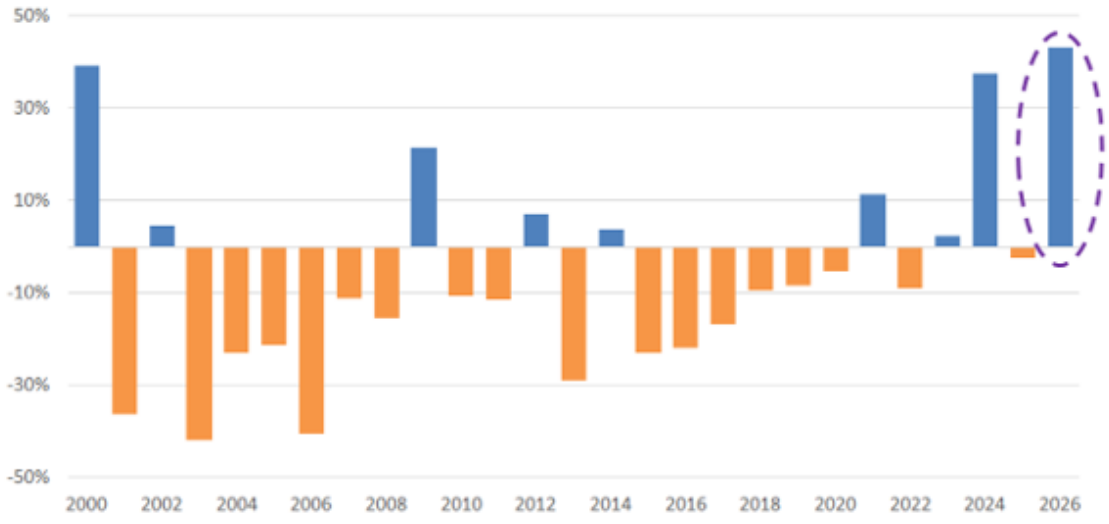


Source: Fidelity International, Bloomberg, October 2026. Note: US 10-year real yield compared with the Holston-Laubach-Williams estimate of the US natural real rate of interest, (R).*

What could push long-dated yields even higher?

Another energy shock could still push real yields higher. The correlation between oil prices and US real yields has risen sharply in recent episodes. A larger or more persistent energy price shock could also begin to feed into longer-term inflation expectations, exerting upward pressure on nominal yields through both real rates and breakeven inflation.

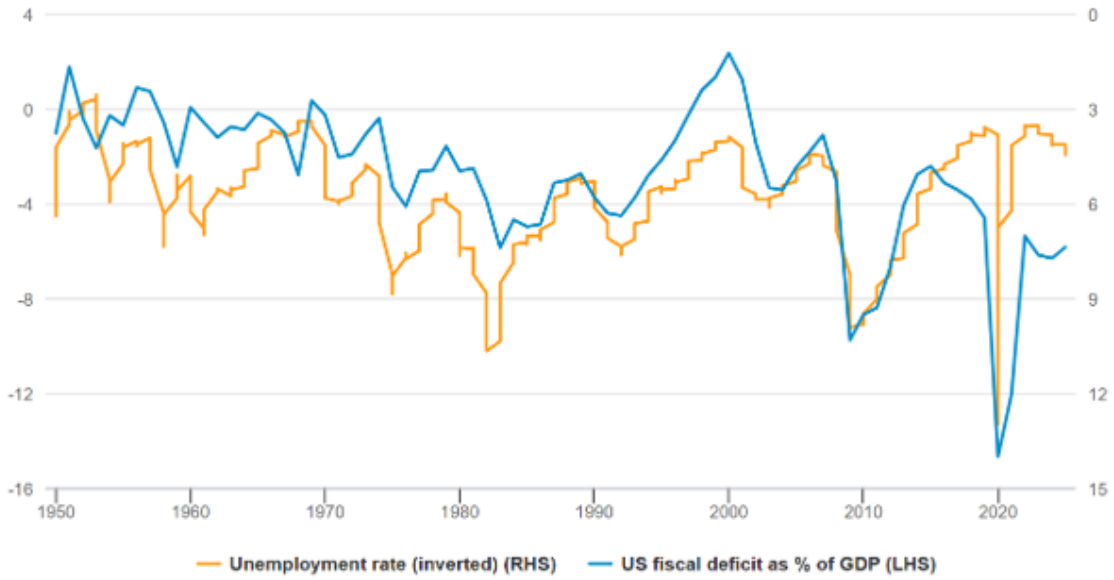
Figure 3: Oil and US real yields have been unusually correlated this year



Source: Fidelity International, Bloomberg, September 2026. For illustrative purposes only.
Note: Calendar-year Pearson correlations of weekly changes in Brent crude oil with US 10-year real yields and 10-year breakeven inflation. Years with fewer than 40 weekly observations are excluded; 2026 is year to date.

Fiscal policy is a slower-moving but important factor affecting bond yields, mainly through the term premium channel. In the US, the fiscal deficit remains around 6% of GDP even though the economy is close to full employment. That is unusual for this stage of the cycle and points to a more structural deficit problem. Debt held by the public is already around the size of annual GDP and, on current projections, is heading towards roughly 110% of GDP by 2030, increasing the amount of Treasury supply investors must absorb.

Figure 4: US deficits remain large despite a strong labour market



Source: Fidelity International, Marobond, U.S. Bureau of Labor Statistics (BLS), September 2025.

This is not an immediate debt-service problem because the effective interest rate on the existing debt stock remains below current market yields. But that buffer erodes as debt is refinanced. If yields stay high and deficits persist, interest costs rise, making debt stabilisation harder and keeping pressure on term premia. Fiscal sustainability concerns can be further amplified through the changing debt ownership structure. For example, US Treasury holdings have shifted towards more price-sensitive private investors and away from more price-insensitive holders, which could require a larger yield move to absorb additional supply.

AI investment adds another source of competition for capital. Hyperscaler and broader AI-related debt issuance is expected to rise further, while investment plans appear largely insensitive to borrowing costs. That additional supply could increase long-end yields' sensitivity to issuance and exert upward pressure on term premia.

France brings fiscal risk into sharper focus

France's 2026 deficit is now projected to be 5.4% of GDP, compared to prior expectations of 5%, after weaker growth, higher rates and inflation-linked spending. Beyond this, there are warnings that without consolidation the deficit could widen to 6.5% in 2027. The proposed budget requires a 1.2% of GDP primary structural consolidation just to return the deficit to 5%, still well above the European

Commission's 3% reference point. Passing that adjustment through a fragmented parliament ahead of the presidential election in six months' time will be difficult. A watered-down budget looks the most likely route, while a rollover budget would bring more fiscal slippage and likely lead to continued uncertainty ahead of elections in spring.

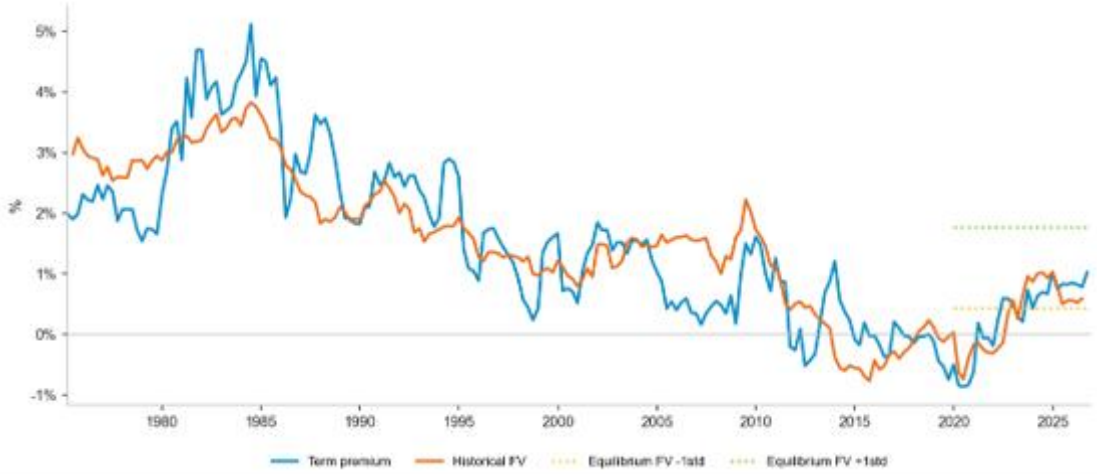
The move in OAT-Bund spreads (the yield differential between comparable French and German government bonds) is a live example of the term-premium risk facing long bonds. Investors are pricing not only higher borrowing needs, but also the political difficulty of stabilising the deficit. For the European Central Bank (ECB), French spread widening on its own may be insufficient to justify intervention via their Transmission Protection Instrument, given the country's weak fiscal position. The ECB threshold is more likely to be spread widening beyond France. If pressure reaches countries with better fiscal fundamentals, such as Spain, the issue becomes less about national fiscal risk and more about monetary policy transmission – possibly meriting intervention in the long-end of the curve.

A structurally higher term premium

A higher term premium is consistent with the macro regime embedded in our Capital Market Assumptions. These forces all raise the compensation investors require to hold long-duration government debt.

Our US fair-value model captures them through debt-to-GDP growth, Treasury holdings by price-insensitive investors, macroeconomic volatility and the convenience yield. It points to a medium-to-long-term equilibrium term premium of around 1%, well above much of the 2012–2019 period.

Figure 5: US term premium has widened, with long-run fair value around 1%



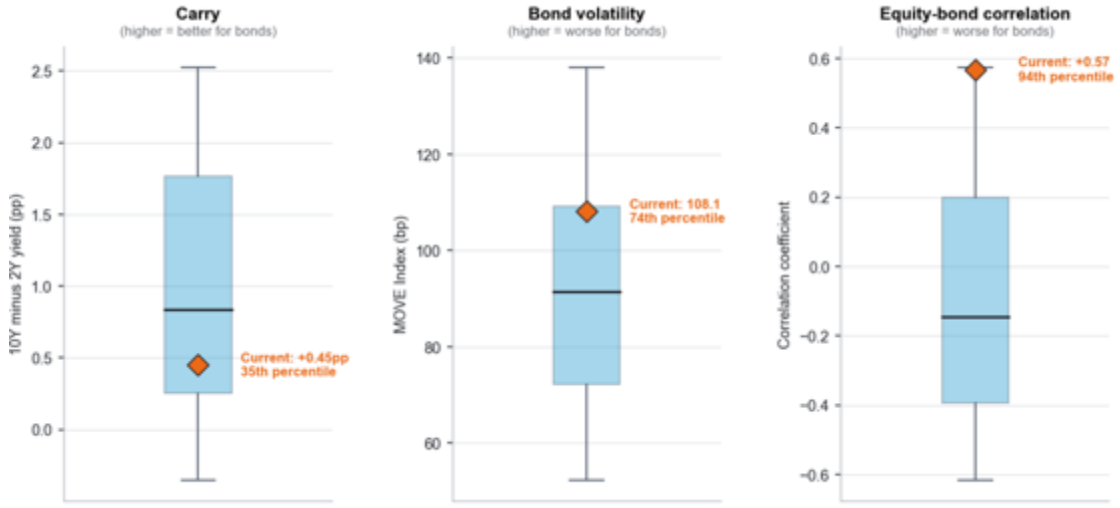
Source: Fidelity International, Bloomberg, Haver Analytics, September 2026. For illustrative purposes only. Note: US 10-year term premium shown against historical and long-run equilibrium fair-value estimates. Historical fair value is estimated using Treasury holdings by US Banks', federal debt/GDP, macroeconomic volatility and the Treasury convenience yield. Long-run equilibrium fair value is approximately 1.1%, with ±1 standard deviation of 0.66 percentage points.

That view also reflects our expectation that inflation and policy rates will settle above their 2010s averages. Term premia will continue to move through the cycle, but the unusually compressed levels of the post-GFC period are not the long-run anchor in our framework.

The role of duration in portfolios

Higher yields alone do not make a strong case for extending duration. Yield curves are relatively flat, and investors can earn substantial income from shorter-dated bonds. Volatility also remains high, and the bond-equity correlation is positive. On all three measures, conditions are unfavourable for duration.

Figure 6: All three key portfolio construction variables are unfavourable for duration risk



Source: Fidelity International, Bloomberg, October 2026. For illustrative purposes only.
Note: Distributions based on daily data from 1990 to present. Boxes show the 25th to 75th percentiles and whiskers the 5th to 95th percentiles. Carry is the US 10-year less 2-year Treasury yield; equity-bond correlation is the six month rolling correlation between daily S&P 500 price return and S&P 7–10 Year US Treasury total returns.

The case for duration would strengthen if growth became the dominant macro risk. A sharp weakening in activity would put downward pressure on policy-rate expectations and bond yields as equities weakened, making the bond-equity correlation more likely to turn negative. In that environment, duration could once again offset part of the equity drawdown.

A sharp repricing of expectations for AI-related capital expenditure and earnings is one possible trigger. US equity markets are highly concentrated in a small group of companies tied closely to the AI investment cycle. A large cut in expected spending or earnings could weaken both equity returns and the broader growth outlook, potentially prompting markets to price a lower policy path and pull real yields down.

Asset allocation implications

Higher yields improve income, but the right duration exposure depends on the dominant macro risk. Government bonds cannot be relied on to protect against inflation and energy shocks in the way they can against growth shocks.

Key takeaways

- Higher government bond yields have restored bonds as an important source of income, improving the outlook for prospective returns.

- Bonds are less reliable diversifiers when inflation, fiscal or energy shocks are driving markets and bond-equity correlations are positive, but duration can still provide an effective hedge against weaker growth.
- Investors should incorporate additional sources of diversification, including, for example, absolute return, market neutral strategies, gold and greater diversification within equity portfolios.

Salman Ahmed is Global Head of Macro and Strategic Asset Allocation; Stefan Rusev is a Senior Strategist, Global Macro and Strategic Asset Allocation; and Conor Parle is a Eurozone Economist at Fidelity International, a sponsor of Firstlinks. The views are their own. This content is issued by FIL Responsible Entity (Australia) Limited ABN 33 148 059 009, AFSL 409340 ('Fidelity Australia'), a member of the FIL Limited group of companies commonly known as Fidelity and Fidelity International. This content is intended as general information only. You should consider the relevant Product Disclosure Statement available on our website www.fidelity.com.au.

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Why high-dividend investing deserves another look

Marc Jocum

Australia has long been a nation of income investors. From retirees funding their lifestyle to investors reinvesting distributions to build wealth, dividends have played an important role in the Australian investment landscape. After several challenging years for company payouts, there are signs the tide may finally be turning.

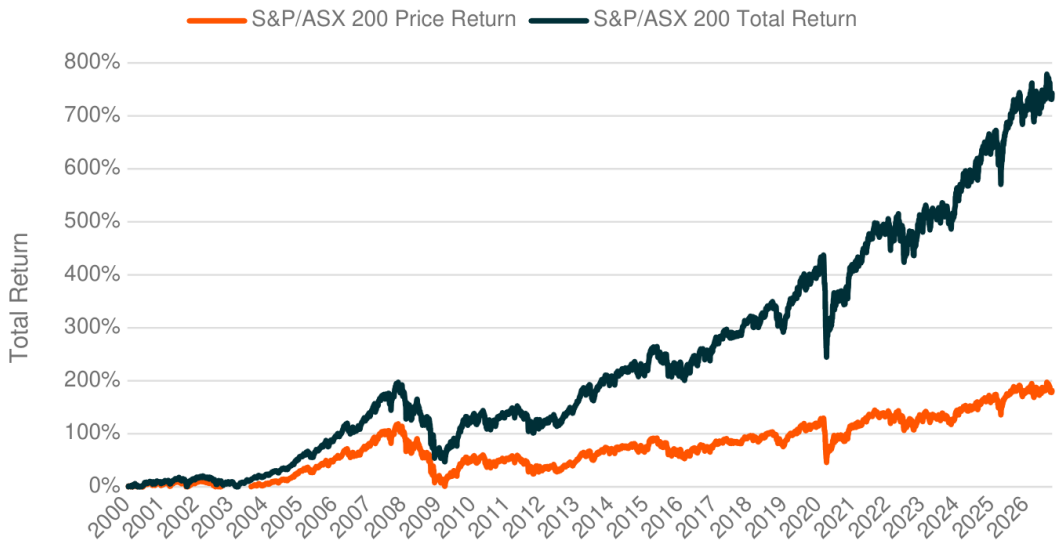
The August 2026 reporting season delivered a welcome improvement in dividends, creating an opportunity for investors to reconsider how income could support their broader investment strategy. While the appeal of high-yielding stocks is understandable, the highest yield does not always translate into the most reliable income.

Investors need to look beyond the headline figure to understand where dividends come from, how sustainable they are and how to build a diversified portfolio capable of generating income across different market conditions.

Australia's dividend engine has struggled but is showing signs of life

For Australian investors, dividends have historically been a powerful contributor to long-term wealth creation. Alongside capital growth, they provide a tangible return from owning businesses, with the potential to reinvest distributions or use them to fund living expenses. In fact, dividends have been a major driver of the Australian share market's total return over the long term.

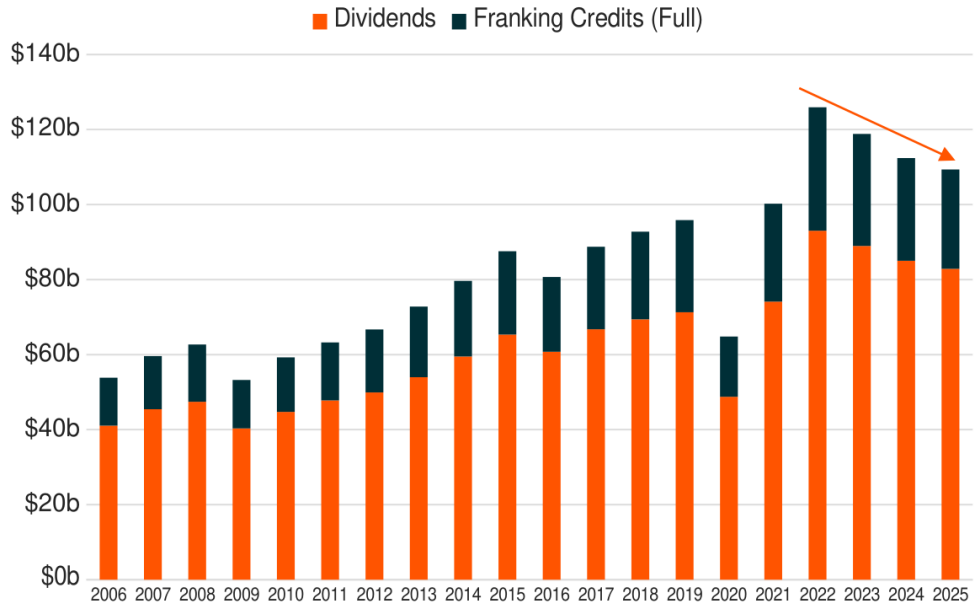
The Australian share market has trended sideways with majority of the returns coming from dividends



Source: Bloomberg data as of 30 September 2026. Past performance is not a reliable indicator of future results. You cannot invest directly in an index. Total return index returns assume reinvestment of dividends and do not include the impact of fees or costs of investing.

However, since 2022, investors have faced a prolonged dividend drought, with distributions declining for three consecutive years. As share prices continued to rise, dividends struggled to keep pace, pushing the broader market's yield lower and making it increasingly challenging for income-focused investors to generate attractive cash flow.

Yearly dividends paid by ASX 200 companies have gone backwards over the last few years



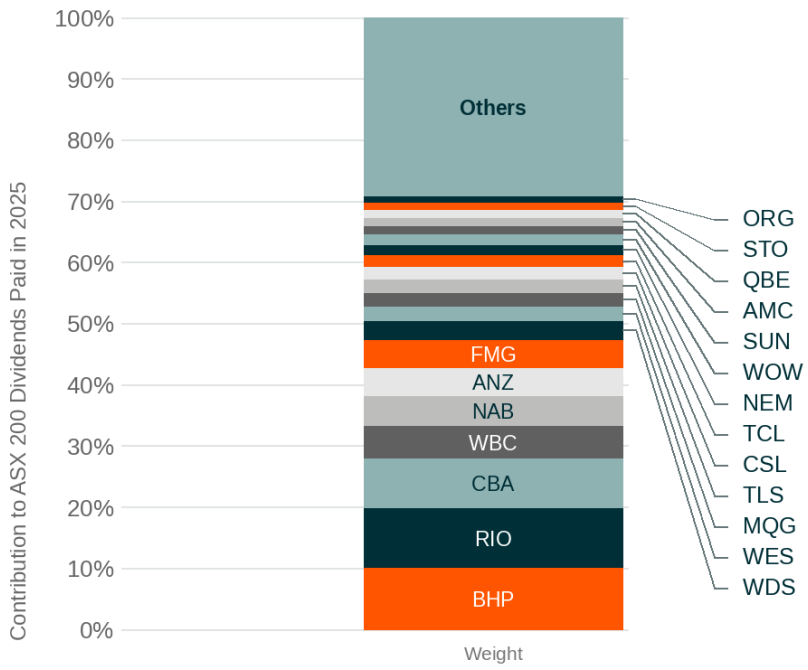
Source: S&P Dow Jones Indices, Bloomberg. Past performance is not a reliable indicator of future results.

The August 2026 reporting season offered encouraging signs of a recovery. The total value of dividends declared by S&P/ASX 200 companies increased 13% compared with the corresponding prior period, with two thirds of companies raising their dividends.[1]

While one reporting season does not guarantee a sustained recovery, the improvement suggests the income outlook may be becoming more constructive. This matters because dividends can play several roles in an investment portfolio. For investors drawing an income, distributions can help meet spending needs without requiring them to sell investments. For those still accumulating wealth, reinvesting dividends can help compound returns over time. And for investors heavily exposed to growth-oriented assets, dividend strategies can introduce different companies, sectors and sources of return.

Australia's relatively high corporate payout ratios have made our nation a tantalising place for income-oriented investors. Yet income is not guaranteed, and the concentration of Australian dividends among a relatively small number of companies makes it important to think carefully about where that income comes from.

Dividends are concentrated in a handful of companies, with the top 20 Australian companies accounting for >70%



Source: Bloomberg. Past performance is not a reliable indicator of future results.

Avoid the alluring inflated yields of dividend traps

A high dividend yield can be tempting, but the biggest number is not always the best investment opportunity.

Dividend yield is calculated by dividing a company's annual dividend by its share price. When a share price falls sharply, its yield can rise even if the company's underlying business is deteriorating. If

earnings and cash flow weaken further, the dividend may eventually be cut, leaving investors with both less income and a potential capital loss.

Consider Nine Entertainment, whose trailing dividend yield was reported at an extraordinary 51.2%, inflated by a special dividend following the sale of its stake in Domain. Yet its forecast dividend yield for 2026 was in the single digits, highlighting how one-off payouts can distort historical yields and create a misleading picture of a company's ongoing income potential. Likewise, companies such as AMP, Lendlease and Myer demonstrate that an attractive trailing yield is no guarantee of success, with all three delivering negative total returns over the past decade despite their appeal to income-seeking investors.[2]

A more disciplined approach to high-dividend investing involves considering forward-looking dividends, applying diversification screens and avoiding potential dividend traps.

Income investing has been particularly attractive so far in 2026, with high-dividend strategies outperforming the broader Australian share market, highlighting the potential for dividend-focused approaches to deliver competitive returns while providing investors with a valuable source of portfolio income.

For investors, the lesson for dividend investment is to focus on the sustainability of income, not just the size of the yield. A thoughtful approach can help investors pursue attractive dividends without blindly chasing companies that may struggle to maintain them.

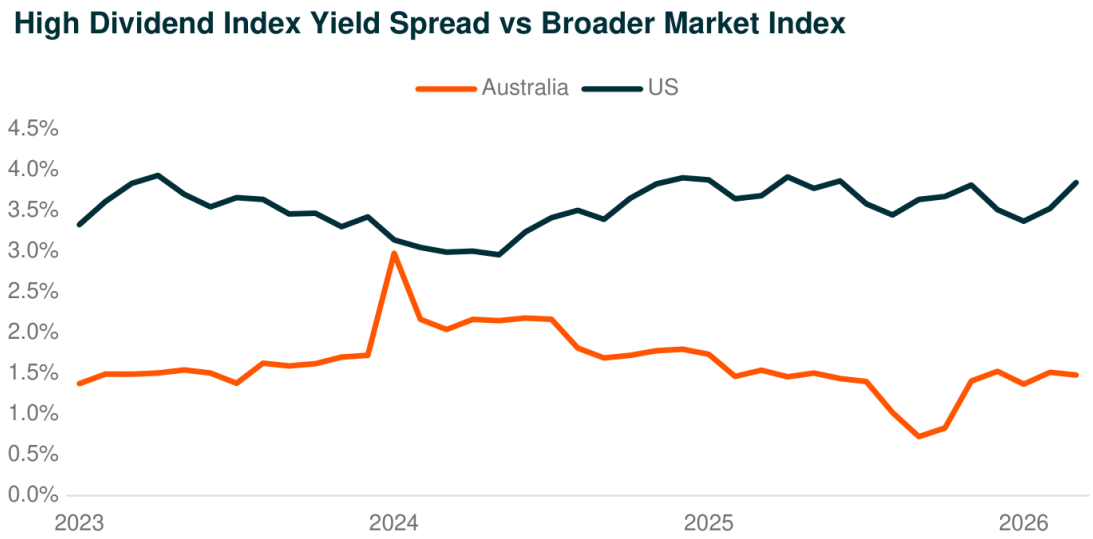
Broadening income opportunities beyond Australia

Australian shares may be a natural starting point for income investors, but relying exclusively on domestic dividends can leave portfolios concentrated in a relatively narrow group of businesses. Banks and resources companies account for a substantial share of Australian market dividends. This means an investor can own numerous Australian shares yet remain heavily exposed to the same economic drivers, from credit conditions to commodity prices.

International equities offer another source of potential income. The US market provides access to dividend-paying businesses across sectors such as healthcare, consumer staples, utilities and energy, broadening the range of companies contributing to portfolio cash flow.

It can complement Australian equity income by introducing different businesses, sector exposures and geographic diversification. While a high dividend Australian income strategy has historically yielded 1-2% above the broader domestic benchmark, the US-based strategy has yielded 3-4% above the broader US benchmark.

This illustrates how investors can approach equity income across domestic and international markets, rather than relying solely on Australia's traditional dividend payers.



Source: Bloomberg data as of 30 September 2026. Australia is represented by the index yield of the S&P/ASX 200 High Dividend Index compared to the S&P/ASX 200 Index, US is represented by the index yield of the S&P 500 Low Volatility High Dividend Index compared to the S&P 500 Index. Past performance is not a reliable indicator of future results. You cannot invest directly in an index.

Tax considerations may also influence portfolio decisions. Australia's latest capital gains tax reforms, applying to relevant gains accruing from 1 July 2027, will change the treatment of capital gains for affected investors. This could encourage investors to place greater emphasis on income-generating investments and incentivise companies to increase dividend payouts to remain attractive to shareholders seeking more tax-effective forms of return.

Dividends may deserve a place in portfolios

The improvement in dividends during the August reporting season is a timely reminder of the role income can play in building and maintaining wealth. Whether the goal is to supplement retirement spending, reinvest distributions or diversify a growth-focused portfolio, high-dividend investing offers another way to think about equity returns.

The important distinction is between chasing yield and pursuing sustainable income. By considering future dividends, avoiding potential traps and diversifying across companies, sectors and countries, investors can make income a more deliberate part of their investment strategy.

Footnotes

1.ASX (7 October 2026): Dividend darlings and disappointments

2.Source: Bloomberg data accurate as of 16 October 2026. Past performance is not a reliable indicator of future performance.

The Global X S&P/ASX 200 High Dividend ETF (ASX: ZYAU) selects high-dividend Australian companies using forecast dividend yields and excludes stocks ranked in the bottom 10% by momentum, while maintaining relative sector weights to the broader market. In other words, it screens out the weakest-performing decile of stocks from its eligible universe, helping reduce exposure to companies whose elevated yields may reflect deteriorating share prices.

The Global X S&P 500 High Yield Low Volatility ETF (ASX: ZYUS) offers exposure to selected high-dividend US companies, with a low-volatility screen helping determine which companies are included.

Marc Jocum is a Senior ETF Strategist at Global X ETFs Australia, a sponsor of Firstlinks.

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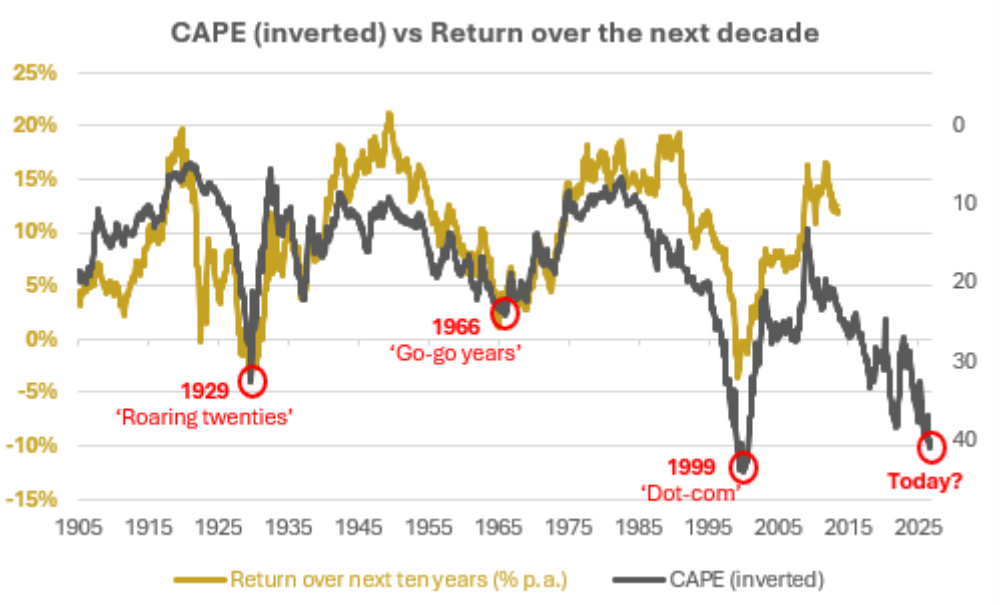
Why 'overvalued' has been such an expensive word

Jason Teh

*his article is the second in a new mini-series, **Eight Temptations of Market Lore**, which explores popular investing rules of thumb and the pitfalls that can accompany them.*

The first article asked whether a high CAPE means the market is expensive. This one asks what investors really want to know: does a high CAPE predict poor returns?

Over the past century, CAPE has forewarned poor returns. Each time CAPE peaked, in 1929, 1966 and 1999, a decade of returns well below the long-run average of about 9% a year followed. Today's CAPE is approaching its 1999 dot-com peak. The chart below inverts CAPE and overlays the subsequent rolling ten-year return to highlight how they track each other closely for most of the century.



Source: Robert Shiller

The CAPE peaks are circled. The decades after 1929, 1966 and 1999 returned -3.4%, 3.9% and -0.7% a year. Looking back, the warnings seem obvious.

But the circles are drawn with hindsight. In December 1996, with CAPE at about 28 and closing in on its 1929 peak, Shiller told the Federal Reserve Board that the market was overvalued. Two days later, Alan Greenspan gave his "irrational exuberance" speech. The decade that followed included the dot-com crash, yet still returned 8.3% a year. That warning gets no circle.

Shiller's warning came at 28, between the 1966 and 1929 peaks. Which peak should set the warning level? Suppose an investor had stayed out of shares whenever CAPE rose above its 1966 peak of 24. Between 1990 and mid-2023, they would have been out of the market 62% of the time. Those months still returned 9.8% a year. Using the 1929 peak of 33 kept investors out only 16% of the time. Nobody could have known in advance which one was right.

A regime shift

Neither peak worked because the relationship between CAPE and future returns structurally changed. From decades starting in the mid-1980s, CAPE began to understate the returns that followed. The dot-com bubble shows this clearly. In 1999, CAPE reached a record 44, about 35% above its 1929 peak and more than 80% above its 1966 peak. Based on the relationship before 1985, that should have ushered in a devastating decade, with losses of about 12.5% a year. The decade actually lost 0.7% a year. That was poor, but far milder than the reading implied.

CAPE went on understating future returns because new structural changes kept arriving, and few investors saw them coming. Interest rates fell for four decades, from about 16% on US 10-year bonds in 1981 to below 2% in the 2010s. Corporate tax cuts in 1986 and 2018 lifted after-tax profit margins. So did booking more profits in low-tax countries as companies expanded overseas. A 2023 Federal Reserve study by Michael Smolyansky found that lower interest and tax costs explain over 40% of the real growth in US corporate profits from 1989 to 2019. Stock buybacks took off after a 1982 SEC rule protected companies from manipulation charges, boosting earnings per share. And highly profitable technology companies, which have repeatedly reinvented their businesses, grew to a larger share of the index.

Recent years show how profit surges can blunt CAPE's warning. At the end of 2019, CAPE was about 30, close to its 1929 peak. The 2020 COVID crash was met with enormous stimulus that sparked a strong recovery in corporate profits. CAPE climbed to about 39 by late 2021, on a wave of speculation that echoed the dot-com boom. It fell back in 2022 as inflation surged, interest rates rose sharply and big tech profits were downgraded. Then two things lifted profits again. First, most technology companies stopped chasing sales growth at any cost. They cut costs and used their pricing power to expand margins. For example, since late 2022, Amazon's EBITDA margin has more than doubled, from about 11% to 24%. Because technology companies are a large part of the index, their margins lift the whole market. Second, the launch of ChatGPT in late 2022 set off a profit boom for chipmakers and cloud providers.

None of this was visible at the time. A regime shift only shows up once the decades behind it have finished. An investor in 1990 had only the old relationship to go on, with no way of knowing how profits would change. In two of the three decades since then, returns beat CAPE's forecast by about 7 and 11 percentage points a year. And in recent years, each time CAPE looked expensive, a profit boom came to the rescue.

Conclusion

Today's CAPE is high by any historical standard. Judged by the relationship before 1985, a CAPE reading of 41 points to a decade with losses of about 10% a year, worse than those experienced during the Great Depression. And judged by the relationship since the mid-1980s, it points to returns of about zero, similar to the decade after the dot-com peak.

Like the circled peaks, both relationships were only visible after the fact. An investor in 1999 or 2019 could see the reading, but not the decade that followed. Today's investors are in the same position. If profits again grow faster than in the past, CAPE will overstate the damage to come. If they slow, the old relationship could return. We will only know which relationship holds in 2036.

So CAPE is better at telling you which way returns lean than how far. A high starting price has usually meant lower returns than a low one. What CAPE cannot tell you in real time is whether the old relationship still holds. For that, return to the question from the first article: is CAPE high because profits are, or because prices are?

Reference: Michael Smolyansky, "End of an Era: The Coming Long-Run Slowdown in Corporate Profit Growth and Stock Returns", Federal Reserve Board, June 2023.

Jason Teh is a financial commentator and portfolio manager. This article is general in nature and does not constitute or convey personal financial advice. It has been prepared without consideration of anyone's financial situation, needs, or financial objectives. Before acting on the areas discussed and contained herein, you should consider whether it is appropriate for you and whether you need to seek professional advice.

AI – A good kind of bubble or just a bubble?

Satyajit Das

True AI believers place their faith in the transformative powers of the technology, sound funding of the capital expenditure, and the ability of firms and investors to manage the associated risks. Unfortunately, "*it ain't what you don't know that gets you into trouble, it's what you know for sure that just ain't so*."

First, technological progress alone does not determine investment success.

Analysis of past investment booms highlights that even if an innovation proves revolutionary, identifying the ultimate winning firms is difficult. The process may take longer than investors expect, and overcapacity and poor capital allocation destroy wealth in the meantime. Often, the ultimate beneficiaries are not the pioneers but later entrants able to acquire distressed assets cheaply.

AI economics are questionable. Given the expected $8-10 trillion investment, one study found that by 2032 annual revenues of $3.7 trillion, (over 9% of estimated US GDP), would be needed to generate a modest unlevered return of 10%. This assumes a 50% cash flow margin and a generous six-year life for the chips. Notwithstanding forecast Total Addressable Markets of $30 trillion (effectively encompassing the global economy), the required increases may not be achievable.

Corporate users are increasingly seeking to limit AI spending or demonstrate clear returns before expanding usage. The majority of individual users are currently non-paying and transitioning them to subscription models is difficult.

Margins are already declining because of the falling price of tokens, by 99% in some cases, and rising expenses for electricity and cooling water, data acquisition to train models and compliance.

Given growing global community resistance to data centres, construction delays will create shortages and increase cost pressures. Firms like Anthropic and OpenAI may struggle to maintain performance advantages and pricing power in the face of growing competition from cheaper Chinese suppliers and open-source models.

These dynamics suggest many AI ventures may find it difficult to meet revenue, earnings, cash flows and return on investment expectations.

Second, investors may be underestimating the risks embedded in the funding structure supporting the AI boom.

The central assumptions are that it is supported by real risk equity capital and that borrowings are underwritten by large AI investors, the hyperscalers - Amazon, Alphabet, Apple, Meta, Microsoft and Oracle as well as chip makers like Nvidia and Broadcom - which have profitable core businesses, strong earnings and strong balance sheets.

In practice, much of this capital may be less patient or permanent than it appears. Venture and private-equity funds have finite lives and ultimately require exits through trade sales or public listings. As a result, continued access to new capital remains important as many ventures will have negative cash flows and need funding for some time.

The funding from hyperscalers and chipmakers was initially from free cash flow. Prior to the present boom, hyperscalers generated free cash flow of around $70 billion. This has reversed to a shortfall of $1.6 billion as AI investments absorb available funds, requiring borrowings and eventually new equity issues.

Current borrowings are running at around $500 billion per annum. AI related ventures have outstanding debt of around $1.2 trillion (14% of all investment-grade debt) which is increasing rapidly. There is growing reliance on credit from private credit funds.

Alphabet, Microsoft, Amazon, Meta and Oracle also have as much as $1.65 trillion of off-balance obligations, compared to $1.35 trillion in traditional debt.

One study found that these commitments lift indebtedness levels by nearly 150% on average and materially weakens their credit quality. There are additional guarantees, revenue support agreements and underwriting of the residual value of processing chips, whose impact is difficult to estimate due to limited disclosure.

A complex ecosystem of AI infrastructure providers and data-centre operators has emerged. Outside of the stronger hyperscalers and chipmakers, many rely on private credit and other forms of debt financing that are typically more expensive and shorter-term than traditional corporate borrowings. Within this highly interconnected system, all participants are totally dependent on the same underlying earnings and cash flows. If AI revenues fail to meet expectations, the inherent circularities mean that financial

stress will spread rapidly beyond the model developers themselves, to the hyperscalers, equipment suppliers and infrastructure providers and ultimately to lenders and investors.

Finally, investment in generic infrastructure does not protect capital. Cisco, for which the investment case in the 1990s was similar, briefly became the world's most valuable company on the assumption that its routers and other products would be crucial to the Internet irrespective of the industry's evolution.

While the company's performance has been steady, investors in Cisco lost out as its share price plummeted in 2000 only reaching the same level after 25 years.

One reason was excess capacity. During the telecoms and fibre-optic boom, investors drastically overestimated demand. Much of the capacity built during that period remains underutilised today. Only around 50% of installed fibre-optic capacity is lit, while average global network utilisation is approximately 26%. The current expansion may not avoid this trap.

AI investment is 17 times that of the 2000 dot com boom and four times the 2008 sub-prime housing bubble. When the dot com boom ended, even survivors like Microsoft, Apple, Oracle and Amazon fell 65, 80, 88, and 94% respectively taking 16, 5, 14 and 7 years to recover their 2000 peaks.

Just as trees do not grow to touch the sky, investment bubbles inevitably deflate when returns fail to live up to expectations and financing dries up.

Notes: All amounts are in US dollars.

Satyajit Das is an internationally respected expert in finance, who presciently anticipated the 2008 global financial crisis. In 2014 Bloomberg nominated him as one of the 50 most influential financial thinkers in the world. He is an author, whose latest book ***The Everything Bubble*** *(Monash University Press) is out in 2027.*

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