



A great week for Japan's LDP, an awful one for UK's Labour

In politics, the highs are high and the lows are low!

Key points:

- A break to the downside in US stocks on Thursday on AI-related concerns could change the backdrop, if this extends to the downside.
- The UK's political crisis continues, with PM Starmer weakened further following the Mandelson scandal. A left-wing succession could put significant downward pressure on gilts and sterling.
- In Japan, PM Takaichi's landslide win supports fiscal discipline and a focus on growth, while very long-dated JGBs are attractive at current valuation levels.
- A supportive policy platform for Japanese stocks is strengthening business investment and consumer spending, with Japan positioned to be a renewed investment opportunity.
- The week's political events in the UK and Japan demonstrate that domestic politics and geopolitics remain significant and persistent market drivers, despite declining volatility elsewhere.

London, 13 Feb 2026: US Treasury yields have continued to range trade over the past week, with a robust US payrolls report allaying concerns that downside risks in the US labour market could be starting to build in the wake of a softer JOLTS survey on job openings. Today's CPI report represents the other major data release of the month, which could drive a reassessment with respect to the economic trajectory. Yet barring a material surprise, it appears that the market pricing of two rate cuts from the Federal Reserve this year seems unlikely to be challenged, for the time being, even if it may appear questionable that the US economy actually needs any additional loosening in financial conditions. Against this backdrop, Treasury market volatility remains subdued, with the MOVE Index not far from its 5-year low.

That noted, a break to the downside in US stocks on Thursday on AI-related concerns could change the backdrop, if this extends to the downside. Barring this, as long as this relatively stable macro environment can persist, it can be broadly supportive for carry trades, as investors seek incremental yield. This is a factor helping to support demand for credit. However, there have been growing signs that this robust demand is running into a tidal wave of new issuance.

Meanwhile, recent earnings releases in US tech have seen further upward revisions to planned 2026 capex spending. In part, we may start to question whether supply chain bottlenecks will actually enable this pace of spending to be realised in practice. However, for now, these trends have led to additional increases with respect to corporate bond issuance estimates, with US IG net new supply already expected to exceed US\$1 trillion in the current calendar year.

This week's jumbo new deal from Alphabet was a case in point, with the US tech giant issuing across curves in multiple currencies, fast on the heels of placing \$20 billion of new debt in the US market. In this respect, it was also interesting to reflect that this issuance included slugs of 100-year bonds from a

company that had its roots in a garage not much more than 25 years ago and that operates in such a fast-moving space. Trying to predict what its future will look like 10 years from now is challenging, let alone in the year 2136!

Yet from a fixed income market perspective, what is very real and discernible is that this represents a material slug of additional duration for markets to digest and, in this respect, it is not at all surprising that supply is weighing somewhat on spreads.

Away from market technicals, however, we would note that credit asset classes should largely be expected to continue to deliver excess returns at a time when recession risk remains very low and default risks are contained. From this standpoint, the macro backdrop continues to appear relatively benign.

However, a theme that is continuing to occupy greater attention relates to the winners and losers from AI and in this respect, it was interesting to see insurance brokers under pressure as market participants question the scope for industry disruption from new tools such as Insurify. In credit markets, we see event risk continuing to build as we move through 2026.

Exposed sectors such as software represent a real challenge to asset classes such as private debt and may also weigh on bank loans. High yield bonds, relatively speaking, are in better shape, whereas in investment grade, it is more the interplay from the technical of supply and demand that may remain the largest determinant in the directionality of spreads.

Aside from this, it seems hard to get too excited about the Treasury market for the time being and we continue to express no strong conviction with respect to duration or curve shape. We are similarly minded with respect to euro rates markets, where we continue to see the ECB on hold for an extended period.

With respect to FX, we think that ongoing US growth exceptionalism can prevent the dollar from weakening much, though we think that it is unlikely to gain upside momentum at a time when global investor flows continue to look away from US markets. With global stocks continuing to outperform the S&P, it seems that this could be a trend that continues to weigh on the greenback for the foreseeable future.

In this context, we would continue to highlight opportunities in some of the high yielding emerging market currencies, where orthodox central banks retain relatively high real interest rates as they continue to seek to bear down on domestic inflation.

Away from events in the US and Eurozone, last weekend's resignation of the British Prime Minister's Chief of Staff, Morgan McSweeney, over his role in pushing the selection of the now disgraced Peter Mandelson as US Ambassador, has done little to cement support for Keir Starmer. As opponents circle, there is a growing sense of inevitability with respect to his impending demise.

Although the Labour Cabinet gave a show of support at the start of this week, it is a possible loss at the bi-election in Gorton and Denton at the end of this month that could be a decisive catalyst. Survival beyond that point could see a wounded Prime Minister last until the May local elections, which are widely expected to be a drubbing at the polls for Labour.

However, in the interim, it is very possible that more will come out over the next few weeks with respect to Mandelson's communications in relation to members of the UK government. As WhatsApp messages and other communications are leaked to the press, the Prime Minister's position could quickly become untenable. Suggestions from the White House suggest that Washington had raised concerns with respect to Mandelson as a security risk and speculation that he then shared classified material is thus potentially toxic.

It is also suggested that Wes Streeting and others close to Mandelson could also be weakened by this tawdry saga. This could open the door to a candidate on the left-wing of the Labour Party, possibly Ed Miliband or Angela Rayner.

A lurch to the left could well have material impacts on the outlook for UK financial markets. Perceptions that this would lead to a loosening of fiscal responsibility and a sense of disinterest in financial markets could add to risk premia weighing on both gilts and the pound.

However, inasmuch as these moves would further undermine business and consumer confidence in the short term, there are likely to be material economic downside risks, which could lead the Bank of England to still lower interest rates. In this case, the pound seems disproportionately vulnerable, whereas moves in gilts would surely deliver a steeper yield curve, which the government could push the DMO to counteract by shortening the issuance of debt supply.

The longer-term consequences of a more left-leaning government could be different. For example, it is possible that Labour could pursue a closer relationship with the EU going forward and be more distant to the US. However, with Reform being the party in ascendancy, Labour will need to react to the populist cause if it is not to be annihilated at the next General Election.

Consequently, it will be interesting to see how this could lead to a more left-wing populist direction of travel. Yet returning to the here and now, during the past week, we have added to short positions in sterling and now hold a relatively high conviction on this view. We continue to reassess our thinking on gilts, where we have been more bullish positioned.

However, in the light of last week's dovish MPC meeting from the Bank of England, we would continue to note that aside from political risks, gilts look attractively valued on a more fundamental basis.

In Japan, it has also been a big week for politics. Takaichi's landslide win affords the Prime Minister a strong hand in leading the country forward, based on her own vision. In this context, Takaichi is focused on delivering economic growth and making Japan stronger. As previously noted, we expect a cut in consumption tax in a supplemental budget in 2026, though we see the fiscal deficit this year remaining below 3.5%, which is far lower than nearly all other developed market countries.

In this context, we continue to think that some of the hysteria with respect to Japanese debt sustainability is overdone, and on the back of this, we continue to highlight the attractive valuation of very long-dated JGBs.

Moreover, Takaichi seems committed to ensuring that future spending is held in check. In this respect, talk that revenues from overseas reserves could be utilised, as Japan seeks to add to its military spending, appear relatively insightful. In this respect, we would disagree that Takaichi will be a populist PM who progressively eases the Japanese fiscal stance during her term in office.

It also strikes us that Takaichi is eager that there be stability in Japanese yields and in the value of the yen. She does not appear particularly motivated to drive the yen stronger, but 160 is looking like an ever-firmer line in the sand when it comes to the government's tolerance for any further currency weakness.

We continue to see the BoJ delivering two rate hikes this year and for the Japanese yield curve to flatten, as shorter-dated yields rise in response to monetary policy normalisation. In this light, we think that 10-year yields may remain around current levels. We ultimately think that 30-year JGBs should trade no more than 100bps over 10s and from this perspective, outright yield levels at 3.5% remain attractive (particularly noting the US\$ hedged equivalent at 6.5% at the current point in time).

We remain structurally bullish on the yen, but in FX we feel that it is best to maintain no position and look to add above 158, should the yen re-test that level. Meanwhile, the policy platform is supportive for Japanese stocks, and a more optimistic outlook can also help strengthen business investment and consumer spending, helping underpin economic gains. After a long time in the shadows, we would note that Japan continues to re-emerge as an interesting opportunity, in the current investment landscape.

Looking ahead

Although we continue to project relatively settled market conditions in core rates over the rest of the month, we would note that the CPI carries the potential for a surprise and in this respect, we are attentive to the risk that inflation exceeds expectations at a time when the US economy remains relatively strong.

There have been plenty of discussions about how AI may drive productivity growth in the US and the broader global economy in the years ahead, though the truth is that there remains quite a lot of uncertainty around this. Although AI adoption is accelerating quickly, we would also observe that changes in productivity may not be smooth nor linear.

In this respect we are more concerned that the rush to deploy cash in the AI arms race could represent an upside risk to prices in the near term if operators chase scarcity of supply in raw materials, components and skilled labour.

This is something we remain attentive to, though should inflation fail to pick up in the near term, this could well be a bullish sign that productivity is picking up earlier and more rapidly than we may have thought and this would have beneficial market implications.

Aside from this, the UK and Japan remain good reminders of how political volatility can be a material market driver. One thing we do know is that even if volatility is dropping elsewhere, when it comes to domestic politics and geopolitics, the trend towards increased volatility remains unbowed. In that respect, it may seem that the UK could be set to see its 7th different Prime Minister in the past 10 years.

There was a time when such revolving-door leadership was a facet of a political basket case, such as Italy was once upon a time. Yet, with Rome now a model of political stability under Meloni, it seems that the UK has inherited this mantle. Indeed, it is worth reflecting that the seven UK Prime Ministers prior to David Cameron spanned a period of 46 years going back to 1964 and a time when the Beatles sat atop the charts. Yet these times are not the swinging 60s in the UK, while in Japan, we may be set for the next few years to be characterized as the roaring 20s.

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