THOUGHT PIECE

IAM
INCOME ASSET MANAGEMENT

September 2025

Why it might be a good time to add duration to portfolios

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When the US sneezes, the world and indeed Australia catches a cold. Is it time to up the duration cure?

In recent days, we have seen Australian bond rates move up modestly on stronger than expected Q2 GDP data. For example, both the Australian 3-year and 10-year bond futures have rebounded and are now back inside their old trading ranges of 96.50-96.70 and 95.60-95.80 respectively. We think this provides a window of opportunity for investors to lengthen duration positions in their debt investment portfolios.

Why go long duration?

1. **Protect income and lock in higher yields in a falling interest rate environment.**

The RBA has already cut rates three times in 2025. Despite recent solid data, the RBA remains under pressure to cut further as a number of global central banks are scheduled to make interest rate decisions in the next few days. The most important, the US Federal Reserve appears poised to begin its rate easing cycle as weaker than expected labour data, weak wages growth and ongoing uncertainty including long term tariff impacts increases the risks of a US recession. The Fed is widely expected to cut rates by 25bps in September to the 4%-4.25% range, with markets currently pricing in a further 25bp cuts at the October meeting and a further 22bps of cuts by the December meeting. When the US sneezes, the world and indeed Australia catches a cold. The US as the largest and deepest capital market will drive global bond yields lower no matter the current efforts to diversify away.

2. **Diversification against equity market weakness**

Bond market prices tend to move in opposite direction to equities, which allows investors to hedge against equity market volatility and smooth portfolio returns over time. Given elevated levels of uncertainty globally and the outsized impact on equity markets, it could be a good time hedge against this risk by modestly increasing allocation to higher duration assets.

How do you go about increasing duration in portfolios?

There are several ways to implement this strategy in portfolios:

- Switch from floating rate to fixed rate coupon securities, from a balanced or 50/50 allocation to a 60/40 or 70/30 allocation in favour of fixed securities.
- Employ a barbell strategy. This strategy involves adding one or two longer dated, 7 year to 15 year tenor, highly rated investment grade fixed securities while maintaining the majority of the portfolio in shorter tenor / floating rate securities. Adding Australian semi-government bonds, typically rated at high single A's to AAA with strong liquidity is a good way to implement the long end of the barbell. The Australian Universities sector, or other sectors that benefit from Federal Government support such as Air Services Australia or NBN could also be used for this strategy.

Please speak to your Relationship Manager if you want to discuss adding duration to portfolios.

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