

Treasury Yields & Stock Prices

- Educational Presentation #17 – Hedge Funds
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- Sources: FRED; Federal Reserve; NY Fed; US Treasury; CBO; FactSet; S&P Dow Jones Indices; A. Damodaran; R. Shiller; Reuters; Financial Times; J.P. Morgan

Agenda

Four questions, from where yields are today to what that means for stocks



Why Yields Are at Their Highest Since 2002

What a Treasury yield is, what moves it, and why 2026 is a real-yield shock



How Yields Feed Into Stock Prices

How the 10-year sets the discount rate for stocks, and why stocks have held up so far



Historical Case Studies

1996 to 2000, 2008 and 2013: what past rate shocks did to stocks



Is This Time Different?

Our model, Bessent's push for lower yields, three paths for the 10-year, and our view



Key Takeaways

Four questions to ask when yields move

Summary: earnings absorbed higher yields, but the yield gap is gone

What each section of this deck shows, and the number that sums it up

Our answer in four steps		
I	Yields are at a 2002 high, and the Fed did most of the lifting The 10-year closed at 5.31% on 5 Oct; up 106bp in 2026, of which 98bp in real yields	5.24% 10-year, 9 Oct
II	Stocks held up because earnings outran the discount rate The multiple fell 6.4% since June, but forward earnings rose 10.4%; the yield gap is now 0bp	0bp yield gap
III	History: why yields move matters more than how far 2008: yields -179bp, S&P 500 -38.5%. 2013: 10-year +126bp over the year, S&P 500 +29.6%	+29.6% S&P 500 in 2013
IV	Our model says 17.5x, not 19.1x: about 8% downside It stays a “good” yield rise only if the Fed stops by December; next tests 28 Oct and 4 Nov	17.5x our fair P/E

Earnings have absorbed higher yields so far; with no yield gap left, the index now depends on growth delivering

Section I: Why Yields Are at Their Highest Since 2002

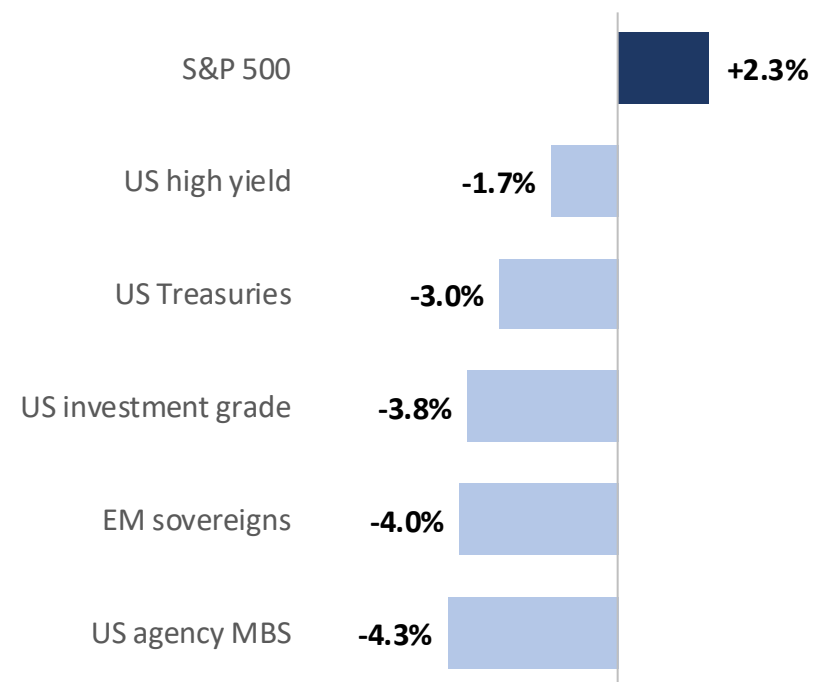
Yields hit a 2002 high, yet stocks set records: one market has it wrong

The 10-year rose 85bp in Q3, its joint largest quarterly rise since 2000, to a 5.31% close on 5 Oct, the highest since May 2002

10-year Treasury yield, weekly close since 2000, %



Total return in Q3 2026, %

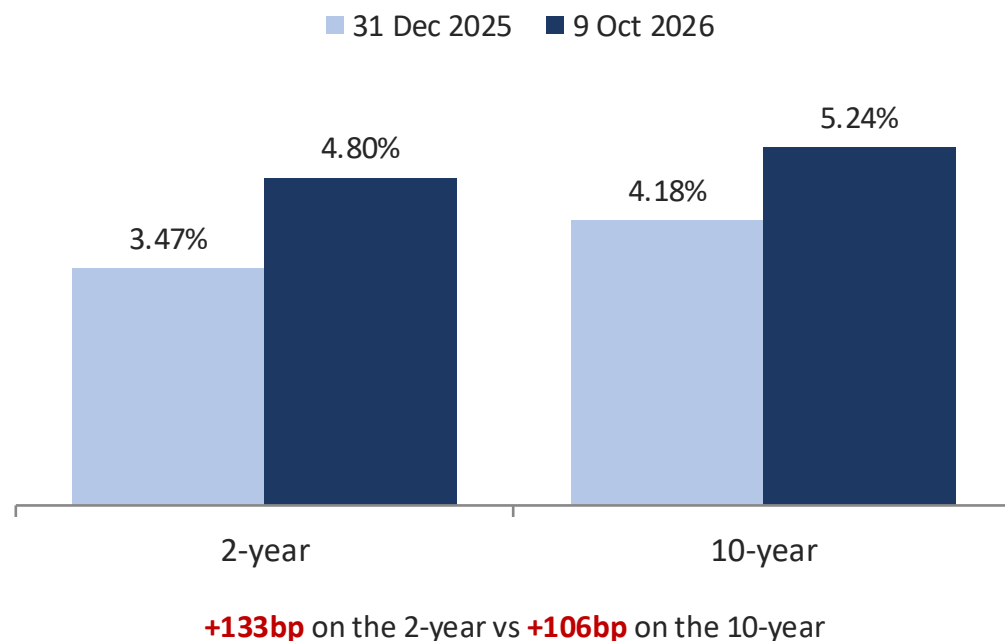


Either stocks know something bonds don't, or they are underpricing rate risk: the rest of this deck tests which

The 2-year follows the Fed, the 10-year prices the next decade

A Treasury yield is the annual return for lending to the US government until maturity; it moves opposite to the bond's price

2-year vs 10-year Treasury yield, %



What each maturity is telling us

1

The 2-year is pricing more hikes

At 4.80% it sits well above the 3.75–4.00% fed funds rate: markets expect the Fed to keep raising, not to cut

2

The Fed agrees

16 of 18 officials see at least one more hike in 2026; median year-end rate 4.125%

3

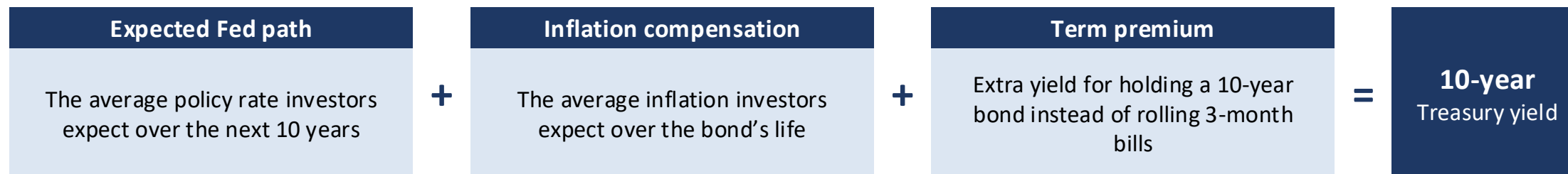
The curve has flattened

The 10-year minus 2-year gap narrowed from 71bp to 44bp this year, as the short end rose faster

The 2-year tells you what the Fed does next; the 10-year adds what investors want for tying money up for a decade

Three building blocks: the Fed path, inflation and the term premium

Every 10-year yield is what the Fed is expected to do, plus cover for inflation, plus extra pay for locking money up



“Good” vs “bad” rises for stocks	
Good rise: the economy is stronger	Bad rise: investors just want more to lend
1 Growth lifts the expected Fed path A stronger economy means investors expect more hikes	1 The term premium or real yields jump Investors demand more to hold bonds; growth does not change
2 Earnings forecasts rise too Profits grow with the economy and offset the higher discount rate	2 Only the discount rate rises Earnings forecasts do not move, so nothing offsets it
3 Stocks can absorb it As in 2013: 10-year +126bp over the year, S&P 500 +29.6%	3 Valuations fall As in 2022: 10-year +237bp, S&P 500 –18.1%

Which block moved matters more than the size of the move: it tells you whether earnings rise alongside the discount rate

Four forces move yields; in 2026 they worked mainly through the Fed

Each force pushes on a different building block; oil lifted inflation, but the Fed's turn to hiking did most of the lifting

1 The Fed	2 Inflation	3 Government borrowing	4 Foreign demand
Moves: Expected Fed path Rate decisions and guidance set the path investors expect	Moves: Inflation compensation Oil, wages and tariffs shape the inflation investors expect	Moves: Term premium The more bonds the Treasury sells, the more investors want to hold them	Moves: Term premium If overseas buyers step back, the premium has to rise
In 2026 -75bp, then +25bp Three cuts in late 2025, then a hike on 16 Sep +133bp 2-year yield in 2026, vs +106bp for the 10-year	In 2026 \$61 → \$138 Brent, end-2025 to the 7 Apr peak (Iran war) +8bp 10-year breakeven inflation in 2026	In 2026 \$2.0tn FY2026 deficit, \$218bn above FY2025 Flat Coupon auction sizes; bills took the extra borrowing	In 2026 80.3% Indirect bid at the 7 Oct 10-year auction (71.8% average) 6.03%, 4.24% UK and Japan 30-year highs: the selloff is global
Role in 2026 Main driver	Role in 2026 Indirect, via the Fed	Role in 2026 Adds to the term premium	Role in 2026 Demand holds up

The expected Fed path and real yields did the lifting, not inflation: the next slide measures how much

Not all yield rises are equal: 2026 is a real-yield shock

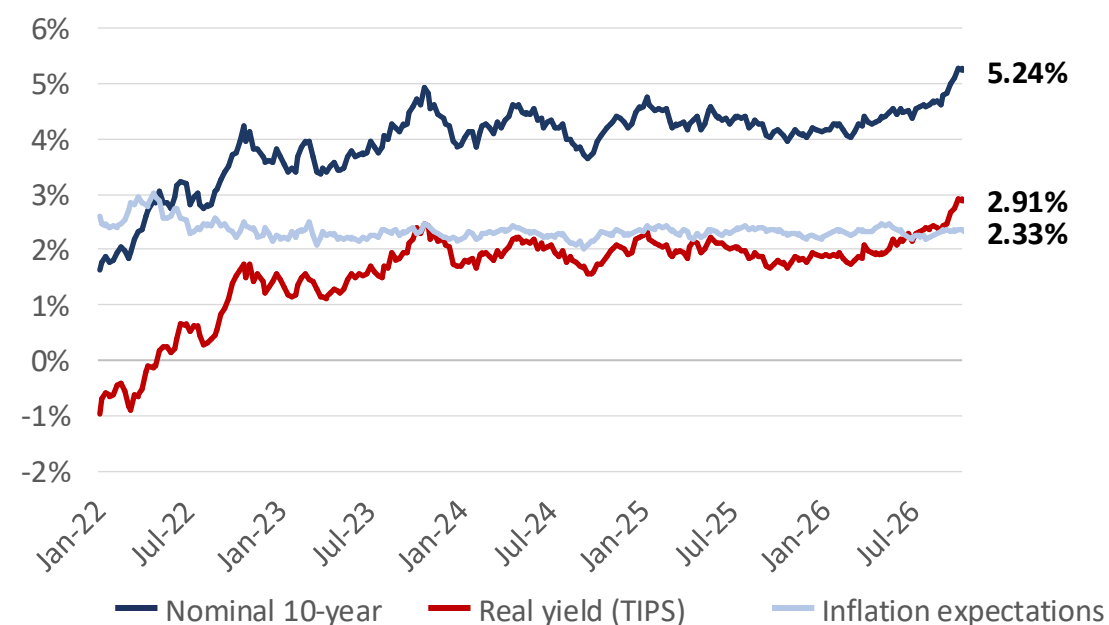
Almost all of 2026's rise in the 10-year came from real yields, the kind that compresses valuations unless earnings keep up

1	+106bp 10-year yield change in 2026 (to 9 Oct)	3	+8bp of which inflation expectations
2	+98bp of which real yield (TIPS)	4	~92% Share of the rise driven by real yields

2026 YTD: what moved the 10-year

Nominal 10-year yield	4.18% → 5.24%
Real yield (TIPS)	1.93% → 2.91%
Inflation expectations	2.25% → 2.33%
Peak real yield (5 Oct)	2.95%

10-year yield: nominal vs real vs inflation expectations



- A real-yield rise lifts the hurdle rate for every stock: it is only 'good' if earnings rise with it, the test the rest of this deck applies
- Inflation expectations barely moved (+8bp): markets see the oil shock as temporary, so this is a Fed and term-premium story

Section II: How Yields Feed Into Stock Prices

Stocks are long bonds: +100bp on the 10-year $\approx$ -16% on fair value

Holding earnings and the risk premium fixed, the discount rate alone moves the fair S&P 500 multiple by ~3–4 turns per 100bp

How the transmission works

10y yield ↑

➡

Discount Rate ↑
 $r = 10y + ERP$

➡

Fair P/E ↓
 $P/E = 1 / (r - g)$

	10y yield	Discount Rate	Fair P/E
Today	5.24%	9.47%	19.1x
After +100bp	6.24%	10.47%	16.0x (-16%)

Fair forward P/E: 10-year yield $\times$ equity risk premium							
10y \ ERP	3.0%	3.5%	4.0%	4.23%	4.5%	5.0%	6.0%
4.5%	30.6x	26.6x	23.4x	22.2x	21.0x	19.0x	16.0x
5.0%	26.6x	23.4x	21.0x	20.0x	19.0x	17.3x	14.8x
5.24% today	25.0x	22.2x	20.0x	19.1x	18.2x	16.7x	14.3x
5.5%	23.4x	21.0x	19.0x	18.2x	17.3x	16.0x	13.8x
6.0%	21.0x	19.0x	17.3x	16.7x	16.0x	14.8x	12.9x
6.24% +100bp	20.0x	18.2x	16.7x	16.0x	15.4x	14.3x	12.5x
6.5%	19.0x	17.3x	16.0x	15.4x	14.8x	13.8x	12.1x
7.0%	17.3x	16.0x	14.8x	14.3x	13.8x	12.9x	11.4x
Blue = richer than today's 19.1x · red = cheaper							

Down the 4.23% column, +100bp on the 10-year takes the fair P/E from 19.1x to 16.0x

A +100bp rise in the 10-year takes fair value from ~7,760 to ~6,520 on the S&P 500:
Small moves in yields now result in large moves in value

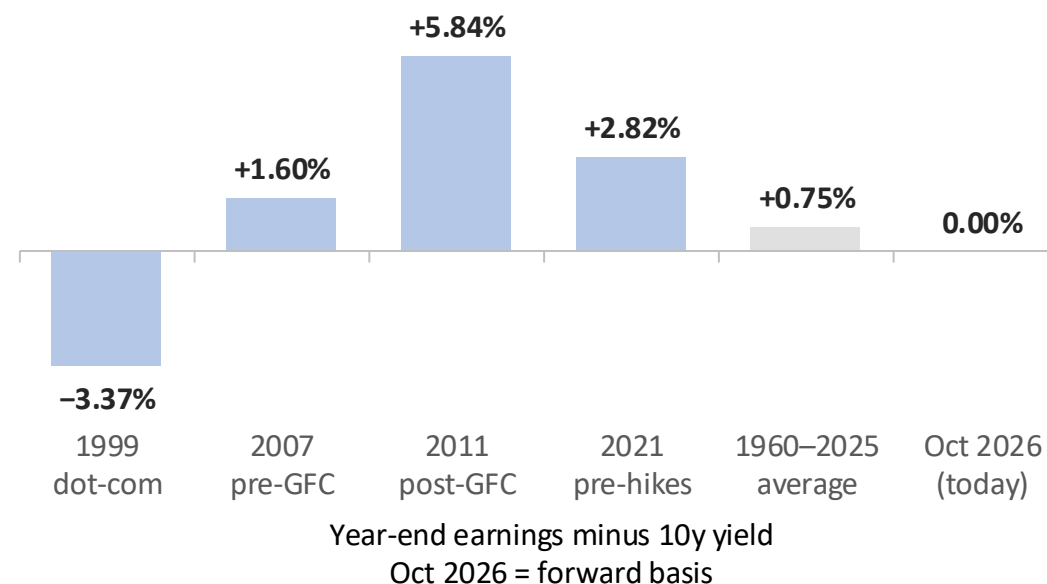
The yield gap has disappeared

The S&P 500 now yields almost exactly what a risk-free 10-year Treasury does, a setup last seen around 2000

1	5.24% S&P 500 earnings yield ($1 \div 19.1x$ forward P/E)
2	5.24% Risk-free 10-year Treasury yield (9 Oct 2026)
3	0bp Extra yield for owning stocks (1960–2025 avg: +75bp)
4	4.23% Second lens: Damodaran implied ERP (avg 4.25%)

Earnings yield minus 10-year yield: today vs key moments

After the GFC stocks paid ~6pp over bonds; today ≈ 0
Of these moments, only the 1999 dot-com peak was thinner (-3.4%)

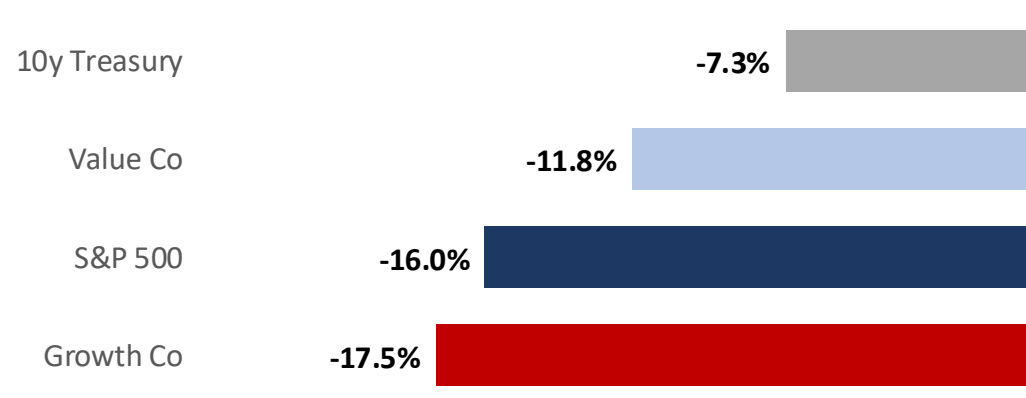


Investors are paid almost nothing extra to own stocks: valuations now rely on earnings growth delivering, not on cheapness

Growth stocks are the long bonds of the equity market

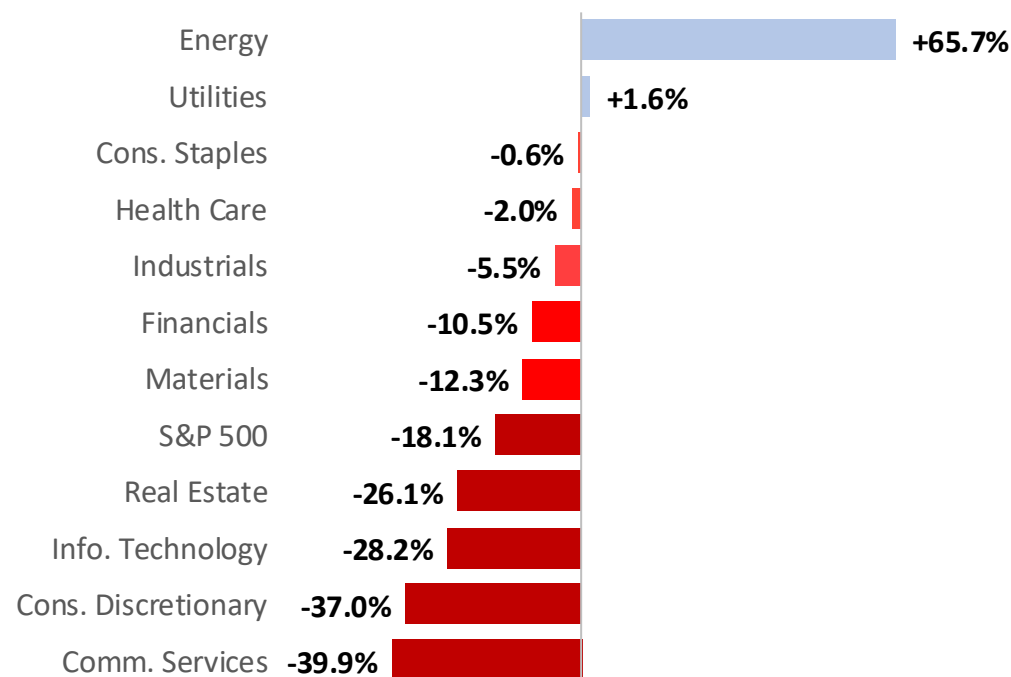
A +100bp rise hits distant cash flows hardest; 2022 proved it, but in 2026 earnings growth protected tech

Hit from a +100bp rise in the 10-year (our model)



	Value Co	Growth Co
Cash-flow growth	~2% a year	15% a year for 10 years
Value from years 11+	49%	75%
Effective duration	11.8 years	17.5 years

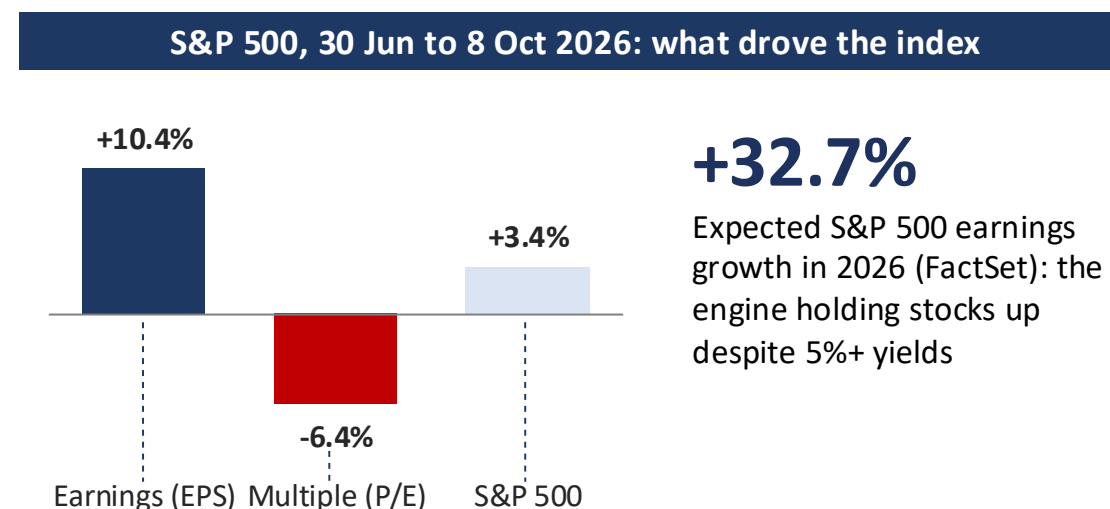
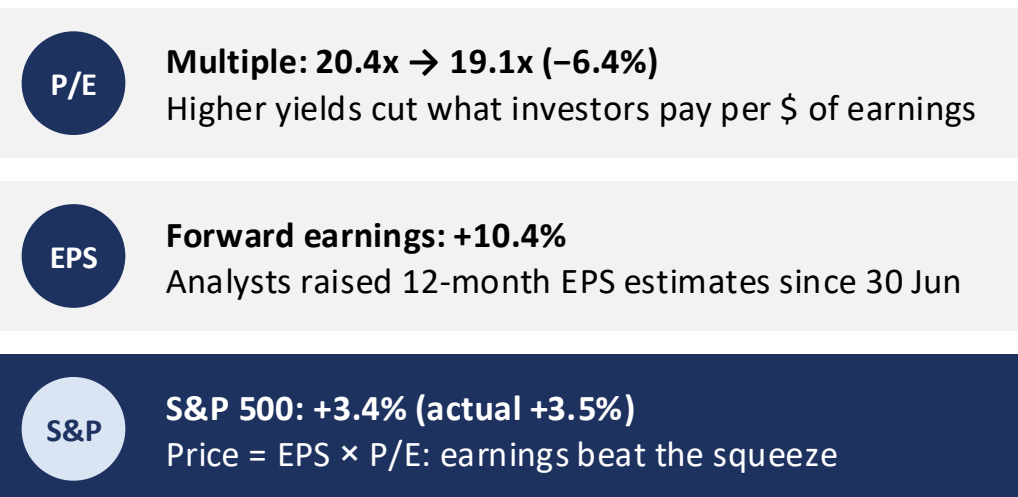
S&P 500 sector total returns, 2022 (10-year +237bp)



Long-duration stocks lose most when yields rise without growth; in Q3 2026 tech rose 7.2% while utilities fell 12.4%

So why haven't stocks fallen? Earnings outran the discount rate

Since June the 10-year rose 78bp and the market multiple fell 6%, yet 10% earnings upgrades lifted the index



Stocks held up because earnings outran the discount rate: the risk is growth slowing while yields stay above 5%

Section III: Historical Case Studies

2026 rhymes with 1999, but today's risk premium is twice as thick

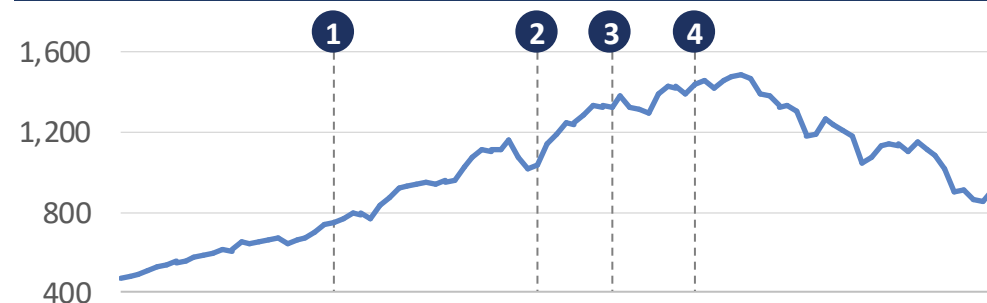
Greenspan flagged stretched valuations in 1996; the S&P 500 still doubled before Fed hikes and an earnings bust ended the run

What happened

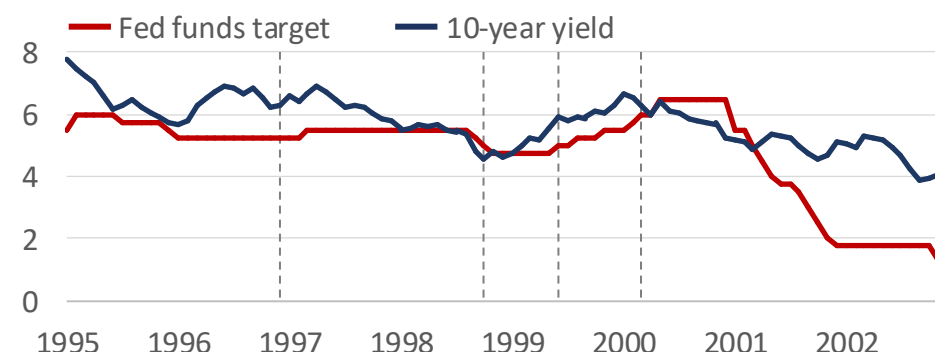
- 1** **5 Dec 1996:** Greenspan asks whether “irrational exuberance” has inflated asset values. S&P 500 at 744.
- 2** **Sep to Nov 1998:** After Russia’s default and LTCM, the Fed cuts three times, from 5.50% to 4.75%.
- 3** **Jun 1999 to May 2000:** Six hikes take the Fed to 6.50%; the 10-year peaks at 6.79%.
- 4** **24 Mar 2000:** The S&P 500 peaks at 1,527, up 105% since the speech. By Oct 2002 it is down 49%.

Then and now	1998 to 2000	2025 to 2026
Insurance cuts	–75bp (1998)	–75bp (2025)
Hikes so far	+175bp, to 6.50%	+25bp, to 4.00%
S&P 500 earnings growth	+24% (1999)	+33% (2026e)
Equity risk premium	2.05% (end-1999)	4.23% (Oct 2026)

S&P 500, monthly average



Fed funds target and 10-year yield, %



The 1999 path needs more hikes and an earnings disappointment: markets price the first, not the second

2008: Paulson's "bazooka" rescued bondholders, not shareholders

Fannie Mae and Freddie Mac were taken over on 7 September, and the 10-year yield then fell together with the S&P 500

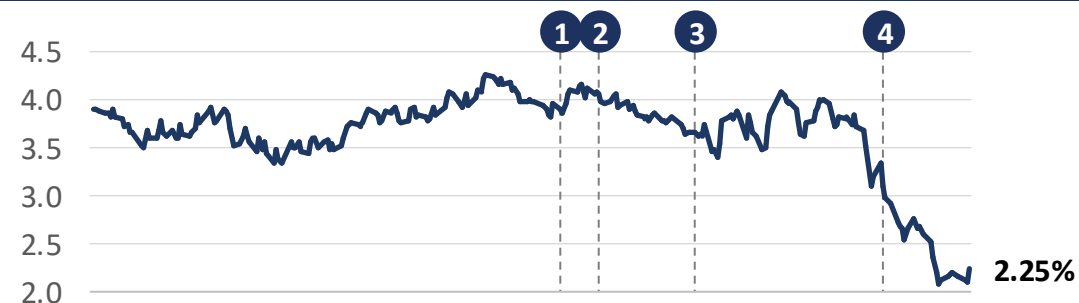
What happened

- 1 **13 Jul:** With Fannie Mae and Freddie Mac shares down about 75% in 2008, Paulson asks Congress for authority to backstop them.
- 2 **30 Jul:** The powers become law. His argument: if markets know you have a "bazooka", you may never have to use it.
- 3 **7 Sep:** He uses it anyway: both firms are taken over, with up to \$100bn each (about \$190bn is eventually drawn).
- 4 **25 Nov:** The Fed pledges to buy up to \$600bn of agency debt and mortgage bonds. The 10-year falls 24bp that day.

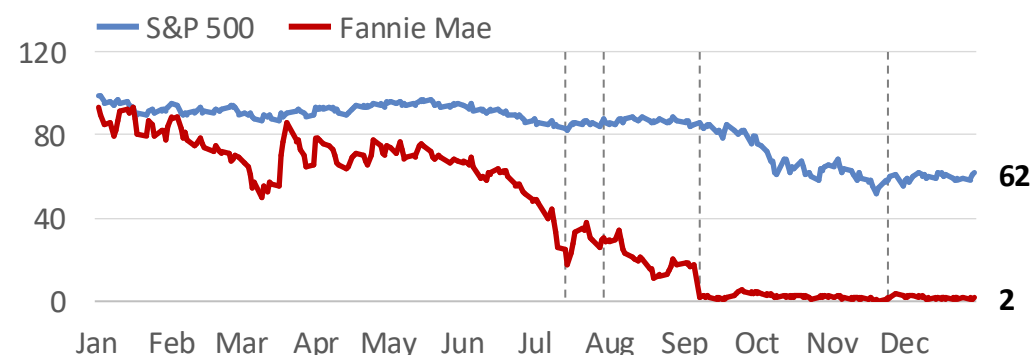
What does this teach an equity analyst?

-  **A backstop for debt is not a backstop for equity**
Mortgage rates fell 42bp in a week; the shares lost 90% and 83%.
-  **Lower yields do not help stocks when fear drives them**
The 10-year fell 179bp in 2008, and the S&P 500 still lost 38.5%.

10-year Treasury yield, %



Share prices, 31 Dec 2007 = 100



Ask why yields move and who a backstop protects: Bessent's buybacks face the same test as Paulson's bazooka

2013 Taper Tantrum: talk lifted yields a full point, yet stocks rose 30%

The Fed changed nothing until December; the 10-year rose from 1.94% to 2.98% (21 May to 5 Sep), all of it in real yields

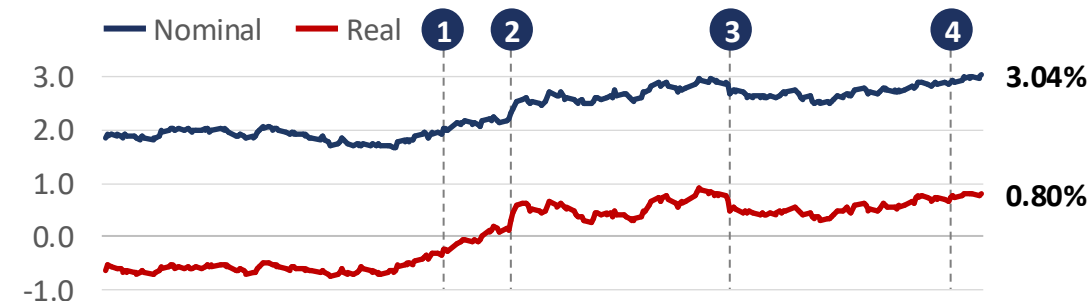
What happened

- 1 22 May:** Fed Chair Bernanke says the Fed could soon slow its \$85bn-a-month bond buying. No rate hike, no change yet.
- 2 19 Jun:** He sets a timetable to end purchases by mid-2014. The 10-year rises 40bp in a week; the S&P 500 loses 3.9% in two days.
- 3 18 Sep:** Markets expect the taper to start. The Fed holds off and the 10-year drops 17bp in a day.
- 4 18 Dec:** The taper arrives: purchases are cut to \$75bn a month. The 10-year moves 4bp; the S&P 500 closes at a record.

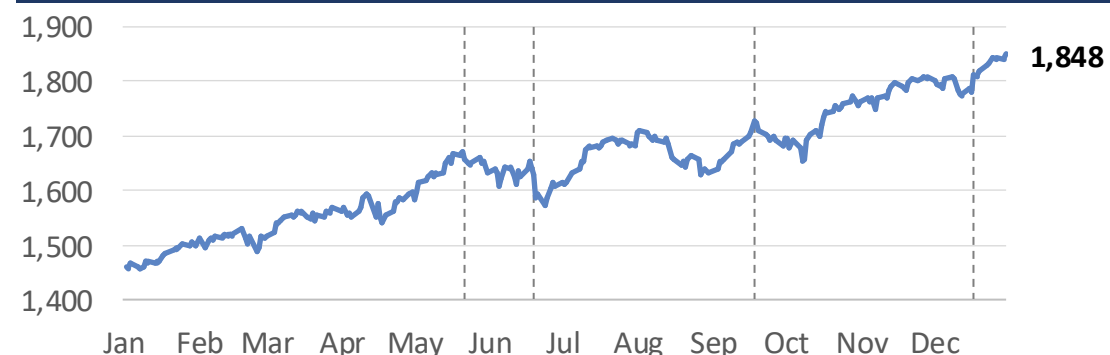
What does this teach an equity analyst?

-  **Markets price the expectation, not the event**
The 10-year rose 104bp on talk of tapering, and 4bp when it came.
-  **Growth and a yield gap let stocks absorb the rise**
S&P 500 +29.6% with a 2.8-point yield gap; end-2025: 0.0

10-year Treasury yield, %



S&P 500, index level



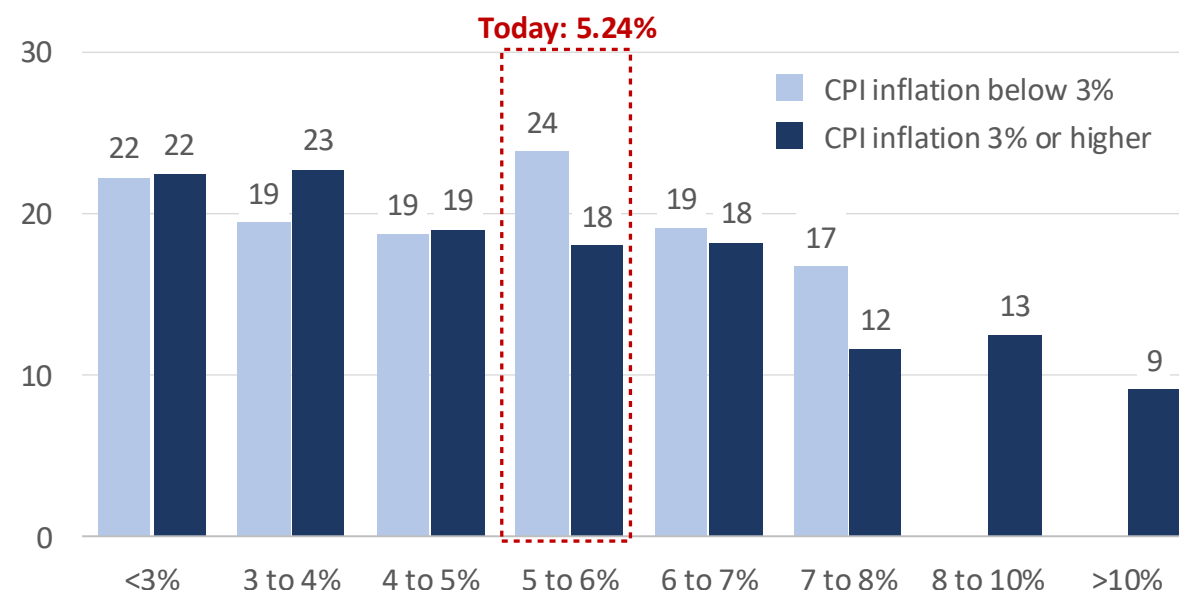
Higher yields hurt stocks unless growth or a yield gap offsets them: in 2013 both did, today the yield gap is gone

Section IV: Is This Time Different?

History says multiples only crack above 7%, with high inflation

Median S&P 500 P/E on trailing reported earnings, by level of the 10-year yield, monthly data 1960 to 2023

Median P/E by 10-year yield band (x)



Bands with fewer than 12 months are not shown. The 5 to 6% low-inflation bar reflects the 1995 to 2001 boom.

Street view

6.0% is where most fund managers would switch from stocks to bonds (BofA survey, Oct 2026)

“Equities can handle higher yields”: J.P. Morgan (21 Sep) calls 2026 “an oil and rates shock”

Our test

Up to a 7% 10-year, the median P/E held near 18x or higher

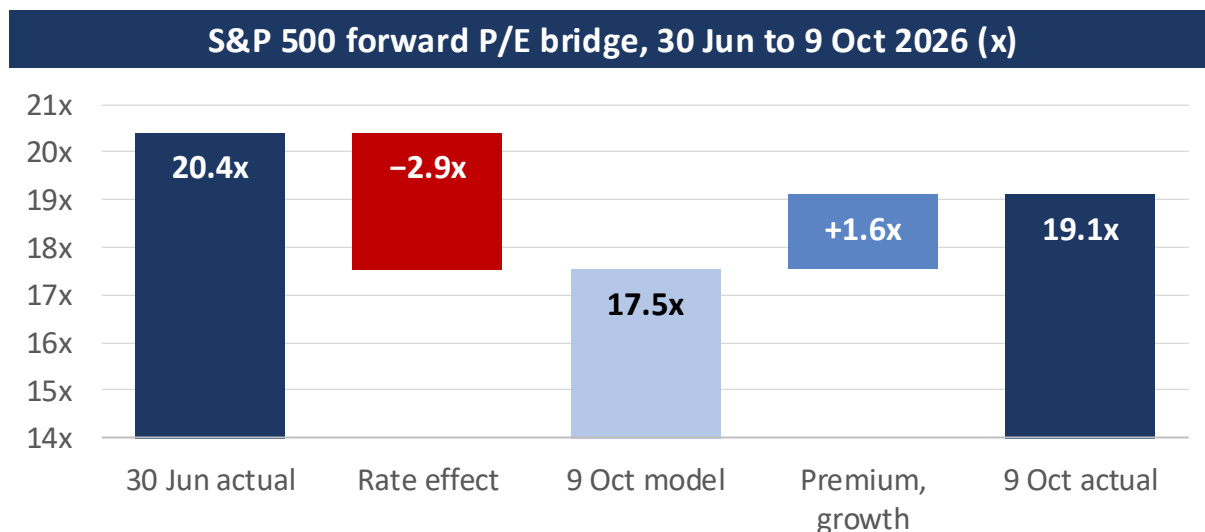
Above 7%, it fell to 9x to 17x, mostly with inflation above 3%

But today’s ~27x trailing P/E is far above these medians:
history backs a 5% yield, not today’s multiple

A 5% 10-year is not a cliff for stocks; inflation that keeps the Fed hiking is

Our model says 17.5x, not 19.1x: stocks priced only half the shock

Bridge of the S&P 500 forward P/E from 30 Jun to 9 Oct 2026, holding June's risk premium and growth assumption fixed



Axis starts at 14x to show the steps; bars are drawn to scale above it

Formula: earnings yield (1 ÷ P/E) = 10-year yield + risk premium – growth				
	Earnings yield	= 10-year	+ premium – growth	P/E
30 Jun actual	4.90%	4.44%	0.46%	20.4x
9 Oct model	5.70%	5.24%	0.46% (held)	17.5x

Three ways to explain the 1.6x gap

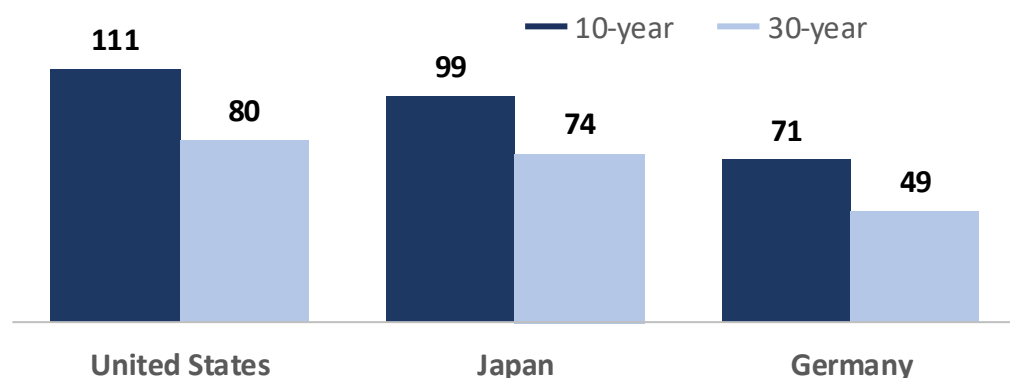
- Investors accept a thinner premium**
 Premium minus growth fell about 47bp. Damodaran's cash-yield ERP, 3.70%, is the lowest since 2008.
- Growth expectations rose**
 Forward EPS is up 10.4% since June; FactSet sees earnings +33% in 2026 and +16% in 2027.
- The market sees the spike as temporary**
 Strategists see 5.00% by year-end and 4.75% in 12 months, but have underestimated yields nine months running.

Unless growth or a lower 10-year arrives, the index multiple has about 8% of downside to our model

Bessent is half right, and his buybacks are too small to fix the rest

The long-end selloff is global, but the US 10-year rose more than Japan's and Germany's, mostly on the expected Fed path

Change in yields, end-2025 to 30 Sep 2026, bp



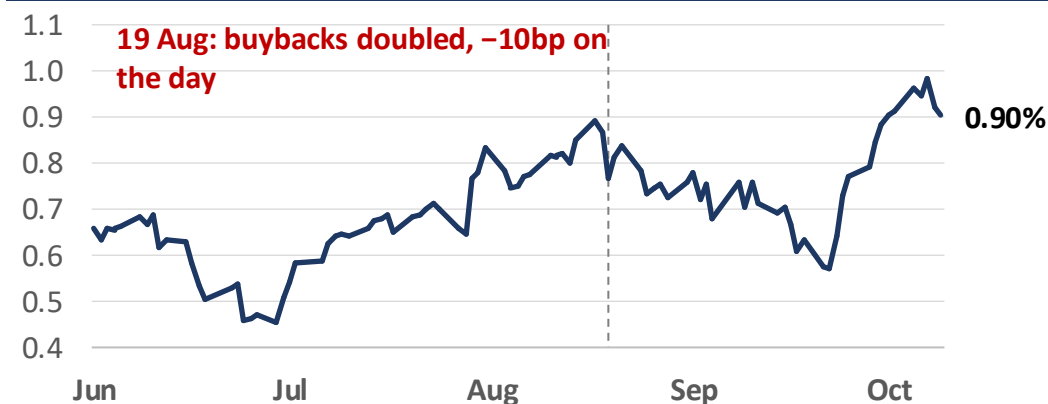
Bessent: "global issues"

True for the long end: UK, French and Japanese long yields hit multi-decade or record highs

But is it only global?

Only half true: the US 10-year rose 111bp, more than Japan's (99bp) and Germany's (71bp)

NY Fed 10-year term premium, %, daily



\$21bn bought back in four operations, 10 Sep to 8 Oct

0.4% of the \$5.4tn of Treasuries with over 10 years left

9% of the \$231bn of long bonds auctioned Aug to Oct

The Fed explains most of the rise and buybacks are 0.4% of long debt: watch the 4 Nov refunding for anything bigger

Three paths for the 10-year, and what each means for fair value

Fair forward P/E from our model under each path, at today's thin risk premium and at June's (19.1x today, with the 10-year at 5.24% on 9 Oct)

Rates retreat		Consensus holds		Break above 6%, premium back to 5%	
10-year	Fair P/E (vs 19.1x)	10-year	Fair P/E (vs 19.1x)	10-year	Fair P/E (vs 19.1x)
4.75%	21.1x +10%	5.00%	20.0x +5%	6.00%	14.8x -23%
-49bp vs 9 Oct	June premium: 19.2x, +0.5%	-24bp vs 9 Oct	June premium: 18.3x, -4%	+76bp vs 9 Oct	June premium: 13.8x, -28%
What it takes: The Fed stops after December and oil fades		What it takes: One more hike and no fiscal shock		What it takes: Hikes into 2027 and the risk premium returns to 5%	
Who sees it: Goldman Sachs; Reuters poll median in 12 months		Who sees it: Reuters poll median for year-end; BofA and Citi		Who sees it: Fund managers' switch point to bonds (BofA)	
Street view vs our test: consensus sits on the middle path, but strategists have underestimated the 10-year nine months running and 28 of 30 see the risks skewed higher (Reuters, 7 Oct).					
14 Oct (done) CPI: 3.7%, core 2.6%	15 Oct (done) Chair Warsh spoke	28 Oct FOMC decision	29 Oct Q3 GDP	3 Nov US midterms	4 Nov Treasury refunding
Upside needs the Fed to stop and investors to stay generous; downside needs only more of the same					

Our view: stocks are priced for the good kind of higher yields

What today's 19.1x is betting on, what could break it, and what would change our mind

What stocks are betting on

1

Earnings keep compounding

FactSet: +33% in 2026 and +16% in 2027

2

Inflation is oil, not wages

Core CPI 2.6% vs 3.7% headline in September

3

History tolerates 5%

The median P/E held at 18x or more up to a 7% 10-year

4

Treasury demand holds

80.3% indirect bid at the 7 Oct 10-year auction

What could break it

1

The Fed is still hiking

16 of 18 officials see more; CPI lifted the 2-year 13bp

2

No yield gap left

Earnings yield equals the 10-year; our fair value 17.5x

3

A narrow market

Over 4 in 10 S&P 500 stocks are down this year

4

Credit is cracking underneath

CCC spreads widened from 885bp to 1,253bp

What would change our mind: a Fed hold in December, core CPI back below 2.5%, or credible fiscal measures at the 4 Nov refunding.

Our call: cautious on the index multiple, not on earnings; it stays a 'good' yield rise only if the Fed stops by December

Key takeaways: four questions to ask when yields move

What an analyst should check when yields move, and what each episode in this deck taught us

Four questions to ask

- 1 Which block moved?**
The Fed path, inflation compensation or the term premium
- 2 Are earnings rising with it?**
If yes, stocks can absorb it; if not, multiples compress
- 3 How much yield gap is left?**
Earnings yield vs 10-year; premium vs 4.25% average
- 4 How long are the cash flows?**
Growth and long-duration sectors take the biggest hit

What each episode taught us

- 1 1996 to 2000: valuation alone doesn't time the top**
The Fed, then earnings, ended the run three years later
- 2 2008: a backstop for debt is not one for equity**
Mortgage rates fell 42bp; shareholders lost 90% in a day
- 3 2013: growth-driven rises get absorbed**
The 10-year rose 126bp over 2013, yet the S&P 500 rose 29.6%
- 4 2026: a real-yield rise with no yield gap left**
Earnings must keep delivering for today's 19.1x to hold

Our answer: yields hit stocks through the discount rate; whether a rise hurts depends on why yields move and if earnings keep up.

Ask why yields are moving before asking how far: the reason decides what happens to stocks



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