
Tech and growth stocks have been among the most vulnerable to rising yields, since more of their value is tied up in anticipated profits further into the future. (UBS)

# The reason yields are rising matters

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**Such a swift rise in yields might be expected to be a problem for equities, presenting investors with an increasingly attractive alternative to stocks and lowering the current value of future cash flows.**

While rising yields can be a headwind, we see several reasons equities can withstand the most recent move:

**The reason yields are rising matters.** When increasing borrowing costs are largely the result of worries over elevated inflation, equities can indeed suffer. This was the case in 2022, amid concerns that inflation was proving stubbornly high, and the Federal Reserve was raising rates aggressively. This in turn led to worries over slowing economic growth, a potential drag on corporate profits. The latest rise in yields has been different. While markets have been anticipating slightly higher inflation in the wake of Donald Trump's election victory, much of the rise in yields has been driven by hopes of stronger economic growth. This built on a trend from October, when the resilience of US data surprised investors.

**The speed of the move in fixed income has not yet been an impediment to stocks**. It is hard to pin down at what point rising yields becomes disruptive, and this can vary over time. However, based on recent data, we estimate that monthly moves in the real 10-year yield in excess of 40 basis points, calculated using Treasury Inflation Protected Securities rather than nominal yields, have the potential to add to equity volatility. The recent moves have fallen slightly short of this threshold, with a rise of 36 basis points in October. The momentum of rising yields also slowed in November. We also believe that the increase in US Treasury yields has gone too far and our base case is for a decline.

**Enthusiasm for AI has made higher yields easier for the market to digest.** Historically, tech and growth stocks have been among the most vulnerable to rising yields—since more of their value is tied up in anticipated profits further into the future. This correlation has weakened recently. As optimism has built over the commercialization of AI, markets have been revising up expectations for cash flows—more than offsetting a slightly less favorable discount rate. While enthusiasm for AI is no longer new, it has contributed to the resilience of markets overall, in our view.

So, we continue to see the outlook for stocks as positive. Historically, stocks have performed well in years when the Fed has been cutting rates while the US economy is not in recession. Against this backdrop, we expect the S&P 500 to reach 6,600 by the end of 2025, around 12% higher than the level at the time of writing. We see value in maintaining diversified exposure to Asia ex-Japan, and in Europe, we like select ideas in small- and mid-cap stocks and Swiss high-quality dividend payers.

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