Standing Up to Higher Rates | 09.25.2026

Interest rates on government bonds have moved sharply higher this year, but you would not necessarily know it from looking at the stock market. The 10-year Treasury yield has climbed from about 4.2% at the start of the year to around 5.2% today, an increase of roughly a full percentage point. Despite that move, the S&P 500 sits just below its all-time high, with roughly two-thirds of the index's companies continuing to trend higher over the long term. That resilience is notable given how much anxiety rising rates have historically created for investors.

Several factors have pushed interest rates higher this year. War-driven inflationary pressures have played a role, but so has an unusually large amount of borrowing. Large federal deficits require the government to issue more Treasury bonds to raise money, while companies are borrowing heavily to fund the massive buildout of AI infrastructure. Economic growth has also remained solid, with consumers still spending, businesses investing, and recent data coming in stronger than expected. Together, persistent inflation, strong borrowing demand, and resilient economic growth have reinforced expectations that interest rates will stay higher for longer.

Higher rates, however, are not necessarily a problem for stocks on their own. Markets now expect the Federal Reserve to raise short-term interest rates three more times over the next year or so. Still, stocks have historically weathered rate hikes as long as the economy and earnings remain healthy. The real risk is not rising rates themselves, but the point at which higher borrowing costs start to freeze up lending. That is what happened in 2018, when credit conditions tightened sharply, and stocks fell in response. So far, we are not seeing that kind of strain. Lending markets remain relatively healthy, with little sign that borrowing costs are anywhere near a breaking point.

We are also watching several other areas closely. Market leadership has narrowed recently, with the 10 largest companies in the S&P 500 accounting for nearly half of the index's gains this year. Investors have piled back into the largest technology stocks as concerns about an AI slowdown have faded, leaving the broader market increasingly dependent on a small group of companies. We would prefer to see more companies contributing to market gains from here.

Several uncertainties still hang over the market. The U.S. and Iran remain at an impasse over control of the Strait of Hormuz. Midterm elections in November could bring their own bout of volatility as investors weigh potential policy shifts. History offers some comfort, though: the 12 months following past midterm elections have generally been a strong stretch for stocks, regardless of which party gained ground.

For now, the market continues to absorb higher rates reasonably well, supported by solid economic growth and healthy credit conditions. Still, higher borrowing costs and narrower market leadership leave less room for error. In that environment, we think the focus should remain on quality businesses with durable, self-sustaining growth.

Thanks,
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