

5% interest rates: When earnings outrun the discount rate

State Street · Chris Carpentier · 2026-09-21 · English original

As US 10-year Treasury yields move toward 5%, higher real rates have weighed on valuations. Yet stronger earnings expectations have provided support, helping equities remain resilient.

As Treasury yields approach 5%, the equity risk premium has compressed and remains at lows, indicating that bonds have become significantly more appealing relative to stocks. Even so, equity markets have remained remarkably strong, reflecting confidence that earnings growth can continue to offset the headwind from higher discount rates.

Weekly Highlights

Source: FactSet. 5% was approached in Oct 2023, but not surpassed.

Source: FactSet. As of 9/11/2026. Real rates equal yield on the US Treasury Constant Maturity Inflation-Indexed (TIPS) 10-Year Index.

5% interest rates: When earnings outrun the discount rate

The approach of a 5% US 10-year Treasury yield would have seemed, not long ago, like an obvious warning sign for equity investors. Conventional market wisdom suggests that higher yields increase the discount rate applied to future cash flows, compress equity valuations, and ultimately undermine stock prices. Yet the market's recent behavior appears to tell a more nuanced story. Even as Treasury yields have climbed toward levels not seen in many years, equity markets have remained remarkably resilient.

This apparent contradiction has fueled a growing debate among investors. Is the equity market ignoring the signal from higher rates, or has the underlying economic and earnings environment changed sufficiently to offset the valuation pressure that accompanies rising yields? While there is no single explanation, the evidence increasingly suggests that equities are not shrugging off higher rates. Rather, the market has already adjusted to them through lower valuations, while stronger earnings expectations have provided an offsetting source of support.

Here, we illustrate this dynamic. The relationship between the S&P 500 forward price-to-earnings ratio and the 10-year real Treasury yield remains largely intact. As real yields have risen, forward valuation multiples have compressed. Over the past year, the market's forward multiple has declined from roughly 23x earnings to approximately 19x, as real yields have moved materially higher. Here we focus on real yields rather than nominal yields because much of the rise in Treasury rates has reflected higher real borrowing costs rather than a substantial increase in long-term inflation expectations. While inflation remains an important macro consideration, long-term inflation breakeven rates have remained relatively subdued, making real yields the more relevant gauge of valuation pressure.

This challenges the notion that equity valuations have become immune to interest rates. Markets are still responding to higher discount rates in a manner broadly consistent with financial theory. Investors today are willing to pay less for each dollar of future earnings than they were when real borrowing costs were

substantially lower. Higher real yields continue to impose a tangible valuation headwind.

Yet valuation is only one side of the equation. Total returns are driven by a combination of earnings growth and changes in valuation multiples. When multiples contract, earnings growth can offset some or all of the resulting drag. Conversely, when earnings weaken, even stable valuations may struggle to support equity prices.

That distinction helps explain why stocks have remained resilient despite the valuation compression. While investors have become less willing to pay elevated multiples, they have simultaneously become more optimistic about the earnings outlook. The chart above highlights the extent of this shift. Forward earnings growth expectations for the S&P 500 have been impressive over the past year, reflecting a combination of stronger corporate profitability and improving revenue trends. Whether these expectations ultimately prove too optimistic remains an important risk. A reacceleration in inflation, a further rise in real interest rates, softer economic growth, or a moderation in the AI-driven investment cycle could all challenge the earnings outlook. The resulting earnings expansion has thus far outweighed the negative impact of a higher discount rate.

This distinction is particularly relevant today because investors often focus disproportionately on interest rates in isolation. A 5% Treasury yield may appear restrictive when compared with the environment that prevailed throughout much of the post-Global Financial Crisis period. However, interest rates do not exist independently of the broader economic backdrop. Higher yields frequently emerge alongside stronger nominal growth, firmer inflation expectations, or improved economic performance, all of which can influence earnings positively.

This chart can help place today's rate environment into this broader context. The chart compares the 10-year Treasury yield with three-year annualized nominal GDP growth and shows that both measures currently reside at levels materially above those that characterized much of the decade following the Global Financial Crisis. As we've now come down after the Covid recovery period, the three-year annualized nominal GDP growth remains in the neighborhood of 5% to 6%, while Treasury yields have moved toward 5%, similar to what was seen in the mid-2000s.

The relationship should not be interpreted as evidence that nominal GDP growth mechanically justifies any specific level of Treasury yields. Bond yields are influenced by numerous factors, including monetary policy, inflation expectations, and fiscal dynamics. Nevertheless, the chart provides useful context. The economy appears to be operating within a different nominal regime than the one investors became accustomed to during the 2010s.

Taken together, the evidence suggests that the market's resilience is less of a sign that investors are ignoring higher rates and more a reflection of stronger earnings and a firmer nominal growth backdrop. While elevated real yields have clearly weighed on valuations, the earnings outlook has thus far been strong enough to offset that pressure.

The key investment takeaway is to focus less on the absolute level of interest rates and more on the interaction between rates and earnings. Higher real yields are a genuine headwind and have already compressed valuations. But thus far, stronger earnings expectations have been the more powerful force.

Source: FactSet, S&P. Data as of 9/14/2026 unless otherwise stated. The performance data quoted represents past performance. Past performance does not guarantee future results. Investing involves risk, including the risk of loss of principal.

Go beyond the headlines...

Skimmed the summary? Dive deeper with the full PDF—your go-to for weekly market insights and analysis.

State Street Global Advisors Worldwide Entities

State Street Global Advisors (SSGA) is now State Street Investment Management. Please go to statestreet.com/investment-management for more information.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without SSGA's express written consent.

The trademarks and service marks referenced herein are the property of their respective owners. Third party data providers make no warranties or representations of any kind relating to the accuracy, completeness or timeliness of the data and have no liability for damages of any kind relating to the use of such data.

Source: <https://www.ssga.com/hk/en/institutional/insights/mind-on-the-market-21-september-2026>