

Daily: Higher yields need not derail markets

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Thought of the day

US Treasuries sold off on Wednesday as higher oil prices and robust economic data raised expectations of faster Federal Reserve tightening, while a weak bond auction added to the selling pressure. The 10-year Treasury yield rose nearly 15 basis points to above 5.1% for the first time since 2007, and the S&P 500 fell 0.8%.

The S&P Global US flash composite PMI rose to 58.4 in September, marking a fourth consecutive month of acceleration and the strongest expansion in private-sector activity since July 2021. The report also pointed to intensifying price pressures, with input costs rising the most in nearly four years due to higher fuel and transport costs. Meanwhile, the USD 70bn sale of five-year Treasuries came in at the highest auction yield since 2006. Fed funds futures now imply a 70% chance of an interest rate hike in October, up from just below 50% a week ago, when the Fed raised its policy rate to 3.75-4%.

But despite the rise in yields and renewed policy concerns, we think the investment outlook remains constructive.

Policy tightening is likely to be less aggressive than current market pricing suggests. While recent comments from Fed officials have been hawkish, our base case is for the Fed to raise interest rates in December before keeping them steady. The median rate projection from policymakers suggests a hold throughout 2027, and we expect steady disinflation over the next six months. Core personal consumption expenditures (PCE) inflation is expected to be revised down by 0.2 percentage points later this month as part of the Bureau of Economic Analysis' annual revisions, while favorable base effects in the first half of next year should also weaken the case for a long sequence of hikes.

Higher yields are creating select opportunities in fixed income despite debt concerns. Concerns over government debt levels have partly contributed to rising bond yields this year, but high debt levels do not automatically imply poor investment returns. Depending on how governments choose to manage their debt burdens, the impact on different asset classes varies. We continue to view fixed income as Attractive and see opportunities across regions and market segments, as higher starting yields offer robust portfolio income. While income-focused investors may prefer short-maturity bonds to reduce duration risk, we also see tactical opportunities in medium- to long-duration high-quality bonds, as well as medium-tenor credit from stronger investment grade issuers.

Resilient economic activity bodes well for corporate earnings. The latest PMI reading reinforces our view that the US economy remains on solid footing, providing a favorable environment for companies to grow revenues and profits. With continued AI investment offering an additional tailwind, we forecast S&P 500 earnings growth of 25% this year and 14% in 2027. The earnings cycle is also strengthening globally, supported by structural trends and a broadening cyclical recovery. We forecast MSCI All Country World earnings growth of 26% this year and 14% next year, which should drive global equities higher over the next six to 12 months.

So, we continue to recommend positioning for further equity gains while diversifying and managing

concentration risk. Resilient growth and robust earnings should help markets withstand a measured tightening cycle, while higher bond yields provide opportunities to add portfolio income. Investors can also use capital preservation strategies, broad commodities, and alternatives to strengthen portfolio resilience.

Source: <https://www.ubs.com/global/en/wealthmanagement/insights/chief-investment-office/house-view/daily/2026/latest-24092026.html>