

Video: CIO Lens Q4 2026: The challenge posed to equities by rising bond yields

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Equities have remained strong but rising oil prices and bond yields are testing this resilience.

Authors

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For the past few years, I've encouraged everyone to ignore the headlines and focus on the medium-term trends. Looser fiscal policy, the artificial intelligence (AI) boom, higher defence spending and a focus on securing supply chains in a geopolitically uncertain world all pointed to stronger nominal growth which is great for equities.

From a cyclical perspective we are still in a very strong environment for growth. However, the risks are rising and these are the indicators I am watching closely.

Firstly, the conflict in Iran has continued for longer than anyone expected. We can't predict the outcome but we know that the supply buffers in energy markets - floating storage and strategic reserves - have largely been exhausted. This means that we must remain alert to the possibility of persistently high energy prices which, in turn, complicate the outlook for central banks. Keep an eye on oil (as well as gasoline, diesel and jet fuel) and gas prices.

Which brings me onto the next point: bonds. I've always said that higher bond yields would be the ultimate constraint on this bull market in equities. In an environment of inflationary, rather than deflationary, shocks and profligate fiscal policies, equity markets can be sustained by higher nominal growth as long as bond investors are willing to fund the borrowing.

The last few months saw significant volatility in bond yields and, with the AI boom being increasingly debt-financed, well-functioning bond markets are more important than ever. The recent interest rate hike in the US indicated that Federal Reserve (Fed) Chair Warsh understands the importance of maintaining the credibility of the Fed, which should keep yields under control for now.

However, I expect these concerns to resurface given our expectations for strong growth and the inflationary risks caused by the Middle East conflict.

At what point do bond yields become a major risk for equities? I would break this into two phases:

We are currently in phase one, where rising bond yields raise the bar for equity performance because they represent a competing asset to generate return and because the level of corporate bond yields sets the hurdle for corporate performance, particularly in AI where some data-centre financing deals are yielding 10% now.

Our equity / bond valuation models are not flashing yet and, despite huge capital expenditure (capex) requirements, hyperscaler balance sheets remain exceptionally strong from a credit perspective. For now, our equity investors still believe that the scale of the AI opportunity is under-estimated, AI adoption

continues and the revenues of the hyperscalers and frontier labs are surging.

Phase two would be when bonds sell off because of concerns about the sustainability of debt. We are not there yet. In the US, strong growth is helping to keep the show on the road and bond markets are already providing some fiscal discipline to European governments.

However, the medium-term trend, given an ageing population, is that government spending will continue to rise. The trigger for these concerns to come to the fore could be a more significant rate shock caused by higher-than-expected inflation, or a meaningful slowdown in growth which would expose the underlying debt dynamics.

We are still in phase one, where the beneficial impact of higher nominal growth on equities is outweighing the risks for bonds. We therefore favour equities over bonds but as bond yields rise the burden of proof is increasing.

Source: <https://www.schroders.com/en/global/individual/insights/cio-lens-q4-2026-the-challenge-posed-to-equities-by-rising-bond-yields/>