Higher rates are back The winners and losers of 5 bond yields

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Key points:

Cash flow matters more when money is expensive: Companies with strong free cash flow, low leverage and limited refinancing needs are better placed to keep investing and returning capital even when borrowing costs stay high.

Higher rates create clear winners and pressure points: Quality financials, energy, commodities and defensive sectors can prove more resilient, while small caps, property, consumer discretionary and long-duration growth face a higher funding or valuation hurdle.

The reason rates are high still matters: Strong growth can support financials and commodities, while inflation shocks or fiscal stress are more challenging for equities broadly. Higher rates call for selectivity, not simply abandoning risk.

Markets are once again facing higher bond yields across the US and other major economies, raising a tougher question for equity investors: how much should they be willing to pay for stocks when safer assets are offering more attractive returns? Higher yields also matter because they raise the discount rate used to value future earnings, putting pressure on equity multiples — especially for companies whose profits sit further into the future.

But equities still play an important role in protecting purchasing power and capturing long-term growth, especially in an environment where inflation remains a risk. The challenge is finding businesses that can continue delivering earnings and cash flows even when the cost of capital stays elevated.

For investors, that puts cash flow, balance-sheet strength and refinancing needs back at the centre of stock selection. Higher rates can favour businesses generating strong cash flows today, while raising the hurdle for companies whose valuations, growth or business models depend heavily on expensive financing.

1. Cash-rich quality

Strong cash generation, low refinancing needs and the ability to fund growth internally can become increasingly valuable as borrowing costs rise. Companies with strong balance sheets are generally less exposed to refinancing pressure and can continue investing even when capital becomes more expensive. However, strong balance sheets do not eliminate valuation or company-specific risks, and highly valued quality companies can still be vulnerable if earnings disappoint or bond yields rise further.

Illustrative company examples: Microsoft, Alphabet, Meta, Apple, Broadcom, Visa, Mastercard

Illustrative examples of ETFs providing exposure to this theme: iShares MSCI USA Quality Factor ETF (QUAL)

2. Quality financials

Higher rates can support interest income and reinvestment yields, particularly for well-capitalised banks and insurers. Market volatility can also support exchanges and trading businesses. Companies with stronger balance sheets and diversified revenue streams may be better positioned than the financial sector as a whole.

At the same time, persistently high rates can weaken credit quality, raise funding costs and increase loan losses, so the impact is not uniformly positive across financial companies.

Illustrative company examples: JPMorgan, Bank of America, Goldman Sachs, Berkshire Hathaway, Chubb, DBS

Examples of ETFs providing exposure to this theme: Financial Select Sector SPDR Fund (XLF), SPDR S&P Insurance ETF (KIE)

3. Energy and commodity producers

Commodity producers can benefit when higher rates are being driven by stronger nominal growth, inflation, supply constraints or geopolitical risks. They can also provide diversification when rising commodity prices are themselves contributing to persistent inflation.

However, commodity equities can be highly volatile and remain sensitive to global growth, commodity prices, regulation and geopolitical developments. A global slowdown accompanied by elevated rates would be considerably less supportive.

Illustrative company examples: Exxon Mobil, Chevron, Shell, TotalEnergies, BHP, Rio Tinto, Freeport-McMoRan

Illustrative examples of ETFs providing exposure to this theme: Energy Select Sector SPDR Fund (XLE), Commodities Select Strategy ETF (COMT), Invesco Bloomberg Commodity UCITS ETF (CMOD)

4. Healthcare and defensive cash flows

Healthcare demand is relatively insensitive to interest rates and the economic cycle. Large pharmaceutical and healthcare companies with strong cash generation may therefore offer relatively resilient earnings if higher rates begin to slow economic growth.

Defensive demand does not remove company-specific risks, including drug-pipeline failures, patent expiries, pricing pressure, regulation and potentially demanding valuations.

Illustrative company examples: Eli Lilly, Johnson & Johnson, Novartis, Roche, Sanofi, AstraZeneca

Examples of ETFs providing exposure to this theme: iShares Global Healthcare ETF (IXJ), Health Care Select Sector SPDR Fund (XLV)

5. Consumer staples and pricing power

Higher rates may eventually slow household spending, but demand for everyday essentials tends to be more stable. Companies with strong brands, recurring demand and pricing power may be better able to maintain cash generation as financing conditions tighten.

However, staples can still face margin pressure from higher input costs, weaker consumer demand and valuation risk, particularly when defensive sectors trade at elevated multiples.

Illustrative company examples: Procter & Gamble, Coca-Cola, PepsiCo, Walmart, Costco, Colgate-Palmolive, Nestlé

Illustrative examples of ETFs providing exposure to this theme: Consumer Staples Select Sector SPDR Fund (XLP), Vanguard Consumer Staples ETF (VDC)

Note: The securities mentioned are provided for illustrative and educational purposes only and should not be considered investment recommendations. Investors should assess individual securities based on their own objectives, risk tolerance and circumstances.

1. Small caps and highly leveraged companies

Smaller companies often have less access to capital markets and greater reliance on bank loans and shorter-duration borrowing. Refinancing therefore becomes more painful when interest rates remain elevated.

Not every small-cap company is highly leveraged, and companies with strong balance sheets can still outperform. But as a group, smaller companies generally face a higher funding hurdle than large cash-rich businesses.

Illustrative examples of ETFs providing exposure to this theme: iShares Russell 2000 ETF (IWM), SPDR Portfolio S&P 600 Small Cap ETF (SPSM)

2. Rate-sensitive property and housing

Property is one of the clearest areas where higher rates transmit directly into the economy.

For REITs and property companies, higher rates raise refinancing costs and make bond yields more competitive with property income. For homebuilders, elevated mortgage rates can reduce housing affordability and demand.

Strong rental growth, housing shortages and well-managed balance sheets can still offset some of these pressures, so selectivity matters.

Illustrative examples of ETFs providing exposure to this theme: Vanguard Real Estate ETF (VNQ), iShares U.S. Real Estate ETF (IYR), SPDR S&P Homebuilders ETF (XHB), iShares U.S. Home Construction ETF (ITB)

3. Consumer discretionary

Higher mortgage, auto-loan and credit-card rates reduce disposable income and make consumers more cautious about large or optional purchases. The pressure tends to be greatest for lower-income consumers and businesses dependent on financed purchases.

Not all discretionary spending suffers equally: affluent consumers and companies with strong brands can remain resilient even when rates are high.

Illustrative examples of ETFs providing exposure to this theme: Consumer Discretionary Select Sector SPDR Fund (XLY)

4. Long-duration and speculative growth

Higher interest rates raise the discount rate applied to future earnings. That matters most for companies where much of today's valuation depends on profits expected many years from now.

The pressure can be even greater for businesses that are still burning cash and need external funding to grow.

Illustrative examples of ETFs providing exposure to this theme: ARK Innovation ETF (ARKK), Roundhill Space & Technology ETF (MARS)

This is also where the distinction between profitable AI leaders and speculative AI stories becomes increasingly important. High rates do not necessarily hurt technology; they raise the bar on valuation and profitability.

5. Emerging markets with funding pressure

Persistently high US yields can support the dollar and increase financing costs for governments and companies reliant on dollar funding. Markets with large external borrowing requirements can therefore become more vulnerable when global liquidity tightens.

But emerging markets should not be treated as one trade. Commodity exporters, countries with high real yields and economies with strong current-account positions can prove considerably more resilient.

Illustrative examples of ETFs providing exposure to this theme: iShares MSCI Emerging Markets ETF (EEM), iShares MSCI Emerging Markets Small-Cap ETF (EEMS), iShares J.P. Morgan USD Emerging Markets Bond ETF (EMB) Note: The securities mentioned are provided for illustrative and educational purposes only and should not be considered investment recommendations. Investors should assess individual securities based on their own objectives, risk tolerance and circumstances.

The bigger message

The key divide in a higher-rate environment is not simply growth versus value or cyclicals versus defensives.

It is increasingly: Cash generators vs. cash borrowers.

Companies with strong free cash flow, manageable debt and pricing power can continue investing even when capital becomes expensive. Businesses dependent on refinancing, cheap mortgages or profits far into the future face a much tougher hurdle.

Higher rates do not mean abandoning equities. They mean being more demanding about what you own.

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