

Higher-for-Longer Rates Pose Additional Risk for Stocks

The Reber Report September 2026

By: Ricci L. Reber, Ph.D.

443-470-8000

TheSimmonsPartnership.com

Ricci@TheSimmonsPartnership.com



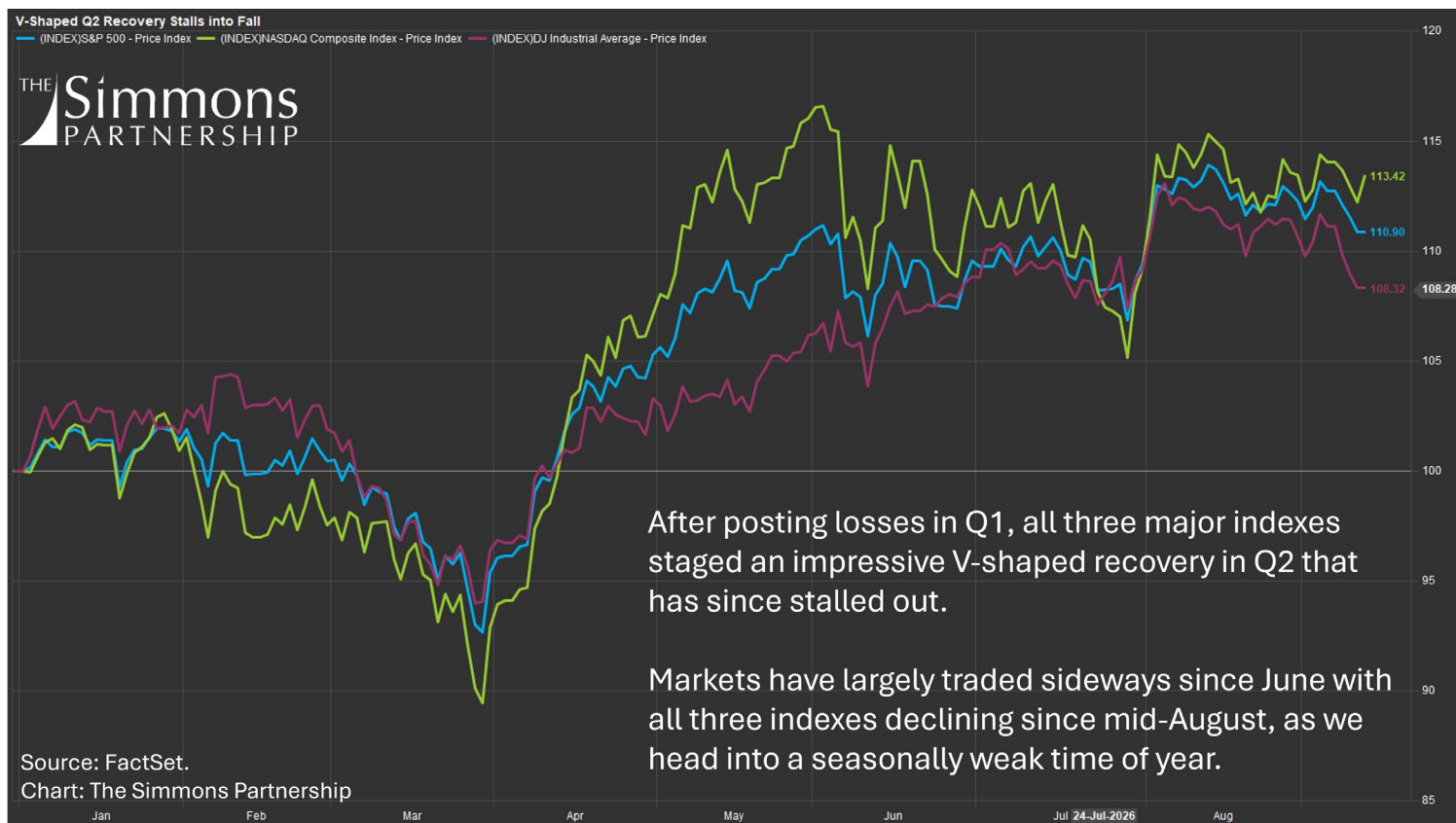
The Federal Reserve hiked interest rates on Wednesday for the first time in three years, but not before the bond market did much of the work for them. Treasury yields have risen steadily since March, briefly touching 5% on the 10-year, with the Treasury Department responding through interventions in both the yen and its own bond buyback program, which speaks to how unusual this environment has become.

Inflation remains uncomfortably above target. The labor market has started to stabilize and is treading water well enough to give the Fed some cover to raise rates to fight it. We believe we're now in a higher-for-longer rate environment, which poses another potential headwind for already stretched equity market valuations. It's a stock-picker's market, and here I will lay out where we're finding value.

V-Shaped Recovery Stalls into Fall

After first quarter losses erased all the gains dating back to September 2025, the major indexes staged an impressive V-shaped recovery off the March lows that peaked on June 2nd. Since then, the rally has stalled out—markets churned sideways throughout the summer and, as of the writing of this report, all three indexes have declined more than 2 percent from their levels in mid-August.

Figure 1



As has been the case for much of the year, these index-level moves mask significant underlying volatility in individual stocks. The market continues to be driven by emotion and on-again-off-again leveraged bets on trading narratives rather than fundamentals.

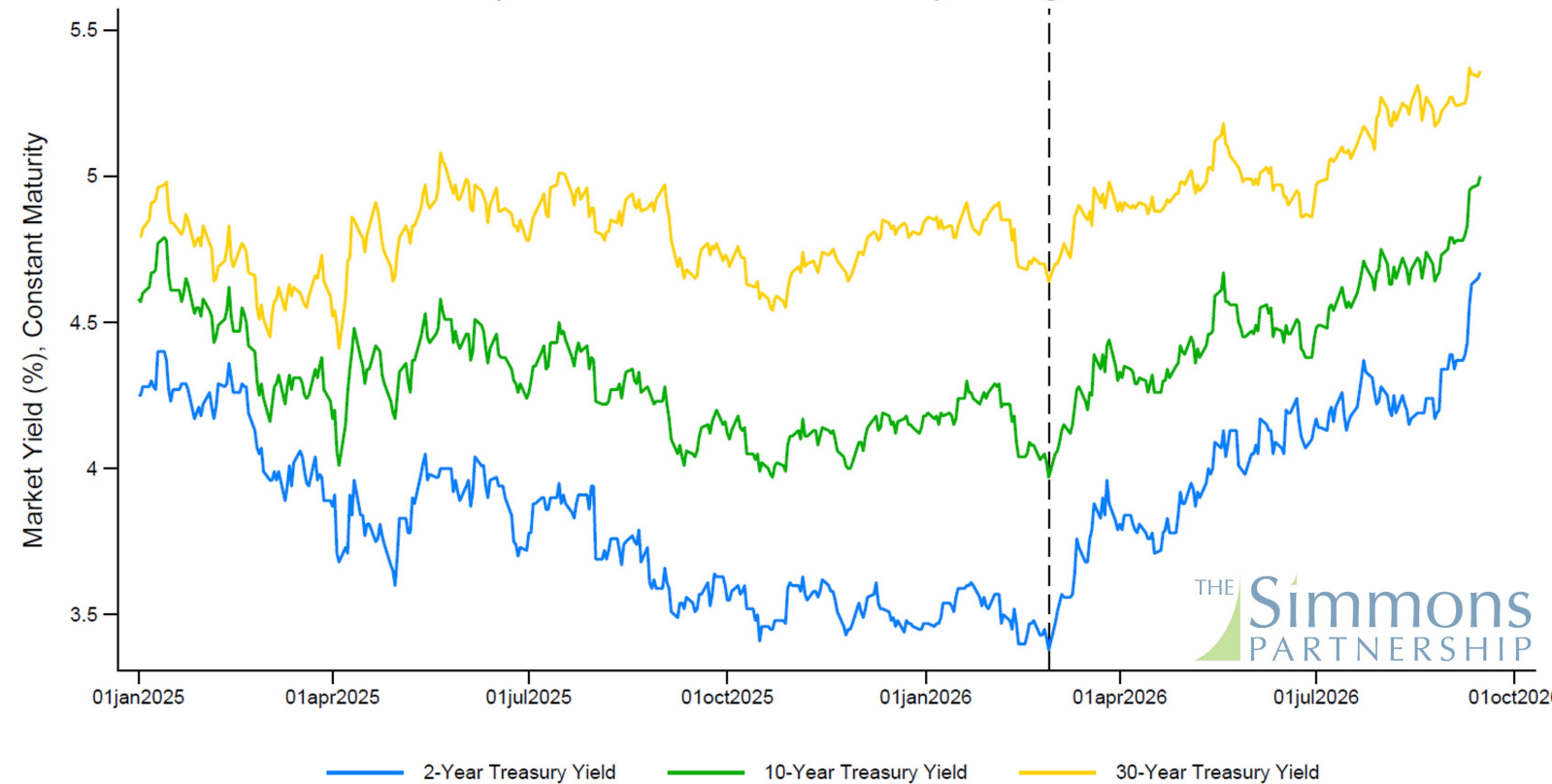
We're now entering one of the seasonally weakest months of the year with potential headwinds from higher rates and significant uncertainty around the path of inflation, economic policy, geopolitics, and mid-term elections.

Rising Rates Pose Additional Risk for Equities

U.S. Treasury bond yields have been steadily rising since March due to a combination of heavy government borrowing, relatively weak demand due to competition from AI-related corporate issuance, elevated inflation, and expectations for Fed rate hikes through the end of this year (rather than the rate *cuts* many expected entering 2026).

The recent selloff in Treasuries has driven yields continually higher, with the 10-year briefly crossing 5% this week for the first time since October 2023. The pressure has been even more pronounced at the long end of the curve—the 30-year Treasury auction on September 10th cleared at 5.308%, the highest auction yield since 2001.

Figure 2 Treasury Yields Have Been Steadily Rising Since March

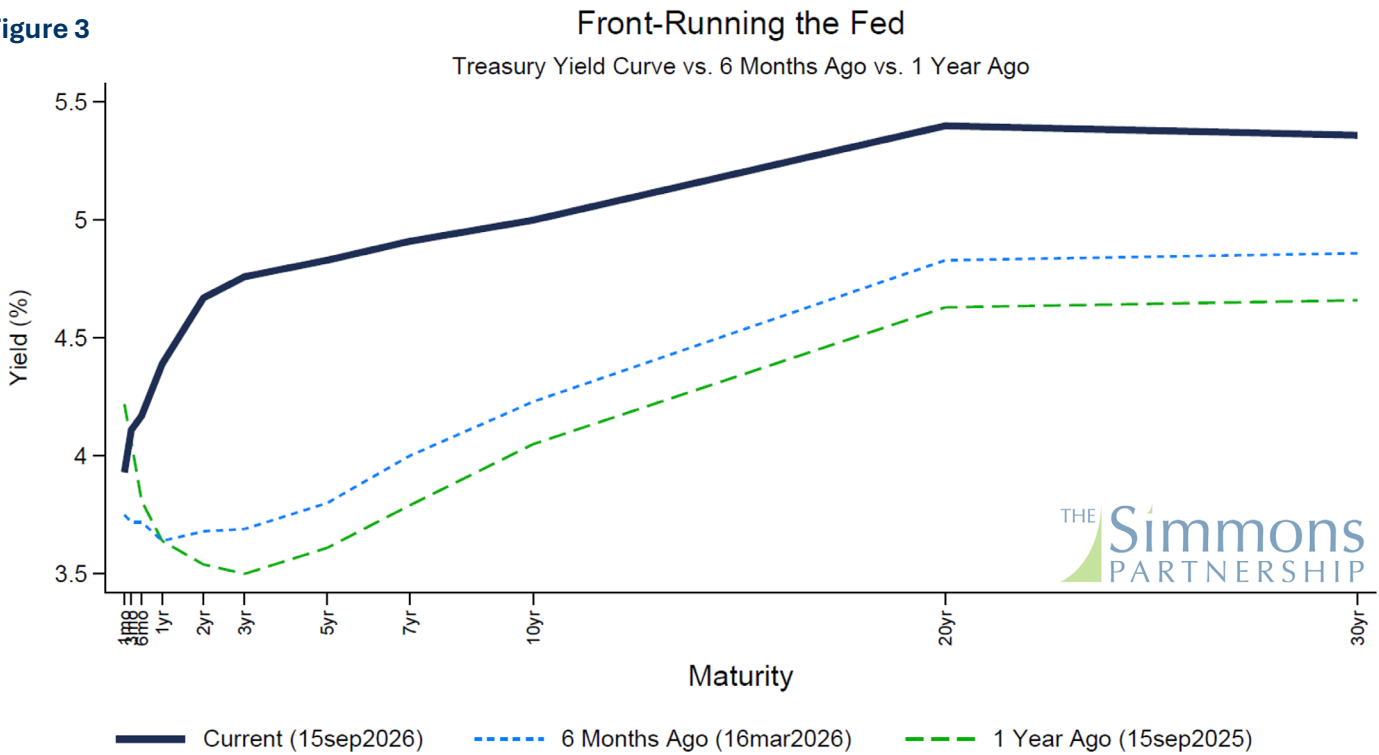


Data courtesy of the Federal Reserve Board of Governors (retrieved from Federal Reserve Bank of St. Louis FRED Database). Calculations by author.

This selloff hasn't just pushed yields up—it has dramatically changed the shape of the entire yield curve. As recently as six months ago, the curve was still inverted at the short end and upward sloping on the long end, reflecting investor expectations of near-term Fed rate cuts paired with an uncertain outlook for inflation and fiscal policy. As inflation expectations accelerated, the bond market priced in near-term rate *hikes* and higher term premia, effectively front-running the Fed and repricing risk across the curve.

The market repricing didn't go unnoticed by the Treasury Department, which engaged in two separate policy maneuvers ostensibly aimed at improving market liquidity but that were in reality about limiting selling pressure and containing their long-term borrowing rates.

Figure 3



Data courtesy of the Federal Reserve Board (retrieved from Federal Reserve Bank of St. Louis FRED Database). Calculations by author.

On July 31st, the [Treasury announced a coordinated intervention in the Japanese yen](#) which, to the chagrin of the EU, they financed with the sale of euros. The alternative would have been for Japan to sell Treasuries to intervene in its own currency putting upward pressure on Treasury yields.

On August 19th, [the Treasury announced it would “at least double, the size of liquidity support buyback operations”](#) for longer dated bonds from a maximum of \$2 billion per operation to \$4 billion per operation. Though yields fell dramatically on the announcement, they rebounded within a day. [By some estimates](#) the total implied size of the buybacks could total just \$28 billion through November 4th—a drop in the bucket compared to the \$5 *trillion* or so in outstanding 20- and 30-year bonds.

To be clear, the U.S. government is not paying off this debt, it's buying back 20- and 30-year bonds with cash generated from selling shorter-term Treasury bills. **These buybacks are akin to taking out a low-rate balance transfer on your credit card to pay down part of your mortgage.** In short order, the government will need to refinance that debt at whatever the prevailing rates are when it comes due. Approximately 20% of U.S. government debt is already T-bills that mature within a year. **Treasury's backdoor yield control creates additional refinancing risk for the government at a time when short-term rates are more likely to rise than fall.** Secretary Bessent is a smart guy, but this is a curious move for a government whose long-term plan appears to be to run the economy hot and inflate our way out of debt—a strategy that works best with long-term debt at low fixed rates.

More importantly for investors, this is a signal. **A Treasury Secretary actively fighting the bond market and intervening in foreign currency markets is not something that happens when everything is okay.** Outside of recessions or acute crises, these moves do not have much recent precedent to draw on. Besides, with tightening monetary policy, the Fed and Treasury are pulling in opposite directions—the Fed weighing further tightening while Treasury scrambles to constrain its borrowing costs and support demand for what will now be more frequent refinancing needs.

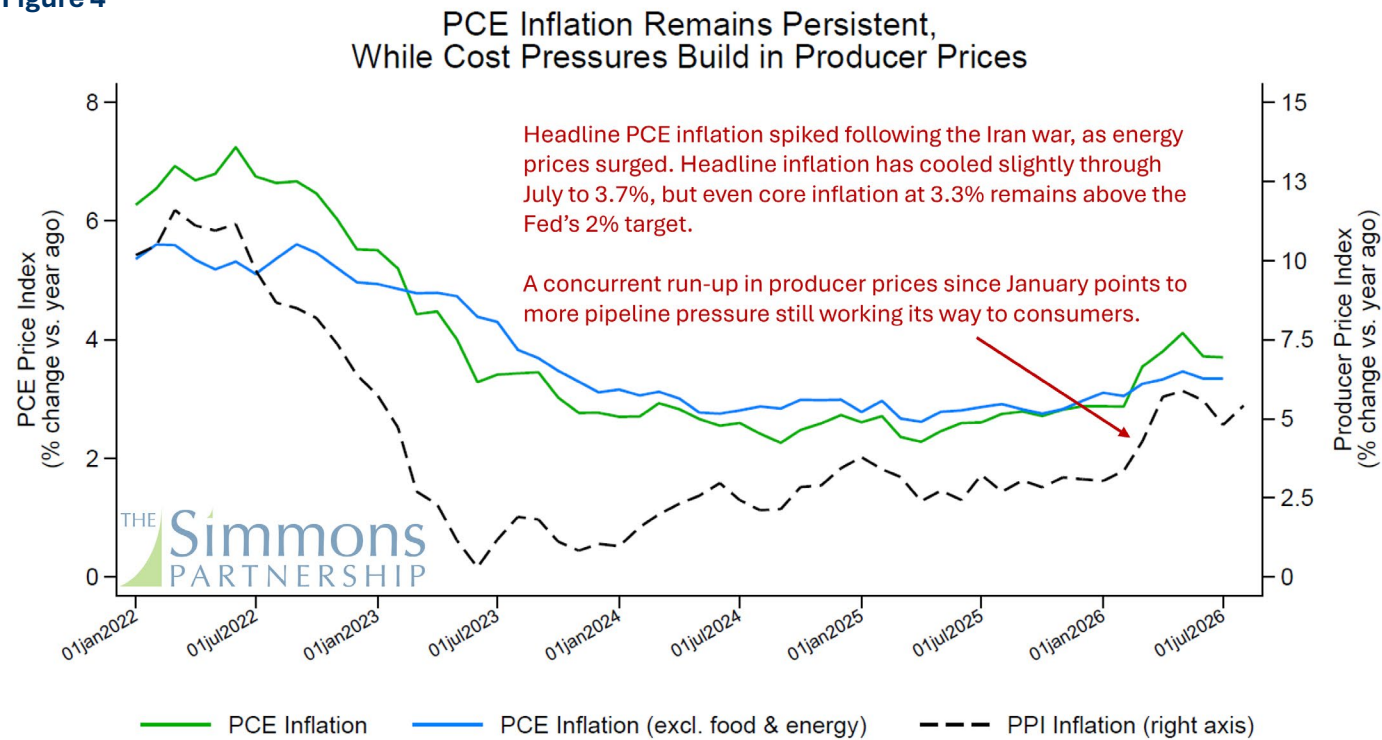
Higher yields are a potential headwind for equities for two reasons. First, a risk-free rate near 5% makes equity valuations less attractive—every dollar of future earnings is worth less today when discounted at a higher rate. That hits long-duration growth names trading at rich multiples the hardest. Second, rates this high make cash, money market funds, and bonds a more credible alternative to stocks for the first time in years. This can pull capital out of equities even without a change in the earnings outlook. That pressure falls hardest on bond-proxy sectors like utilities, whose dividend yields now compete directly with risk-free returns, and on refinance-dependent sectors like real estate, where higher rates increase the cost of servicing and rolling over debt.

Inflation: Persistently Above Target

Headline PCE inflation spiked following the Iran War to its fastest pace since April 2023, topping out at 4.1% in May as energy prices surged. Though year-over-year headline inflation has since cooled slightly to 3.7% in July, even core inflation (excluding food and energy prices) at 3.3% remains uncomfortably above the Fed's 2% target.

Moreover, erratic and incomprehensible trade policy and unforced errors in Iran have delivered a steady onslaught of “one-time price shocks” that have persisted for so long that they may have already become entrenched in consumers’ inflation expectations. A [recent report by economists at Moody’s](#) notes that about 52% of PCE components—not just energy—have risen more than 3% in the past year, suggesting that inflation has started to metastasize throughout the economy.

Figure 4



Data courtesy of the U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics (retrieved from Federal Reserve Bank of St. Louis FRED Database). Calculations by author.

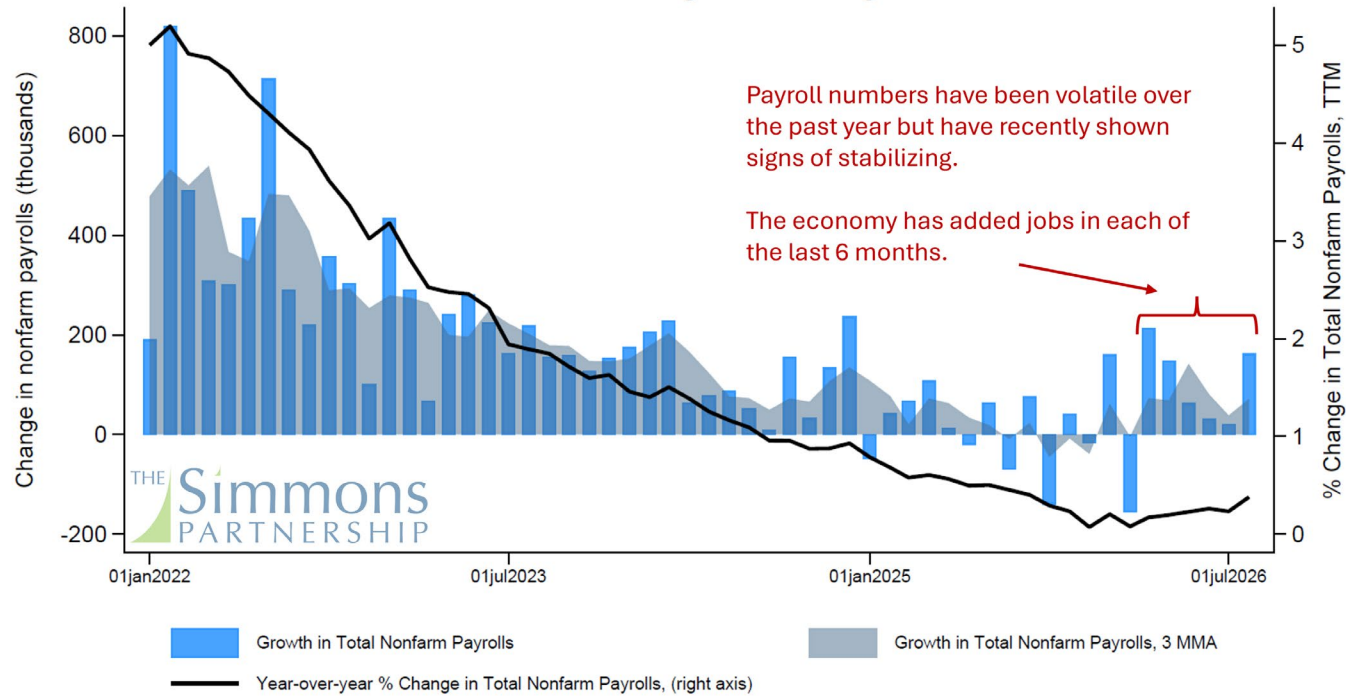
Producer prices, meanwhile, had already begun climbing in January — well before the war started in late February — suggesting a separate source of cost pressure building outside the energy shock. That pipeline pressure has yet to fully work its way through to consumers.

Labor Markets: Stable Enough to Let the Fed Off the Mat

I have been critical of the U.S. hiring situation for a long time—and for good reason. But we have started to see some green shoots in the labor market. [August nonfarm payrolls rose by 162,000](#), more than triple the consensus estimate of 53,000, while the unemployment rate held at 4.1% for the fourth straight month. That’s below the median unemployment rate of 5% over the past 25 years and at a level many economists would consider full employment. Notably, the economy has added jobs in each of the last six months, adding a total of 639,000 jobs since February. **Given where we were this time last year—shrinking jobs numbers and steadily rising unemployment—this is an almost unbelievable about-face.**

But we’re not completely out of the woods yet. The labor market continues the low-hire, low-fire grind that I’ve been writing about for the better part of the past year. New graduates are having a hard time breaking into the labor force, as AI threatens entry-level jobs. Layoffs have declined from last year’s highs but the total number of job openings in the economy has remained roughly flat for over two years. Meanwhile, the quit rate—the share of employed workers who voluntarily quit their jobs—remains stuck at pandemic lows. Together **the data suggest neither firms nor workers possess the confidence to make changes given the current economic environment.**

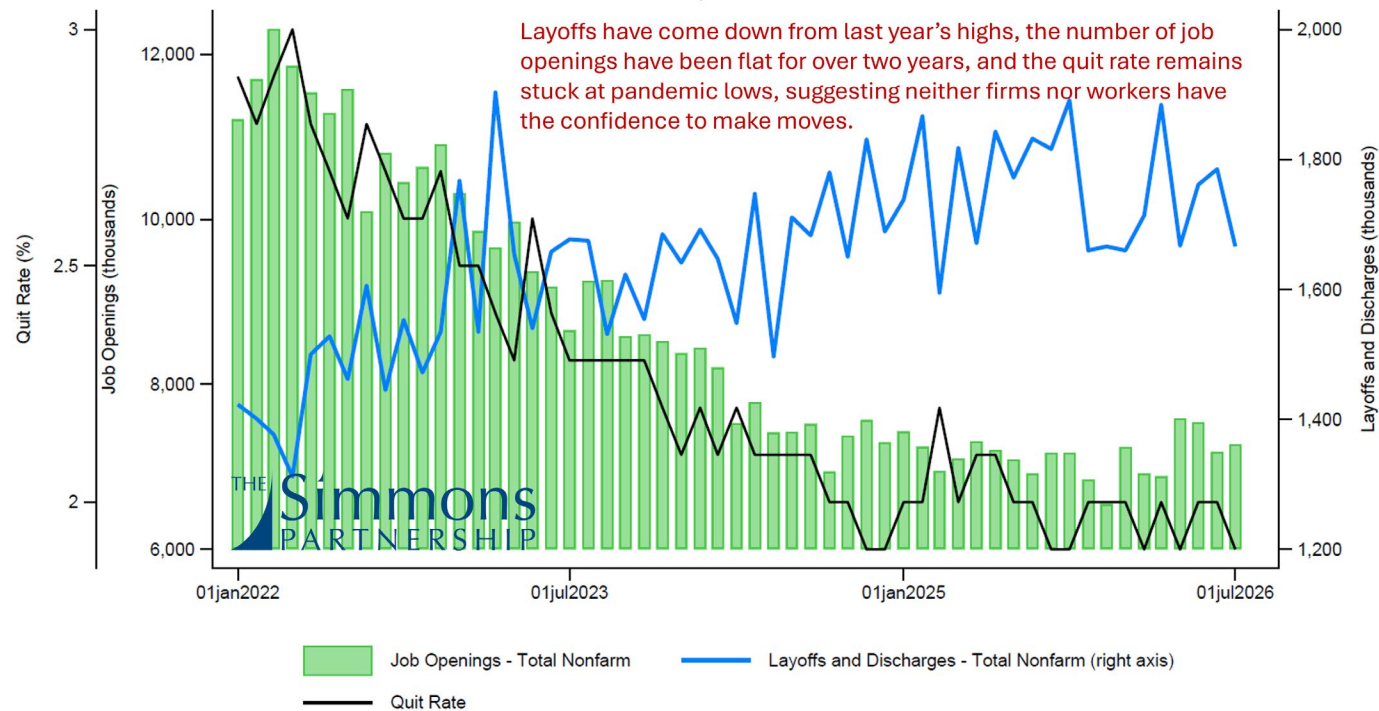
Figure 5 Labor Market Starting to Show Signs of Life



Data courtesy of the U.S. Bureau of Labor Statistics (retrieved from Federal Reserve Bank of St. Louis FRED Database). Calculations by author.

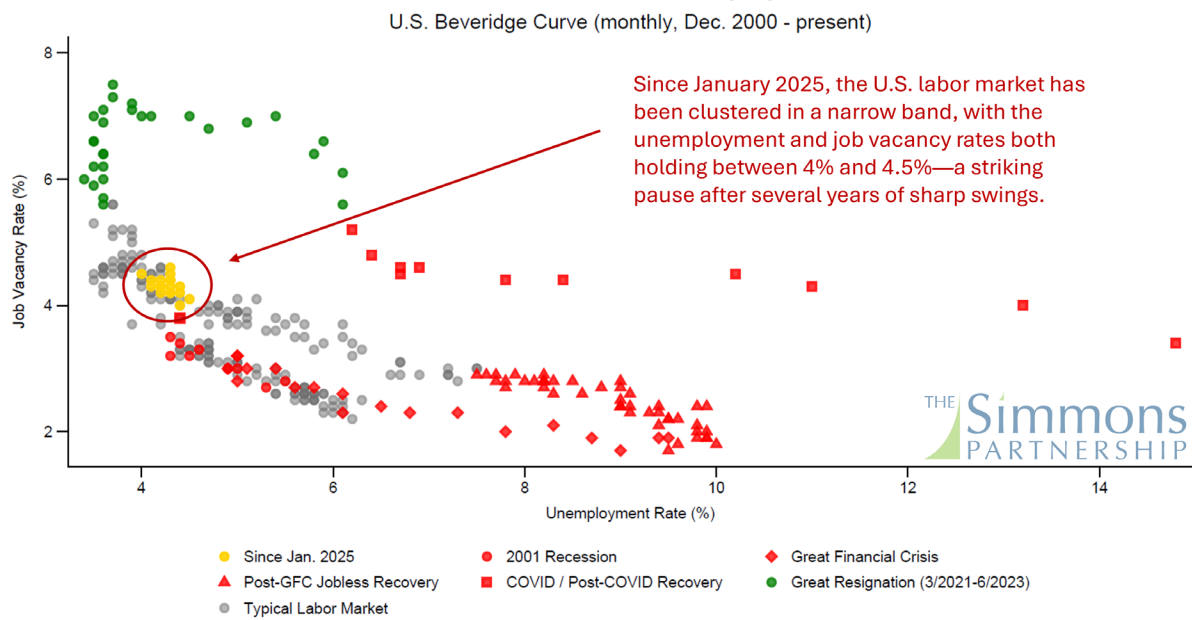
This isn't new. There has been little movement in both job vacancy rates and the unemployment rate since the beginning of 2025. The Beveridge curve (Figure 7) provides a useful visual representation of the tradeoff between job vacancies and unemployment rates—it is typically downward sloping, as fewer job vacancies are accompanied by higher unemployment rates and vice versa. You can see that both rates have been clustered in a narrow band for the past 20 months—a striking pause after several years of sharp swings.

Figure 6 Still a Low-Hire, Low-Fire Job Market



Data courtesy of the U.S. Bureau of Labor Statistics (retrieved from Federal Reserve Bank of St. Louis FRED Database). Calculations by author.

Figure 7 Little Movement in Vacancies or Unemployment in Two Years

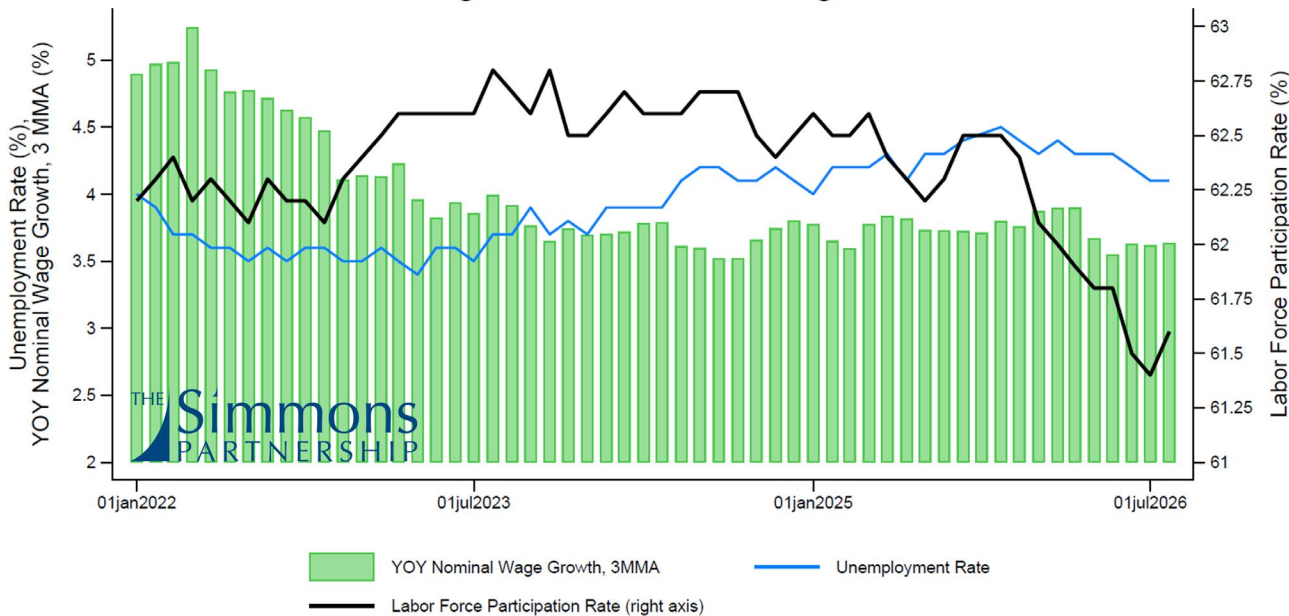


Data courtesy of the U.S. Bureau of Labor Statistics (retrieved from Federal Reserve Bank of St. Louis FRED Database). Calculations by author.

And there’s still one little wrinkle that bothers me: **rising unemployment duration and falling labor force participation**. As I noted back in the spring, continued unemployment claims are declining while unemployment duration remains high. If unemployment were falling because people are finding jobs, you would expect unemployment duration—not just claims—to decline as well. But average unemployment duration continues to rise—now 26.3 weeks—and more than 27% of unemployed people are out of work for more than 27 weeks.

Moreover, the steady decline in the unemployment rate since February has corresponded directly with a decline in labor force participation. This makes the unemployment rate look better than it really is.¹ **The unemployment rate has been falling for the wrong reasons.**

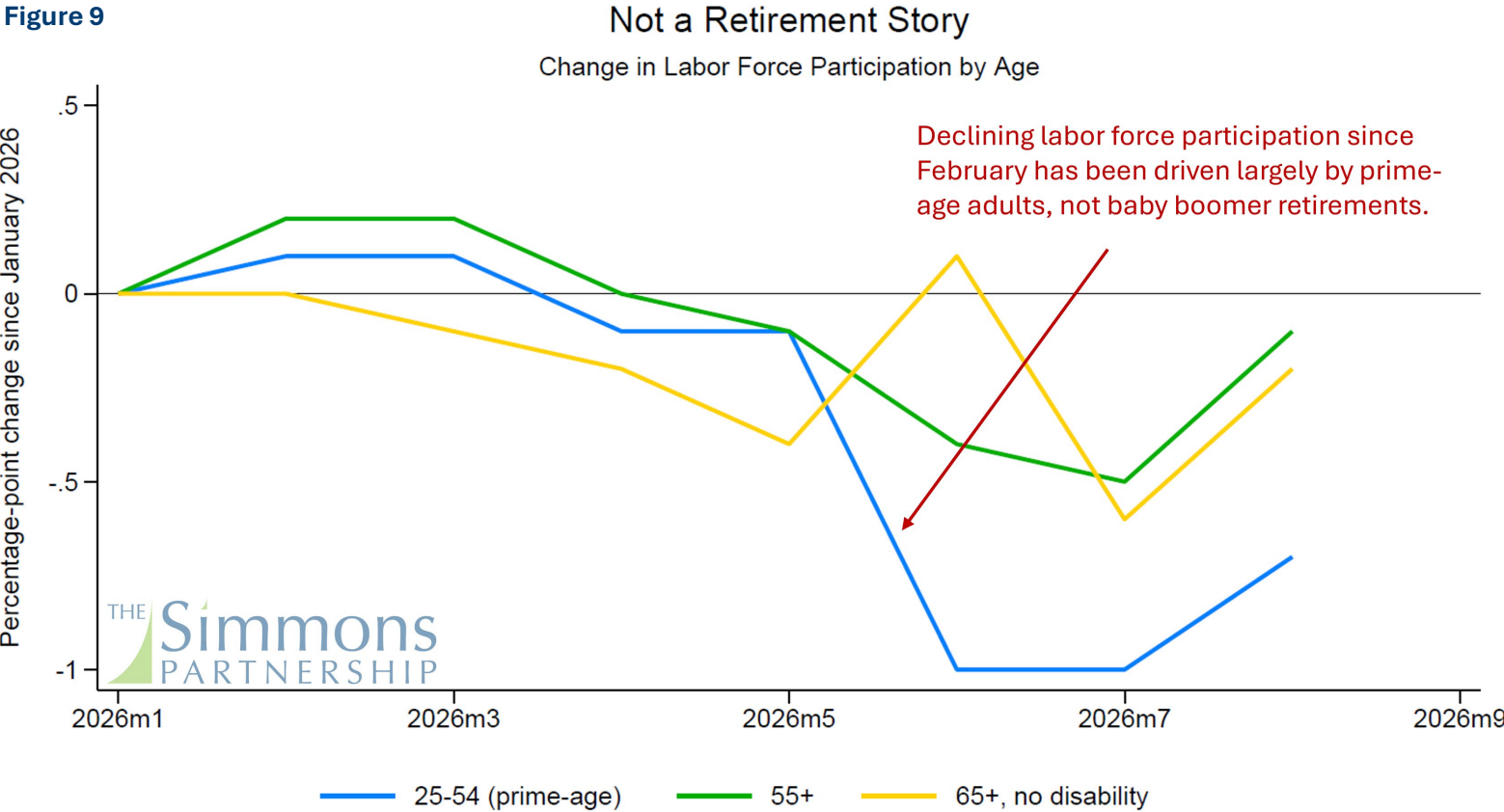
Figure 8 Unemployment Falls on Declining Labor Force Participation, Wage Growth Remains Stagnant



Data courtesy of the U.S. Bureau of Labor Statistics and Federal Reserve Bank of Atlanta (retrieved from Federal Reserve Bank of St. Louis FRED Database). Calculations by author.

¹The headline (U-3) unemployment rate is the ratio of unemployed persons to total labor force. If an unemployed person is actively looking for work, they are considered both unemployed and in the labor force. However, if they decide to stop looking for work—for example, they no longer need a job or they become so discouraged with their job search that they stop looking—they are statistically no longer considered part of the labor force. **They drop out of the numerator and the denominator.** For example, if you have 5 unemployed people and a labor force of 100, the unemployment rate is 5%. If one unemployed person becomes discouraged and leaves the labor force, you now have 4 unemployed and a labor force of 99—the unemployment rate declines to 4% because you lost a potential worker, not because the labor market improved.

Is that just baby boomers retiring? No. The steady decline since February has been observed across the board but has been largely driven by prime-age adults. While only about 23% of individuals 65 and older are still in the labor force, they have been steady participants (perhaps a grim signal about the state of retirement in this country, but that’s for another day).



Data courtesy of the U.S. Bureau of Labor Statistics (retrieved from Federal Reserve Bank of St. Louis FRED Database). Calculations by author.

For the past two years, the combination of a challenging labor market and above-target inflation has kept the Fed on the sidelines—not wanting to cut rates for fear of stoking the inflation fire and not wanting to raise rates for fear of quashing growth and cutting off oxygen to the labor market. **While this is no doubt a tough job market for many, there is enough evidence here to suggest the labor market has reached an equilibrium and is treading water well enough to give the Fed some cover to hike rates to fight inflation.**

[With a unanimous vote on Wednesday to raise the Federal Funds Rate by 25 basis points](#), and expectations for at least one more increase this year, Fed officials obviously agree. Only time will tell if this rate hiking cycle—the first in three years—is too little too late for inflation and if the labor market is in fact strong enough to withstand the potential slowdown that could ensue.

A Stock-Picker’s Market

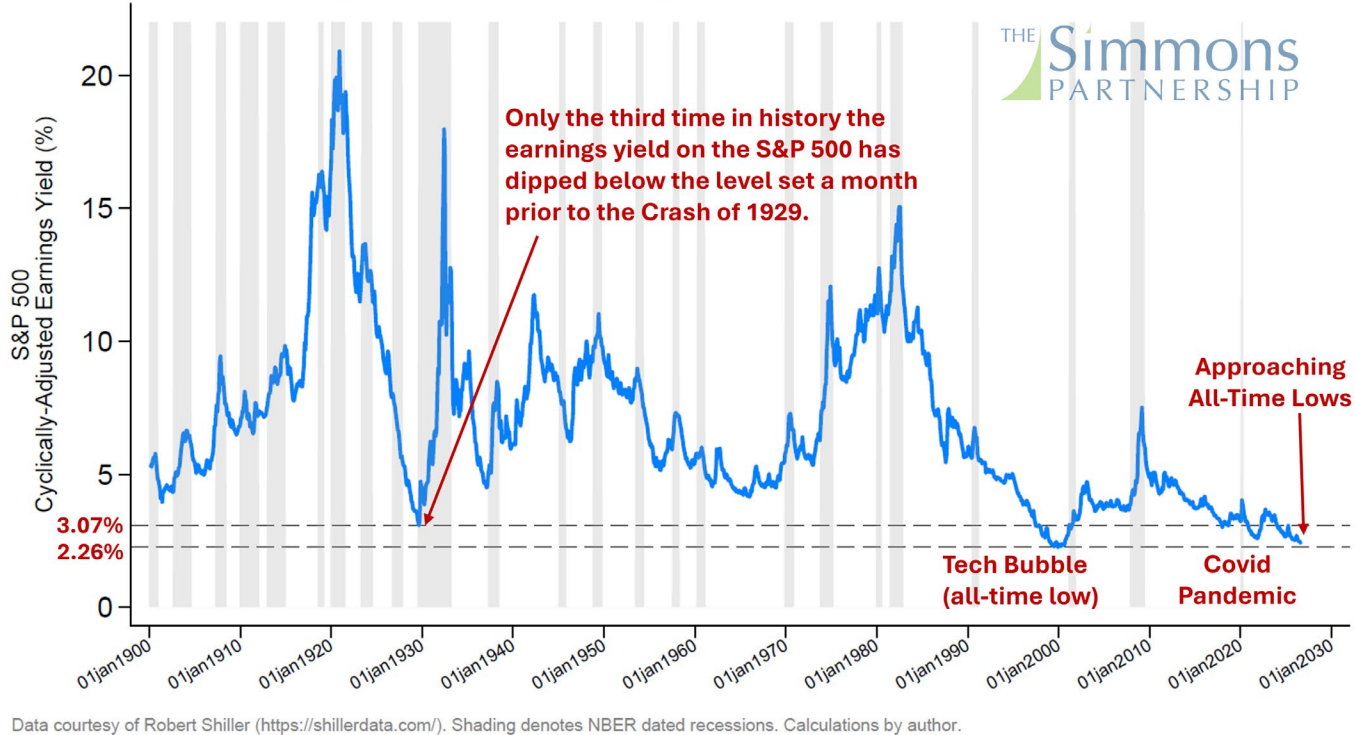
[As I have noted here many times](#), nearly every valuation measure we follow suggests the broad market is overvalued, with most metrics more than two standard deviations above their long-term averages. For example, the total value of the S&P 500 to U.S. GDP is now 2.5 standard deviations above its historical trend (Figure 10)—well above anything we’ve seen in the past 75 years.

Meanwhile, the cyclically-adjusted earnings yield—the inverse of the often-cited cyclically-adjusted price-to-earnings (CAPE) ratio—is trading near the all-time low of 2.26% set in December 1999, **just before the dot-com crash in March 2000**. The current reading is also below the 3.07% **level recorded a month before the October 1929 market crash that marked the start of the Great Depression**. This is only the third time in history we’ve been below that level—the other times weren’t great (Figure 11).

Figure 10 **Buffett Indicator: U.S. Stock Market Value to GDP**



Figure 11 **Earnings Yield Approaching All-Time Low Set in December 1999**



Regular readers know that earnings yield is one of my preferred metrics for quickly summarizing overall market valuation. Not only does it illustrate how historically overvalued markets currently are but it conveniently allows us to compare equity returns with other asset classes such as bonds, CDs, and cash.

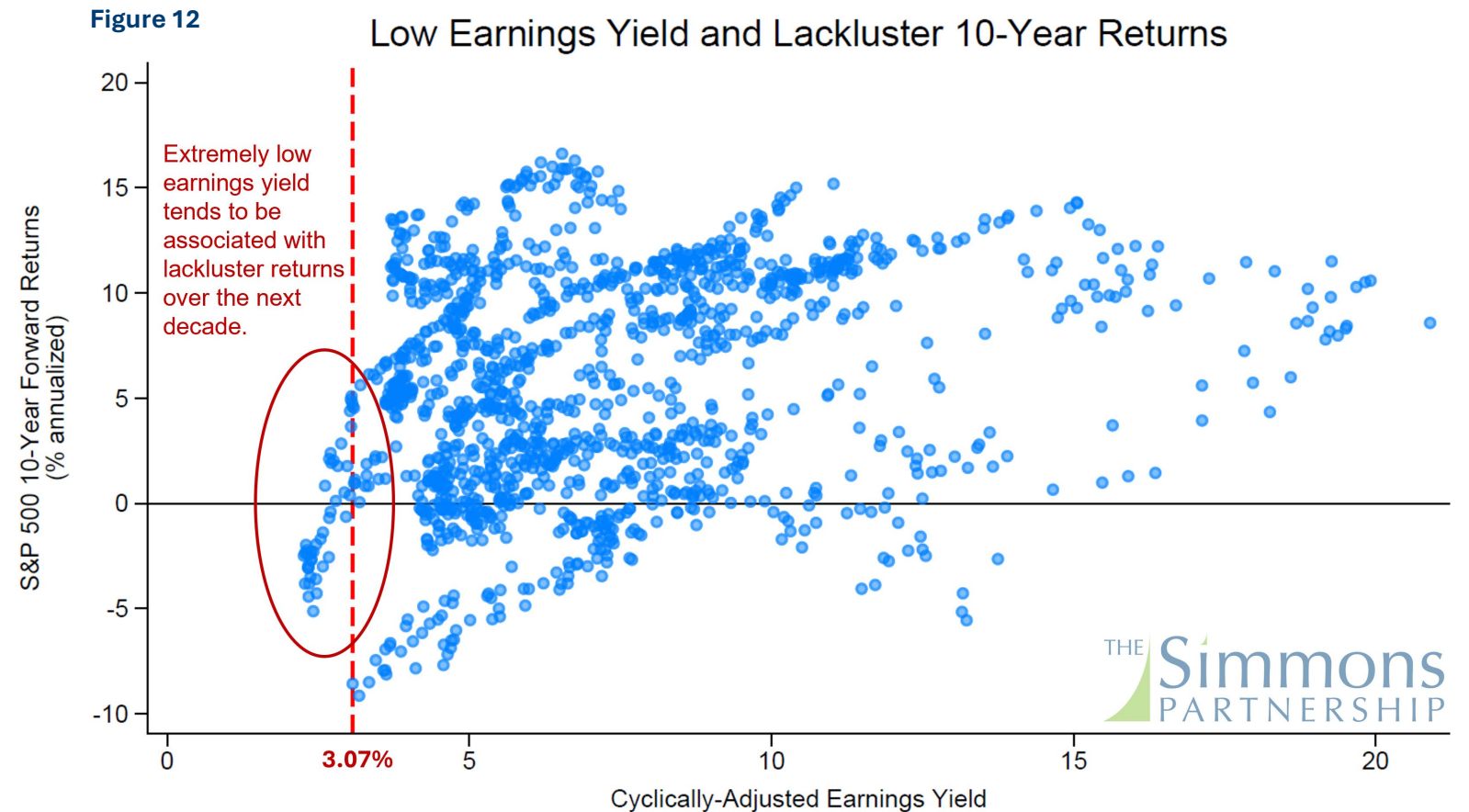
It's easy to see how this works:

$$\text{Earnings Yield} = \frac{\text{Earnings Per Share}}{\text{Price Per Share}}.$$

Currently, the cyclically-adjusted earnings yield on the S&P 500 is a paltry 2.46%. As of the writing of this report, that’s less than half the yield on a 10-year Treasury (5.0%) and less than the yield on a 3-month, FDIC-insured CD (4.1%).

At these levels, investors simply are not being compensated for taking broad market risk. The market is pricing in above-trend real earnings growth, productivity gains that more than offset future cost pressures, structurally higher profit margins, and a benign macroeconomic and policy environment along with durable economic growth, a solid labor market, stable prices, and low interest rates. **Given the current macro environment, we believe such expectations are overly optimistic: not impossible, but unlikely.**

History suggests valuations matter for investors because they tell you something about the returns you can expect to earn in the future and your margin of safety in making an investment. When the earnings yield falls to historically low levels, markets are pricing in future growth as if it’s a certainty. **Earnings yields at these levels tend to be associated with lackluster forward 10-year returns.** Over the past 125 years, earnings yields below 3% have been followed by 10-year annualized returns between -5.1% and 2.8%—the median 10-year annualized return is -2.74% (Figure 12).



Data courtesy of Robert Shiller (<https://shillerdata.com/>). Calculations by author.

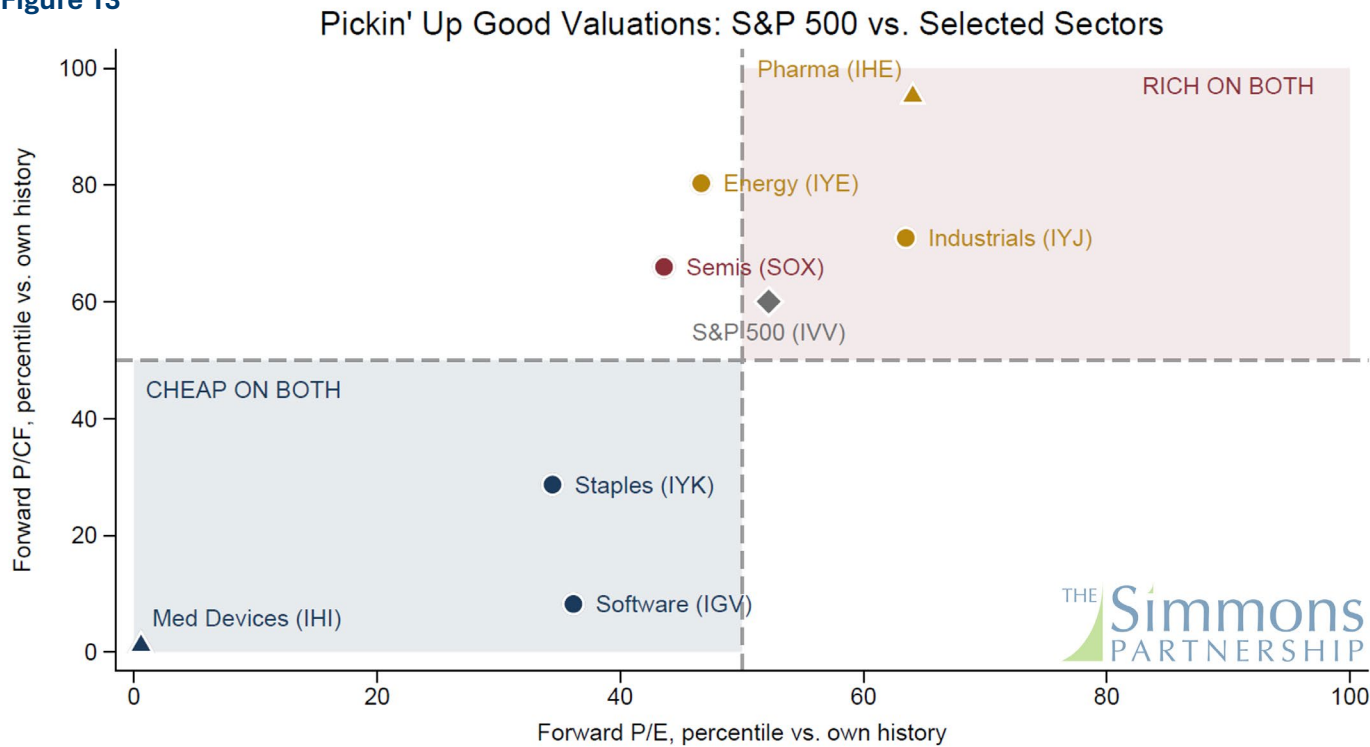
At current valuations, investing in the broad market offers limited margin of safety and, therefore, asymmetric risk. Unless valuations continue to expand, the potential return for these overvalued stocks is limited while there is significant downside risk from multiple compression, even without a recession.

This is not to say that all stocks are overvalued. **We believe this is—and will continue to be—a stock-picker’s market.** We remain invested in quality companies with strong balance sheets and cash flows and continue to add to those positions as multiples become attractive. Notably, these diamonds in the rough have gotten harder to find.

We continue to see significant value in software names—particularly select Software-as-a-Service (SaaS) companies, with deeply entrenched businesses and AI integration that stand to benefit from (not be displaced by) their clients’ AI adoption.

We continue to see compelling value in medical device manufacturers, many of which are trading at their cheapest forward price-to-earnings and price-to-cash flow metrics in a decade. We also believe they stand to be beneficiaries of AI-driven productivity gains that could meaningfully shorten development and time-to-market for new products.

Figure 13

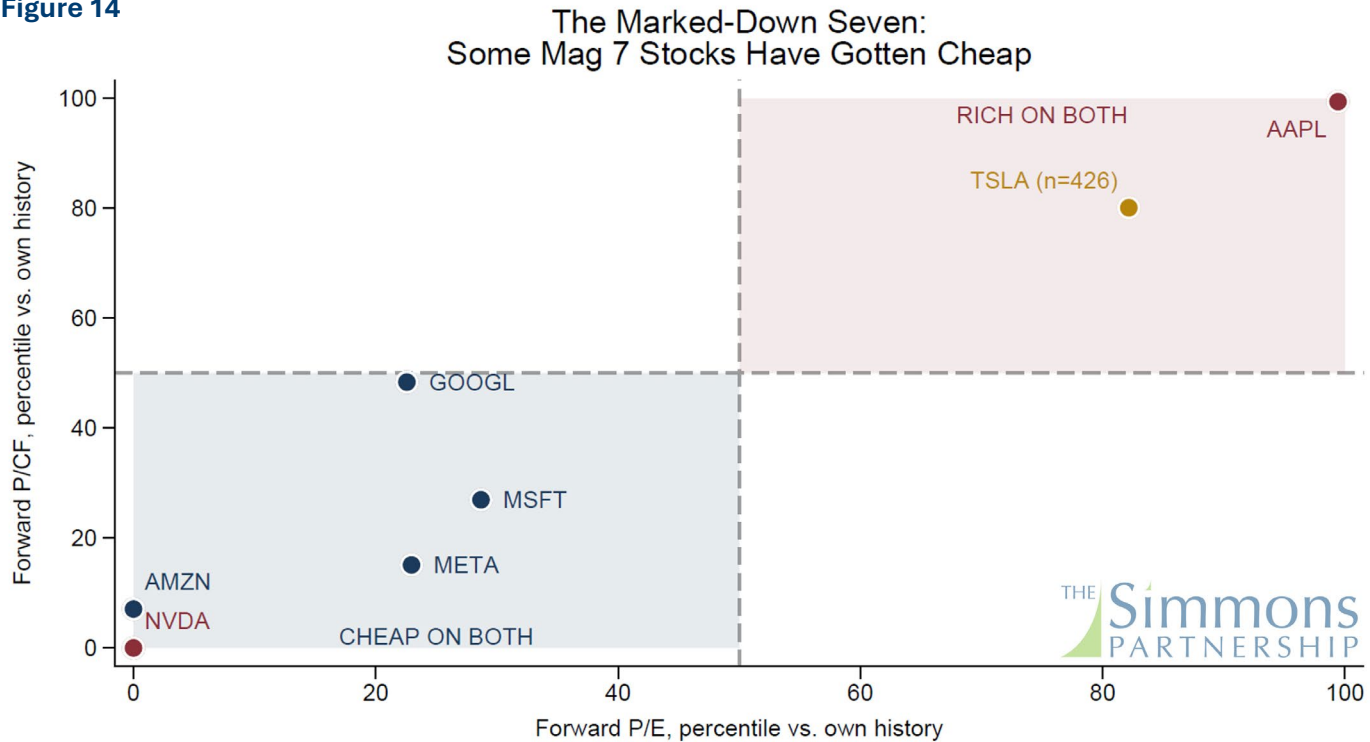


Source: FactSet. Calculations by author.
Percentiles calculated vs. each ticker's own 1-year forward P/E and forward P/CF history, through September 11, 2026.

We also like select consumer staples names that we see as both undervalued and that offer defensive cash flows, dividends, and diversification if broader economic conditions deteriorate.

Lastly, for the first time in a while, some of the so-called “Magnificent Seven” stocks look to be relatively cheap (Figure 14). Though, investors must weigh current valuations against the effect of rising interest rates on this sector broadly. As of the writing of this report, some of those names have declined between 10% and 16% from their highs back in the summer.

Figure 14



Source: FactSet. Calculations by author.
Percentiles calculated vs. each ticker's own 1-year forward P/E and forward P/CF history using weekly data through September 11, 2026.

What Does This Mean for Your Money?

For now, the market appears to be holding up on the heels of a strong earnings season, but we expect supply-demand imbalances in the bond market, higher inflation expectations, and a Fed tightening cycle will result in **a higher-for-longer rate environment at least into next year**. This could eventually put pressure on equities. Long-duration growth names, bond proxies, and refinance-sensitive parts of the market could be the hardest hit—we have been underweight tech for a while and have significantly scaled back exposure to utilities and real estate.

We believe this is—and will continue to be—a stock picker’s market. We remain selective in our equity allocation, focusing on value stocks and rotating into sectors that we believe are both inexpensive based on history and have the potential to benefit from AI diffusion. If we assume this market is going to continue higher, the promise of AI has to expand beyond chip makers, frontier labs, and hyperscalers to old boring economy companies and sectors.

The concurrent stock boom and bond selloff creates a good opportunity for investors to derisk portfolios and reposition for what we believe will be a bumpier ride over the next year or so. Given the drama in the bond market, we have shortened duration in our fixed income exposure to minimize interest rate risk, as prices on shorter-term bonds decline less than longer-term bonds in response to rate increases. And with money market funds yielding between 3.5% and 4%, we can retain the optionality of cash on the sidelines while still earning a competitive yield.

Lastly, given geopolitical uncertainty, higher energy prices, and sustained cost pressures coming down the pike from producer prices, we expect above-target inflation to persist. As such, we have leaned into gold, oil, and agricultural commodities as an inflation hedge.

Sophisticated investors require more sophisticated investment strategies.
If you ever get the feeling your advisor is outsourcing you, give us a call.

Ricci L. Reber, Ph.D.
Chief Economist and Portfolio Manager
The Simmons Partnership, Inc.
“Delivering Advice with Passion & Integrity”
(443)470-8000 office
(443)470-8887 direct

IMPORTANT NOTE FROM THE SIMMONS PARTNERSHIP INC.
The Simmons Partnership Inc. ("The Simmons Partnership") is an investment advisor located in Maryland. The Simmons Partnership and its representatives are in compliance with the current registration requirements of those states in which The Simmons Partnership maintains clients. The Simmons Partnership may only transact business in those states in which it is registered, or qualifies for an exemption or exclusion from registration requirements. The attached selected materials are aggregated by The Simmons Partnership for your information only. The Simmons Partnership is not representing that the views in the attached materials are the only views on the subject matter, or that the views or conclusions depicted in the materials represent guaranteed outcomes. Many of the materials include charts or graphs prepared by third parties. These third parties prepared such charts and graphs using their own information or information they believed to be reliable. The Simmons Partnership has not independently verified either the underlying data or any of the intimated or directly stated conclusions of such materials. The Simmons Partnership does not make any representations or warranties as to the accuracy, timeliness, suitability, completeness, or relevance of any information prepared by any unaffiliated third party, whether linked to The Simmons Partnership's website or incorporated herein, and takes no responsibility thereof. All such information is provided solely for convenience purposes only and all users thereof should be guided accordingly. The distribution of the attached materials should not be construed by any consumer and/or prospective client as The Simmons Partnership's solicitation to effect, or attempt to effect transactions in securities, or the rendering of personalized investment advice for compensation. Any communication by The Simmons Partnership with a client or prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the person resides. A copy of The Simmons Partnership's current written disclosure statement discussing The Simmons Partnership's business operations, services, and fees is available from The Simmons Partnership upon request. Past performance may not be indicative of future results. Historical information about investments or financial markets is not necessarily indicative of future market behavior or the wisdom of any particular investment, investment strategy, or asset allocation. Therefore, no current or prospective client should assume that future performance of any specific investment, investment strategy (including the investments and/or investment strategies recommended by The Simmons Partnership) or product made reference to directly or indirectly by The Simmons Partnership will be profitable. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will either be suitable or profitable for a client or prospective client's investment portfolio. Historical performance results for investment indices and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. The investment discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances. Additional information is available upon request.
When participating in a covered call strategy, the investor is at risk of having to sell the stock if the stock's price rises above the strike price. Remember, in exchange for receiving the premium of having sold the calls, the investor is obligated to sell the stock if the option is exercised. Past performance is no guarantee of future results.