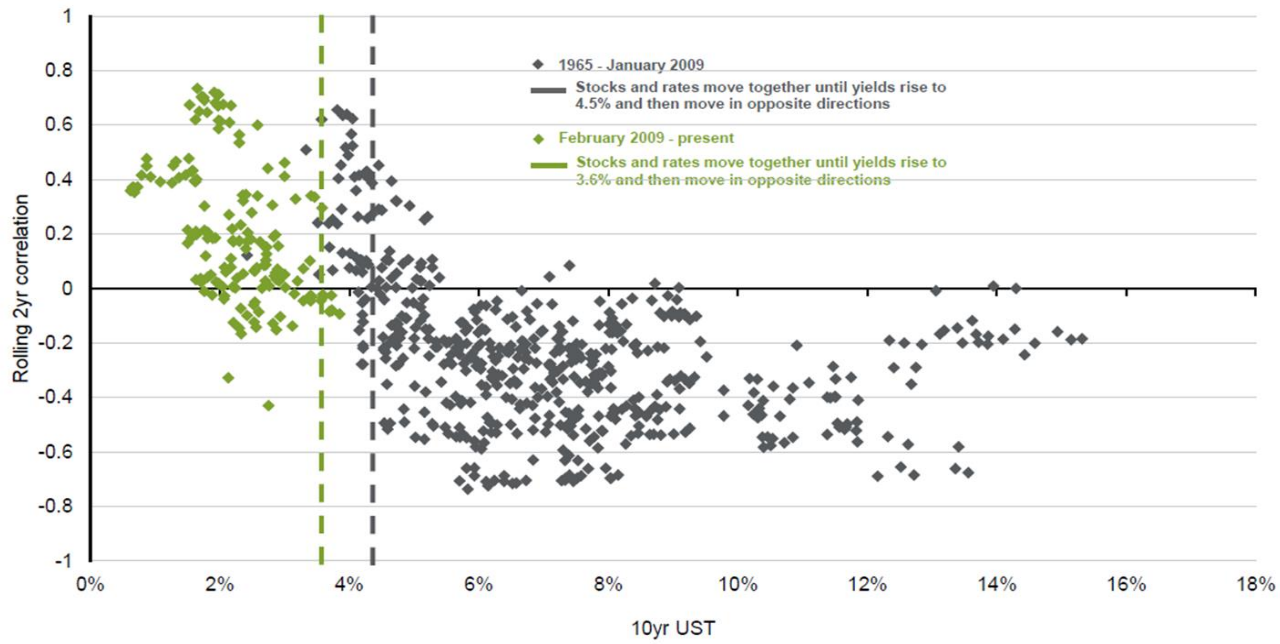
The 10 Year Treasury Yield and Stocks/Bonds

By Derrell Crimm, June 16, 2022

As the yield on the 10-year U.S. Treasury pushes ever closer to 3.5%, a rate not seen since February 2011, the effects on people's finances and investments are significant. The increase from 1.5% in January to 3.4% in June is usually a 2 – 3-year transition. However, with this increase in less than 6 months, the markets are abruptly changing.

The chart below shows the 10-year treasury (on a rolling 2-year comparison) with the S&P 500 stocks.

Stock returns and interest rate movements before and after the Global Financial Crisis
Monthly S&P 500 returns, 10yr U.S. Treasury, rolling 2yr correlations, 1965 – present



Source: FactSet, J.P. Morgan Asset Management. X-intercept for each data set is calculated using a quadratic regression where interest rates are the independent variable and the rolling 2-year correlation of stock returns and interest rate movements is the dependent variable.
Guide to the Markets – U.S. Data are as of June 15, 2022.

You can see that as the yield increases (10yr UST), the stock market struggles to be positive. Since future earnings as a percentage are less, the interest costs are higher. For example, if a company can earn 10% in the year and the 10yr Treasury is 1.5% then it will earn 8.5% (10% – 1.5% = 8.5%). However, if the company is earning 10% and the 10yr Treasury is 3.5% then the company is earning only 6.5% (10% - 3.5% = 6.5%). Lower earnings mean a lower stock price. Then when earnings are below current inflation rates, stocks decline also.

The bond market is the same. The higher the 10yr Treasury yield the lower the value of current bond holdings. When interest rates increase, new bonds are more attractive than older bonds. Therefore, older bonds go down in value (2% bonds you own are not as valuable to a buyer as 3% bonds held by another investor).

When you see the 10yr Treasury turn down, then the stock market and bond markets are likely to increase. As the Federal Reserve continues to increase the discount rate to take money out of the economy, the 10-year Treasury yield is likely to continue to increase. However, this too shall pass. This year is the 1 out of 4 years when the market declines. Remember, you own quality and that will benefit you when the market turns upward.