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Bond yields have been higher in the last few years than at any time since the Global Financial Crisis. This makes for a good opportunity set in fixed income. But some investors are asking if we've reached the point where expected bond returns are so high that it makes sense to trade off some equity exposure for more weight in fixed income.

One thing to keep in mind is that discount rates for stocks factor in current interest rates. All else equal, higher bond yields should lead to higher expected stock returns. In other words, the premium for stocks over bonds may not shrink just because of higher rates.

It makes sense then, that the US equity premium has historically been unrelated to the level of interest rates. In years when the One-Month US Treasury Bill rate was below its historical median, the average equity premium was about 9.9%. In above-median rate years, it was 8.1%. However, the difference between these averages is not statistically reliable, meaning there's not enough evidence to support the premise that the premium is higher in one environment than the other. [1]

Given that the evidence suggests the excess returns for stocks over bills are similar regardless of interest rate level, investors should be cautious changing up their stock/bond mix based on current yields. Maintaining current asset allocations allows bond managers to navigate a rising rate environment and position the interest-bearing component of your portfolio for steady, predictable returns going forward.

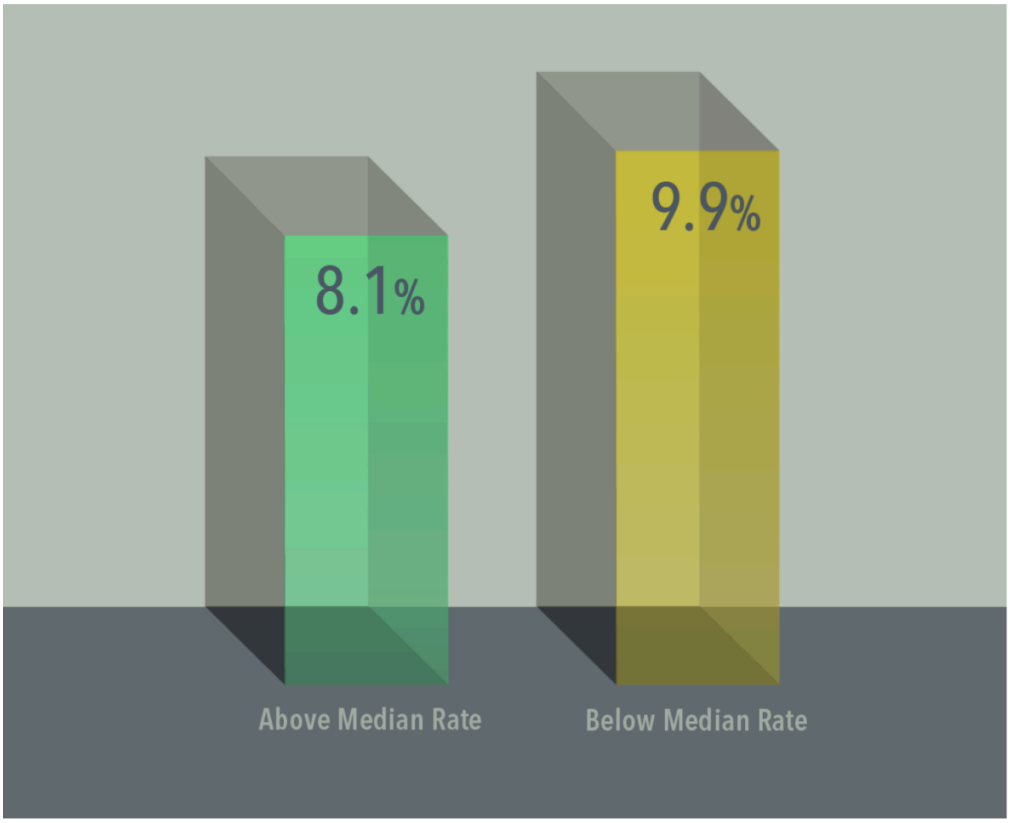
Maintaining discipline through all market cycles is highly correlated to favourable investment outcomes. So wherever interest rates may be headed (likely higher), a steady-as-she-goes approach is the best way to grow your wealth.

Thanks for reading!

Martin

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Average Annual Equity Premium Conditional on One-Month Treasury Bill Rates at Start of Year 1927–2025



Past performance is not a guarantee of future results.

Dimensional, 2026

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