

Weekly CIO Letter

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The 5% Hurdle Rate

When the safest asset in the system yields 5%, every other asset must justify why investors should accept more risk.

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Executive Summary

A psychologically important threshold returned to global markets this week.

The U.S. 10-year Treasury yield briefly moved above 5% on 14 September, its highest level since October 2023. The move reflects several forces at once: persistent inflation, oil above US\$100, expectations of renewed Federal Reserve tightening, resilient economic activity and continued concern around fiscal issuance.

The number itself is not a crisis signal. It is an opportunity-cost signal.

At a 5% risk-free yield, investors no longer need to move far along the risk spectrum to generate meaningful nominal income.

That changes the comparison for:
equities;

corporate credit;

real estate;

private markets;

emerging markets;

and long-duration assets.

The central question for portfolios is therefore shifting from “Will rates fall?” to:

“Which assets can generate enough cash-flow growth to justify their premium over a 5% Treasury?”

The inflation backdrop explains why that question matters.

U.S. CPI increased 0.4% in August and 3.4% year over year. Core CPI increased 0.3% during the month and 2.4% over twelve months. Producer prices rose 0.4% in August and 5.4% year over year, with goods prices rising 1.1% in the month.

The ECB already responded.

On 10 September it raised its three key policy rates by 25 basis points, citing the energy shock and the expectation that inflation will remain above target for an extended period.

The Federal Reserve decides on 16 September. Markets entered this week pricing a high probability of a 25-basis-point hike.

The investment regime is not simply “higher rates.”

It is one in which the hurdle rate for taking risk has risen materially.

1. Five Percent Is Historically Unusual for This Generation — Not for Markets

The post-2008 investment regime trained investors to think of Treasury yields above 4% as exceptional.

Longer history tells a different story.

Capital Group notes that U.S. long-term government bond yields traded between 3% and 6% during

62% of the period since 1871. Its August chart placed the 10-year Treasury at 4.75%, already well above the Fed funds rate at the time.

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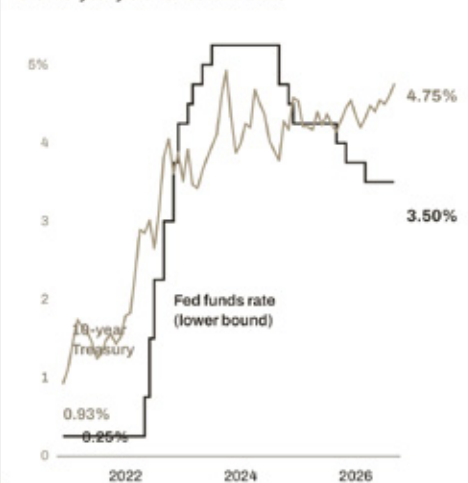
A return to higher Treasury yields

U.S. 10-year Treasury yield, 1871 to 2026, in %. Inset compares the 10-year with the fed funds lower bound.

U.S. 10-year Treasury yield



U.S. 10-year yield vs. fed funds rate



Source: Capital Group / Federal Reserve Bank of St. Louis / LSEG Datastream / Robert Shiller. Long history at annual frequency; inset at monthly frequency, January 2021 to September 2026.

The latest move to 5% therefore does not necessarily imply financial instability.

It may instead represent normalization toward an environment in which investors demand greater compensation for:

inflation uncertainty;

fiscal supply;

term risk;

and a stronger nominal-growth backdrop.

That distinction matters.

A 5% Treasury yield driven by stronger growth is substantially different from a 5% yield driven by collapsing fiscal credibility.

Current evidence suggests both growth and term-premium components are contributing.

The U.S. economy remains resilient enough that investors cannot simply assume slower growth will force long rates lower.

At the same time, fiscal issuance and inflation uncertainty are making investors less willing to hold long-du-

ration government debt at historically low compensation.

Capital Group argues that the broader adjustment is closer to a normalization of rates than an imminent debt crisis.

Oil Makes the Threshold More Difficult

Brent crude climbed above US\$107 per barrel on Monday following renewed attacks on Middle Eastern energy infrastructure and shipping routes.

Yet the current oil shock differs from the 1970s.

J.P. Morgan estimates gasoline expenditure at only about 2.5% of U.S. disposable personal income, far below historical oil-shock periods. Its analysis suggests current gasoline prices would need to rise dramatical-

ly before matching the household burden observed in 1980.

That helps explain why growth has remained resilient despite energy prices above US\$100.

The economy can absorb a larger oil shock than in previous decades.

The bond market may be less forgiving because the same energy shock complicates inflation expectations and monetary policy.

2. The New Policy Problem Is Credibility, Not Just Inflation

The latest U.S. inflation data contain an important nuance.

Headline CPI reaccelerated in August, partly because gasoline rose 3.9% during the month, accounting for more than one-third of the monthly increase.

But core CPI remained at 2.4% year

over year.

Producer inflation tells a less comfortable story.

PPI increased 5.4% year over year, with goods prices rising sharply in August.

The result is not a clean inflation regime.

It is a mixture of:

energy pressure;

goods-cost pressure;

still-moderate underlying consumer inflation;

and resilient demand.

That is difficult for central banks.

Raising interest rates cannot create oil.

But central banks may still tighten to prevent an energy shock from changing wages, expectations and broader price-setting behavior.

That is effectively what the ECB did last week.

Its September projections now show euro-area inflation averaging 3.0% in

2026, 2.5% in 2027 and 2.1% in 2028. It expects headline inflation to peak around 3.6% in Q4 2026, largely because of energy.

Monetary tightening increasingly functions as a credibility tool rather than a direct cure for supply shocks.

That distinction helps explain an unusual market dynamic:

a rate hike can sometimes be positive for long bonds if investors believe it prevents inflation expectations from becoming unanchored.

Conversely, leaving rates unchanged can push long-term yields higher if investors interpret inaction as insufficient commitment to price stability.

That is why several bond investors now see the greater near-term risk as a Fed hold rather than a modest hike.

3. Five Percent Changes the Mathematics of Equity Valuation

Stocks are not automatically unattractive when Treasury yields reach 5%.

Economic history contains many periods in which equities performed well alongside high nominal rates.

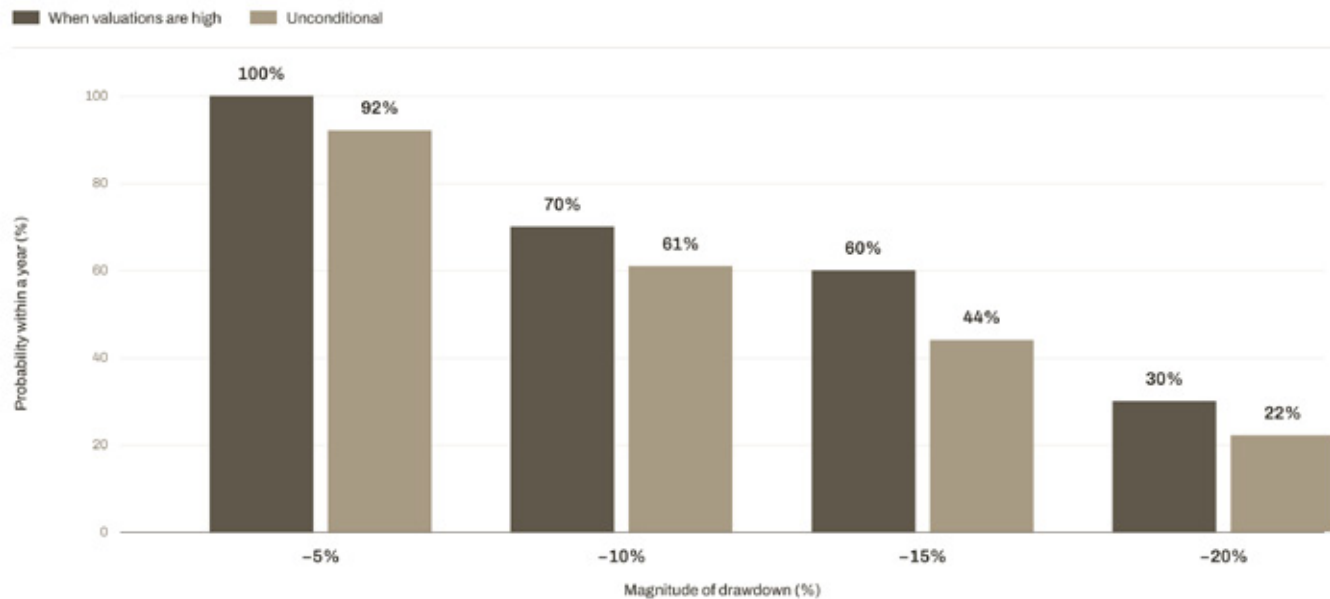
But the valuation hurdle becomes higher.

Goldman Sachs Asset Management provides a useful warning.

Its September analysis shows that when U.S. equity valuations have historically been in their 9th or 10th decile, meaningful drawdowns have occurred more frequently than in the unconditional market history.

Managing bull markets and potential volatility

Probability of an S&P 500 drawdown within a year, by magnitude, in %.



Source: Goldman Sachs Asset Management / Bloomberg, data through 31 August 2026.

High valuations do not predict an imminent decline.

They reduce the margin for error.

At a 2% Treasury yield, investors may tolerate high multiples because the alternative return is low.

At 5%, the comparison changes.

A stock trading at a high multiple needs to deliver:

strong earnings growth;

durable margins;

capital efficiency;

or strategically valuable scarcity.

Otherwise, the risk-free asset becomes increasingly competitive.

The relevant equity question is not simply whether rates are high.

It is whether earnings growth exceeds the increase in the discount rate.

That is why quality and earnings durability matter more as yields rise.

4. The Higher Hurdle May Favor Markets With Better Growth-to-Valuation Ratios

This week BlackRock upgraded emerging-market equities back to overweight.

Its argument is not based primarily on lower rates.

It is based on earnings.

BlackRock's current chart compares

MSCI Emerging Markets with MSCI USA on expected twelve-month earnings growth and forward valuations.

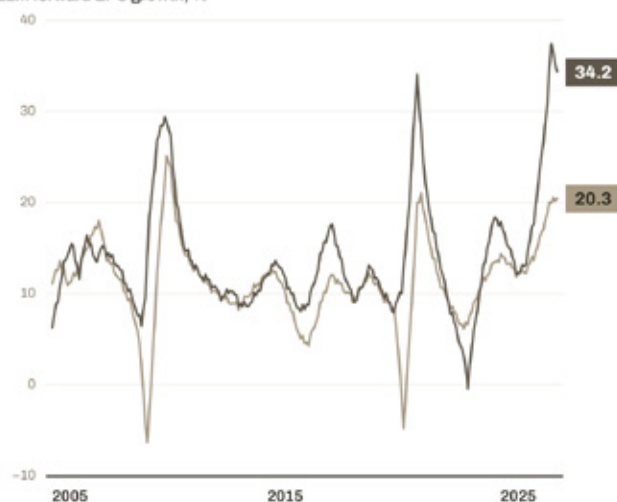
EMERGING MARKETS

Exceptional growth without demanding valuations

MSCI EM against MSCI USA, monthly, 2005 to September 2026.

— MSCI EM — MSCI USA

12m forward EPS growth, %



12m forward PE, x



Source: BlackRock Investment Institute / LSEG Datastream, September 2026.

The comparison is notable.

Emerging markets are not uniformly low-risk.

They contain significant exposure to geopolitics, currency volatility, commodities and governance differences.

But the current combination of faster expected earnings growth and lower valuation offers greater compensa-

tion for those risks than several years ago.

BlackRock specifically highlights South Korea and Taiwan as beneficiaries of semiconductor and AI infrastructure scarcity, while parts of Latin America provide exposure to commodities and physical infrastructure required by that same investment cycle.

A higher global hurdle rate may therefore accelerate a shift away from indiscriminate equity exposure toward markets and sectors where earnings growth is sufficiently strong relative to price.

That does not require abandoning the United States.

U.S. companies continue to generate exceptional earnings.

It means valuation discipline becomes more valuable.

The Same Logic Applies to Credit

At a 5% Treasury yield, investors require more compensation to accept credit risk.

If corporate spreads remain exceptionally tight, the incremental yield may no longer justify:

default risk;

liquidity risk;

subordination;

or refinancing risk.

Credit selection becomes increasingly important when government bonds themselves offer meaningful income.

The goal should be to take credit risk where spreads compensate for it — not simply because yield is available.

Portfolio Implications

Government Bonds

Starting yields have improved significantly.

That increases future expected income.

But long duration still carries substantial term-premium and inflation

risk.

We continue to prefer earning attractive carry without assuming unnecessary duration until the inflation and fiscal outlook becomes clearer.

Equities

Higher rates do not automatically end an equity bull market.

They raise the required quality of earnings.

We favor businesses with:

- strong free cash flow;

- pricing power;
- low refinancing dependence;
- high returns on invested capital;
- earnings growth capable of exceeding the higher discount-rate hurdle.

Emerging Markets

The combination of stronger expected earnings growth and lower valuations has improved the relative case.

That does not justify broad, undifferentiated exposure.

Technology supply chains, selected financials, commodity exporters and infrastructure-linked markets may offer more attractive asymmetry than the asset class in aggregate.

Inflation Protection

The latest energy shock reinforces the usefulness of instruments whose payoff is less dependent on a rapid return to 2% inflation.

Goldman Sachs Asset Management currently views TIPS as a useful hedge against inflation tail risk.

Cash and Short Duration

A 5% sovereign yield changes the value of waiting.

Liquidity no longer necessarily means giving up substantial income.

Cash and short-duration bonds can serve simultaneously as:

income;

liquidity;

and optionality.

That combination is valuable when valuations are elevated and policy uncertainty is high.

Risks to the Thesis

The first risk is that the energy shock reverses quickly. A geopolitical agreement or restoration of oil infrastructure could pull yields and inflation expectations lower.

The second is that the Fed surprises by holding rates unchanged while successfully convincing investors that inflation remains contained.

The third is that strong earnings continue to overwhelm the impact of

higher discount rates, allowing equity multiples to remain elevated longer than historical comparisons suggest.

The fourth is that emerging-market earnings forecasts prove too optimistic, particularly if the global technology cycle slows.

The fifth is that 5% itself attracts enough demand into Treasuries to cap yields and produce a rapid reversal.

Our Perspective

At Astro Wallenius, we believe the 5% Treasury threshold is important less because of the number itself and more because of what it represents.

For much of the post-financial-crisis era, investors were pushed outward along the risk curve because safe assets offered little income.

That environment has changed.

A sovereign benchmark near 5% forces every investment to answer a more difficult question:

Why should the investor accept additional risk?

Some assets have a strong answer.

Rapid earnings growth.

Scarcity.

Inflation protection.

Liquidity premiums.

Structural growth.

Others may not.

This is an environment for selectivity rather than simple risk reduction.

The opportunity set remains broad.

The cost of being wrong has increased.

Final Thoughts

The 10-year Treasury reached 5%.

Oil is above US\$100.

The ECB has already tightened.

The Federal Reserve may follow.

And equities remain near historically elevated valuations.

Yet the global economy is not collapsing.

That combination defines the current regime.

The risk-free rate is no longer irrele-

vant.

It is once again competing directly for capital.

Portfolio construction should reflect that competition.

Quality should earn its premium.

Growth should justify its valuation.

Credit should pay for its risk.

And liquidity should no longer be treated as dead capital.

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