FAQs

Stuck in a 5% world

This is a redaction of a 18-page report published on September 28, 2026. Please reach out to your BofA Securities representative or Merrill Global Wealth Management financial advisor for more information.

01 October 2026

Equity and Quant Strategy
United States

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Q: Is it time to revisit bonds? Quant work says yes....

We have been bond bears since the ZIRP days but see a better set up today. Why? (1) Bonds today are more attractive than the S&P 500 index than at any point in the past 20+ years based on earnings yield and dividend yield, and easily clear short duration CD yields. (2) Valuation is a bad market timing signal but has been a strong predictor of long-term S&P returns and implies -3% p,a. index returns for the next decade, +3% for the average stock, which, with a 2% dividend yield, is a wash.

...and recent policy shifts and demographics are supportive

We are encouraged that the Fed and Tsy Secretary focus on the long end of the curve. Disinflation from demographics and maybe eventually AI suggest a lower rates ceiling than the 70s/80s. Bond allocations are at 4y lows despite 5ppt higher returns, whereas cash stockpiles have been undeterred by inflation cutting into real returns. But Fed rate hikes until inflation subsides suggests stabilizing 10y Tsy yields in the medium-term.

Q: What's the doom level of rates for equities?

Historically significant levels include: 5% where investors grew agnostic between bonds and stocks, 6% above which bond/stock correlations shifted negative and >7% is where PE multiples have dropped. But a better question may be: *why* are rates rising? Growth, productivity and deregulation are equity positive, sovereign risk, buyers' strikes and stagflation are not. Our rates team see upside rate risk for good and bad reasons.

Q: Which equities are most impacted by rates/YC shifts?

Real Estate, Tech, Utilities and Comm Svcs, based on performance betas to 10yr rates over the past decade. Bear flatteners (short rates rising faster than long rates, like this year) hurt Real Estate, Utes and Financials but there are nuances (see inside).

Q: How does today's leverage risk compare to history?

Better than prior cycles. S&P 500 net debt/EBITDA is below its long-term average, its effective debt cost is below 4%, and 80% of debt is long-term fixed, up from 60% in 2007. Leverage has increased in pockets (Tech, Healthcare) but is manageable. Small caps have more risk than the S&P 500 given a larger proportion of floating-rate debt. Consumer balance sheets are fine according to economists. Risk sits on gov't balance sheets: net interest expense to GDP is at a record high.

Q: Is rate volatility a reason to sell the S&P 500?

No. Macro is difficult to predict. Extending one's time horizon has been one of the most effective ways to avoid losses: the probability of losing money drops from 46% to 5% by extending one's holding period from a day to a decade. Panic selling can be costly given that the best days often follow the worst days. Since the 1930s, investors who missed the 10 best days per decade would have generated price returns of just 140% vs. 35,000% for those who stayed invested.

ZIRP: Zero interest rate policy

YC: yield curve

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Rate FAQs: Stuck in a 5% world

Q: Is it time to revisit bonds? Quant work says yes....

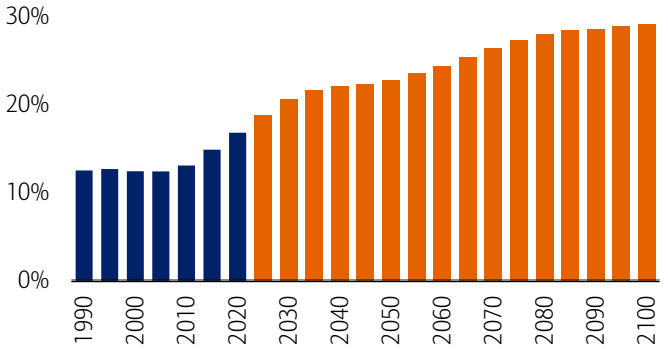
We have been bond bears since ZIRP days but see a better set up today. Why? (1) Bonds today are more attractive relative to the S&P 500 than at any point in the past 20+ years based on S&P 500's earnings yield and dividend yield. (2) Valuation is a bad market timing signal but has been a strong predictor of long-term returns and now implies -3% S&P 500 returns over the next decade, +3% for the average stock where, with a 2% dividend yield, is a wash. We still like equities with positive gearing to growth and inflation over bonds and cash.

...and recent policy shifts and demographics are supportive

We are encouraged that the Fed and Treasury Secretary are focused on the long end given the US debt burden. Aging demographics (and maybe eventually AI) argue for disinflationary pressures and a lower rates ceiling than the 70s/80s. Bond allocations are the lowest since 2022, cash allocations are at highs, but cash's real return is likely capped in the near term as policymakers attempt to curb inflation and push 10y yields lower over the medium-term.

Aging demographics = more demand for income-generating assets

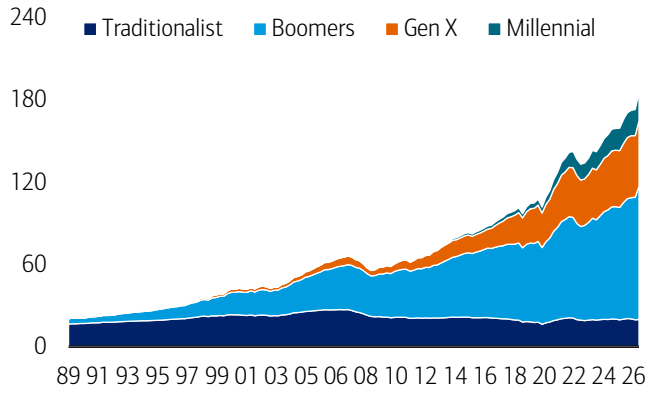
Exhibit 1: 65+ population is expected to grow from 17% in 2020 to 23% by 2050 and 29% by 2100
Percentage of US population older than 65 (1990-2050)



Source: Census Bureau (Population Division), BofA US Equity & Quant Strategy
Note: orange bars denote Census forecasts

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Exhibit 2: Boomers + Traditionalists hold >60% of total household net worth
Household net worth by generation (1989-2Q26)

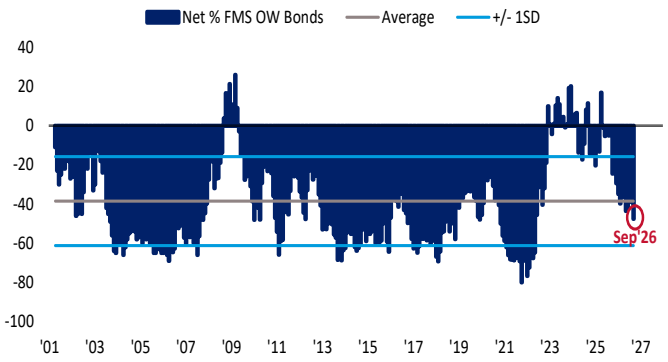


Source: Haver Analytics, BofA US Equity & Quant Strategy

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Investors are underweight bonds

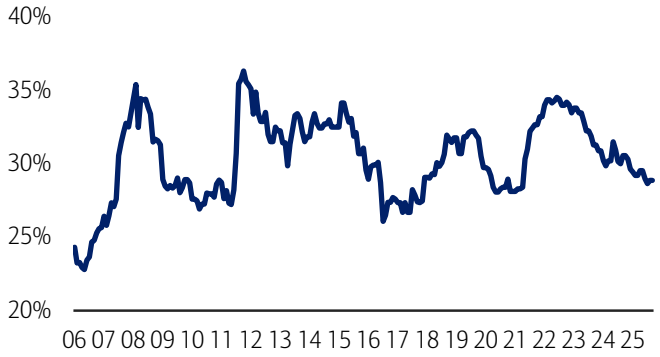
Exhibit 3: 48% of Global Fund Manager Survey investors are net underweight bonds, the biggest underweight since May 2022
Global fund manager survey: Net % of fund manager survey investors that are overweight bonds (as of 9/10/2026)



Source: BofA Global Fund Manager Survey

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Exhibit 4: Sell side strategists are recommending the lowest allocation to bonds since early 2022
Sell side strategists' average recommended allocation to bonds (2006-8/31/2026)



Source: BofA US Equity & Quant Strategy; Note: based on a monthly survey of sell side strategists; represents recommended allocation to bonds at each month end

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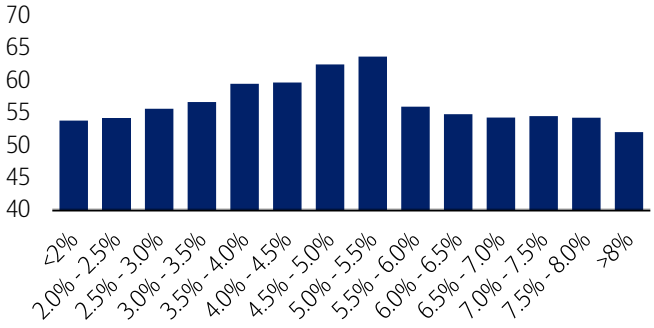
And retirees are sitting on $8tn cash where the average CD yields about 2%.

Q: What's the doom level of rates for equities?

5% is the level at which investors have been agnostic between bonds and equities, 6% is when correlations between stocks and bonds go negative, and 7% is the level at which PE multiples compressed – but sometimes for good reasons – higher E, like this year. A better question is why rates are going up: equity positive reasons (growth, productivity, deregulation...) or negative reasons (buyers strike, sovereign risk, inflation).

How high can rates go?: Our rate strategists use various frameworks to analyze the potential path of rates going forward (e.g., Taylor, Fed action reversal & real funds). They expect the 10yr to settle at 5% by year-end but highlight fundamental upside risks, noting that 5.5%+ cannot be ruled out. See Rate Frameworks and Global Rates Weekly 'From Jackson to action' Sept 18.

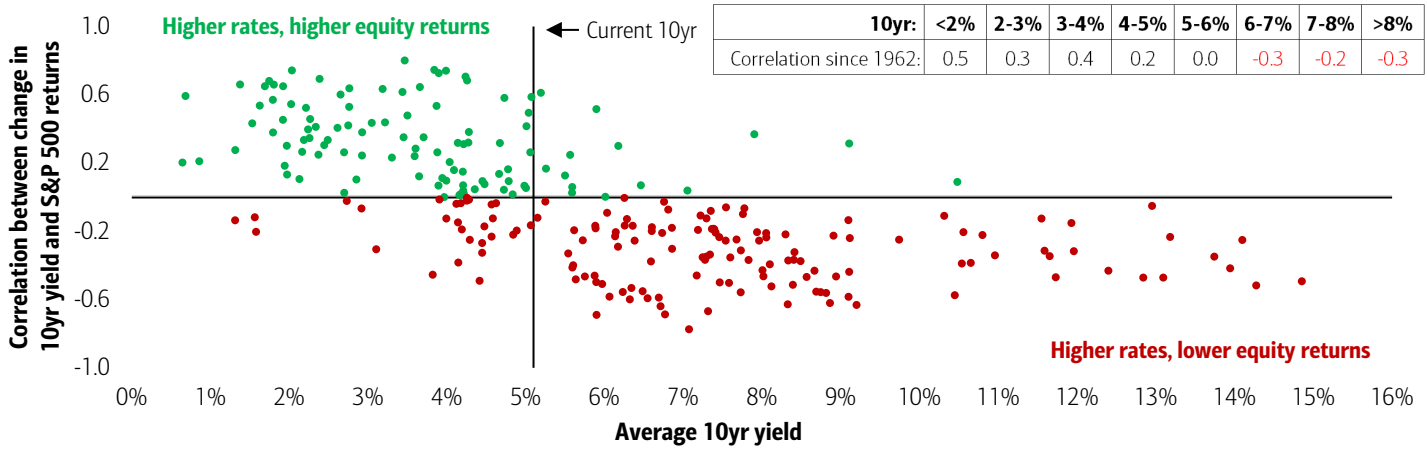
Exhibit 5: Sell side strategists' average recommended allocation to stocks has dropped once the 10yr moved above 5.5%
Sell side strategists' average recommended allocation to equities (in %) bucketed by 10yr Treasury yield range (1985-8/31/2026)



Source: BofA US Equity & Quant Strategy, Bloomberg

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Exhibit 6: S&P 500 returns have been negatively correlated with higher rates when the 10yr yield is above 6%
Average 10yr yield vs. the correlation between daily changes in the 10yr yield and S&P 500 returns each quarter (each dot represents a distinct quarter from 2Q1962-2Q2026, table shows correlations throughout entire time period)

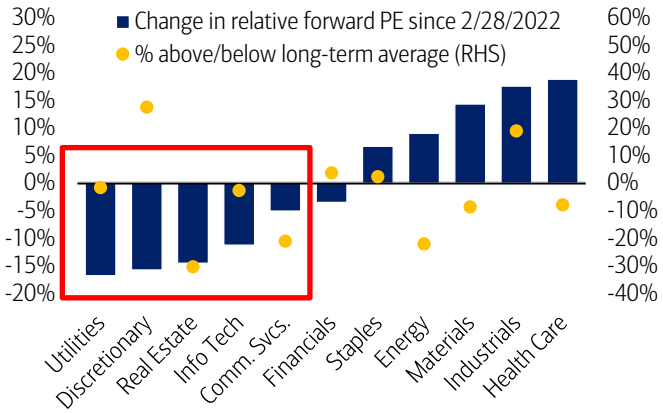


10yr:	<2%	2-3%	3-4%	4-5%	5-6%	6-7%	7-8%	>8%
Correlation since 1962:	0.5	0.3	0.4	0.2	0.0	-0.3	-0.2	-0.3

Source: Bloomberg, BofA US Equity & Quant Strategy

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Exhibit 7: ...all of which have de-rated since the Fed's 2022 hiking cycle
Change in relative Fwd PE (vs. S&P 500) since 2/28/2022 and % above/below long-term average since 1986 (as of 8/31/2026)



Source: Haver Analytics, BofA US Equity & Quant Strategy

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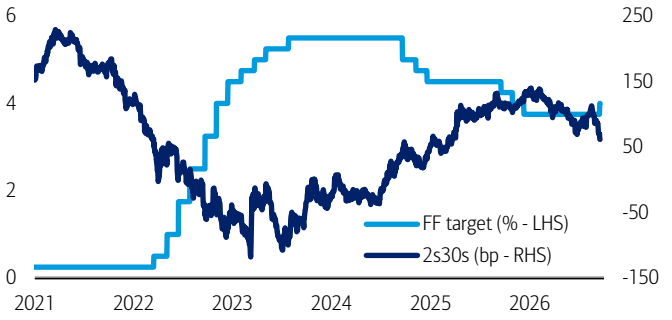
Past hiking cycles: bond proxies, Comm. Svcs., Discretionary, Fins fared worst

The sectors which underperformed the index most consistently during historical tightening cycles were bond proxies (Utilities and Real Estate) along with Communication Services (especially Telecomm, which is now a small part of Communication Services – see Relative Value), Consumer Discretionary and Financials. Sectors which historically fared best were Tech, Staples, Energy and Health Care. But dispersion of returns for many sectors was wide, indicating that factors rather than sectors may be a stronger explanatory variable.

What about bear flatteners?

BofA rate strategists see room for bear flattening (i.e., short-term rates rising faster than long-term rates) as our economists forecast two additional Fed hikes this year. Historically, the S&P 500 has posted weaker monthly returns during bear flatteners than under other yield curve backdrops. Real Estate, Utilities, and Financials have been the biggest laggards during these periods.

Exhibit 8: There is room for the curve to flatten as the Fed reverses the 2025 rate cuts
2s30s curve vs FF target



Source: Bloomberg, BofA Global Research

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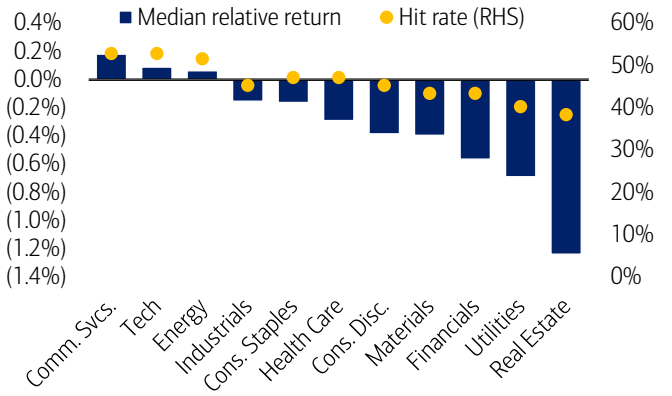
Exhibit 9: Yield curve shift descriptions
Bull and bear flattener and steepener descriptions

Yield curve shift	Definition
Bull flattener	Long term rates fall faster than short term rates
Bull steepener	Short term rates fall faster than long term rates
Bear flattener	Short term rates rise faster than long term rates
Bear steepener	Long term rates rise faster than short term rates

Source: BofA US Equity & US Quant Strategy; Note: if short and long term rates move in the opposite directions, the change with the bigger magnitude defines the shift.

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Exhibit 10: Real Estate, Utilities, and Financials have performed the worst in bear flattener months
Median sector relative performance and hit rates during months of bear flattening (1976-8/31/2026)



Source: Bloomberg, BofA US Equity & Quant Strategy

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Reminder: the perils of market timing

Macro moves are difficult to predict, but extending one's time horizon has historically been one of the most effective forms of loss avoidance: the probability of losing money in the S&P 500 drops from 46% to 5% by extending one's holding period from a day to a decade. Panic selling can be costly given that the market's best days often follow its worst days. Since the 1930s, investors who missed the 10 best days per decade would have generated price returns of just 140% vs. 35,000% for those who stayed invested.

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Underperform	N/A	≥ 20%

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