Weekly Commentary with Professor Jeremy J. Siegel



Rising Real Rates Signal Stronger Growth: Upgrading Equity View

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The market continues to hold near all-time highs despite pressure from higher bond yields. This week brought relatively little economic data, but the important takeaway is that the underlying economy still looks strong. High-frequency indicators, jobless claims and consumer spending data continue to point to solid growth, while this week's CPI, PPI and retail sales reports will provide the next important test for both the economy and the Federal Reserve.

I still expect the Fed to hold rates at its October meeting unless the incoming inflation data are dramatically different from expectations. November and December remain much more open. In fact, I would not completely rule out another 25 or even 50 basis point increase later this year. Bank deposits (the major part of the money supply) are still growing at a pace that is faster than what would be consistent with 2%–3% inflation, and the yield curve is steeper than its 40-year average, particularly when looking at the relationship between the two-year rate and the Fed funds rate. Those are not signs of an economy that requires monetary easing.

What has changed more meaningfully is my view of long-term equity returns. With the S&P 500 trading around 19 times earnings, the inverse P/E suggests roughly a 5.5% long-term real return. But higher real interest rates also should be interpreted as a signal that the economy is capable of sustaining stronger growth. Higher real economic growth supports stronger earnings growth. I have therefore raised my estimate of long-term real equity returns to approximately 5.5%–6.5%. That is still below the historical long-run trend, but it is a meaningful improvement in the outlook.

This is why I remain constructive on equities. Higher rates are not necessarily bearish for stocks if those rates reflect stronger productivity and economic growth. If yields stabilize and growth expectations remain intact, equities can continue to move higher. The real danger would be a sudden technological breakthrough that makes a large portion of the current spending on data centers and compute obsolete. That is a risk worth monitoring because it would resemble what happened to parts of the fiber-optic industry during the dot-com bubble. But there is no evidence of that today.

I am less enthusiastic about making a strong directional call on long-term bonds. The move to higher yields has already been substantial, but the structural fiscal issues remain, particularly the long-term pressures from Social Security and other government expenditures. If oil prices fall back into the $60s or $70s, I could see a 50–100 basis point decline in longer-term yields as inflation expectations ease. At the same time, I still think the 10-year Treasury can trade in roughly a 4.75%–5.25%, potentially 5.5%, range if the current pressures persist.

There is also an important crowding-out dynamic developing in the economy. The enormous borrowing requirements associated with hyperscaler investment in AI infrastructure are competing for capital with housing and other sectors. The Fed cannot simply accommodate all of that demand without risking another inflationary impulse. Until productivity gains begin to offset the extraordinary investment spending, some other areas of the economy will have to absorb tighter financial conditions.

That is particularly visible in housing, where there has been very little productivity growth over many decades. Higher mortgage rates are putting pressure on the lower end of the housing market, although higher-end housing remains relatively resilient because rising stock prices have supported household wealth.

Investors need to distinguish genuine productivity-driven growth from businesses whose valuations depend on an increasingly ambitious narrative. But my message now: higher rates that stabilize are not a reason to abandon equities. They may actually be part of the evidence that the economy and equity backbone is stronger than many realize.

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