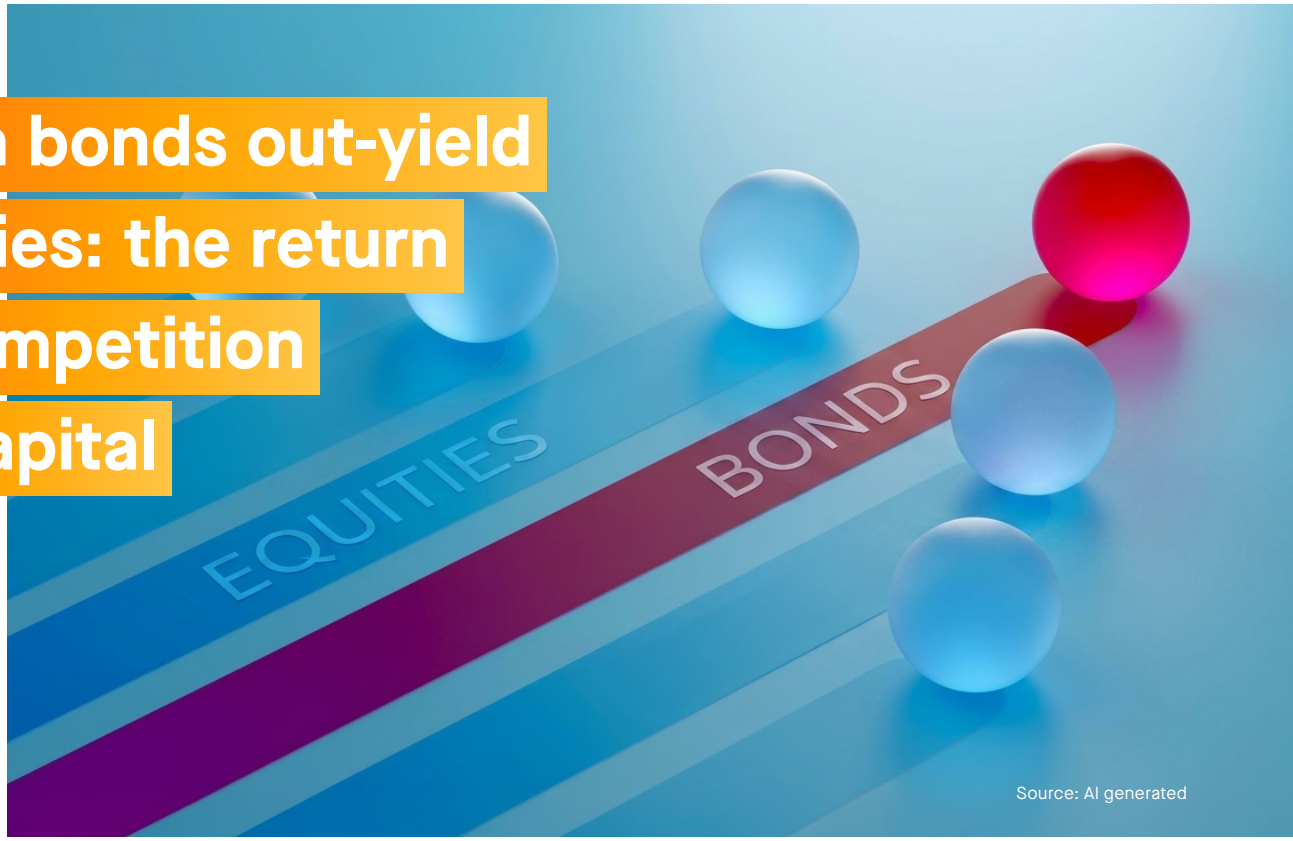
When bonds out-yield equities: the return of competition for capital



Source: AI generated

The S&P 500 earnings yield has fallen below Treasury yields for the first sustained period since the dot-com era. Does this mark a new regime for equity investors?

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For most of the past two decades, equities offered investors a clear yield advantage over government bonds. That relationship has now reversed. The S&P 500 earnings yield stands below the 10-year Treasury yield for the first sustained period since the dot-com era, raising questions about the attractiveness of equities relative to bonds.

The picture, however, is more nuanced than the headline suggests. While the nominal equity risk premium has effectively disappeared in the United States, equities still offer a positive premium over inflation-protected bonds. The challenge is that this cushion has fallen to one of its lowest levels in three decades.

This does not necessarily signal an imminent bear market. Rather, it marks the return of genuine competition for capital. In a world where bonds once again offer attractive yields, equity returns are likely to depend increasingly on earnings growth rather than multiple expansion.

1. Why the earnings yield should normally exceed the bond yield

The earnings yield, calculated as trailing earnings divided by price and equal to the inverse of the P/E ratio, is the simplest proxy for the long-term return potential embedded in equity markets. Comparing it to the 10-year government yield gives a crude but widely watched equity risk premium (ERP). The textbook rationale for a positive spread is straightforward. Equity cash flows are uncertain, cyclical, junior in the capital structure, and subject to drawdowns that bonds held to maturity do not face. Investors should be paid for that risk. Empirically they have been: the S&P 500 earnings yield exceeded the 10-year Treasury yield by roughly 2.3pp on average between 1990 and 2026, and by 2.6pp over the past 20 years.

One caveat differentiates fact from dogma. Some economists would argue that the relevant comparison is with nominal Treasury yields, since investors ultimately allocate capital based on nominal returns. Others prefer TIPS, noting that corporate earnings tend to grow with inflation whereas bond coupons are fixed in nominal terms. With US inflation at 4.2%, this distinction is central, and we address it directly in section 3.

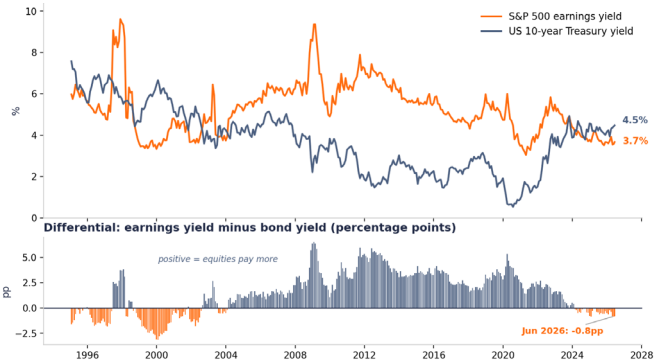
2. The US inversion: anatomy and causes

In mid-June 2026, the S&P 500 earnings yield stands at 3.67% against a 10-year Treasury yield of 4.48%, a spread of −0.80pp versus a long-run average of +1.55pp since 1995. The spread has been negative almost continuously since May 2025 and intermittently since late 2023, after two decades in positive territory. It now sits in the 15th percentile of its 31-year history.

The inversion is the product of both blades of the scissors. The numerator: the AI-led re-rating has pushed the S&P 500 to ~27x trailing earnings while tangible AI profits remain modest relative to the capex deployed, multiple expansion has outrun earnings. The denominator: the 10-year yield is being held above 4.5% by sticky inflation (4.2%), a record fiscal trajectory (a $1.2tn deficit in the first eight months of FY26, ~$2tn projected, and some $10tn of Treasury issuance over the coming year), a rebuilt term premium and geopolitical risk premia following the Iran conflict. Add a heavy IPO calendar, including companies such as SpaceX and Anthropic, and a new corporate investment cycle, and the defining feature of the post-2009 regime—excess liquidity with no alternative to equities—has given way to genuine competition for capital. TINA ("There Is No Alternative") is over: a US investor can now lock in a Treasury yield that exceeds the earnings yield generated by the S&P 500.

Logically, one of three things must be true: bonds are mispriced (yields fall as inflation and deficits surprise favourably), equities are mispriced (multiples de-rate or earnings must catch up), or the valuation framework itself is mis-specified for a new macro regime of higher nominal growth and AI-driven productivity. The honest answer is that the market is currently paying up for the third explanation while the first two remain live risks.

Chart 1: S&P 500 Earnings Yield vs. US 10-Year Treasury Yield
The earnings yield has fallen below Treasury yields for the first sustained period since the dot-com era.



Source: Syz, Bloomberg

3. The real-yield test: what TIPS change, and what they don't

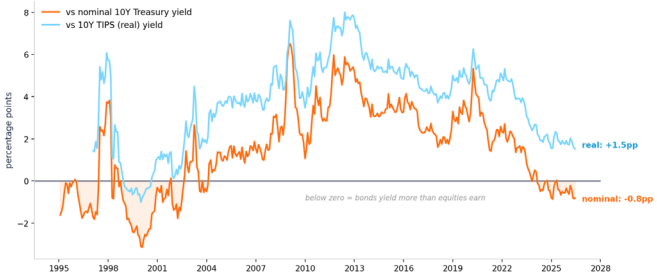
The debate becomes particularly relevant when inflation is elevated. While many investors focus on nominal Treasury yields because capital is ultimately allocated on a nominal basis, others prefer to compare equities with the 10-year TIPS yield, the real risk-free rate. Since corporate earnings tend to grow with nominal GDP and inflation over time, the TIPS framework provides a useful cross-check. On this basis, the picture softens materially: at 2.16%, the 10-year real yield sits 1.5pp below the S&P 500 earnings yield, equities still offer a positive premium over the real risk-free rate. Of the 4.5% nominal Treasury yield, 2.3pp is inflation compensation—the implied breakeven—that corporate earnings can potentially recapture through nominal growth. Part of the nominal inversion therefore reflects the inflation compensation embedded in Treasury yields.

What TIPS do not change is the relative verdict. The real spread averaged +4.6pp over the past 20 years and +3.8pp since 1997; today's +1.5pp is the same 15th-percentile reading as the nominal metric. The only time the spread ever went negative was between December 1998 and July 2000, reaching a trough of −1.0pp at the peak of the dot-com bubble. Two further observations are worth noting. First, with breakevens at just 2.3% against spot CPI of 4.2%, the bond market appears to expect inflation to converge back toward its long-term average over time. The elevated nominal yield therefore reflects high real rates and term premium more than elevated inflation expectations. Second, that is arguably the less comfortable decomposition for equities: a 2.2% real discount rate, near post-GFC highs, represents genuine competition for capital and a genuine drag on duration-heavy valuations. Unlike nominal pressures, higher real rates cannot simply be eroded by inflation.

Viewed through the TIPS lens, US equities are not yielding less than bonds, but they offer the thinnest real cushion since 1999–2000. The key message is not that equities offer no premium over inflation-protected bonds, but that the premium has become exceptionally thin by historical standards.

Chart 2: S&P 500 Earnings Yield vs. Nominal and Real Treasury Yields (TIPS)

Looking beyond the nominal inversion: the apparent inversion softens once inflation compensation is removed from bond yields.



Source: Syz, Bloomberg

4. Four regions, four different messages

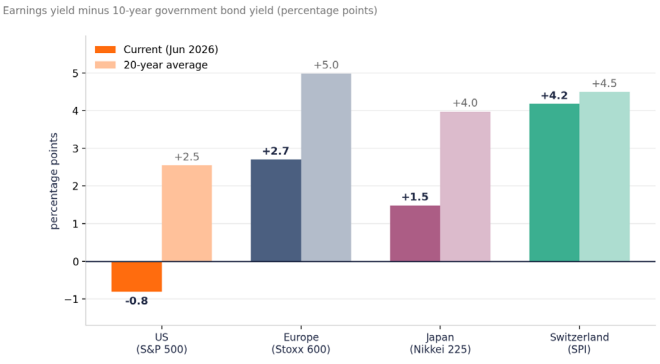
Region / index	10Y govt yield	Earnings yield	Spread (pp)	20y avg (pp)	Percentile*
US — S&P 500	4.48%	3.67%	−0.80	+2.55	15%
Europe — Stoxx 600	3.00% (Bund)	5.70%	+2.70	+5.00	22%
Japan — Nikkei 225	2.63%	4.11%	+1.48	+4.00	5%
Switzerland — SPI	0.42%	4.59%	+4.17	+4.50	44%

**Percentile of current spread within each market's own history (US since 1995, CH since 1999, EU since 2001, JP since 2004).*
Source: Bloomberg, Syz Group.

The inversion is American, not global but the compression is broad. Europe still offers a 2.7pp cushion, yet that is barely half its 20-year norm and a 22nd-percentile reading. The Stoxx 600 spread has only been negative once, from 2002-2004. Japan's +1.5pp looks comfortable in absolute terms, but is the most extreme reading of the four relative to history (5th percentile). It is not driven by equity exuberance but by the violent normalisation of JGB yields, which rose from below 1.0% in October 2024 to 2.63% today as the BoJ exits decades of financial repression. Japanese equities have so far absorbed a +170bp rise in bond yields remarkably well, but the margin for error is shrinking fast. Switzerland is the outlier of normality: at +4.2pp, the SPI spread sits at its 44th percentilebroadly in line with its 20-year average, supported by a 10-year Confederation yield of just 0.42%. In relative-value terms, Swiss equities remain the only major market where investors are still paid a historically normal premium over the domestic risk-free rate—a structural case for home-market exposure and a backdrop in which quality-defensive Swiss large caps continue to screen well globally.

Chart 3: Equity Risk Premiums Relative to History

All major regions except Switzerland trade below their 20-year average risk premium, with the sharpest compression in Japan and the United States.



Source: Syz, Bloomberg

5. The 1995–2000 precedent: an inversion is not a sell signal

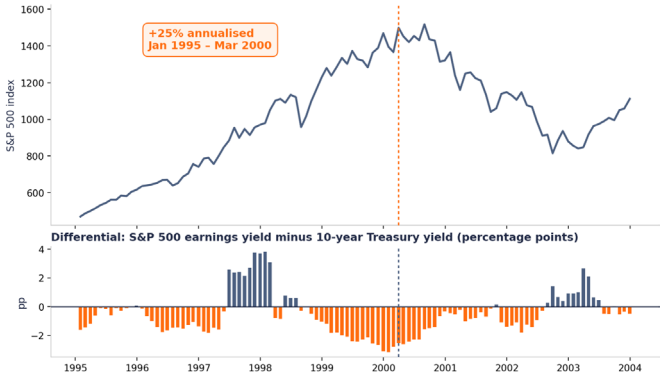
The strongest argument against drawing a mechanically bearish conclusion comes from the data itself. Between January 1995 and March 2000, the S&P 500 earnings-yield spread was negative on average (−0.6pp), with episodes reaching −1.8pp in 1996-1997 and a trough of −3.1pp in January 2000. Yet over the same period, US equities compounded at roughly 25% annualised, one of the most powerful bull runs on record. Investors who exited on the first inversion in 1995 would have missed five years of exceptional returns.

In other words, the spread only "worked" as a signal at extremes, and even then without meaningful timing precision. The 2000–03 bear market (−49% for the S&P 500) began long after the inversion had already become consensus knowledge.

Two lessons. First, a negative spread is a statement about long-horizon expected returns and risk asymmetry, not about the next 6–12 months. Momentum, earnings revisions, and liquidity dominate at that horizon. Second, the depth matters: today's −0.8pp is closer to the mild 1995-1997 readings that preceded further strong gains than to the −3pp extreme of early 2000. The analogy also carries a structural difference in equities' favour: the dot-com leaders were largely profitless, whereas today's mega-cap technology complex generates enormous free cash flow, the question is the return on $700bn+ of annual AI capex, not the existence of profits.

Chart 4: S&P 500 Performance and the Earnings Yield–Treasury Yield Spread, 1995–2003

Despite a persistently negative earnings yield–Treasury yield spread, the S&P 500 compounded at roughly 25% annually for five years.



Source: Syz, Bloomberg

6. Investment conclusions

- **Limited valuation cushion** in US large cap. Relative to nominal Treasuries, the valuation cushion has disappeared. Relative to inflation-protected bonds, it remains positive but near the lowest level of the past 25 years. Future returns are therefore increasingly dependent on earnings delivery rather than multiple expansion.
- **Earnings remain the offsetting force.** Consensus expects 2026 EPS growth of approximately 24% for the S&P 500, 17% for the Stoxx Europe 600, 15% for Japan and more than 50% for MSCI Asia ex-Japan. As long as earnings growth continues to outpace rising discount rates, equity markets can absorb unusually low risk premiums.
- The signal is asymmetry, not direction. **The 1995-2000 precedent argues against de-risking** on the spread alone, but it also shows that eventual repricing can be severe when earnings disappoint or real yields continue to rise.
- **Relative value** favours Switzerland, then Europe. Switzerland is the only market still offering a historically normal premium over its risk-free rate, while Europe retains a meaningful cushion despite significant compression.
- **The bond market remains the key trigger.** A move in the US 10-year Treasury toward 5% would put further pressure on equity valuations, while a decline toward 3.5% would largely resolve the current tension between bonds and equities.

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