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Higher for Longer

Implications for Institutional Portfolios

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Between the Global Financial Crisis and the end of 2021, US institutional investors operated in a world of low interest rates. Investors adapted, treating cash as a drag on returns, choosing assets that had embedded leverage, and reaching for riskier, less liquid assets to meet return targets that bonds alone could not. Those conditions no longer hold. Many investors are aware that rates have moved higher, but perhaps not all have worked through what sustained higher rates may mean for how institutional investors build and manage portfolios.

This paper asks a conditional question: if short- and long-term rates remain well above their 2009 to 2021 levels for an extended period, and the yield curve maintains an upward slope, what follows for US institutional portfolios? The paper does not forecast rates or address their effects on inflation or economic growth. It concentrates on the steady state of higher rates rather than any transition, including a further rise. The discussion covers how short-term and long-term rates affect portfolios, their application to individual asset classes, leverage, and portfolio construction.

Key Takeaways

- **Once prices adjust, higher rates raise expected returns for many assets.** Starting yields have historically been a consistent guide to bond returns over the following decade. Credit earns a higher base rate. Hedge funds, commodities, and risk mitigating strategies earn more on their cash collateral. Equities face a higher hurdle, but many other factors drive their returns.
- **Short-term rates and long-term rates affect portfolios in different ways.** Short-term rates mainly affect the return on cash, the cost of borrowing, and the hurdle for risky and illiquid assets. Long-term rates mainly affect the valuations of long-duration assets and the cost of long-maturity financing. Some borrowers can shift from one to the other as financing conditions change.
- **Existing private assets and new commitments may offer different returns.** Private market valuations have been slow to reflect higher rates. Legacy debt must be refinanced at higher rates as it matures. Both effects should fade over time. New commitments may benefit from lower entry prices.
- **Leverage depends more on spreads than on the level of rates.** Leverage adds value when assets earn more than they cost to finance. The slope of the yield curve matters a great deal. Higher rates leave portable alpha neither more nor less attractive. Financing costs could still rise from here, so spreads deserve close monitoring.
- **Higher rates give investors more flexibility.** Investors may be able to target the same expected return with lower expected risk, or a higher expected return at a similar level of expected risk, all else equal. Cash, long-term Treasuries, and other defensive assets now cost less to hold.
- **Higher yields make complexity more of a choice and less of a necessity.** Investors may wish to evaluate allocations that were made mainly to add return. Simplifying has costs of its own, and conditions could change again (e.g., rates could fall or rise further).

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How Short-term and Long-term Rates Affect Portfolios

The yield curve contains a rate for every maturity, from overnight lending between banks to 30-year government bonds. For portfolio purposes, two segments matter most. Short-term rates, such as the federal funds rate and the yield on Treasury bills, reflect the cost of borrowing and the return on cash. Long-term rates, such as the yields on 10-year and 30-year Treasuries, reflect the return an investor can lock in for a decade or more.

From 2009 through 2021, short-term rates sat near zero for long stretches and long-term rates fell to historic lows (see Figure 1). Since 2022, both have returned to levels last seen before the Global Financial Crisis (GFC). From 1990 through 2008, the 3-month Treasury bill yield averaged about 4.1% and the 10-year yield about 5.7%.[1] Current levels are closer to those averages than to the 2009 to 2021 period.

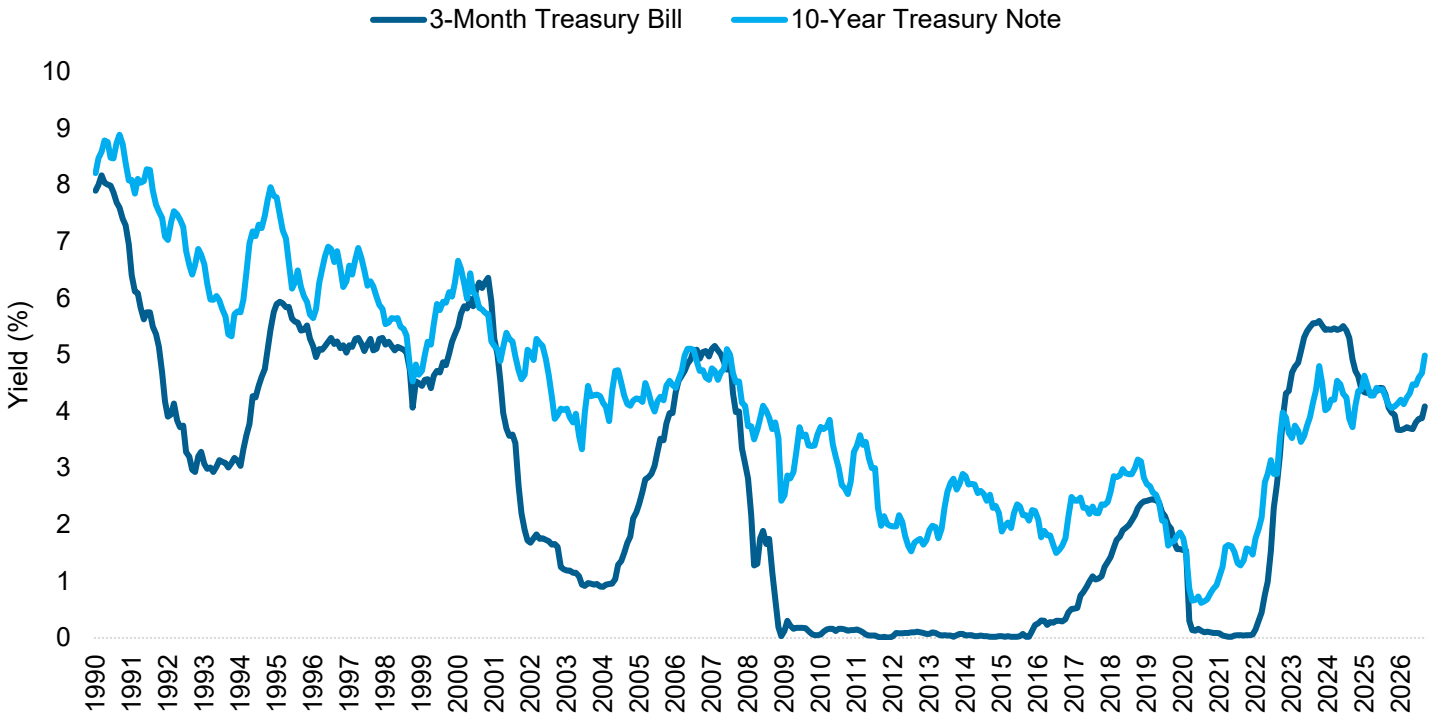
The two segments reach a portfolio through different routes. Short-term rates impact a portfolio through three main mechanisms. First, short-term rates determine the return on cash and on the collateral that investors post when they gain exposure through futures and other derivatives. Second, they set the cost of floating rate borrowing, whether by an investor, a fund manager, or a company. Third, they establish the hurdle that every risky or illiquid asset must clear, since an investor can always hold cash instead.

Long-term rates affect a portfolio differently. Long-term rates help determine the discount rates that markets apply to distant cash flows, so they bear directly on the valuation of stocks, property, infrastructure, and other long-lived assets. They determine the income and price sensitivity of longer maturity bonds. They set the cost of long-dated fixed rate borrowing. For some investors, notably corporate pension plans, they also determine the present value of liabilities.

The slope of the yield curve influences whether short-term or long-term rates matter more for a given strategy. With an upward-sloping curve, an investor who borrows at short-term rates to hold longer maturity assets earns a positive spread, and the size of that spread depends on how steep the curve is. With a flat or inverted curve, the same position earns little or nothing. This paper assumes an upward-sloping curve but makes no assumption about its steepness. The leverage section returns to this point, since slope matters most there.

Figure 1

Short- and Long-Term Treasury Yields, 1990 to 2026



Source: FRED. Market Yield on US Treasury Securities at 10-Year Constant Maturity and 3-Month Constant Maturity, Monthly Average. Data as of September 30, 2026.

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Figure 2
Primary Interest Rate Driver by Asset Class

Asset Class	Primary Rate Driver	Main Mechanism
Cash and short-term bonds	Short-term rates	Income resets quickly with short-term rates
Core and long-term bonds	Long-term rates	Income and price sensitivity to long yields
High yield bonds	Both	Fixed coupons reflect long-term rates; issuers refinance at prevailing rates
Bank loans and private credit	Short-term rates	Floating coupons reset with short-term rates; borrower interest burden rises
Public equities	Long-term rates	Discount rates on distant cash flows; refinancing for indebted firms
Buyouts	Both	Floating rate acquisition debt; exit valuations
Core real estate and core infrastructure	Long-term rates	Cap rates and discount rates; fixed rate financing
Value-added and opportunistic real estate	Short-term rates	Floating rate financing
Hedge funds, commodities, and trend following	Short-term rates	Return on cash collateral

Source: Meketa Investment Group. Characterizations are general. Other factors can affect these asset classes.

Whether an asset class is more sensitive to short-term or long-term rates reflects current conditions, and it can change (see Figure 2). Private equity sponsors, real estate owners, and infrastructure investors borrow wherever financing is cheapest. In recent years, buyout financing appears to have shifted toward private credit lenders, who typically lend at floating rates, while owners of core real estate and core infrastructure appear to have leaned toward fixed rate debt. These preferences have reversed before and could reverse again if the relative cost of fixed and floating rate borrowing changes. An asset class that is driven mostly by short-term rates today could become more sensitive to long-term rates tomorrow.

Investors spent more than a decade adapting to the low-rate period, and several habits from that period may no longer fit. Cash served as a residual that portfolios minimized. Leverage drew on borrowing costs so low that almost any asset seemed worth financing. Fixed income offered so little income that investors treated it mainly as a hedge rather than a source of return. Private markets pacing models assumed relatively short holding periods, which depended partly on a dealmaking environment backed by cheap debt. Each of these habits rested on low rates, and each deserves another look.

Asset Class Implications

Cash and Short-term Bonds

From 2009 through 2021, cash earned so little that holding it imposed a clear opportunity cost. With Treasury bill yields near 4%, cash now provides a meaningful return in its own right, and the opportunity cost of holding a modest liquidity reserve has fallen considerably compared with the years before 2022.

Ironically, higher cash yields bring a different risk: reinvestment risk. Short maturity instruments roll over frequently, so their income adjusts quickly whenever short-term rates change. An investor who holds cash or short-term bonds enjoys higher income while short-term rates stay high but has little protection if they fall. Still, opportunity cost will remain the larger concern for investors with a high return target. Income lost if cash yields fall from 4% to 1% would be small compared with the return an investor would forgo if equities rose sharply (for example, by 20% in a year).

A larger operating cash reserve may cost less than it once did, which can ease the management of capital calls and benefit payments. For institutional investors with return targets above current cash yields, cash remains a headwind

to meeting those targets, though a smaller one at yields near 4%. The stronger case for cash may be as downside protection. At current yields, cash is a less costly form of downside protection than it was for more than a decade after the GFC.

Core and Long-term Bonds

High-quality bonds offer the clearest case of how starting conditions shape future returns. The yield on a bond when an investor buys it has historically served as a good guide to the return that the bond will deliver over a horizon roughly equal to its duration.[2] The mechanism is intuitive. If yields rise after purchase, the bond loses value, but the investor reinvests coupons and maturing principal at the new, higher yields. Over time, the higher reinvestment income offsets the initial price loss. If yields fall, the opposite occurs.

This relationship generally holds true for the broad investment grade bond market. Historically, the starting yield-to-worst on the Bloomberg US Aggregate Index has served as an approximate guide to the subsequent returns that an investor would have earned by owning that index over the following decade, though it has not been precise (see Figure 3). Returns tended to exceed starting yields when rates fell over the subsequent decade and fell short of them when rates rose.

Once repricing is complete, higher starting yields imply higher forward returns for high-quality bonds. Investors who held bonds through 2022 and 2023 bore the cost of the transition, as rising yields drove down prices. Investors who hold them from here, at higher yields, start from a stronger position. Bonds remain exposed to further losses if yields rise again. Over a horizon of five to ten years, however, a 5% starting yield on Treasuries would give a bond investor more room to absorb an adverse move in rates than a 1.5% yield did.

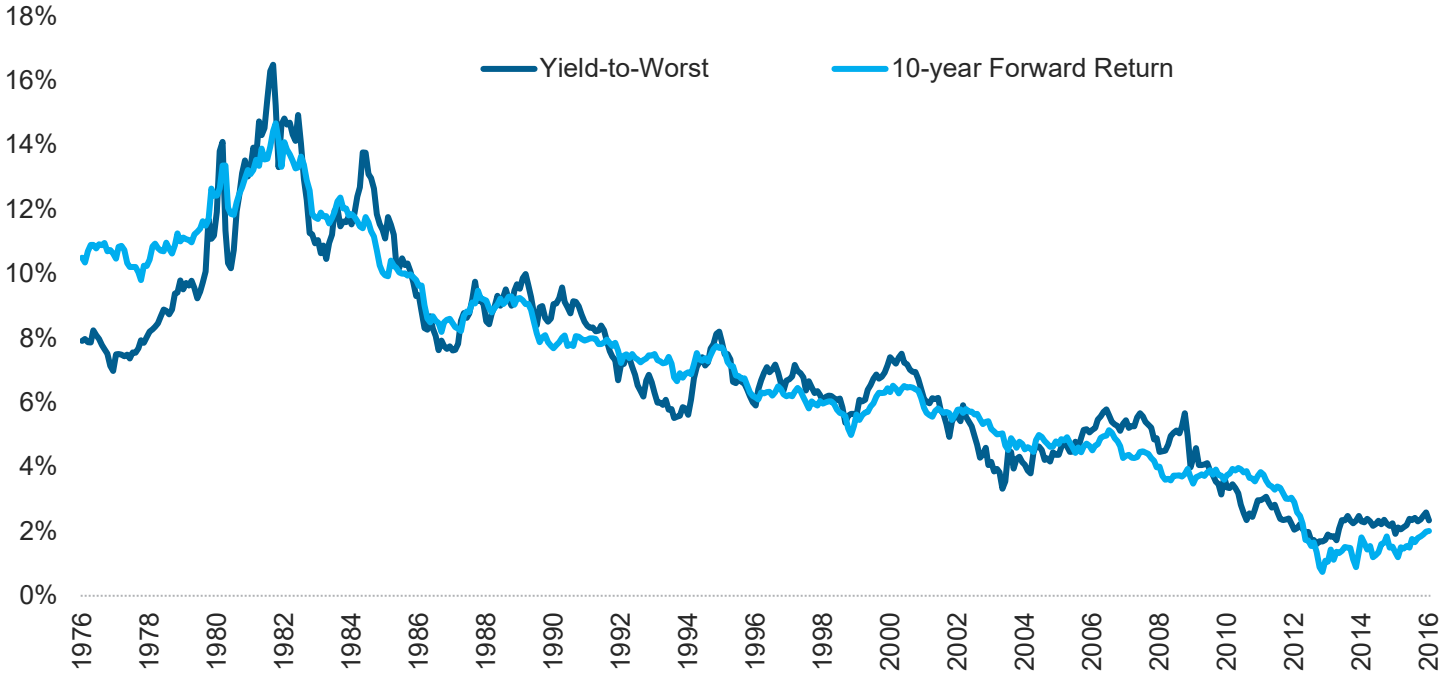
In portfolios heavy with equities and other risky assets, long-term Treasuries often serve as ballast, since their prices have tended to rise in many, but not all, equity sell-offs. During the low-rate period, long-term Treasuries performed that role while offering very little income. At higher yields, they offer both ballast and a meaningful return. They also bring considerable sensitivity to further changes in long-term rates, and they have provided little protection when equities and bonds fell together, as they did in 2022.

Public and Private Credit

The return on a credit investment can be thought of as two pieces: a base rate, which tracks Treasury yields of a similar maturity, and a credit spread, which compensates the investor for the risk of default. A reasonable starting estimate of the expected return equals the yield, less the losses the investor expects to suffer from defaults after recoveries. This framework applies to high yield bonds, bank loans, and private credit alike.

Figure 3

Starting Yield for Investment Grade Bonds versus Subsequent 10-Year Return



Source: Meketa calculations using data for the Bloomberg US Aggregate Index for the period starting January 1976 through December 2025.

Higher base rates therefore lift the expected return of credit. Holding credit spreads and default losses constant, a high yield bond, a syndicated loan, or a direct loan should offer a higher forward return when Treasury yields are higher. This point sometimes gets lost in discussions that focus on whether credit spreads look attractive. While spreads are very important, the base rate matters too, and it has risen considerably. Depending on the level of spreads, credit might be more compelling because higher base rates provide greater flexibility in achieving a target rate of return (e.g., while taking on less equity risk).

The mechanics differ by instrument. High yield bonds generally pay fixed coupons, so their yields respond to both short- and long-term rates, and issuers feel the effect of higher rates gradually as they refinance maturing debt. Bank loans and most private credit pay floating coupons that reset with short-term rates, typically every one to three months. Floating rate lenders therefore receive higher income almost immediately when short-term rates rise and continue to receive it for as long as short-term rates stay high.

The same mechanism creates the main offset. A floating rate coupon that rises for the lender also rises for the borrower. Companies financed with floating rate debt must devote a larger share of their cash flow to interest, which leaves less room for error if earnings disappoint. Over time, a higher interest burden may raise default rates, push more borrowers toward paying interest in kind rather than in cash, and reduce recoveries. In the framework above, higher rates raise the yield but may also raise expected losses. The net effect depends on how much of the higher yield the lender retains after defaults, a question that turns on underwriting quality and borrower resilience as much as on rates.

For investors, the implication is that credit assets likely offer higher forward returns in a higher rate environment. Higher rates may also increase the risk of credit losses.[3] Assessing that trade-off requires attention to borrower interest coverage, the share of income paid in kind, and the terms of new loans, not just to headline yields.

Public Equities

Equity returns come from three sources: the income that companies pay out, the growth in their earnings, and changes in the price that investors pay for those earnings. Higher rates affect each, but the most direct route runs through valuation. Investors expect a return from equities that exceeds what they can earn on bonds and cash. When bond yields rise, the return that investors seek from equities rises with them, unless investors are willing to accept a smaller premium for bearing equity risk.

However, rates are only one influence on equity returns. Whereas yields drive the returns of bonds, equity returns depend on many other factors, such as earnings growth and investor sentiment. These factors can, and perhaps will, overwhelm the effect of rates. Two outcomes are possible, and markets may deliver some combination of both. Equity prices may fall relative to earnings until the prospective return offers a more attractive premium over bonds. Alternatively, prices may hold up, in which case the premium that equities offer over bonds narrows.

The effect is not uniform across the market. Companies whose values depend heavily on cash flows expected far in the future (e.g., fast-growing companies with little current profit) behave in some respects like long-term bonds. Changes in discount rates affect their present value more than they affect the value of mature companies that generate most of their cash flow today.[4] A sustained period of higher long-term rates may therefore weigh more heavily on long-duration equities than on the broad market.

Higher short-term rates can also matter for companies that borrow. Many large companies extended the maturity of their debt and locked in low fixed rates during the low-rate period, which has delayed the effect of higher rates on their interest costs. Smaller and more heavily indebted companies, which rely more on floating rate loans, feel the effect sooner. As older debt matures and companies refinance at prevailing rates, the gap between the two groups may narrow, but the transition could take several years.

Private Equity

Buyouts rely heavily on borrowed money. A sponsor typically finances a substantial share of the purchase price with debt, uses the company's cash flow to service that debt, and seeks to sell the company several years later at a higher value. Since the GFC, cheap and plentiful debt has allowed sponsors to use more leverage and to pay higher prices.

A company's value equals its expected cash flows discounted at the cost of capital. The cost of capital, or discount rate, is the return a buyer requires on the whole purchase. It blends the interest rate on the debt with the higher return the sponsor expects on its equity. The cost of borrowing is only one part of it. Cheaper debt lowers the blend, so a buyer can pay more for the same cash flow. For example, a company with $10 million of annual free cash flow growing at 5% is worth about $333 million at an 8% discount rate, but only $200 million at 10%.[5]

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Higher financing costs change this arithmetic. A buyer who borrows at a higher rate must pay less for a given company if they are seeking the same return. Alternatively, the buyer can contribute more equity, use less debt, accept a lower expected return, or assume more operational improvement. These adjustments have appeared to varying degrees since 2022 (e.g., leverage levels in new buyouts have declined from their peaks).[6]

Sellers, meanwhile, have in many cases been reluctant to accept lower prices, particularly when their companies continue to perform well. The resulting gap between buyer and seller expectations has slowed transaction activity and, with it, the distributions that investors rely on to fund new commitments.[7] This slowdown is largely a transition effect. In a steady state with higher rates, buyers and sellers would eventually converge on prices consistent with the new cost of capital. How long a convergence on pricing takes is uncertain, and the backlog of companies bought with cheaper debt may take years to clear. A further rise in rates would restart that process.

For new commitments, lower entry prices and more conservative capital structures may support future returns, provided that sponsors do not simply rebuild leverage as financing conditions allow. Sponsors can also switch between fixed and floating rate debt as their relative costs change. A buyout financed with floating rate private credit today could be refinanced with fixed rate debt later, shifting its exposure from short-term rates to long-term rates. For existing portfolios, the picture depends heavily on whether reported values have adjusted, a question taken up below.

Real Estate

Real estate investors often express property values through the capitalization rate, or cap rate, which equals a property's net operating income divided by its price. A cap rate functions much like a yield. When investors demand higher returns, cap rates rise and prices fall, all else equal. Because real estate competes with bonds for investor capital, cap rates have tended to move with long-term Treasury yields over time, though the spread between them has varied considerably and the adjustment has often been slow.

Higher long-term rates therefore put upward pressure on cap rates and downward pressure on property values. Once values adjust, however, a higher cap rate means a higher income yield for new buyers. As with bonds, the pain falls mostly during the transition, and the steady state offers higher income.

Financing determines which rates matter most. Core real estate, which typically uses modest leverage and has leaned toward fixed rate debt, is affected mainly by long-term rates. Value-added and opportunistic strategies, which use more leverage and have leaned toward floating rate debt, feel higher short-term rates more quickly through their interest costs.

Infrastructure

Core infrastructure assets, such as regulated utilities, toll roads, and contracted energy facilities, generate long-lived and often predictable cash flows. In this respect, they resemble long-term bonds, and their valuations are sensitive to the discount rates that investors apply. Higher long-term rates therefore weigh on core infrastructure valuations in much the same way they weigh on core real estate, and once valuations adjust, they offer higher prospective income to new investors.

Non-core infrastructure, which includes development projects and assets with greater operating or commodity exposure, typically carries more leverage and has relied more heavily on floating rate financing. These strategies are more exposed to short-term rates, and their returns depend more on the spread between asset returns and borrowing costs.

Existing Assets and New Commitments

Private equity, real estate, and infrastructure raise a question that public markets largely do not: should investors expect different returns from the assets they already own than from new commitments made today?

In principle, the answer is no. In a market where prices have fully adjusted, an existing asset and a new one bought at the same price should offer similar expected returns, because the forward return depends on the price paid today rather than the price paid originally. An investor who bought a property at a 4% cap rate in 2021 and an investor who buys a similar property today at a 6% cap rate face the same future cash flows. The original owner has already absorbed the loss in value.

In practice, however, two factors can drive a wedge between existing assets and new ones. The first is repricing lag. Private market valuations rely on appraisals and models rather than daily trading, and they have tended to adjust more slowly than public markets.[8] If reported values remain above the price that the asset would fetch today, the forward return measured from the reported value will be lower than the return available to a new buyer. This gap has been evident for much of the period since 2022.

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The second factor is legacy financing. An existing asset carrying fixed rate debt locked in at lower rates benefits from a liability that costs less than current market rates. That below-market financing supports the equity return until the debt matures, at which point the owner must refinance at prevailing rates. Assets facing large refinancing needs in the next few years may therefore experience a drop in cash flow that newer assets, financed at current rates from the outset, have already absorbed.

Neither factor appears permanent. Reported values tend to converge with transaction prices over time, and legacy debt rolls off as it matures. In a sustained higher rate environment, the difference between existing assets and new commitments should therefore narrow. A further rise in rates could widen the gap again before it closes. In the meantime, it may be relevant to distinguish between the two when evaluating private markets programs, setting expectations, and considering secondary sales or purchases.

Hedge Funds and Commodities

Many hedge fund strategies hold allocations to cash or cash equivalents, either because they gain market exposure through futures and swaps, which require only a fraction of the notional value as collateral, or because they run a mix of long and short positions. Short positions add to this effect. When a manager sells a borrowed security, the cash proceeds remain with the lender as collateral and earn interest, less a fee for borrowing the security. The return on collateral and short proceeds therefore provides part of the strategy's total return. When cash yielded close to zero, that component contributed almost nothing. With cash near 4%, it contributes a more helpful share, although the effect on expected total return for many strategies may be modest.

Commodity futures follow similar logic. An investor who buys commodity futures posts collateral, typically held in Treasury bills, and the return on that collateral has historically made up a substantial part of the total return of commodity futures investments.[9] However, the gain is likely smaller than the rise in cash yields. Higher rates also raise the cost of holding physical inventory, which tends to push futures prices above spot. How much of the collateral gain this offsets varies by commodity and depends mostly on inventory levels. The net impact is uncertain. Higher short-term rates raise the return on collateral, but higher inventory carrying costs may offset part or all of that gain. Any benefit shows up mainly in long-term returns. Over periods of a year or less, volatile spot prices drive returns and overwhelm the return on collateral.

Risk Mitigating Strategies

Risk mitigating strategies (RMS) aim to protect a portfolio during periods of equity market stress. A useful way to organize them distinguishes between strategies intended to respond quickly in a sharp drawdown, such as long-term Treasuries, long volatility, and tail risk hedging, and strategies intended to respond to more prolonged declines, chiefly trend following.[10] Higher rates affect each of these differently.

Long-term Treasuries benefit most visibly. When long yields stood near 1.5%, Treasuries offered little income and potentially limited room for yields to fall further in a flight to safety. At yields above 5%, they offer considerably more income and a larger potential price gain if yields fall sharply in a crisis. The caveat remains that Treasuries have provided protection mainly when equity declines coincided with falling yields. In episodes where equities fell because rates rose, as in 2022, long-term Treasuries added to the losses.

Long volatility and tail risk strategies buy protection, typically through options. Their cost consists of the premiums paid, which the investor loses if the protected event does not occur. These strategies usually hold most of their capital in cash or short-term Treasuries, so higher short-term rates raise the return on their collateral. Higher rates also reduce the theoretical price of put options slightly, all else equal, though volatility and market demand for protection drive option prices far more than interest rates do.[11] The net effect is a modestly higher total return, with the cost of protection, measured relative to cash, largely unchanged.

Trend following strategies take long and short positions in futures across equities, bonds, currencies, and commodities, and hold most of their capital as collateral. Studies of trend following typically measure its returns in excess of Treasury bills, which highlights that cash income forms a separate component of total return.[12] Higher short-term rates raise that component, as they do for other strategies that use futures.

Higher rates raise the absolute expected returns of most risk mitigating strategies, and they do so mostly through cash income rather than through any change in the protection the strategies offer. The exception is long-term Treasuries, whose higher yields improve both their income and, potentially, their capacity to rally in a crisis. The combination of potential downside protection and lower opportunity cost may make RMS more attractive, in absolute terms, for investors seeking to hedge extreme risks in their portfolio.

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Leverage

Leverage is the use of borrowed money, or its economic equivalent, to gain investment exposure greater than the capital committed. Whatever its form, leverage follows a simple rule. It adds value when the assets it finances earn more than the cost of financing them, and it subtracts value when they earn less.

This rule clarifies what higher rates do and do not change. The level of rates matters less than the spread between expected returns and borrowing costs (see Figure 4). If borrowing costs rise while expected asset returns stay unchanged, the benefit of leverage shrinks. If expected asset returns rise by the same amount as borrowing costs, the benefit of leverage stays the same. If expected returns increase more than the borrowing cost does, the benefit of leverage grows.

One version of this spread is the yield on 10-year Treasuries minus a borrowing cost equal to the 3-month Treasury bill yield plus 0.5%. The spread has averaged about 0.9 percentage points since 1990 (see Figure 5). It was unusually wide for much of the low-rate period, when short-term rates sat near zero. With an upward-sloping yield curve, the spread is positive, though as of September 2026, it remains below its average since 1990. The steeper the curve, the more favorable the economics of borrowing short to hold longer maturity assets. A flatter curve narrows the margin and leaves less room for error. A steeper curve carries its own risk. If it steepens because long-term yields rise, longer maturity assets lose value before the wider spread pays off.

Figure 4

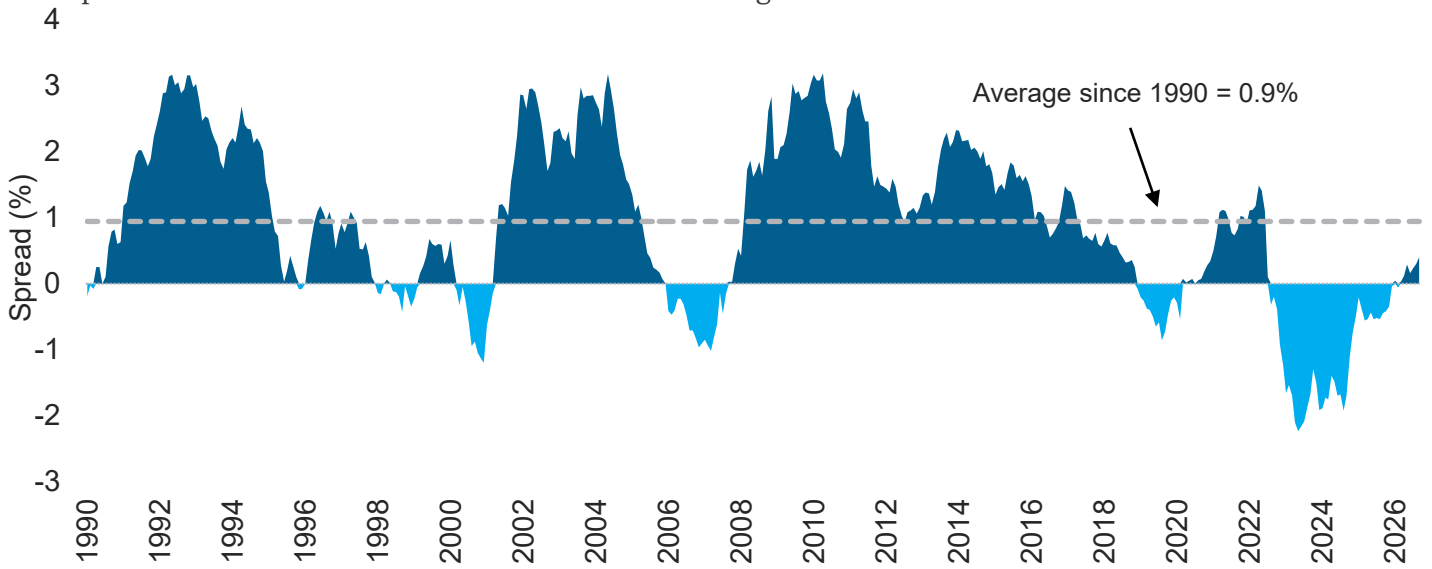
Levered Returns under Different Rate Assumptions (Illustrative)

	Low Rates	Higher Rates, Spread Decreases	Higher Rates, Spread Stays the Same	Higher Rates, Spread Increases
Cash yield	0.5%	4.0%	4.0%	4.0%
Financing cost	1.0%	4.5%	4.5%	4.5%
Unlevered expected return	7.0%	9.0%	10.5%	12.0%
Levered expected return	8.2%	9.9%	11.7%	13.5%
Benefit from leverage	1.2%	0.9%	1.2%	1.5%

Source: Meketa Investment Group. Assumes leverage of 1.2 times capital and a financing cost equal to cash plus 0.5 percentage points. Levered return equals unlevered return plus 0.2 times the difference between unlevered return and financing cost. This example is hypothetical and provided for educational purposes only. It is not a projection or forecast, does not reflect fees, transaction costs, or taxes, and does not represent the performance of any Meketa client or fund.

Figure 5

Yield Spread of 10-Year Treasuries over Illustrative Borrowing Costs



Source: FRED, as of September 30, 2026. Illustrative borrowing costs equal the yield on the 3-month Treasury bill plus 0.5%. Reflects market yield on US Treasury Securities at 10-year constant maturity and 3-month constant maturity, monthly average. The borrowing cost assumption does not necessarily represent the financing available to any investor.

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For a levered investor, one of the largest risks has always been a rise in short-term rates, which raises financing costs on positions already in place. When short-term rates sat near zero, borrowing was cheap, but rates had little room to fall and much room to rise, as investors discovered in 2022. At current levels, they can move meaningfully in either direction. A further rise would add to those costs again. Leverage also carries risks that have little to do with borrowing costs, including margin calls, the need to hold liquid reserves, counterparty exposure, and the possibility of being forced to sell at an inopportune time.[13]

Explicit Leverage

Portable alpha offers a useful case study. In a typical implementation, an investor gains market exposure through futures and invests the capital that the futures do not require in a separate strategy intended to produce returns uncorrelated with the market.[14] The futures carry an implied financing cost tied to short-term rates. The separate strategy, often a hedge fund or other absolute return strategy, typically produces a return built on cash plus whatever value its manager adds.

At first glance, higher rates might seem to undermine portable alpha by raising the financing cost. However, a second effect largely offsets it (see Figure 6). While the financing cost rises with cash, so does the return on the alpha source, since much of that return comes from cash income. What matters is whether the alpha source earns more than cash by a wider margin than the futures financing exceeds cash. That margin depends on manager skill and on futures pricing, not on the level of rates. Portable alpha is therefore neither more nor less attractive on this measure. The same offset holds if short-term rates rise further. Financing costs would rise, but so would the cash income on the alpha source.

Fund-Level Leverage

Fund-level borrowing has grown in importance in private markets. Subscription lines of credit allow a fund to borrow against investors' uncalled commitments, delaying capital calls. When rates were low, these facilities offered an inexpensive way to smooth capital calls and, as a side effect, raise reported internal rates of return by shortening the period over which investors' capital was at work.[15] At higher rates, the interest cost of these facilities rises, which reduces net multiples of invested capital and may also reduce the net internal rate of return (IRR).

Leverage remains a legitimate tool in a higher rate environment. Its case rests on the spread between expected returns and financing costs, and that spread now requires closer analysis than it did when borrowing cost almost nothing.

Portfolio Construction

Flexibility on Expected Return and Risk

Higher rates offer flexibility. During the low-rate period, many investors faced a difficult choice: accept lower expected returns or take more risk to meet their targets. Public pension plans, for which the data are most complete, did some of both. They lowered their assumed rates of return by about a percentage point between 2007 and 2022 and shifted toward riskier, less liquid assets. Alternatives rose from about 20% of their assets in 2009 to 35% in 2022, with the combination of equities and alternatives reaching 77%.[16]

Figure 6

Portable Alpha under Different Cash Yields (Illustrative)

	Low Rates	Higher Rates
Cash yield	0.5%	4.0%
Equity market return (via futures)	7.0%	7.0%
Plus: alpha source net return	2.5%	6.0%
Less: implied financing cost	0.8%	4.3%
Total net return	8.7%	8.7%
Excess return over equity market	1.7%	1.7%

Source: Meketa Investment Group. Hypothetical example assuming an equity market return of 7.0%, an alpha source that returns cash plus 2.0 percentage points, and futures financing equal to cash plus 0.3 percentage points. The alpha source return is an assumption that may not hold in practice and is net of manager fees.

Higher rates may ease that choice. All else equal, a portfolio's expected return rises roughly in line with the yields on its fixed income and cash holdings. The expected return of an illustrative 60/40 portfolio rises from 4.58% using our 2021 capital markets expectations (CMEs), when rates were near a nadir, to 5.71% using our 2026 CMEs. Adjusting our 2026 CMEs for yields as of September 30, 2026, raises the figure to 6.24% (see Figure 7). The expected return of a complex multi-asset portfolio rises from 5.67% to 6.54%, and further to 6.90%, respectively. Hence, an investor may be able to pursue the same expected return target while shifting some of their portfolio from riskier to lower risk assets, and in doing so, reduce the overall level of risk in their portfolio.

Alternatively, an investor could maintain the same allocation and, all else equal, have a higher expected return at a similar level of expected risk. However, the net effect depends on whether risk premiums on other assets hold steady or narrow. If they narrow, the case for shifting toward bonds strengthens.

Investors who increased the risk posture of their portfolio to meet return targets in the low-rate period may find it useful to reassess that decision. Some may conclude that they can reduce risk without materially lowering expected return. Others may conclude that their current allocation remains appropriate. Either way, the question deserves fresh analysis rather than an assumption that the conditions of the past decade still apply.

Higher Yields Make Complexity More of a Choice

For several decades, institutional portfolios have grown steadily more complex. As yields on high-quality bonds fell, investors added equities, private markets, hedge funds, and other alternative strategies, in large part because lower risk assets could no longer supply the returns their objectives required. Each addition brought higher fees, less liquidity, greater demands on governance, and more operational burden. Many investors accepted those costs partly out of necessity.

Higher rates loosen that constraint. When high-quality bonds can provide a meaningful share of a portfolio's expected return, complexity becomes more of a choice. Investors gain flexibility to reduce risk, increase liquidity, or simplify. They also gain a sharper test for each component of the portfolio: what does it add, after fees, beyond what a simpler and more liquid alternative could provide?

The answers will differ by strategy and by investor. Some complex allocations earn their place on grounds other than return, such as diversification or protection in particular environments. Others were justified mainly by the need for incremental return, and investors may wish to evaluate those more closely. However, simplifying could carry explicit and opportunity costs. For example, shrinking a private markets program could take years, and attempts to accelerate it through secondary sales may involve selling at steep discounts. Moreover, the market environment could change again (e.g., rates could fall or rise further), and rebuilding an allocation could prove slow and expensive. A simple 60/40 portfolio may not meet every investor's objectives. Investors may find it useful to identify which sources of complexity remain worth their cost.

Fixed Income Structure

Higher yields also affect how investors might structure their fixed income allocations. During the low-rate period, investors had reason to favor short-term bonds or floating rate instruments to limit their exposure to rising rates, or to reduce high-quality bond allocations in favor of credit. With yields higher across the curve, high-quality bonds offer more income and, at longer maturities, more potential to cushion equity losses in a flight to safety. Longer maturities still carry more risk if yields rise further.

Figure 7

Illustrative Impact on Expected Return

	Expected Return using 2021 CMEs	Expected Return using 2026 CMEs	Expected Return using Yields as of 9/30/26
60/40 Portfolio	4.58%	5.71%	6.24%
Complex Multi-Asset Portfolio[17]	5.67%	6.54%	6.90%

Source: Meketa Investment Group. Return assumptions are net of expenses. The 60/40 portfolio consists of 60% global equity and 40% US investment grade bonds. Expected returns are based on Meketa's 10-year capital markets expectations. The first set uses our 2021 expectations, and the second set uses our 2026 expectations. The third set adjusts the 2026 expectations for investment grade bonds, TIPS, multi-sector credit, private credit, commodities, hedge funds, and RMS based on interest rates as of September 30, 2026; note that these adjustments are intended to be illustrative and do not represent formal capital markets expectations.

Some investors may consider pairing short-term Treasury Inflation-Protected Securities (TIPS) with long-term Treasuries. Short-term TIPS offer inflation protection with little sensitivity to changes in interest rates, while long-term Treasuries have often provided ballast against equity losses.[18] This approach separates two objectives that a single intermediate maturity bond allocation would combine, and it may pursue each more efficiently. Historically, short-term TIPS have protected against inflation better than intermediate bonds. Long-term Treasuries have tended to cushion equity losses with fewer dollars. An investor could also size each sleeve to the risk that concerns it most. Whether it suits a particular investor depends on that investor's objectives, constraints, and existing exposure to interest rates elsewhere in the portfolio.

Risk Mitigating Strategies Revisited

Higher rates change the calculus for investors who maintain dedicated risk mitigating strategies. The opportunity cost of holding defensive assets has fallen, since long-term Treasuries now offer meaningful income and other strategies earn more on their collateral. That lower opportunity cost may allow some investors to hold a larger defensive allocation without sacrificing as much expected return as they would have in the low-rate period.

Any expected return advantage of long-term Treasuries relative to other crisis hedges will depend on the shape of the yield curve. A steeper yield curve, rather than higher yields alone, provides long-term Treasuries with a higher yield than strategies whose collateral is invested in cash.

When considering how to construct an RMS portfolio in this environment, investors who prefer lower fees and less complexity may favor cash and long-term Treasuries. Investors comfortable with greater complexity may find that higher cash yields make a portfolio that uses all the tools available in the RMS toolkit more compelling, and easier to adopt and stick with, than during the low-rate period. When considering the balance between cash and long-term Treasuries, the choice largely depends on how concerned the investor is about stagflation, as that is an environment in which cash has historically held up better than long-term Treasuries.[19]

Liquidity, Pacing, and Rebalancing

Higher rates affect liquidity management in several ways. Holding a larger cash reserve can ease the management of capital calls, benefit payments, and collateral requirements for derivatives. Higher rates lower the opportunity cost of holding such a reserve.

Private market pacing models that assumed distributions would arrive at the pace of the low-rate period may overstate future cash flows, particularly while the backlog of older investments clears. If rates stay higher, slower exits may persist, which supports the view that the distribution cycle will remain longer than earlier assumptions suggested. Investors may benefit from stress testing these models against slower distributions.

Rebalancing interacts with all these considerations. The primary purpose of rebalancing is to keep a portfolio aligned with the objectives, risk tolerances, and constraints set out in its investment policy, rather than to enhance returns.[20] Investors with large private markets allocations typically rebalance through the liquid portion of the portfolio and through commitment pacing. Higher cash yields reduce the cost of holding the liquid reserves that this approach requires.

Currency Hedging

Interest rates also affect the cost of hedging currency exposure. The cost of a hedge roughly equals the difference between short-term rates in the two currencies. When US rates sit above those of other developed markets, US investors who hedge foreign currency exposure earn that difference rather than pay it. If rates diverge further, the gain grows. If they converge, it shrinks. Higher rates do not change the case for hedging in an obvious way, but investors may want to revisit hedge ratios as rate differentials move.

Summary

For more than a decade, US institutional investors built portfolios around low interest rates. Rates have since returned to levels that prevailed for much of the pre-GFC era. If they remain there, many of the conventions that investors developed in the low-rate period may need revisiting.

Higher rates affect portfolios in two ways. Short-term rates affect the return on cash, the cost of borrowing, and the hurdle for risky and illiquid assets. Long-term rates affect valuations, duration, and long-dated financing. Different asset classes are more sensitive to one or the other, and some can shift between them as financing conditions change.

Once prices adjust, higher rates raise the expected returns of many assets. Bonds offer higher starting yields, and hence higher forward returns, all else equal. Equities face a higher hurdle, but many factors other than rates drive their returns. In private markets, existing assets and new commitments may offer different returns until valuations and legacy financing adjust. Higher yields on cash and Treasuries, along with higher collateral yields for many risk mitigating

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strategies, lower the opportunity cost of defensive assets. The net effect is that higher rates may let investors target the same expected return with lower expected risk, or a higher expected return at a similar level of expected risk. They also set a tougher test for complexity. Investors may wish to evaluate allocations made mainly to add return.

The conclusions in this paper are unlikely to hold equally in every environment. Rates can remain high for different reasons. They could also fall or rise further. Why rates stay high, or where they go next, will shape how long-term Treasuries, borrowers, and leverage fare. The implications of higher rates will differ across investors, depending on their objectives, liabilities, liquidity needs, and governance. The common thread is that higher rates give investors more choice. They also give investors reason to revisit assumptions formed in a very different period.

End Notes

1 Source: FRED. Market Yield on US Treasury Securities at 10-Year Constant Maturity and 3-Month Constant Maturity, Monthly Average. Data as of September 30, 2026.

2 Source: Martin L. Leibowitz, Anthony Bova, and Stanley Kogelman, "Long-Term Bond Returns under Duration Targeting," Financial Analysts Journal 70, no. 1 (2014): 31–51.

3 Note that higher rates alone will not affect the default and recovery assumptions in Meketa's capital markets expectations (CMEs), as our CMEs assume a full market cycle.

4 Source: Patricia M. Dechow, Richard G. Sloan, and Mark T. Soliman, "Implied Equity Duration: A New Measure of Equity Risk," Review of Accounting Studies 9, no. 2–3 (2004): 197–228.

5 This 40% change in valuation may overstate how sensitive values are to rates in general. The valuation change is large partly because the gap between the discount rate and growth in this example is small (3 points rising to 5). With lower growth or a higher starting rate, the same two-percentage-point rise would cut value by a smaller share.

6 Sources: Preqin, accessed October 9, 2026; StepStone SPI data as of December 31, 2025, via PitchBook "Q2 2026 US PE Breakdown."

7 Source: Meketa Investment Group, "The Private Equity Distribution Squeeze," July 2026.

8 See Meketa Investment Group, "Converging Paths or Persistent Gaps? Understanding Valuations Across Public and Private Equity," March 2025.

9 Source: Gary Gorton and K. Geert Rouwenhorst, "Facts and Fantasies about Commodity Futures," Financial Analysts Journal 62, no. 2 (2006): 47–68.

10 Source: Meketa Investment Group, "Risk Mitigating Strategies (RMS) Framework," March 2023.

11 Source: Fischer Black and Myron Scholes, "The Pricing of Options and Corporate Liabilities," Journal of Political Economy 81, no. 3 (1973): 637–54.

12 Source: Brian Hurst, Yao Hua Ooi, and Lasse Heje Pedersen, "A Century of Evidence on Trend-Following Investing," Journal of Portfolio Management 44, no. 1 (2017): 15–29.

13 For a more thorough discussion on leverage, including its risks, see Meketa Investment Group, "Leverage," June 2021.

14 Source: Meketa Investment Group, "Portable Alpha," August 2026.

15 Source: Institutional Limited Partners Association, "Subscription Lines of Credit and Alignment of Interests: Considerations and Best Practices for Limited and General Partners" (ILPA, June 2017).

16 Source: The Pew Charitable Trusts, "Increased Risk, Complex Investment Landscape Require Prudent Pension Management Practices," issue brief, April 16, 2025.

17 The composition used for the illustrative Complex Multi-Asset Portfolio is 15% investment grade bonds, 5% TIPS, 5% multi-sector credit, 5% private credit, 30% global equity, 15% private equity, 5% real estate, 5% commodities, 5% infrastructure, 5% hedge funds, and 5% RMS.

18 See Meketa Investment Group, "Short-term TIPS," August 2025; see also Meketa Investment Group, "Long-term Treasuries in Diversified Portfolios," September 2025.

19 See Meketa Investment Group, "Long-term Treasuries in Diversified Portfolios," September 2025.

20 Source: Meketa Investment Group, "Rebalancing," October 2026.

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