

Financial Markets Following the Resumption of Fed Rate Hikes

1 October 2026

How Have Long-Term Interest Rates, USD/JPY and US Equities Performed During Fed Tightening Cycles?

In September 2026, both the Federal Reserve (Fed) and the Bank of Japan (BoJ) decided to raise policy rates. Market participants increasingly expecting both central banks to continue tightening amid concerns that inflationary pressures could reaccelerate. Since 1994, the Fed has initiated six rate-hiking cycles, beginning in February 1994, June 1999, June 2004, December 2015, March 2022 and September 2026 (Figure 1).



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Figure 1: Fed Tightening Cycles and Their Triggers

February 1994	Pre-emptive rate hikes implemented in response to growing concerns that inflation was beginning to accelerate.
June 1999	Rate hikes following the recovery from the Asian Financial Crisis, the Russian financial crisis, and the collapse of LTCM, amid the rapid expansion of the technology bubble.
June 2004	A policy normalisation cycle following the recovery from the dot-com bust and the September 11 attacks, with the Fed raising rates consecutively in 25-basis-point increments.
December 2015	The first-rate hike in seven years, following stabilisation after the China market shock and a prolonged period of near-zero interest rates.
March 2022	Rate hikes in response to accelerating inflation driven by the post-pandemic reopening of economic activity and the commodity-price shock caused by Russia's invasion of Ukraine.
September 2026	Rate hikes triggered by renewed concerns over inflation, fuelled by higher oil prices and expanding AI-related investment.

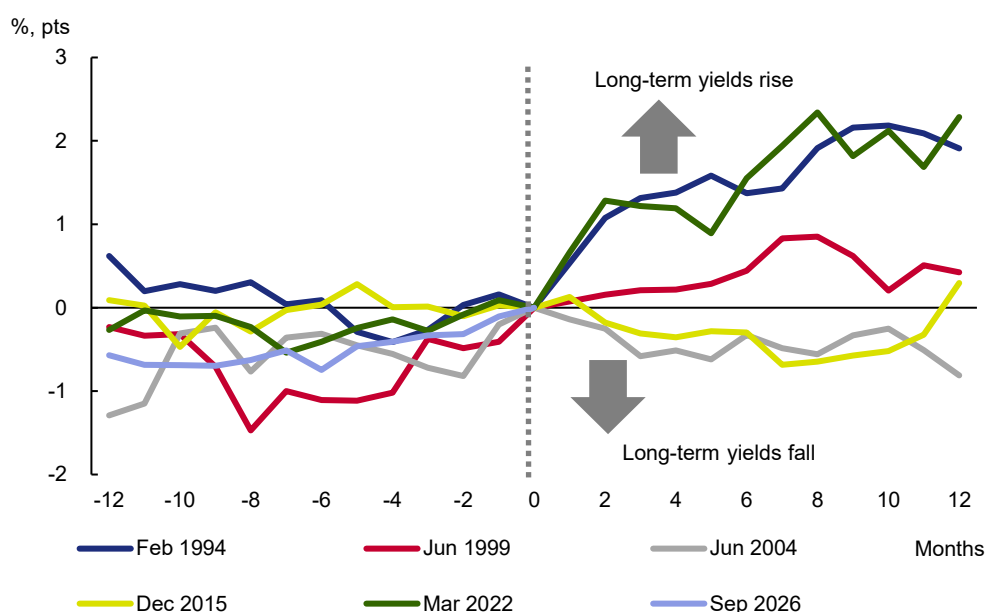
Source: Asset Management One Co., Ltd.

Figures 2, 3 and 4 show how US long-term interest rates, the USD/JPY exchange rate and the S&P 500 forward P/E ratio evolved around the start of each Fed tightening cycle.

Looking at US long-term interest rates (10-year Treasury yields), yields continued to rise after the start of tightening in 1994, 1999 and 2022. By contrast, they remained broadly range-bound or declined modestly in 2004 and 2015 (Figure 2). In those episodes, subdued inflation expectations likely prevented long-term yields from rising. During the 2000s, inflation appears to have been contained by an expansion in manufacturing capacity, supported by China's accession to the World Trade Organization (WTO) and growth in the labour force across emerging economies, as well as by a global surplus of savings.

Today, the environment appears more similar to that of 2022, with inflationary pressures remaining elevated. If economic activity remains resilient and the Fed continues to raise policy rates, long-term interest rates could rise still.

Figure 2: U.S. 10-Year Treasury Yields Around Fed Tightening Cycles



Source: LSEG Datastream, Asset Management One Co., Ltd.

- Notes:
1. Changes over the 12 months before and after the start of Fed tightening cycles since February 1994.
 2. Month 0 denotes the month in which the tightening cycle began.
 3. The policy rate shown for Month 0 is the level prior to the initial rate hike.

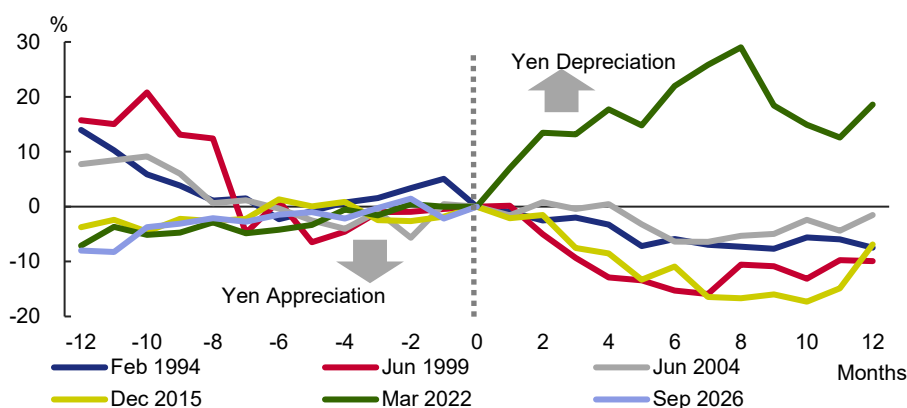
Turning to the USD/JPY exchange rate, the yen appreciated against the US dollar after the start of Fed tightening in every cycle except 2022 (Figure 3). In the tightening episodes prior to 2022, Japan was experiencing a prolonged period of deflation, which likely supported yen appreciation as real interest rates remained relatively high. By contrast, the yen weakened sharply in 2022, as the Fed raised rates while the BoJ largely maintained its accommodative stance despite rising inflation. This time, however, the situation is different, as the BoJ is also accelerating the pace of rate rises.

As for US equities, S&P 500 valuations, measured by the forward P/E ratio, have generally remained range-bound or shown a modest downward trend following the start of tightening cycles (Figure 4).

Forward P/E ratios declined significantly in both 1994 and 2022, reflecting equity market weakness triggered by a sharp rise in long-term interest rates.

In periods when valuations remained broadly stable, earnings growth often drove equity prices higher despite tighter monetary policy. These were therefore largely earnings-driven markets.

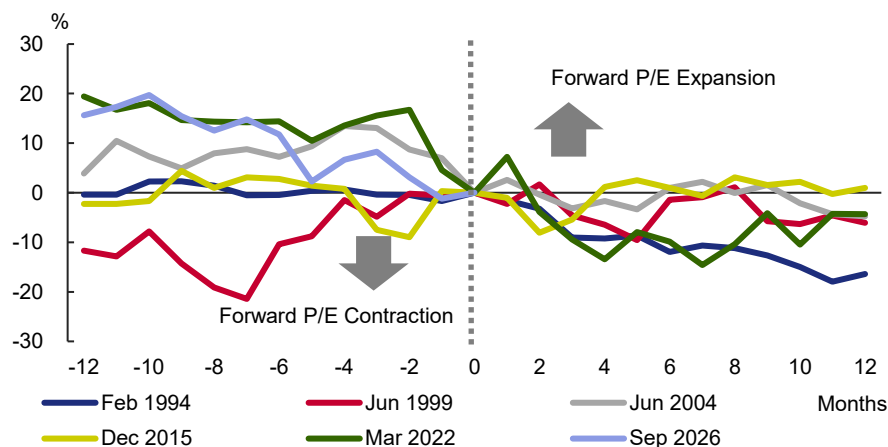
Figure 3: USD/JPY Around the Start of Fed Tightening Cycles



Source: LSEG Datastream, Asset Management One Co., Ltd.

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Figure 4: S&P 500 Forward P/E Around the Start of Fed Tightening Cycles



Source: LSEG Datastream, Asset Management One Co., Ltd.

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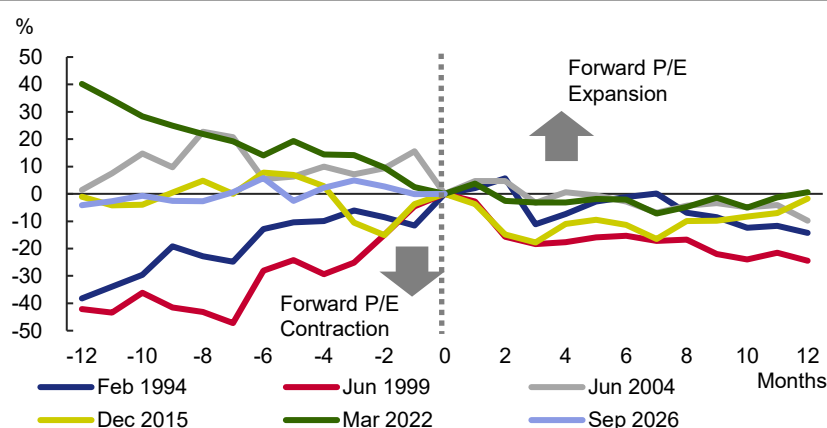
What About Japanese Equity Valuations?

Japanese equity valuations have followed a pattern broadly similar to that of US equities. Following the start of Fed tightening cycles, valuations generally remained range-bound or declined modestly (Figure 5). During Japan's deflationary period, Fed tightening often coincided with yen appreciation, which likely weighed on Japanese equities and limited upside potential. More broadly, as long as the global economy, led by the US, remained resilient, earnings growth tended to support equity prices even during periods of monetary tightening.

At present, domestic equity market fundamentals remain solid (Figure 6). TOPIX forward EPS continues to trend higher, while the earnings revision index has improved significantly, reflecting increasingly positive analyst revisions to earnings forecasts. As a result, earnings growth is offsetting valuation headwinds stemming from higher interest rates.

Importantly, this earnings growth is being driven by primarily capital expenditure from US hyperscalers, rather than by domestic demand. Consequently, the negative impact of rising domestic long-term interest rates on equity valuations remains relatively limited.

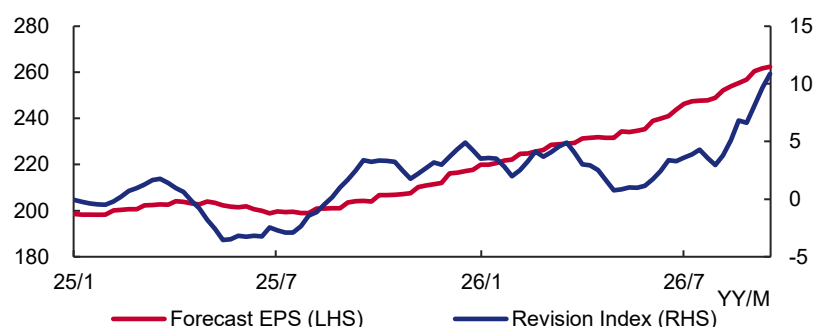
Figure 5: TOPIX Forward P/E Around the Start of Fed Tightening Cycles



Source: LSEG Datastream, Asset Management One Co., Ltd.

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Figure 6: TOPIX Forecast EPS and Earnings Revisions



Source: LSEG Datastream, Asset Management One Co., Ltd.

- Notes:
1. Weekly data from 3 January 2025 to 18 September 2026.
 2. Forward EPS represents consensus earnings per share forecasts for the next 12 months.
 3. The revision index shows analysts' earnings forecast revisions (6-week moving average).

Monitoring Economic Trends and Financial Conditions

For equity markets, the key issue is not higher interest rates themselves, but whether tighter financial conditions ultimately lead to a deterioration in economic activity. So far, however, there is little evidence of excessive monetary tightening in either Japan or the United States.

The US economy is currently being supported by capital expenditure from hyperscalers. While these companies rely partly on external financing, their investment spending is also backed by strong cash generation. As a result, such investment is likely to remain relatively insensitive to higher interest rates in the near term, suggesting that the impact on equity markets should remain limited for now.

From next year, however, investors is likely to be a focus increasingly on the returns generated by these investments. The monetisation of AI-related investment is likely to be a key determinant of equity market performance in both Japan and the United States.

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