Equities in Focus

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Value Stocks' Edge in Higher-Rate Environments

When money has a price, cash flow matters. If higher rates persist, value stocks and dividend growers could remain among the market's biggest beneficiaries.

Key Takeaways

1. **Higher Rates Not Always a Hinderance**
   While equity multiple expansion can be limited by higher rate regimes, opportunities are not.
2. **The Cash Flow Bird in the Hand**
   Many value stocks generate predictable cash flows sooner, making them less sensitive to discount-rate pressure.
3. **Look Beyond Dividend Yield**
   Fixating on a stock's current yield versus its ability to grow it may prove disappointing.

Value's Rate Rapport
Display 1 shows that when the 10-year Treasury yield moves above 4.50%, price/earnings (P/E) multiples tend to contract. If rates stay elevated, investors may seek favorable fundamentals and not rely solely on multiple expansion. This backdrop helps explain why value equities remain compelling.

Value stocks are generally more "short duration" than high-growth equities, as more of their cash flow is realized sooner versus further out in the future. *Display 2* illustrates that even when two companies generate the same total cash flow over five years, the company receiving cash earlier has a meaningfully higher present value when applying a discounted cash-flow analysis where the discount rate is elevated. After all, a dollar received today is worth more than a dollar received in the future.

When Waiting Pays
But the same does not always hold true for dividends. *Display 3* demonstrates how dividend growth and high cash flow stand out among the factors most positively associated with rising 10-year Treasury yields versus cheap and high-yielding stocks. The higher-quality value factors have historically fared better than lower-quality measures like book value because they are less cyclical.

And investors should avoid confusing today's yield with tomorrow's income opportunity. The Microsoft and AT&T comparison on *Display 4* demonstrates the difference. In March 2016, AT&T offered a much higher current yield than Microsoft, but by July 2026, Microsoft's yield on cost* was higher by virtue of its steady dividend growth, while AT&T's was lower after its dividend was cut in February 2022.

Our View

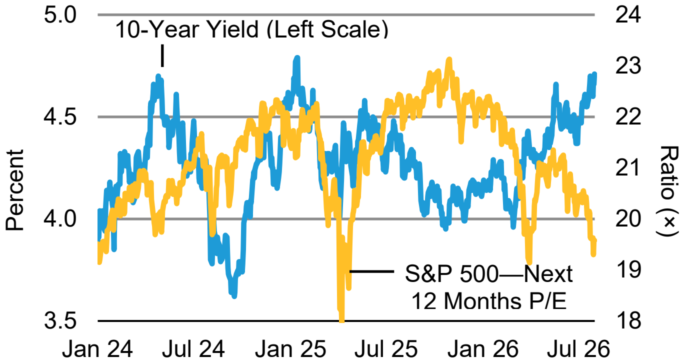
While the value opportunity set is large, themes we are emphasizing range from healthcare services for seniors, to homebuilding and renovation. And dividend growth strategies can serve as a better beta (watch On Demand The Build a Better Path, Part Two: 3-D Investing webcast series) by adding a cash-flow discipline to equity exposure. Over long horizons, that growth can be as important as the starting yield!

*Measures the yield based on the initial purchase price of the stock, not the current stock price.

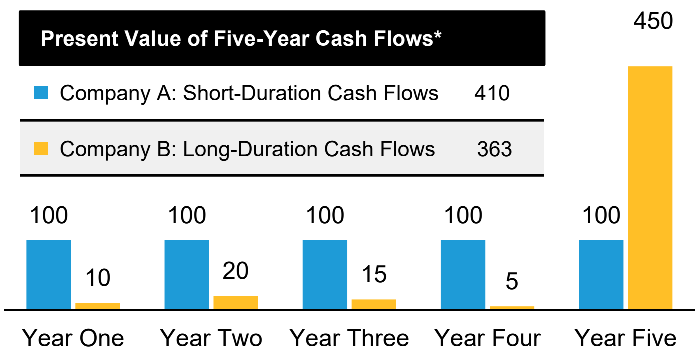
To learn more about AB's equity investment solutions and to access other market insights, visit Equity Investments | AB.

When Rates Stifle P/E Expansion, Cash Flow Upfront Is Often Prized

Display 1: 10-Year Yield vs. S&P 500 Forward P/E



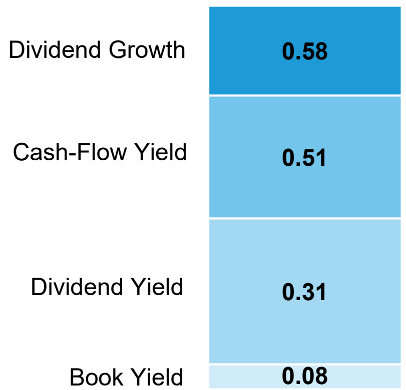
Display 2: Why Cash-Flow Duration Matters: Illustrative Example (USD)*
Discount rate = 7%



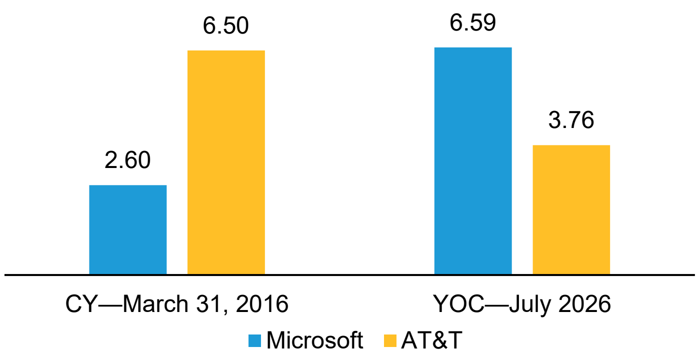
Past performance and current analysis do not guarantee future results.
*Hypothetical example for illustrative purposes only. Present value reflects what future cash is worth today. Because a dollar received later is worth less than a dollar received now, each payment is reduced based on how far it arrives in the future and the discount rate applied. Cash that arrives sooner keeps more of its value, so a company with earlier payments has a higher present value than one receiving the same total later.
Left display as of July 31, 2026; right display as of June 1, 2026
Source: FactSet, S&P and AB

Dividend Growth and Endurance Are Key; Look Beyond Yield

Display 3: Five-Year Factor Correlations to 10-Year US Treasury Yields: Dividend Growth and Cash-Flow Yield Lead the Pack*



Display 4: Current Yield (CY) as of March 31, 2016, and Yield on Cost (YOC) as of July 31, 2026
Percent



Past performance does not guarantee future results.
*Left display shows the factor correlations to the 10-year Treasury yield with –1.0 = perfectly negatively correlated, 0 = no correlation, and 1 = perfectly positively correlated.
Right display methodology: Current Yield = annualized dividend of AT&T and Microsoft as of March 31, 2016, divided by the price per share of AT&T and Microsoft as of March 31, 2016. Yield on Cost = annualized AT&T dividend as of July 2026 and Microsoft annualized dividend as of May 2026, divided by the AT&T and Microsoft price per share as of March 31, 2016.
As of July 31, 2026
Source: Piper Sandler and AB

The value of an investment can go down as well as up, and investors may not get back the full amount they invested. Capital is at risk. Past performance does not guarantee future results.

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