



**VERMA
ANALYTICS**

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BEYOND THE HEADLINES: WHY INTEREST RATES DEFINE MARKET REALITY

IN THIS REPORT

- **THE PRIMARY SIGNAL** – Why research suggests that common headlines, from geopolitical tensions to political cycles, are often secondary forces compared to the single most quantifiable variable in modern markets: interest rate expectations. *p. 1*
- **REGIME ANALYSIS** – Statistical evidence from four distinct market inflection points over the last decade that proves interest rates are the dominant engine behind both dramatic drawdowns and powerful rallies. *p. 2 – 3*

OVERVIEW

Distinguishing between meaningful, alpha-generating signals and market “noise” is a common challenge in the modern investing world. While geopolitical tensions, pandemic-related shutdowns, and political cycles have dominated headlines, our research suggests that these events are secondary forces in markets compared to a single, quantifiable variable: the market’s expectation of the direction of interest rates. Changes in the cost of capital directly impact the valuation of equities, as higher rates increase the discount rate applied to expected future earnings. Conversely, falling rates lower the cost of capital, allowing for the expansion of valuations as we’ve seen over the last two years.

This report provides statistical evidence that interest rates are the dominant driver of both market drawdowns and rallies within the observed regimes. By analyzing four distinct market inflection points over the last decade, we demonstrate that when interest rates move, they act as the main engine driving market movement, despite other headlines often dominating the spotlight.

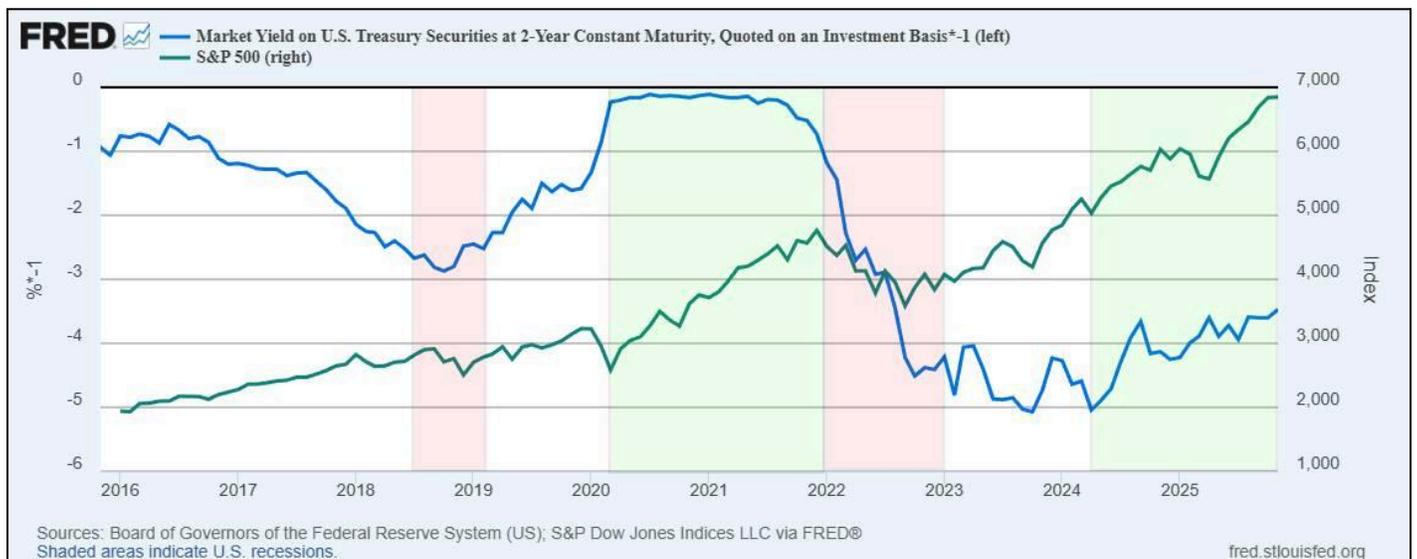


Figure 1: The ‘Mirror Effect’ – Overlapping the S&P 500 with the inverted 2-Year Treasury yield (used as an observable proxy for market expectations of interest rates) shows that major equity performance cycles are closely synchronized with the expectation of the direction of interest rates.

STATISTICAL EVIDENCE

Throughout this analysis, we refer to the OIS (Overnight Index Swap) curve as the conceptual signal for market expectations of monetary policy, while empirically implementing this signal using the U.S. 2-Year Treasury yield due to its liquidity, observability, and close alignment with near-term policy expectations.

All regression analysis is conducted using monthly closing data to reduce short-term market noise and better capture structural relationships across market regimes.

To measure beyond the basic visual observation, we conducted a regression analysis comparing the U.S. 2-Year Treasury against the S&P 500 during key market regimes over the last 10 years.

We focused on two primary metrics:

- **Correlation (r):** The direction and synchronization of the relationship.
- **“Explanatory Power” (R²):** Exactly how much of the S&P 500’s movement is explained by rates.

Period	Market Event	Correlation (r)	Explanatory Power (R ²)
Last 10 Years	Baseline Growth	0.580	33.67%
Q4 2018 - Q2 2019	The "Powell Pivot"	-0.486	23.63%
Mar 2020 - Q4 2021	COVID Response	0.572	32.68%
Q1 2022 - Q4 2022	The “Great Tightening”	-0.793	62.87%
Q1 2024 - Present	The “Easing Trade”	-0.761	57.84%

KEY MARKET REGIMES

A. 2015 - Present: The Long-Term Baseline

Over the last decade, markets have maintained a positive correlation (+0.58) with interest rates. In a “normal” economic regime, rates and stocks often rise together as a byproduct of an economy expanding in a healthy manner. Even within this broader trend, we can see that interest rates remained a persistent factor, explaining roughly one-third of all market variance.

B. Q4 2018 - Q2 2019: The “Powell Pivot”

Despite record earnings growth at the time, markets underwent a structural shift in Q4 of 2018, which saw the S&P 500 decline roughly 19% peak-to-trough. Markets seemed to have finally hit their pain threshold for interest rates following comments from Powell in late October, stating that rates were “a long way from neutral,” thereby raising the

market's expectations for imminent rate hikes. This period saw the correlation flip to -0.49, proving that when rates move too far or too fast, they override fundamental strength. The subsequent "Powell Pivot" in early 2019, where the Fed signaled a pause in hikes, immediately sparked a sharp rally back to all-time highs.

C. Mar 2020 - Q4 2021: The Pandemic Response

The COVID-19 era provides the ultimate test of this thesis. Despite a total global shutdown and major uncertainty of future business activity, markets bottomed and rallied in lockstep with the emergency collapse of the OIS curve. An R^2 of 32.7% during a global health crisis strongly suggests that liquidity and a lower cost of capital can override even the most catastrophic headlines.

D. 2022: The "Great Tightening"

Due to rapidly climbing inflation throughout 2021, the OIS curve spiked higher in 2022, driving the cost of capital higher and thereby forcing equity valuations lower. While many headlines were focused on the emergence of the Russia/Ukraine conflict, our data suggests that interest rates were the primary driver of market movement. An R^2 of 62.9% means that nearly two-thirds of the market's price action was statistically associated with the rising cost of capital. Geopolitical events were merely an after-thought for the market amidst the most aggressive monetary tightening cycle in forty years.

E. Q1 2024 - Present: The "Easing Trade"

The current market rally is characterized by an extremely high negative correlation (-0.76). This confirms that the "AI Trade" and other fundamental stories are secondary to the market's expectation of falling rates. We are currently in a "High Sensitivity" regime where the portfolio is mathematically tethered to the OIS curve; any shift in rate expectations is likely to result in immediate and significant valuation adjustments.

CONCLUSION

The data in this report confirms that we are currently operating in a "Rate-First Regime", where interest rates act as the dominant marginal driver for equity markets. While sector-specific narratives (i.e. the AI trade) or geopolitical headlines capture public attention, these factors remain secondary to the fundamental cost of capital. As we move into 2026, our research suggests that investors prioritizing the "signal" (the OIS curve) over the "noise" (media headlines) can better anticipate the inflection points that dictate equity market direction.

IMPORTANT DISCLOSURES

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