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WHEN INFLATION BITES

US EQUITY INCOME IN FOCUS: NAVIGATING A VOLATILE INFLATION AND RATE ENVIRONMENT

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The world is working differently. For much of the past 15 years, growth stocks in the US captured the market's attention while value remained out of favour. As the investment backdrop evolves, that dynamic may be starting to shift. With US core personal consumption expenditures inflation expected to rise toward 3.5% to 4% and the Federal Reserve projected to deliver two additional rate hikes over the next 12 months, inflation may prove more persistent than many investors had anticipated.[1] At the same time, the path of inflation and interest rates is likely to remain volatile, creating a market environment in which investors may be better served by flexibility rather than conviction in any single outcome.

Inflation is no longer a temporary disruption to wait out; it is a structural force reshaping every portfolio. Investors who recognise its effects may be better positioned to help protect, adapt and pursue their desired outcomes. Yet the key challenge is not just higher inflation itself. It is the risk of being caught off guard on monetary policy, much as many investors were in late 2021 and early 2022. With conditions feeling relatively balanced, this may not be a time for a one-way bet, but rather for a dynamic approach that can position and trade around the data as it evolves.

Why does inflation reshape the opportunity in equity income?

When inflation rises and rates remain elevated, the market's most expensive and rate-sensitive companies can face greater pressure, particularly after extended rallies. By contrast, value stocks that provide dividend income typically trade at lower valuations and tend to have greater representation in mature, cash-generative sectors such as financials, energy, utilities and industrials. Many of these businesses may be better positioned to pass higher input costs through to consumers, and their earnings are often anchored in steady, near-term cash flows rather than distant growth expectations, which can become less valuable as inflation and rates rise.

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In practice, this backdrop may favour companies that can set prices rather than forced to absorb them: businesses driving or benefitting from higher inflation, such as energy and materials, and those with pricing power, such as industrials and select consumer names. The shorthand may be to buy price makers and sell price takers. Historically, value has also tended to be more resilient when inflation expectations move higher. In an environment where services and shelter inflation remain elevated even as goods prices moderate, those characteristics may become increasingly relevant.

Recent market performance has reflected some of these dynamics. As of the end of September 2026, the Russell 1000 Value outpaced the Russell 1000 Growth by roughly 1,300 basis points year to date.[2] Even so, the opportunity in value may be less about making a directional call on inflation and more about recognising that a more persistent and uneven inflation regime can create a wider range of winners and losers across the market.

How does US equity income translate that backdrop into a potential advantage?

If inflation and interest rates remain volatile rather than moving in a straight line, broad value exposure alone may not be enough. Security selection, style discipline and portfolio flexibility may become increasingly important in separating companies that are genuinely positioned to benefit from this environment from those that simply appear inexpensive on the surface.

Our US Equity Income strategy is designed to express a value view through a disciplined but flexible investment process. It focuses on companies that meet four criteria: attractive valuations, strong and improving fundamentals, catalyst-driven business improvement and momentum, and the ability to pay sustainable dividends and grow them over time. This approach is intended to identify genuine value opportunities – companies that appear underpriced relative to their business strength and long-term potential – rather than businesses that may simply look inexpensive for structural reasons.

The process also supports style consistency. Over the past decade, the strategy has remained highly consistent in maintaining its large-cap value discipline, offering distinct and diversified positioning relative to many other equity allocations. This may be particularly relevant given the increasing growth bias of most large US indices. The 2026 Russell reconstitution further highlighted how the large-cap value universe is changing,[3] while the team's positioning has continued to reflect investment conviction rather than benchmark changes. That combination of consistency and adaptability may become increasingly important as market leadership broadens beyond a narrow group of mega-cap stocks.

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Where are the most compelling opportunities, and what risks warrant caution?

The opportunity set may be broadening further. The One Big Beautiful Bill Act reinstated 100% bonus depreciation and expanded research and development and interest expense deductibility, measures that could support free cash flow across capital-intensive industries. Some of that activity may benefit US banks and capital markets businesses, particularly in an environment where a steeper yield curve supports net interest margins and deregulation increases lending capacity. Financials may therefore remain an important area within value, offering both cyclical upside and potential defensive characteristics depending on market conditions.

Among higher interest rate beneficiaries, companies with strong balance sheets and limited near-term debt maturities may be better positioned. Insurance companies may benefit from both higher inflation, through premium growth, and higher rates, through investment income; however, investors will need to be selective across the sub-sectors as pricing cycles can vary. More broadly, as mega-cap leadership persists but market breadth shows signs of improvement, the universe of undervalued companies with strong fundamentals may continue to expand.[4] For active managers with a disciplined process, that may create additional scope for differentiated security selection.

A key risk remains concentration. Market returns remain influenced by a relatively small group of companies, and the path of inflation and interest rates may remain volatile rather than moving in a single direction. The greater risk may be being caught off guard by a shift in monetary policy, as many investors were in late 2021 and early 2022, rather than any single outcome. That reinforces the importance of manager selection, portfolio discipline and maintaining clear style exposure while remaining adaptable as leadership changes.

On a relative basis, the biggest risk to value investing would be a reversion in inflation and interest rates to pre-Covid pandemic levels. Most investors we speak with view that as unlikely in the near term, suggesting growth and value returns may be more balanced in the current regime. In that environment, value exposure may serve as a differentiated source of total return and diversification.

The case for value exposure is not a one-way bet on ever-rising inflation, but rather a recognition that inflation, in its many forms, is reshaping portfolios and demanding a more dynamic approach. We believe US Equity Income, with its disciplined but flexible process, remains a relevant strategy for navigating this environment.

Endnotes

1. Source: BNY Investments Strategy & Research Group as of 17 June 2026.
2. Source: Morningstar as of 30 September 2026.
3. FTSE Russell®, June 2026 Russell US Indexes Reconstitution: Summary of Changes, 26 June 2026.
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The value of investments and the income received can fall as well as rise and investors may not get back the original amount invested.

Key investment risks: US Equity Income strategy

Objective/Performance Risk: There is no guarantee that the strategy will achieve its objectives.

Derivatives Risk: Derivatives are highly sensitive to changes in the value of the asset from which their value is derived. A small movement in the value of the underlying asset can cause a large movement in the value of the derivative. This can increase the sizes of losses and gains, causing the value of your investment to fluctuate. When using derivatives, the strategy can lose significantly more than the amount it has invested in derivatives.

Counterparty Risk: The insolvency of any institutions providing services such as custody of assets or acting as a counterparty to derivatives or other contractual arrangements, may expose the strategy to financial loss.

Geographic Concentration Risk: Where the strategy invests significantly in a single market, this may have a material impact on the value of the strategy.

Concentration Risk: A fall in the value of a single investment may have a significant impact on the value of the strategy because it typically invests in a limited number of investments.

High Yield Companies Risk: Companies with high-dividend rates are at a greater risk of not being able to meet these payments and are more sensitive to interest rate risk.

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