



WATSON CAPITAL | CAPITAL MARKETS STRATEGY

The 5% Hurdle Rate

Why the refinancing regime changes capital allocation

Equity markets can absorb a high discount rate for a time. Corporate cash flows cannot ignore a higher refinancing rate forever. The next phase of this cycle will be decided increasingly on the liability side of the balance sheet.

September 28, 2026 | 9-minute read | Watson Capital Management LLC

10-Year Treasury | 5.17% | September 25 close

2-Year Treasury | 4.81% | September 25 close

Bank Prime Rate | 7.00% | After the September Fed increase

Q3 Treasury Borrowing Estimate | \$671B | Privately held net marketable debt

Executive View

Rates have moved from a valuation input to an operating constraint.

The central issue is no longer whether a 5% Treasury yield can compress equity multiples. It is whether businesses can refinance, invest, acquire, and return capital without eroding per-share economics.

Watson Capital Thesis

The market is entering a refinancing regime in which the marginal cost of capital matters more than the average cost carried on existing balance sheets. Strong issuers should retain access to funding, but the gap between companies that can self-fund growth and those that must repeatedly refinance it is likely to widen.

1. Long rates are transmitting into corporate decisions. The 10-year Treasury ended September 25 at 5.17%, up 21 basis points from September 21, while the 2-year rose only 5 basis points. The curve steepened because long-term capital became more expensive faster than short-term capital.¹

2. The refinancing calendar is becoming a strategy question. A larger volume of U.S. corporate debt begins maturing in 2027. Most high-quality issuers should manage the reset; weak borrowers with thin interest coverage, low pricing power, or near-term maturities have less room for error.²

3. **Capital supply is abundant, but no longer indiscriminate.** Investors are differentiating between traditional issuers and borrowers with large, open-ended funding programs. That selectivity is visible even among highly rated companies.³

4. **Energy keeps the policy path asymmetric.** EIA expects Brent near \$90 per barrel in the second half of 2026 and projects continued export constraints through year-end. That limits how quickly inflation pressure can fade.⁶

5. **The correct response is a higher proof threshold, not blanket defensiveness.** Self-funded growth, short payback periods, durable margins, and manageable maturities become more valuable as financing gets dearer.

What Changed

Markets rose while the hurdle rate moved higher.

For the week ended September 25, the Nasdaq gained 2.1% and the S&P 500 rose 1.2%, while the Dow advanced 0.3% and the Russell 2000 fell 0.8%.⁸ The headline was resilience. The underlying signal was divergence: large-cap growth absorbed the bond selloff, but smaller companies and financial shares were less convincing.

Indicator	Sep. 21	Sep. 25	Five-day change	Interpretation
10-year Treasury	4.96%	5.17%	+21 bps	Higher long-duration financing benchmark
2-year Treasury	4.76%	4.81%	+5 bps	Near-term policy expectations stayed restrictive
2s10s curve	+20 bps	+36 bps	+16 bps	Term premium and long-capital risk increased

Why this matters: a steepening led by the long end differs from a rally driven by easier policy. It raises the benchmark for mortgages, corporate debt, municipal finance, acquisitions, and long-duration investment. The change is small in days but consequential when applied to multi-year financing.

The Regime Shift

Three transmission channels now matter more than the index level.

01

Refinancing and cash flow

Debt issued during the low-rate years is repriced only when it matures. That creates a delayed transmission mechanism. Companies can appear insulated until interest expense resets, reducing free cash flow available for investment, dividends, and buybacks.

02

Competition for capital

Treasury projected \$671 billion of privately held net marketable borrowing for the July-September quarter.⁵ Corporate issuers are simultaneously preparing for refinancing and growth investment. The borrower must now compete harder for each incremental dollar.

03

Inflation-policy feedback

The Fed raised its target range to 3.75%-4.00% in September, and major banks lifted prime lending rates to 7.00%.⁴ Fed commentary has emphasized that inflation pressure is broader than energy alone, reducing the probability of a quick policy reversal.⁷

The analytical distinction

A higher discount rate changes what an asset is worth. A higher refinancing rate changes what a business can afford to do. The second effect is slower, more uneven, and ultimately more important for credit quality and per-share value.

The 2027 Test

The maturity wall will separate access from economics.

Reuters reported on September 25 that a growing volume of U.S. corporate debt begins maturing in 2027. The base case is not a universal credit event. The more useful question is whether refinancing preserves or impairs equity economics.²

Most resilient

Self-funded compounders

- Positive free cash flow after capital expenditure
- Limited near-term maturities
- Strong interest coverage
- Ability to reduce discretionary spending

Primary risk: valuation, not access to capital.

Underwrite carefully

High-quality external funders

- Investment-grade access
- Large multiyear investment programs
- Funding needs that may exceed internal cash generation

- Returns dependent on utilization and execution

Primary risk: project returns fail to clear the new marginal cost.

Most exposed

Leveraged refinancers

- Weak or volatile free cash flow
- Concentrated 2027-2028 maturities
- Low pricing power
- Debt-funded buybacks, acquisitions, or expansion

Primary risk: refinancing converts into equity dilution, asset sales, or covenant pressure.

Technology adds a second layer. Goldman Sachs estimates cited by Reuters place gross debt issuance from major hyperscalers at \$420 billion in 2027, about 60% above estimated 2026 issuance.³ The implication is broader than technology: even highly rated borrowers can face wider concessions when many issuers seek capital at once.

Capital Allocation

Every use of cash should be re-underwritten against the marginal rate.

Decision	2026-2027 hurdle test	Preferred response	Warning signal
Capital expenditure	Risk-adjusted return clears the fully loaded financing cost with a margin of safety	Prioritize shorter payback, staged commitments, and measurable utilization	Open-ended spending justified primarily by strategic narrative
Acquisitions	Downside cash flow covers debt service without relying on multiple expansion	Use earn-outs, seller financing, and conservative leverage where appropriate	Synergies are required to meet base-case interest coverage
Share repurchases	Expected per-share return exceeds debt repayment and liquid fixed-income alternatives	Buy back only at a material discount to conservative value	Repurchases financed with new debt or executed at peak multiples
Debt management	Liquidity runway extends beyond the concentrated maturity window	Stagger maturities, preserve revolver capacity, and pre-fund selectively	A single year carries a disproportionate share of maturities
Cash reserves	Liquidity has a defined strategic purpose and earns a competitive return	Maintain dry powder for refinancing, dislocation, or high-conviction investment	Cash is consumed to defend an uneconomic capital program

For corporate decision-makers

- Model debt maturities and committed capital expenditure together, not in separate planning exercises.

- Replace historical weighted-average interest cost with the current marginal financing rate in new project decisions.
- Stress-test interest coverage at refinancing rates 100-200 basis points above the base case.
- Identify discretionary projects that can be paused without damaging the core franchise.

For investors

- Distinguish companies with expensive debt from companies that merely carry old low-cost debt.
- Track maturity concentration, fixed versus floating exposure, and free cash flow after required investment.
- Reward self-funded growth and penalize recurring dependence on external financing.
- Evaluate acquisitions and buybacks as financing decisions, not just earnings-accretion exercises.

Scenario Framework

Use explicit triggers instead of a single rate forecast.

Normalization

Inflation cools; long yields retreat

Signals: August PCE softens, energy risk fades, and the 10-year moves sustainably below 4.75%.

Implication: refinancing windows improve and duration-sensitive assets receive relief.

Higher for longer

Growth holds; financing stays expensive

Signals: the 10-year remains near 5%-5.5%, oil stays elevated, and the Fed retains a tightening bias.

Implication: selection shifts toward cash conversion, pricing power, and maturity discipline.

Funding stress

Term premium and credit risk rise together

Signals: long yields break higher, issuance concessions widen, and weak borrowers lose market access.

Implication: protect liquidity, reduce refinancing exposure, and demand a larger risk premium.

Near-term decision calendar

Sep. 30

BEA: August Personal Income and Outlays, including the PCE price index; third estimate of second-quarter GDP and corporate profits.⁹

Oct. 6

EIA and BEA: October Short-Term Energy Outlook and August U.S. international trade data.

Continuous

Market: long-end Treasury yields, new-issue concessions, maturity extensions, and management revisions to capital spending.

Watson Capital Conclusion

The balance sheet is becoming the strategy.

At a 5% risk-free benchmark, management teams cannot treat financing as an administrative function performed after strategic decisions are made. Financing terms now help determine which strategies are economically viable.

The strongest businesses will not necessarily be those with no debt. They will be those that match the duration of assets and liabilities, preserve optionality, and fund growth from evidence rather than momentum. For investors, the opportunity is to identify that discipline before the refinancing calendar makes it obvious.

Source Notes

Primary data and selected reporting

1. Federal Reserve Board via FRED, [10-Year Treasury Constant Maturity Rate](#) and [2-Year Treasury Constant Maturity Rate](#), observations through September 25, 2026.
2. Reuters via Investing.com, [“Corporate debt maturities set to test U.S. borrowers as rates rise,”](#) September 25, 2026.
3. Reuters, [“Corporate bond buyers get picky with flood of AI debt,”](#) September 22, 2026.
4. Reuters, [“Major U.S. banks raise prime rate after first Fed rate hike since 2023,”](#) September 16, 2026.
5. U.S. Department of the Treasury, [“Treasury Announces Marketable Borrowing Estimates,”](#) May 4, 2026.
6. U.S. Energy Information Administration, [Short-Term Energy Outlook](#), released September 9, 2026.
7. Reuters, [“Fed’s Barkin says economy may be firming, inflation not limited to energy, tariff shocks,”](#) September 22, 2026.
8. Manulife John Hancock Investments, [Weekly Market Recap](#), week ended September 25, 2026.
9. U.S. Bureau of Economic Analysis, [2026 Release Schedule](#), accessed September 28, 2026.

Methodology: Market data are through September 25, 2026 unless otherwise stated. Basis-point changes are calculated from published Federal Reserve daily observations. Scenario thresholds are Watson Capital decision guardrails, not point forecasts.

Published article: <https://www.watsoncapitalmgmt.com/insights/the-5-percent-hurdle-rate>