Technology Moves Forward as Bond Yields Surge

U.S. and international equity markets continue to move higher, albeit more slowly. Despite a slow rotation into cyclicals, which has been occurring over the past several months, technology continues to move forward. This could be evidence that investors aren't completely convinced we are on the brink of reopening our society, or that investors truly believe technology has a more permanent advantage due to changes in how we live and do business. We have touched on this issue before and will not belabor the point again beyond saying it is likely a combination of the two. We will keep watching this rotation play out as a more pronounced recovery takes hold.

The other big story to be watching is the precipitous rise in bond yields since August. The 10-year Treasury yield has climbed 80 basis points in six months. This is strong evidence that we are getting some inflationary pressures due to expected demand growth. Interestingly, the U.S. dollar is weakening. One would expect the dollar to strengthen as rates here in the U.S. rise relative to the rates in other countries. The fact that the dollar is not rising is further support for the international growth story. China and other emerging markets are producers of much of the world's commodities and increased business activity is very good for those economies. Their potential for particularly strong growth is outweighing the impact of rising U.S. rates. Look for outperformance in international stocks over the short to medium term.

The rising rate story is not all good. It is hurting bond, fixed income and other safe asset portfolios. These assets are all negative since August while the major stock indices are all up double digits. If rates continue to rise it will eventually stymie growth as the cost of capital begins to erode earnings growth. Another factor to always consider is the importance of the bond market. The worldwide bond market is much bigger than the equity market. As such, if bond investors are hurting, it usually shows up sooner or later in the form stock prices dropping. I am not saying we are anywhere near that yet but yields need to take a breather for a real recovery to take hold in the first part of this year. The Federal Reserve is certainly aware of this and I would expect them to step in if markets don't resolve the issue independently.

Last week's commentary can be found here.


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