Weekly Market Review

By: Joe Clark, CFA, Allegheny Research Team

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Rising U.S. Treasury yields were one factor leading the stock market to a 0.70% decline last week as markets paused to consider how this would impact stocks. For the most part, rising yields are viewed as the economy is improving; therefore, investors are selling bonds to move to riskier assets. Bond yields and prices move in opposite directions, so bond prices are forced lower when investors sell bonds while yields go higher. Increased economic growth is one reason for an increase in yields. However, some factors can impact yields and not be friendly to the stock market.

Inflation has been a concern of many since the Federal Reserve started Quantitative Easing during the 2008 Financial Crisis. This concern picked up steam since Washington D.C. pulled out all the stops about a year ago when the COVID-19 pandemic began and enacted massive spending programs to keep the economy afloat. Now, with another stimulus package under debate, some are expecting this to lead to higher inflation. While higher inflation in the future is entirely possible, the current rise in rates should not be blamed on inflation. The stock market has been trading with a post-COVID, return-to-growth outlook for quite some time, and now it is the bond markets turn to catch up. Analysts have been increasing their GDP growth estimates for 2021, leading the bond market to become more aligned with the stock market by expecting a return to economic growth.

As the bond market accounts for economic growth in the form of higher interest rates, the stock market also must adjust. Last week we saw a slight decrease in the overall index but looking at the underlying sectors can tell us more about this dynamic. Value-oriented sectors, such as financials and energy, were the leaders last week, as they stand to benefit from higher economic growth. Meanwhile, growth-oriented sectors such as technology and health care, which have been the dominant players over the past market cycle, were the laggards on the week and the main contributors leading the market to a slight loss. This is not to say higher rates will be a negative factor for growth stocks; these stocks could soon return to the front of the pack. Investors will need to re-evaluate what rising rates mean for their portfolio since we have become accustomed to a declining rates environment.

Markets operate in cycles, whether it is a market sell-off or a leadership transition, and no one knows when a turning point is approaching. Maybe this is a short period, and growth stocks soon return to favor. Perhaps it is a value rotation that will be long-lasting. Either way, maintaining a diversified portfolio will provide the best probability of benefiting from whatever cycle the market throws at us next.