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Investment Outlook

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Update

The Fed Has Spoken, Is Anyone Listening?

Last year's index inequality continues to unwind as investors move from the pandemic-assisted, stay-at-home, growth stocks to the recovery-assisted Cyclicals. It's been a persistent theme in recent weeks that comes as no surprise. That shift has weighed heavily on the Tech sector and companies that flourished during the pandemic. While many solid companies that have been sold recently will eventually go on to make new highs as the recovery broadens, a number of last year's high flyers will not. A number of those stocks are unlikely to reclaim the ludicrous valuations they enjoyed in 2020 for many years to come.

What has come as a surprise is the relatively sudden rise in yield of the 10-year treasury. It's all CNBC can talk about ad nauseam. After all, drama sells advertising. We'll forget the drama and provide some perspective that's been lacking in the recent reporting. The 10-year yield peaked at 3.25% in 2018 in anticipation of a fiscal-assisted rebound in the economy. It normalized in 2019 as the economy reached escape velocity on the wings of full employment. It then plummeted to a generational low of 0.53% last year at the peak of the pandemic and the depth of recession. Today, it's approaching the 1.75% level. Why is that important? The 10-year treasury yield is a key indicator of economic expansion or contraction and the demand for credit. Mortgage and other lending rates correlate strongly to changes in the 10-year and impact segments of the economy such as housing, auto sales, and business investment. It's no secret that the economy is improving.

We've learned that, much like the stock market, the 10-year treasury can overshoot in recording cyclical highs and lows before normalizing to actual conditions. That's what this move represents: Another step toward normalization. It reflects optimism about controlling, not eradicating, the virus to the point of seeing *all* segments of the economy join in The Reopening. More importantly, it announces the demise of deflation pressures and a much wished for return of inflation. Talk of runaway inflation serves only as drama for TV audiences and clickbait for web-obsessed day traders. Those who insist the Fed will have to alter its monetary policy in response to the move in the 10-year aren't listening to Chairman Powell. Since Q4 2020, he has had to repeat for a forgetful press the Fed's simply stated intent to allow inflation to overshoot its mandated threshold of 2% "for some time" before responding with a policy revision. We'll get there, but not "for some time" and certainly not in 2021. We heard him the first time.

The financial media and Twittersphere overlook a couple of key points: We're still 10 million people and *years* away from the full employment we enjoyed in 2019. In addition, we're only weeks away from receiving a dose of *fiscal* tightening in the form of new initiatives and higher taxes to fund the expansive wish list of the new administration. Both are headwinds for economy and should go a long way in alleviating concerns over runaway inflation. For now, the stock market will reflect the economy's progress along a path toward full recovery. That means a continuation of the normal rebalancing among indexes that we're now seeing. It also looks like treasury yields may have gotten ahead of the recovery and will likely settle in a range that reflects actual conditions rather than the most extreme speculations. We'll monitor conditions and keep you posted. Stay tuned.

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