Monthly Market Insights

Data and opinions as of March 31, 2021

Stocks rebound to new highs as bond yields rise further

Stock markets turned higher in March, driven by continued progress in vaccine administration, U.S. stimulus payments, and positive economic data releases. The Federal Reserve is keeping monetary policy accommodative, and even revised up their projections for GDP growth and the unemployment rate for 2021.

Despite the continued rise in both nominal and real Treasury yields, risk-on market sentiment drove both the S&P 500 and Dow Jones Industrial Average to new highs. Meanwhile, the NASDAQ saw weakness for another month as technology stocks continued to face headwinds created by rising rates. Inflation is expected to increase in the coming months and will remain on investors' minds.

The NEI perspective

Inflation to run hot. Rising global inflation is a primary concern for investors. Fiscal stimulus, excess savings, supply constraints, and the U.S. Federal Reserve's policy stance are all supportive of inflation running hot this year.

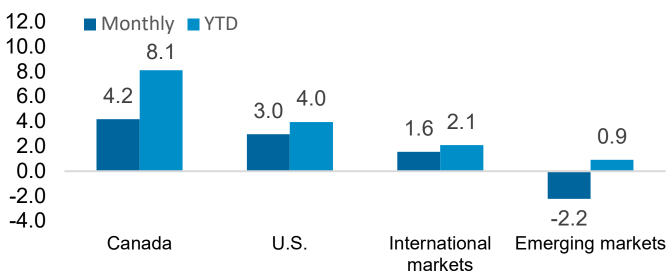
Fed committed to new inflation framework. The Fed has confirmed it will allow inflation to go over its long-term 2% target, showing it is committed to its new inflation framework known as the "flexible form of average inflation targeting," or FAIT.

Rotation into economically sensitive assets continues. The outlook for global economic growth continues to be upgraded due to the massive amount of stimulus and the pace of vaccine distributions. The rotation into stocks with high beta to economic growth such as cyclical and value stocks continues.

From NEI's Monthly Market Monitor for April 2021. Click here to get the full report.

Equity

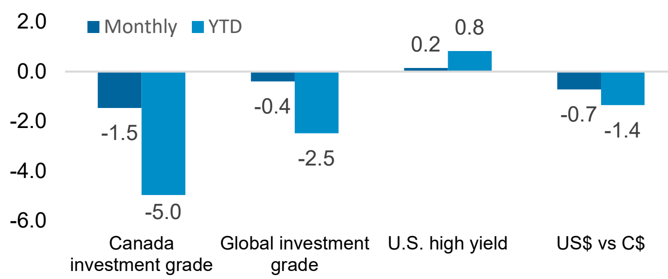
% return in C$



Canada: MSCI Canada; **U.S.:** MSCI USA; **International markets:** MSCI EAFE; **Emerging markets:** MSCI Emerging Markets. Source: Morningstar Direct.

Fixed income and currency

% return in C$



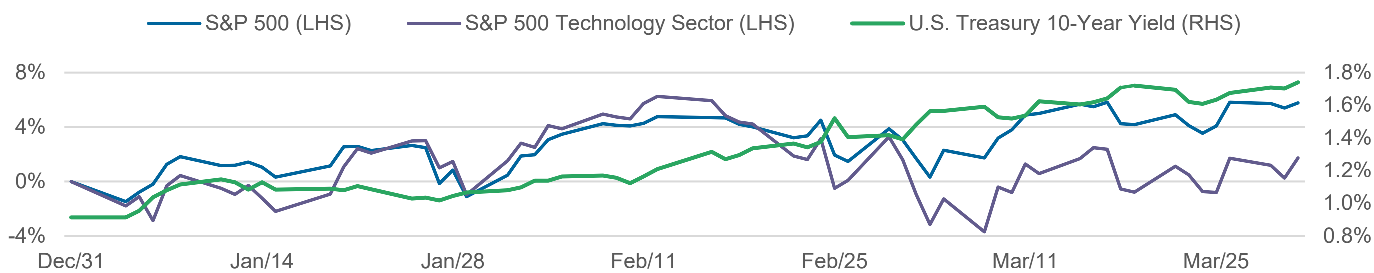
Canada investment grade: Bloomberg Barclays Canada Aggregate; **Global investment grade:** Bloomberg Barclays Global Aggregate; **U.S. high yield:** Bloomberg Barclays U.S. High Yield. Source: Morningstar Direct.

Why have rising bond yields hurt technology stocks?

To understand the relationship between bond yields and stock prices, we must first explore what bond yields signify beyond simply the returns one would expect for holding a bond until maturity. Government bond yields are a proxy for the "risk-free rate," that is, the minimum return investors require before accepting additional risk. Short-term bond yields are largely influenced by central banks via policy rates, while longer-term bond yields are determined by market forces. While it's true that rising long-term bond yields generally reflect more positive economic prospects ahead, they can have a negative impact on certain asset classes.

A stock price is typically determined by taking all future expected cash flows generated by the company and "discounting" them to an aggregate present value. A dollar of cash flow generated 10 years from now is worth less than a dollar today. But how much less? At a very basic level, investors can use the risk-free rate to calculate the present-day value of future cash flows. The higher the risk-free rate, the lower the present value of a future dollar. The further out the time horizon, the greater the impact of changes to the risk-free rate. Technology and other high-growth companies will have a greater portion of their cash flow generated in later years (10 years plus) and are therefore more sensitive to a rise in interest rates. This phenomenon works both ways—as bond yields fell last year at the onset of the pandemic, recall that technology stocks led the recovery rally.

Year-to-date stock market returns in the wake of rising bond yields



Source: Bloomberg. Data as of March 31, 2021. S&P 500 returns are expressed in local currency.