Market Strategy
by STRATEGAS A BAIRD COMPANY

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# Market Strategy Weekly

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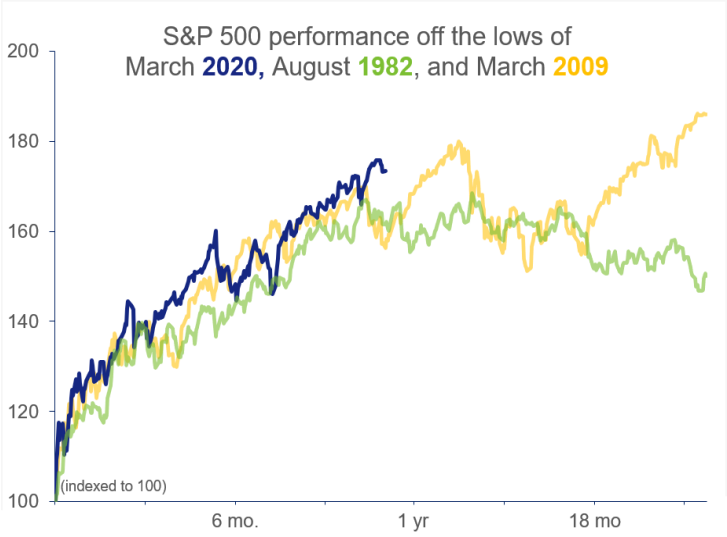
## YIELDS SPIKING | EQUITY MARKETS SHAKY | RECOVERY FIRM

Despite all the stock market volatility this week, we think it makes sense to start in the fixed income world, where the yield on the 10-yr Treasury bond briefly broke through 1.60% Thursday. This is still low by historical standards but represents a sharp and rapid move in rates—recall that the yield was just 0.92% at the end of 2020. Higher bond yields make equity markets nervous for a variety of reasons (as we've seen this week), but the speed of this move is especially noteworthy.

We look at weakness in the bond market (remember, bond prices fall as yields rise) and the resulting equity market volatility as both a test and a signal. The test comes in the form of markets staking out the pressure points of a new policy regime in Washington. And the signal? The question of whether the proposed $1.9 trillion stimulus is too much for an economy on the path toward reopening, still flush with cash from prior relief bills, and midway through vaccine rollout.

So, is it too much? At this stage, the market may think so. As just one example, there was especially weak demand for 7-yr US government bonds at Thursday's auction. **With a strong growth outlook ahead, the safety of Treasury bonds has become less appealing to some investors.** This also creates an issue for the Treasury department, who'll likely need to scale up debt offerings to pay for additional stimulus. And as we approach the debt ceiling as early as Q2, this could prove a thorn in the current Administration's side.




Elsewhere, we suspect a sharp rise in yields heightens concerns of inflation (as we've covered recently) as well as concerns of a potential curbing of recent housing market strength. The key on all of this will be follow-through—it's critical for the recovery to grow into itself and to deliver against the lofty expectations embedded in prices.

On this front, the selloffs and volatility that follow major market bottoms allow all the moving parts to reconnect—a necessary step for a robust recovery. We can see this clearly in one of our favorite charts: the current market rally off the March 2020 lows vs. similar moves in 1982 and 2009.

**Ultimately, we wouldn't be overly concerned by market dislocation in the near-term.** The building blocks remain in place for a durable economic recovery—remember the sequence: a recovery catalyst (in this case the reopening) leads to increases in activity, demand, output, revenue, investment, and profits. We're not at the reopening yet but stick with the Baird team and we'll get there together. Stay well and we'll see you again soon.

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