WEALTH SOLUTIONS GROUP

BAIRD
Private Wealth Management

In the Markets Now

Taper talk, taper tantrum

We believe in the old saying: a picture is worth a thousand words. Here, we aim to recap recent market action and provide some perspective to investors.

PWM Equity & Fixed Income Research
Ross Mayfield, CFA
Investment Strategy Analyst

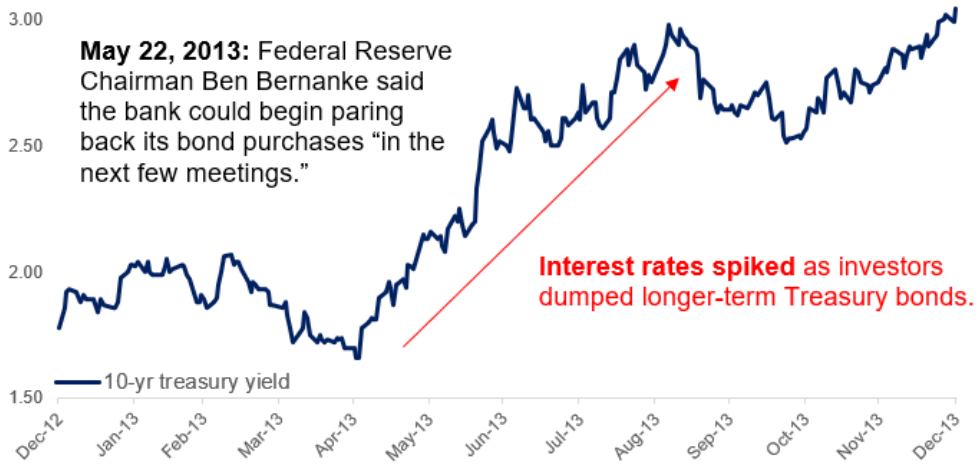
August 2021

ON THE FED "TAPERING" AND WHAT IT MEANS FOR INVESTORS

In normal parlance, "tapering" might be a reference to a pair jeans or a nice haircut, but in the often-cryptic world of investment lingo, it has taken on a different meaning entirely. And if you haven't started hearing references to the Federal Reserve "tapering" yet, you almost certainly will in the coming months. So let's take a look at why that is and if it matters for investors.

But first, a bit of recent history. When the coronavirus pandemic sent markets plummeting, the Federal Reserve reacted swiftly and strongly, slashing interest rates and reintroducing its GFC-era bond-purchasing program in order to stop the bleeding. Since then, the Federal Reserve has been buying about $80 billion of Treasury bonds per month to soothe financial markets. As the theory goes, buying Treasurys helps keep rates low, markets liquid, and signals to investors that easy policy is here to stay. It's meant as short-term medicine until the economy can get back on its feet.

Thankfully, we're getting there. And with the Fed especially focused on a strong labor market recovery, July's impressive monthly jobs report was exactly what the doctor ordered. We're now just ~6 million jobs short of pre-pandemic—still a ways to go, but much improved from being down 22 million in April 2020. At the very least, it's enough progress to get the Fed talking "tapering," meaning a slow shrinking of the bond-purchase program mentioned above. Or, as markets interpret it: **The beginning of the end of hyper-friendly monetary policy**.



Easier said than done, however. In many ways, the market has become addicted to the Fed's liquidity spigot, and so any mention of tightening policy can cause some indigestion (as has been the case for much of the last decade). Take the famed "taper tantrum" of 2013, when the market was rocked by an informal announcement of Fed tapering: In just four months, the 10-year Treasury yield nearly doubled, long-term bond prices plummeted, and the market's fear gauge (the VIX) spiked. **The Fed head-faked tightening, and the market roiled in response.**

So what are the lessons for today? While 2021 is not perfectly identical to 2013 (for one, the Fed has gotten a lot better at telegraphing their policy moves), many still expect bond yields to rise from here and for volatility to broadly increase. That seems like a fair outcome to prepare for—not just because of the potential for tapering, but because volatility has been historically low and because bond yields have been stubbornly suppressed. And even if it doesn't come to fruition, preparing for this outcome—higher volatility in equities and potential losses in fixed income—is worth planning for. Talk to your Baird Advisor today.

Disclosures

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

This report does not provide recipients with information or advice that is sufficient on which to base an investment decision. This report does not take into account the specific investment objectives, financial situation, or need of any particular client and may not be suitable for all types of investors. Recipients should consider the contents of this report as a single factor in making an investment decision. Additional fundamental and other analyses would be required to make an investment decision about any individual security identified in this report.

For investment advice specific to your situation, or for additional information, please contact your Baird Financial Advisor and/or your tax or legal advisor.

Fixed income yield and equity multiples do not correlate and while they can be used as a general comparison, the investments carry material differences in how they are structured and how they are valued. Both carry unique risks that the other may not.

Past performance is not indicative of future results and diversification does not ensure a profit or protect against loss. All investments carry some level of risk, including loss of principal. An investment cannot be made directly in an index.

Other Disclosures

UK disclosure requirements for the purpose of distributing this research into the UK and other countries for which Robert W. Baird Limited holds an ISD passport.

This report is for distribution into the United Kingdom only to persons who fall within Article 19 or Article 49(2) of the Financial Services and Markets Act 2000 (financial promotion) order 2001 being persons who are investment professionals and may not be distributed to private clients. Issued in the United Kingdom by Robert W. Baird Limited, which has an office at Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB, and is a company authorized and regulated by the Financial Conduct Authority. For the purposes of the Financial Conduct Authority requirements, this investment research report is classified as objective.

Robert W. Baird Limited ("RWBL") is exempt from the requirement to hold an Australian financial services license. RWBL is regulated by the Financial Conduct Authority ("FCA") under UK laws and those laws may differ from Australian laws. This document has been prepared in accordance with FCA requirements and not Australian laws.