GLOBAL ECONOMY AND FINANCIAL MARKETS SHORT COMMENTARY

26 February, 2021

Treasury yield hit 1.6% - what does it mean to the market?

Market has been focused on the recent continuous increase in treasury bond yields over the past 2 weeks, reflecting fears among investors that the rising interest rates could soon triggered a downward pressure on corporate earnings as well as the stock market. The pace at which yields have increased in which posed a threat for stock markets, especially to the growth stocks. As seen in the past weeks, Nasdaq's decline was the most significant, as growth and tech stocks are more susceptible to rising yields. Nasdaq tumbled more than 7% from the peak, while S&P and Dow Jones slipped about 2%.

US 10 Years Treasury Yield: rose from 0.5% in July 2020 to 1.61% on 25 Feb, the highest since the outbreak of COVID-19.

Source: Bloomberg

Why are yields going up?

1. **The selloff in bonds pushing up yields**

   The vaccination and US government further fiscal relief plan will lead an improving economy, inflation expectation has climbed so as bond yield. Despite soothing words from Fed Chair Jerome Powell helped equities recover on Tuesday (23 Feb), interest rates continued their recent rise and the yield curve steepened amid optimism over economic recovery. The selling off in bonds pushed up yield to 1.61% on Thursday (25Feb). Powell downplayed inflationary pressure and financial stability risk, he explained the rising bond yields showed market is confident in the outlook of economic rebound. He indicated again that the central bank was not moving toward changing its dovish policy stance. Powell further emphasized that the current bond purchases from the Fed will not decrease until “substantial progress” has been made toward the Fed’s goals of low unemployment and stable inflation at about 2% annually. However, the dovish speak did not lead to any significant drawdown in bond yields.

2. **Inflationary pressure**

   Market has priced in optimism on economic recovery, which pushed the 10-year breakeven inflation rate rose to 2.21%, the highest since 2014, even exceeding the Feds 2% target. A steeper yield curve also indicates investors are anticipating an economic rebound will occur earlier rather than later. Powell said that consumer prices partially rebounded over the rest of last year since the outbreak. However, for some of the sectors that have been most adversely affected by the pandemic, prices remain particularly soft. So inflation still have not met Fed’s long-term target.

Recent stock market performance

Recently, growth stocks and tech stocks are indeed susceptive and lagged amid concern over rising interest rates, while cyclical, financial and energy sectors are holding up better on economic recovery.

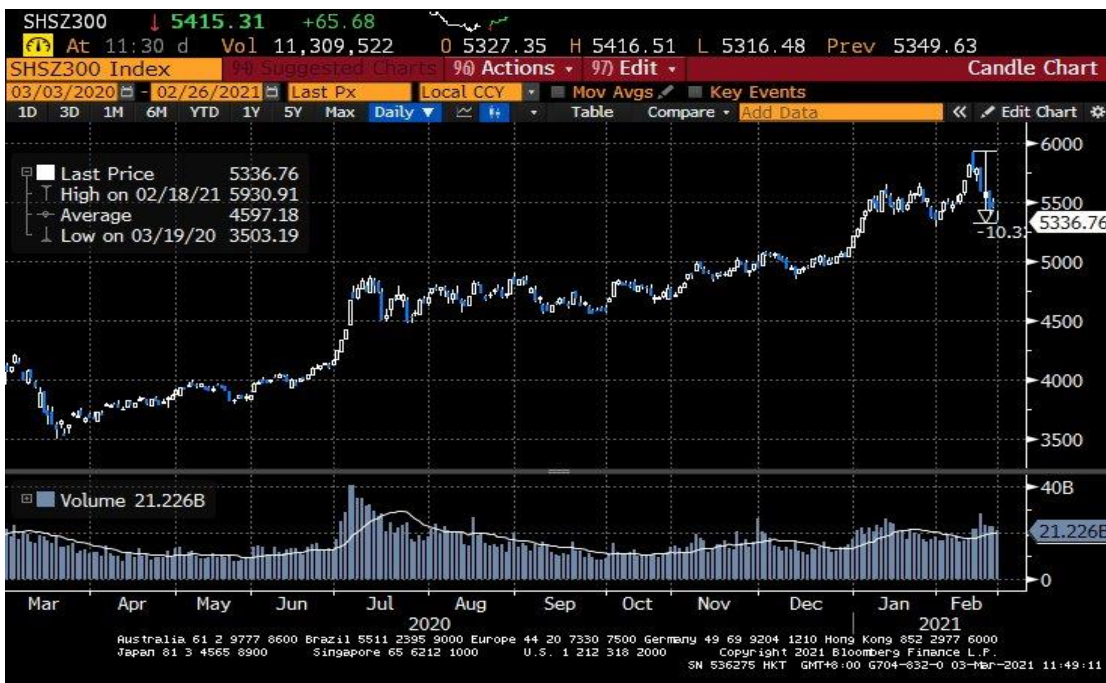
US Nasdaq Index: fell by near 7% in the past two weeks.

Source: Bloomberg

Europe STOXX 600 Index: slipped by 3.7% from the recent peak, major growth stock fell as a rally in commodities added to concerns about inflation and as bond yields rose further.

Source: Bloomberg

China CSI 300 Index: dropped by over 10%. Although the China stock market may be less sensitive to the rising US bond yield, the China stock market recently suffered fall down as the market feared that the China Government may withdraw its very loose monetary policy as the economy is fully recovered



Source: Bloomberg

Rising bond yield is pressuring the stock market in particular gave growth and tech stocks a hard hit in terms of their high valuation and higher borrowing costs for them.

1. **Stock Market Valuation**
   The launch and popularity of vaccine application signaling economic recovery. Investors tended to rotate out of growth stocks into cheaper cyclicals, travel related stocks expected to benefit most from the recovery. Higher bond yields and valuation worries weighed most on mega-caps and growth stocks, especially those strongly rebounded last year since the outbreak and most of them with indeed very demanding P/E ratio which may be overvalued and dampened the overall market.

2. **Higher interest costs for companies**
   A rise in bond yields denotes higher interest rates in the economy. Higher interest rates push up the cost of loans taken by companies. This ultimately affects their profits and hence the returns of shareholders. The stocks of companies with a large amount of debt are particularly impacted. In addition, it also drives up borrowing costs which will lower the investment intentions of companies. The rising bond yield is expected amid the economic recovery; however, the pace of which yields have increased so fast in a very short period of time may pose threats in particular to the stock market.

Despite the recent downside in stock markets, the market sentiment is still optimistic as global economy is expected to recover strongly in 2021. In particular, Asia Pacific market is likely to see stronger growth prospects. On the other hand, the US market may happen to be more volatile recently due to rapid raising yield and valuation is getting expensive and some of the favorable factors had been already priced in the upside recorded in the last year. At last, the synchronized global recovery and continued large government spending and deficits are very likely to continue to put significant upward pressure on inflation and bond yield. Investors thus should continue to pay attention on bond yields and should be very selective and valuation-conscious across the asset spectrum.

Source: Bloomberg, CNC, WSJ, MarketWatch, Yahoo News, Reuters

Important Note & Disclaimer:

- The document is property of AMG FINANCIAL GROUP. All information in this document is strictly for information purposes only and should not be considered as an invitation, an offer, or solicitation, to invest or a recommendation to buy or sell any particular security or to adopt any investment strategy mentioned herein. AMG Financial Group Limited (here after AMG) endeavors to ensure the accuracy and reliability of the information provided but do not guarantee its accuracy or reliability and accept no liability for any loss or damage arising from any inaccuracies or omission. Some of the information in this document may contain projections or other forward looking statements regarding future events or future financial performance of countries, markets or companies. These statements are only predictions and actual events or results may differ materially. Any opinion or estimate contained in this document is made on a general basis and is not to be relied on by the reader as advice. AMG reserves the right to make changes and corrections to its opinions expressed in this document at any time, without notice to the recipients of this document. Any unauthorized disclosure, use or dissemination, either whole or partial, of this document is prohibited and this document is not to be reproduced, copied, and made available to others.

Investment involves risks. The value of any investment and the income from it can rise as well as fall as a result of different market risks, such as currency and market fluctuations. Past performance figures shown are not indicative of future performance. The recipients of this document should seek for professional advice if they are in any doubt about any of the information contained herein. This material has not been reviewed or approved by the Securities and Futures Commission.

For any comments, please send email to us at enquiries@amgwealth.com.

AMG FINANCIAL GROUP
40/F, 118 Connaught Road West, Hong Kong
Telephone: (852) 3970 9531 Facsimile: (852) 3426 2650