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How are stock markets currently reacting to increases in yields?

Erste AM Communications



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In the 1990s, Democratic political consultant James Carville said, “I used to think that if there was reincarnation, I wanted to come back as the president or the pope or as a .400 baseball hitter. But now I would like to come back as the bond market. [You can intimidate everybody.](#)” The bond market has continued to prove this point in recent weeks.

Economic indicators for the fourth quarter of 2020 and early 2021 have been stronger than expected. E.g.: Strong growth in durable capital goods shipments in the U.S. in January. The exception was China’s purchasing managers’ indices, which fell for the third month in a row in January.

Together with the start of vaccine programs, this has led to an upward revision of expectations for economic growth in the medium term. Because this also means that the negative output gap is smaller than expected, the medium-term inflation outlook has been revised upward somewhat. Central bank targets for inflation may be reached earlier than expected in some countries.

This environment has led to an increase in government bond yields. Yields on 10-year government bonds in the USA rose from 1.0% at the beginning of February to 1.4% at the end of the month. The trend was similar in Germany, where an increase from -0.5% to -0.3% was observed. However, two developments were new:

- The increase is no longer slow but relatively fast
- For two weeks now, the rise in nominal yields has no longer been driven by rising inflation expectations (10Y U.S. breakeven inflation rates even declined slightly to 2.15% most recently), but by a rise in real yields (10Y U.S. from -1% to -0.75%).

Rise in yields does not only affect government bonds

However, the rise in yields does not only affect government bonds. Basically, the valuation of any financial instrument (stocks, bonds) but also of real estate results from the sum of discounted future cash flows / cash flows.

The yield of credit-secured government bonds has a direct influence on the level of the discount rate. If government bond yields rise, this also leads to a rise in the discount rate and (provided other expectations remain unchanged – *ceteris paribus*) the price of the financial instrument falls.

We were also able to observe this process on the stock markets last week. The US leading index S&P 500 lost -2.4%, the EuroStoxx 50 closed 2% lower on a weekly basis. Assets with a long duration and a high valuation were particularly affected by the price declines. The latter include, for example, US technology stocks, which suffered losses of almost 5% (NASDAQ 100).

For the next month, the key question will be whether interest rates will rise more than growth expectations. We currently assume that

- the economic recovery will continue and may also surprise on the upside
- central banks will remain ultra-expansive, but will not be averse to slight further increases in yields, as this can reduce the risk of bubbles forming
- in case of further and strong yield increases, the yield curve management of central banks will become more obvious.

Thus, the financial environment will remain supportive on average, but volatility will increase.

Market correction used for acquisitions in ESG funds

With interest rates rising significantly in recent weeks, growth companies in particular have come under significant pressure and a rotation into cyclical “re-opening” companies has been evident. Despite these price corrections, all major equity markets have posted positive performance since the beginning of the year.

Cleantech, hydrogen/fuel cells, electromobility and, above all, renewable energy were hit even harder by profit-taking. These movements also affected the performance of the [ERSTE GREEN INVEST](#) and the [ERSTE STOCK ENVIRONMENT](#), which lost about 10% in the last few days. This was used to make further acquisitions.

The fundamental environment and thus our long-term outlook has not changed, which is why we have recently started to cautiously use the correction for additional purchases in our most favored companies.

▲ Risk notes according to 2011 Austrian Investment Fund Act

ERSTE GREEN INVEST may exhibit increased volatility due to the composition of its portfolio: i.e. the unit value can be subject to significant fluctuations both upwards and downwards within short periods of time.

▲ Risk notes according to 2011 Austrian Investment Fund Act

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