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IMPACT OF RISING RATES ON THE STOCK MARKET

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The recent sharp rise in longer-term interest rates due to concerns about the Federal Reserve scaling back its stimulus program has pressured nearly all asset classes:

- The S&P 500 slipped 3.9% during the two-day period ending June 20th.
- Foreign stocks fell even more than U.S. stocks.
- Bond prices fell sharply as the yield on the 10-year Treasury spiked to a 22-month high.
- The price of gold has been in a near free-fall. On June 26th gold closed at $1201, down 10% since June 19th and 27% since the start of 2013.
- What was odd was that the price of nearly all asset classes fell during this time. Typically stock and bond prices have a low correlation to each other (i.e. they don't move in sync) and gold prices have a zero or even negative correlation to stock and bond prices. This indicates to us that markets are acting irrationally.

"If this is the beginning of a prolonged period of rising interest rates, what could that mean about the prospects for the stock market?"

If this is the beginning of a prolonged period of rising interest rates, what could that mean about the prospects for the stock market? The answer may be, "not bad". Birinyi Associates, a stock research firm, analyzed nine periods since 1962 when the yield on the 10-year Treasury significantly increased over a sustained period of time. They found that *from the start of the rise in rates, the S&P 500 increased a median 0.8% three months later, a median 11.3% six months later and a median 13.8% a year later.*

How can this be? Aren't rising interest rates supposed to hurt stock prices? It appears that *it is not so much the increase in rates that hurts, but the absolute level of rates.* According to a Standard & Poor's study that tracked market performance going back to 1953, U.S. stocks actually posted their best returns when 10-year Treasury yields rose towards 4%. On the other hand, when yields exceeded 6%, stocks started to lose money. "The 'sweet spot' for equity prices appears to be a rising rate environment between 3% and 4%, as a growing economy reduces unemployment while increasing corporate earnings, yet does not trigger growth-slowing efforts by the central bank,", explained Sam Stovall, S&P's chief equity strategist. The 10-year Treasury closed at 2.5% at the end of June (up from 1.7% on May 1st).

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