Big changes rocking Wall Street conceal an inconvenient truth: It's a return to normal

BY STAN CHOE Associated Press Nov 17, 2023

- Trader Sal Suarino works on the floor of the New York Stock Exchange Nov. 1. It's easy to get swept up by Wall Street's hullabaloo over high interest rates, rising Treasury yields and other superlatives about financial markets. But the truth is that conditions in financial markets are actually reverting to historical norms, not diverging from them.

Richard Drew ap

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NEW YORK — It's easy to get swept up in all the superlatives popping up about investing and financial markets.

The 10-year Treasury yield is at its highest level since 2007! The Federal Reserve has hiked its main interest rate to the highest level since 2001! Bond funds are on track for one of their worst years in decades!

Diminished in all the hullabaloo is that conditions in financial markets are actually reverting to historical norms, not diverging from them.

To be sure, the speed at which interest rates have snapped higher since the spring is jarring. But the 10-year yield is still lower than it was for roughly three decades, from the late 1960s through the late 1990s.

Rather than think of today's conditions as strange, it's perhaps easier to think of the last few decades as the anomaly. Ever since the ghoul of high inflation was broken in the 1980s, the Federal Reserve has been quick to aid the economy and financial markets during times of trouble.

That meant if lots of layoffs were happening or if the stock market was tumbling too frightfully, the Fed could cut interest rates down to zero. If that wasn't enough, the Fed could keep going with unconventional programs, such as purchasing however many bonds it thought was necessary to keep financial conditions easy. The Fed could do all that because inflation for a long, long time simply wasn't a problem.

Now it is. And that means the Federal Reserve doesn't have the same freedom to cut rates so quickly, because lower rates can give inflation more fuel.

After decades when changes like the internet and off-shoring manufacturing helped lower inflation, the global economy now faces conditions that could exacerbate it. Companies want multiple suppliers for example, rather than just the cheapest after the pandemic demonstrated the pain of snarled supply chains.

"We think higher rates are here to stay as the Fed keeps policy tight to fight inflation," strategists at BlackRock Investment Institute wrote in a recent report.

What all this means for investors depends on what kind of investments they're making.

For savers looking for safe places to park their cash, the much higher yields on online savings accounts, CDs and short-term Treasury bills are welcome. Instead of getting nearly nothing, they're finally getting something.

For investors holding longer-term bonds, there's both a plus and a minus. Higher yields mean new bonds getting issued today are paying more in income. That's helpful. But older bonds are paying less. That causes their prices to drop, which hurts investors already holding bonds in their portfolios.

For stock investors, it can make things much more challenging. When bonds are paying more in interest, investors are less willing to pay high prices for stocks, which are riskier and can force investors to wait a long time for big growth. That puts downward pressure on all stocks.

That hurts even more when the stock market broadly looks expensive relative to corporate profits, and it ups the pressure on being selective, says Bryant VanCronkhite, senior portfolio manager at Allspring Global Investments. A return to inflationary pressure means economic cycles may not last as long as they used to, VanCronkhite says.

"The Fed was very good at manipulating the economy and markets because they could focus on full employment, and they could let the market cycle play out longer," he said. "If under this new paradigm, it's ill-equipped or unwilling to inject itself into the markets with the same speed, it's natural we're going to have a little bit longer and more frequent recessions than before."

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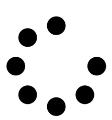

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