2021: Rising Yields, Solid Earnings

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Economic growth this year is likely to be strongest in decades, but the implications of this growth are hotly debated. In the fixed-income markets, we see nominal yields rising even if inflation does not accelerate beyond the 2% to 3% range. And in the equity markets, we expect 2021 to be all about earnings growth (above expectations, in many cases).

Watch the video or read the recap below.

That economic growth this year is likely to be strongest in decades is becoming increasingly a consensus view. The implications of this robust growth, though, are still being hotly debated.

Specifically, we see rising nominal bond yields and downward pressure on price-to-earnings (P/E) multiples as completely consistent with the Goldilocks scenario of rapid economic growth and tame inflation.

Fixed-Income Markets

In the fixed-income markets, the debate has focused on rising inflation as the byproduct of what is now largely expected very rapid economic growth this year.

But historical evidence of the past seven decades suggests that rising 10-year yields are a function of the increase in the nominal GDP growth.

The fact that real economic activity is expected to accelerate substantially argues for nominal yields rising, in our view—even if inflation does not accelerate beyond the 2% to 3% range.

Equity Markets

Now let's turn to equities. Stock markets rise in periods of accelerating growth. But this year, much of the increase in stock prices is likely to come from rapidly growing earnings instead of expanding P/E multiples, as was the case last year.

And we expect 2021 to be all about earnings growth well in excess of expectations in many cases. And this, too, would be consistent with prior experience during economic expansion.

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