Who Is Harmed And Unharmed By Higher Long-Term Rates?

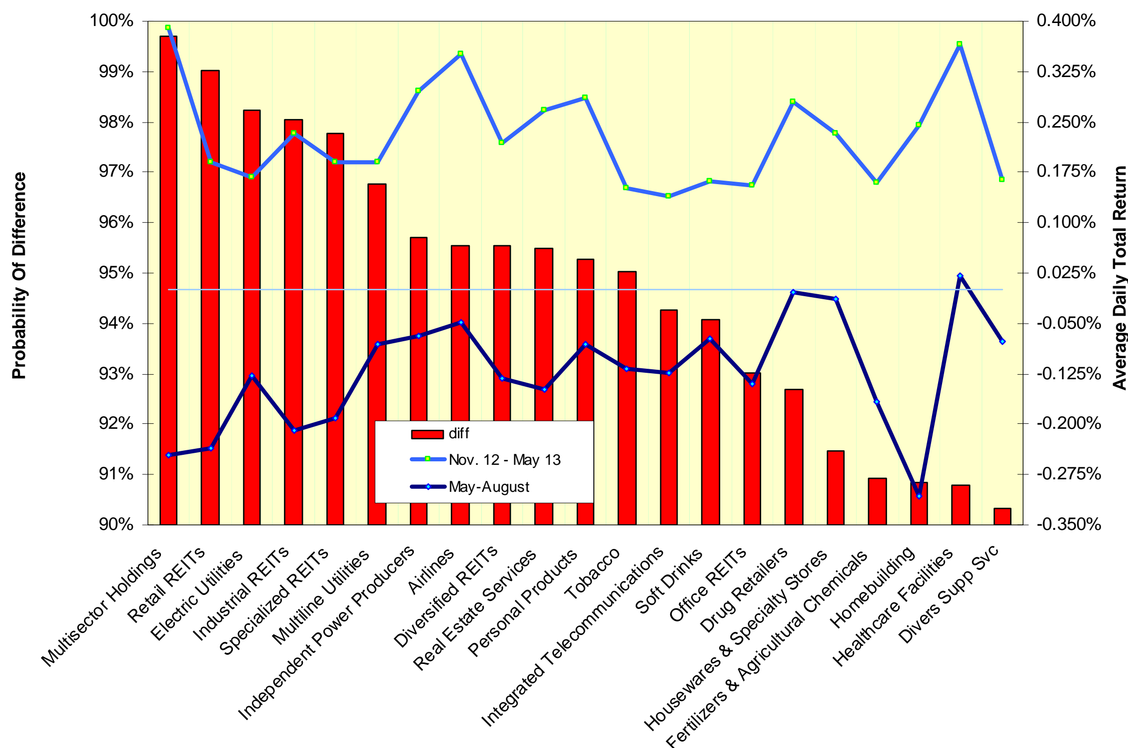
You can always be certain of living in uncertain times, which is why the old Wall Street adage about markets not liking uncertainty is so devoid of content. It was not even four months ago when I could analyze which industry groups' behavior diverged the most and least from the broad market's as a function of excess global liquidity.

Now the question has to be which industry groups have been hurt the most and the least by the sudden rise in long-term interest rates. As an aside, this jump and the concomitant bearish steepening of the yield curve were visible back in January; had it not been for developments such as the bungled Cypriot bailout – remember that? – and Japan's expansion of QE in March and April, respectively, we would have been at our present bond selloff earlier.

Hurt By Higher Yields

Let's compare return streams for 144 industry groups in the S&P 1500 Supercomposite across two periods. The first period will be from the November 14, 2012 downside breakout in the yen and the beginning of our own post-election rally through May 2, 2013. The second period will extend from the first upside breakout in ten-year Treasury yields through the release of the FOMC June Minutes last week.

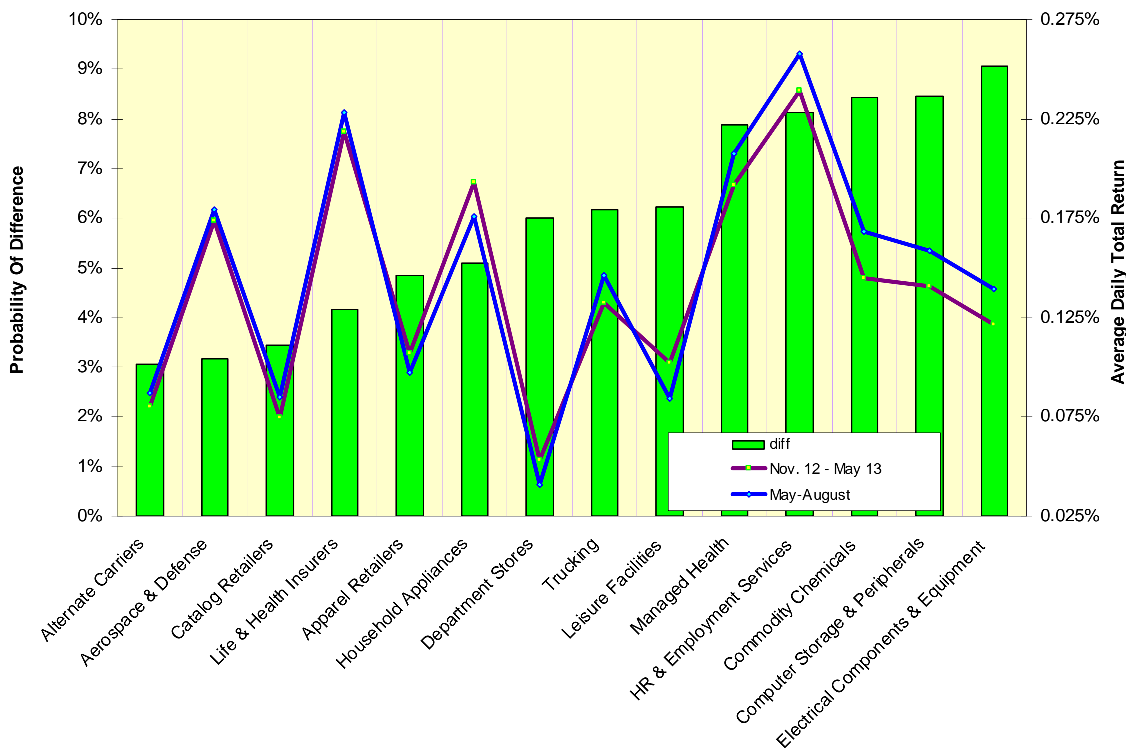
A total of 21 groups' returns changed at a 90%+ confidence interval; all of these changes were from higher returns to lower returns. The list is dominated by REITs, utilities and a host of consumer staples such as personal products, tobacco and soft drinks; unsurprisingly, the homebuilders are on this list, too. If these groups sound like a who's who of winners from the November 2012 – April 2013 period, a time when supposedly defensive issues were leading the market, it is because they are. The REITs include some well-recognized names as Simon Property Group (SPG), Prologis (PLD), Plum Creek Timber (PCL), Public Storage (PSA), Weyerhaeuser (WY) and American Tower (AMT); the consumer staples list is populated by firms such as Altria (MO), Coca Cola (KO) and Avon Products (AVP).



Unfazed By Higher Yields

A total of 14 groups' returns were unchanged at a 90%+ confidence level. Unlike the list above, these have no strong connecting theme. In only two of the cases, those for household appliances and leisure facilities, did returns decrease after May 2, 2013 from the November 2012-May 2013 period. These two groups include firms such as

International Speedway (ISCA), Life Time Fitness (LTM) and Whirlpool (WHR). I guess if you are determined to bench-press a refrigerator while running around a racetrack, higher Treasury yields are not going to stop you.



The pattern from earlier in the year of having supposedly defensive stocks leading the way higher as investors chased yield was not sustainable; at some point dividend yields had to approach an arbitrage bound with both corporate and government bonds. Growth, or the embedded call option on earnings, is a much more sustainable path to higher equity returns.

As firms availed themselves of the opportunity to issue debt during the period of artificially low rates and as corporate balance sheets still show a large amount of cash, higher yields will be less damaging to corporate profitability than they might have been in an earlier time. The real question is whether governments will be able to function with their high debt loads after a decade of incontinent spending habits once the Federal Reserve stops monetizing their debts.