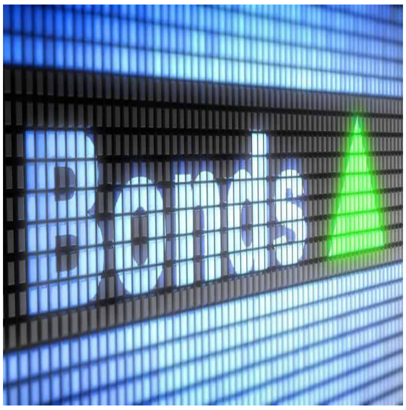

Forget Shopify! Here's How to Find Value as Bond Yields Rise

Description

Investors have the jitters over the plunging bond market and climbing bond yields. The recent pullback in 10-year Treasury note prices has caused yields to swell ahead of the post-COVID economic reopening. Inflation will rear its ugly head again, and as employment bounces back, there's a real risk that the economy could overheat, pressuring central banks to reverse their extreme dovish stances.

Rising bond yields: The worry of the month

Despite the drastic action in the bond market, the U.S. Fed isn't flinching. It's focused on employment, not a modest inflation spike that chairman Jerome Powell sees as short-lived. The Fed bailed us as investors out during the 2020 stock market crash, and I think you have to side with the Fed and give Powell the benefit of the doubt.

The rapid uptick in bond yields has been quite worrisome to some beginner investors who've overweighted themselves to the hottest momentum winners of last year. But don't think for a second that we've witnessed the start of a new long-term trend, a historic reversal, or a bottoming out in bond prices.

Over the longer term, I still see bond yields and interest rates as being under considerable pressure. The U.S. Fed can step in and cap bond yields to soothe rattled investors, but I don't think they need to. In Japan and Germany, where bond yields are essentially nil or less than nil, fixed-income investors have an incentive to buy the U.S. or Canadian 10-year note, which, I believe, should prevent bond yields from surging above the 2.5% mark this year.

Can bond yields surge meaningfully above 2% this year? Sure, but could it also retrace back below the 1% mark over afterwards? I certainly wouldn't rule it out.

Nobody made money by worrying over what the herd is already worried about

Higher bond yields are bad news for growth stocks, especially for those that aren't expected to be profitable until way out in the future.

Instead of wasting your time following others by trying to predict the unpredictable, I'd take a page out of the great Warren Buffett's playbook by focusing on your strengths as an investor.

The recent bout of market volatility is a good thing.

There's no sense in trying to scare yourself out of the markets. Rising bond yields are less than ideal. But don't think they'll continue skyrocketing. They could remain stagnant or even retreat.

As such, I think it's vital that investors spread their bets across some of the sold-off growth stocks that may not have deserved to take a one-two hit to the chin over these past few weeks. They're likelier hold their own if the 10-year yield soars above 2%, and they'll stand to skyrocket if yields retreat if in the likely event that the Fed is proven right about their expectations.

Where's the greatest value? Think growth — profitable growth

Mr. Market corrected a slew of frothy growth stocks, many of which deserved to be re-valued sharply to the downside (think **Shopify**). Others may have been unfairly dragged down with the rest of the growth group. It's the latter (think profitable tech stocks like **Constellation Software** (TSX:CSU)) that I think hold the most opportunity at this juncture.

Constellation is a diversified software company that's perfected M&A. The stock dipped 6% on bond yield fears only to bounce over 7% off the bottom. Should Mr. Market pummel tech over rising bond yields again (I think they will), be ready to pull the trigger on Constellation Software and other wildly profitable tech companies that shouldn't be hit as hard as the "sexy" so-called story stocks.

The Foolish takeaway amid rising bond yields

Now, I have no idea where bond yields are headed next or if beginner investors will shrug off a steeper pullback in the 10-year bond.

Regardless, I'd look to areas of the growth market that won't stand to crumble like a paper bag if bond yields were to continue swelling at this pace. I'm talking about "growth" companies that have real underlying fundamentals and earnings, not the "sexiest" growth stories or trends that have been bid-up by speculators in 2020.

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