Equity markets around the world continued to advance last week, again thanks to continued improvements in economic growth and an overall sense that macro risks have been receding.

At the same time, bond prices sank as yields moved sharply higher, with the yield on the 10-year Treasury jumping to close to 2.3% after trading at around 2.0% for several months. Meanwhile, oil and gasoline prices rose again, gold prices fell and the US dollar gained some strength.

As we have been saying for the past several weeks, it appears the US economy is improving to the point that it is entering a self-sustaining cycle, helped in large part by advances in the labor market. We have recently been seeing improvements in retail sales (with January's figures up by 1.1%) and we are expecting that gains in employment will translate into faster income appreciation and additional consumption. One cautionary note is that jobless claims have stopped falling in recent weeks, which suggests that the future pace of jobs growth may be more subdued than we have seen in the past few months. It is possible that the warm winter weather may have skewed jobs growth to the upside.

At the beginning of the year, two of the main risks to global economic growth appeared to be the ongoing European credit crisis and the possibility of a hard landing in China. While those risks seem to have receded since that point, a new one has emerged: rising oil prices. Since December, oil prices have advanced by roughly $20 per barrel. Our assessment is that roughly half of that comes from growing optimism about the prospects for global growth as well as some supply shortfalls. The other half can be attributed to the risk premium coming from noise in the Middle East and concerns about Iran. Quantifying the exact impact of the "Iran premium" is extremely difficult since there is a near-limitless range of possible developments that could impact oil prices. The worst-case scenario would be for some sort of military conflict that could disrupt the flow of oil through the Straits of Hormuz, but at this point that seems unlikely.

In any case, it is important to remember that the current run up in oil prices is still only about half of what occurred around this point last year, and at present we do not believe oil prices have risen to the point that they represent a significant threat to the pace of global growth.

An additional development that drew attention last week was the dramatic rise in Treasury yields. The rise in yields came at the same time that the Federal Reserve held its regular interest rate policy meeting. At that meeting, the Fed confirmed that economic growth is clearly not weakening and may be strengthening, and the central bankers retained their commitment to keeping rates low for the foreseeable future. At this point, markets appear to be signaling that an additional round of quantitative easing is not in the cards, which (along with improved growth) helps explain the advance in yields.

The selloff in bonds does raise the question of how much further it can go before higher yields represent a threat to equity markets. In our view, current macro conditions warrant additional increases in yields. We believe a fair value for the 10-year Treasury is currently around 2.5% or higher. It is important to remember that before last week, we saw several months of improved economic data without a corresponding rise in yields, so in many respects, last week's moves represent a sort of "catch-up" effect for the bond market. We believe the current trend of rising yields signals an acknowledgement of growing optimism around the economy and, as such, is a positive for stocks.

While it is important to remain cognizant of the risks facing the markets, our overall view toward stocks remains constructive. Since the current rally began last autumn, we have seen some market pullbacks, but they have been brief and shallow, likely because many investors remain underweight equities and have been using pullbacks to buy on price dips. Now that bond prices are falling, we believe investors as a whole will finally begin to move out of Treasuries and into stocks. As such, as long as the macro fundamentals remain reasonably good, we believe equities should grind higher from here.

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