With economic data coming in generally better than expected, equity markets stabilized last week.

The recent better-than-expected economic data has come from modest firming in the manufacturing sector, as seen in the uptick in the ISM Manufacturing Survey, and a solid jobs report. Although we see little evidence of the economy taking off, we continue to believe we should see slow improvement into year's end.

However, there is a flipside to continuing progress in the recovery: Eventually, the Fed will have to pull back on its extremely accommodative monetary policy. At this time in the economic cycle, it means a tapering and eventual cessation of the Fed's quantitative easing bond-buying program. With a solid if uninspiring June payroll report, the odds rise that the Fed will begin to taper the rate of asset purchases sometime this fall.

While markets can withstand a small rise in interest rates without derailing the rally, the risks going forward have risen. We saw on Friday that markets can weather a modest rate increase, as stocks rallied despite the selloff in bonds. And there is further evidence that investors are growing accustomed to somewhat higher rates: At some point, however, higher rates will create a more significant headwind for stocks. While there is no magic level, a prolonged and substantial move over 3% in the 10-year US Treasury yield would represent a risk to equities for several reasons. Higher rates would hurt corporate margins, slow the housing recovery and create more of an alternative for yield-hungry investors.