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US stocks: Bonds maintain a hold

By Jack Buehrer

The first quarter of 2013 has seen a soaring stock market push the main US indices to new all-time highs. But investors have yet to show a willingness to abandon their lower-yielding fixed income securities.

Stocks have maintained a sharp climb since January, buoyed by positive jobs numbers, a strengthening housing sector and record corporate profits. The Dow Jones Industrial Average, a price-weighted average of 30 blue-chip stocks, surpassed its all-time high in the first week of March. Simultaneously, the S&P 500 index of large-cap companies, more widely used by investment professionals, reached a new high in early April.

US investors poured about $38bn into US stock mutual funds in January, the first month since April 2011 that the asset class saw positive net inflows, according to the Investment Company Institute. Stock funds saw net outflows again in February.

Stock inflows have yet to come at the expense of investors' appetite for funds that invest in bonds. The year has featured net positive inflows for bond funds each month, giving analysts pause in declaring the stock market's gains the beginning of what some have called a "great rotation" out of bonds and into equities. Given that money has been flowing into bonds and out of US stocks steadily since the first quarter of 2009, many investment industry professionals have been waiting for years for this great rotation.

Still, advisers say they are starting to field calls from clients who have yet to jump on the equities bandwagon wondering when – and if now – is the time to reallocate money to US equities. Kevin Myeroff, an adviser at Royal Alliance Associates, says most portfolios were still 50 per cent in equities, even at the height of the financial crisis. Most investors, he adds, remain skittish about stocks but are starting to believe, or at least acknowledge, the hype.

"The memory of 2008 is still clear and fresh to them, so they're not drinking all the Kool-Aid just yet," Mr Myeroff says. "In many cases, people have been afraid to dip a little further in but they're starting to get more aggressive in their mindsets."

The re-emergence of stocks has had little effect on investors' overall exposure to bonds, says Russ Koesterich, global chief investment strategist at BlackRock. He says the money going into stocks has not been coming out of bonds but out of cash.

Gerry Klingman, an adviser at Raymond James Financial Services in New York, says many investors are kicking themselves for not having stayed in equities in the aftermath of the financial crisis and fear that they have missed their chance.

So what will it take for investors to leave bonds behind and go full tilt into equities? Mr Koesterich argues that little can happen in the near term to cause a large-scale rotation from bonds to stocks.

"You need more sustained growth in equities and you need more good economic news. It's a slow process," he comments. "Bond yields are still at record lows, so investors are going to need to start losing money in bonds before they start dumping them. But that's not what's happening."