

# MARKET WRAP

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## Share investors find a new love

Bonds were the most popular asset class in 2010 as investors licked the wounds of sharemarket volatility, writes **Philip Baker**.

It seems local investors are turning their backs on shares. Over the past year the sharemarket has been characterised by a high degree of volatility, with investor confidence in stocks still undermined by the fallout from the global credit crisis. Many investors have been left licking their wounds and wondering just where they should place their money.

A survey of market players shows more than a third of retail investors have tipped more money into fixed income products such as bonds.

Australia may have weathered the financial crisis better than most but investors don't want to risk losing more of their hard-earned savings.

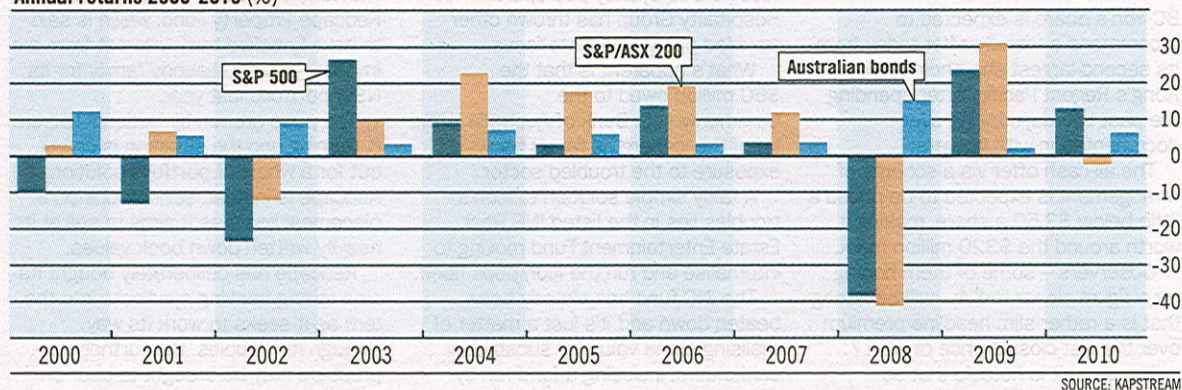
According to a 2010 Datamonitor survey of local consumers, 35.4 per cent of investors increased their holdings of cash products such as high-interest savings accounts, while bonds were the most popular asset class in 2010, with 33.5 per cent of Australian investors adding to or taking out a government or corporate bond for the first time.

This was in stark contrast to 2009, when investors increased their bond holdings by only 20.3 per cent.

"It is hard to see the attraction of a high-interest savings account dimming any time soon," said Datamonitor senior analyst Andrew Haslip. "We expect this product to remain a favourite among Australian investors."

### Bonds are beautiful

Annual returns 2000-2010 (%)



SOURCE: KAPSTREAM

### MARKET MONITOR

**Global credit stock is forecast to rise around \$US100 trillion between now and 2020. At \$US213 trillion, this will see global credit maintained at around 180 per cent of global GDP.**

Glenn Mumford, page 22

The move into bonds comes as bond yields are rising on positive economic data, in the United States in particular, where retail investors are putting money back into stocks.

The latest data from the Investment Company Institute shows US investors put more than \$US6 billion into global and domestic stock funds in the week ending on January 12, the largest weekly inflow into stocks since May 2009. Since October, retail investors in the US have tipped almost \$US9 billion into stocks and \$US3 billion into bonds.

Government bond yields have generally edged higher over the past few weeks on solid global economic data. Bond yields in debt-troubled European countries are still facing

upward pressure because of worries about an increase in supply in the months ahead.

Historically, local investors have been underweight bonds, with most happy to take the extra risk and rewards equities offer.

Bond experts have long argued that local investors should own more bonds, but up until the financial crisis they have largely been ignored, despite their performance.

According to Kapstream Capital, bonds have outperformed equities since the beginning of 2000.

Over the past 10 years, the S&P 500 Index has returned minus 1.4 per cent annually, while the benchmark S&P/ASX 200 in Australian dollars has returned just shy of 4 per cent, excluding dividends. In contrast, the UBS Australian Composite Bond Index has generated an annual return of 6.4 per cent.

FIIG Securities analyst Stephen Nash argues that fixed income plays a role in alleviating the problems that can occur from shares.

He reckons annual return characteristics show that fixed

income returns are not only much less volatile than equity returns but that bonds also have a much more consistent cumulative return stream than equities.

Low inflation, US Fed purchases of government bonds as well as most central banks being intent on keeping interest rates on hold should keep yields in key advanced countries reasonably under control in the short term. But the risk of a sharp back-up in global bond yields at some point is very high, says AMP Capital Investors chief economist Shane Oliver.

"Bond yields in key advanced countries are still well below longer term sustainable levels and the record inflows into bond funds seen in recent years are at risk of becoming record outflows," Mr Oliver said.

One advantage for local investors is that bond yields in Australia are more in line with long-term sustainable levels, so the chances of a sharp spike in yields and sharp capital losses for investors in Australian bonds is less likely than is the case for global bonds.