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From The Desk of CIO

~ Ang Kok Heng

Funds are Avoiding Equities – But for How Long?

"Fund flows into fixed income and out of equities have been relentless the past five years……Low yields may be unappealing, but until investors actually experience losses on their bond portfolio, it's unlikely they'll feel compelled to move en masse into risky equities."

Extracted from "Cross-Asset Strategy 2013: Transition Path" by Morgan Stanley Dec 12, 2012

In its report "Cross-Asset Strategy 2013: Transition Path", Morgan Stanley discussed about the preference for fixed income instruments in the past (see Chart 1).

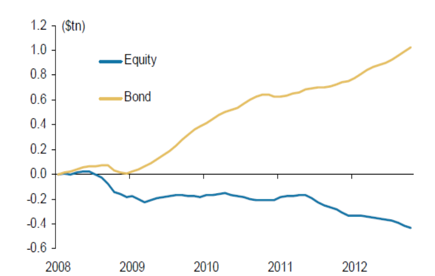
The author, however, believes that such trend will continue into 2013 for 2 main reasons a) the net supply of US fixed income is shrinking and hence reduces the risk of potential losses to bonds and b) investors will continue to ride the trend until they experience losses from their bond investment.

As interest rates trend lower, the forward returns from bond investments will in turn become less alluring. Although the risk of losing money from bond investment is not apparent presently, as the Fed is adamant to keep rates low till 2015, the investing merits in bonds as well as other high-yielding low-risk equities are diminishing too. This is evident from the attractive dividend yield which is exceeding the US 10-yr treasury yield (see Chart 2). Indirectly the chart also indicates that equities are undervalued at the present moment.

Investors should be wary of basing investment decision on historical return of bond investment by staying invested in this "safe haven" or even putting more allocation into bonds as "past return may not necessary reflect the future return". After the sub-prime crisis, bonds have performed better than equities in many instances, but it is getting tougher for fund managers to repeat the recent good performance of bond investment under the present declining interest rates environment.

Chart 1: Funds Flow Avoided Equities

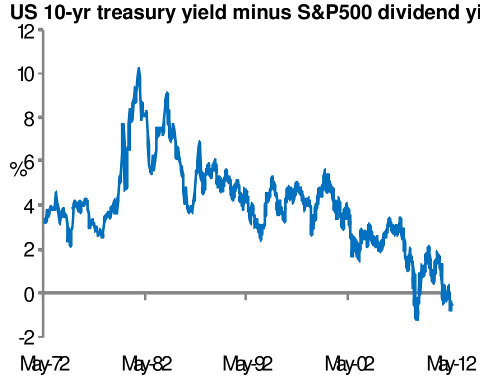
Cumulative Flows into Fixed Income and Equities



Source: ICI, Morgan Stanley Research

Chart 2: Dividend Yield > Treasury Yield

US 10-yr treasury yield minus S&P500 dividend yield



For Phillip Capital Management Sdn Bhd

Nona Salleh
Executive Chairperson