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Headline: The rich are turning bullish, and they ain't rotating

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They are using cash, not selling bonds, to buy equities

By **CAI HAOXIANG**

[SINGAPORE] As they put the nightmare of the global financial crisis behind them, high net worth individuals are turning positive on equities and buying them again.

But they are not really participating in the "great rotation" – Wall Street's hypothesis of a once-in-a-generation bond sell-off – to pay for riskier equity assets.

This is because the wealthy are still using cash to pay for both equities and bonds, and also prefer the stable income provided by the latter, say seven private banks interviewed by *The Business Times*.

Citi Private Bank Asia Pacific head of investment Debashish Duttagupta said fund flows are going from cash into both fixed income and equities.

Sentiment among clients is that US growth will surprise on the upside, he said. "What we're seeing is that people are becoming pro-risk."

Citi private banking clients have 28 per cent in fixed income, 26 per cent in cash, 36 per cent in equities and 10 per cent in alternatives on average, he said.

Similarly, Hou Wey Fook, chief investment officer of Bank of Singapore, said that as bank deposit interest rates are expected to remain close to zero for a while, any inflows into equities are more likely to come from cash than from bond holdings.

Hugues Delcourt, ABN Amro's private banking CEO for Asia and Middle East, summed up the consensus view: "We don't see many clients switching from bonds to equities as most investors feel comfortable with the credit risk of the issuers and are prepared to hold the bonds till maturity. Switching from cash to equities is more common."

Even though the wealthy are turning more positive on equities, many are still reluctant to make risky bets.

Gary Dugan, Coutts chief investment officer for Asia and Middle East, said there is some profit-taking on fixed income at the margins, though clients still hold 60 per cent of their assets in fixed income on average and just 30 per cent in equities.

Cash is best: *Fund flows are going from cash into both fixed income and equities.* FILE PHOTO

The majority of clients he surveyed are positive on equities now, he said.

"But if you ask how they're investing, they still haven't implemented their strategy. So it's a slow move back in. If we get three quarters in a row of good news, then they'll come rushing back."

Mark Matthews, Asia head of research for Bank Julius Baer, said many clients still shy away from the volatility of stocks.

"There exists a large universe of investors who cannot invest in equities due to their volatility, and those who need the stable income that bonds provide," he said.

The "great rotation" hypothesis had been making its way in investment circles since the start of the year, as global stocks saw a surge of interest while bonds, at historically low yields after a 20-year bull run, were looking overpriced.

The risks of a damaging macroeconomic event, like the US falling off the fiscal cliff, a hard landing for China or a eurozone collapse, seem to have been averted.

Most investment houses have also been advising clients to shorten the duration of their bonds and put their money in high-yield bonds or riskier asset classes such as equities.

Said Singapore Management University finance professor Francis Koh: "There is a belief that interest rates have no room to decline further. This environment means that bond yields will not increase and, thus, little upside is available from fixed income.

"The world economy looks like that it is recovering, although slowly ... But no catastrophic scenarios, so, (there's a) move to equities."

Retail investor activity is just one part of the market. A recent Reuters report said Deutsche Bank data for 2012 shows the global pool of mutual and exchange traded funds is valued at around US$28 trillion, less than half the combined US$57 trillion of slower-moving, more conservative pension and insurance funds.

But there are signs that money managers have been selling US government bonds.

DBS Private Bank head Tan Su Shan also said she is seeing some "rotation out of long-dated bonds and perpetuities into equities".

Nevertheless, evidence of a big bond sell-off has not appeared. A Coutts report on Feb 18 noted that money flows show investors have the same appetite for bonds and equities.

US mutual fund flow data through to early February shows net inflows of US$23.8 billion into bond funds and US$22.4 billion into equity funds, it said.

Looking ahead, the private banks say equities will do well this year. Ms Tan of DBS said clients have been interested in China, Hong Kong, selected US names and sectors and Japan.

Michael Markovich, global interest rate research head at Credit Suisse Private Banking, said central banks are likely to keep rates low even given current growth assumptions, which are already somewhat optimistic.

"Our analysis shows that equity is more attractive than corporate bonds. Central banks want us to see it that way, that's why they want to depress yields," he said.

ABN Amro's Mr Delcourt is advising clients to increase their portfolio weighting in equities, particularly in the markets of Asia Pacific and Latin America. In terms of sectors, he recommends going overweight in healthcare, industrials and energy.

Mr Duttagupta of Citi recommends holding on to real-estate investment trusts and looking at undervalued US bulge bracket banks. However, he said, a correction might be coming and those who want to trade might want to take some profit on stocks and replace them with call options.

"If you're buy and hold, do nothing," he said.

But Mr Dugan of Coutts sounds a warning note on bonds. "It feels like the last hour of the party. A lot of clients who want to sell bonds think they'll be out before everyone else," he said.

"Bond markets in Asia are still young; they are not that liquid. If people start to see losses on bond portfolios, I think everyone might exit at the same time and there will be the risk of a severe adjustment."