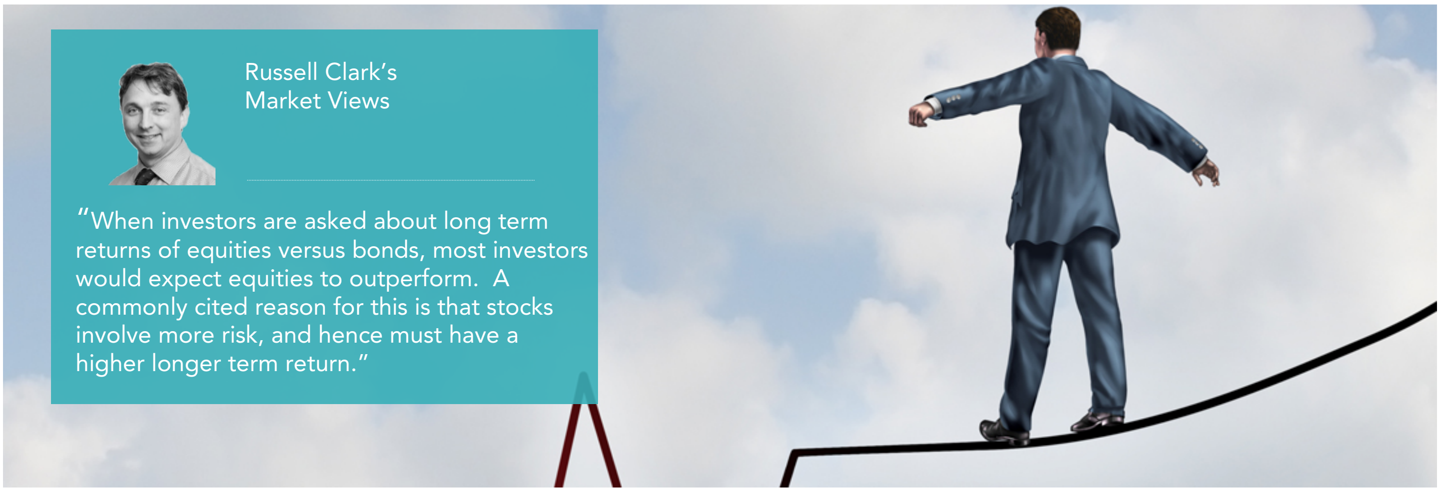
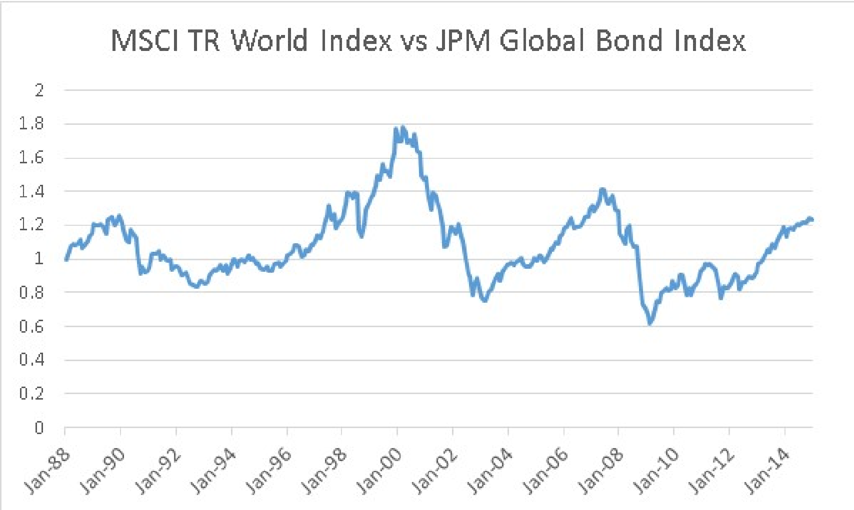
RUSSELL CLARK
INVESTMENT MANAGEMENT

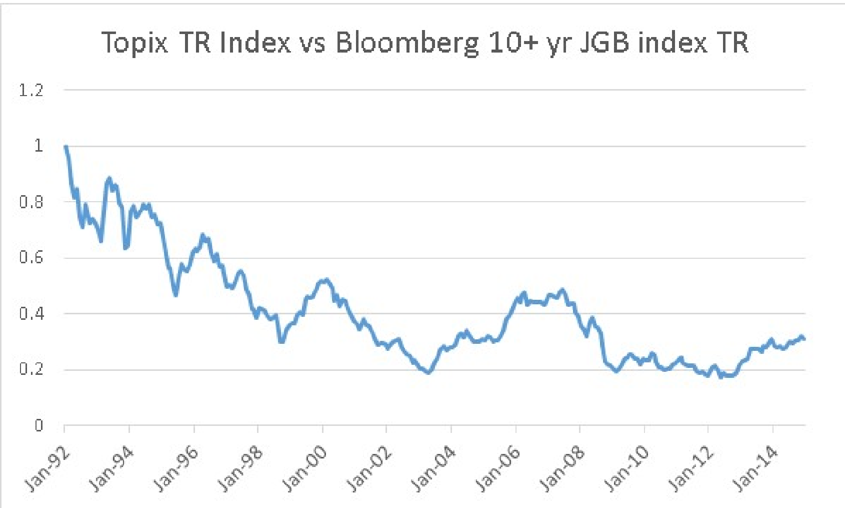
MARKET TIMING AND BONDS VERSUS EQUITIES



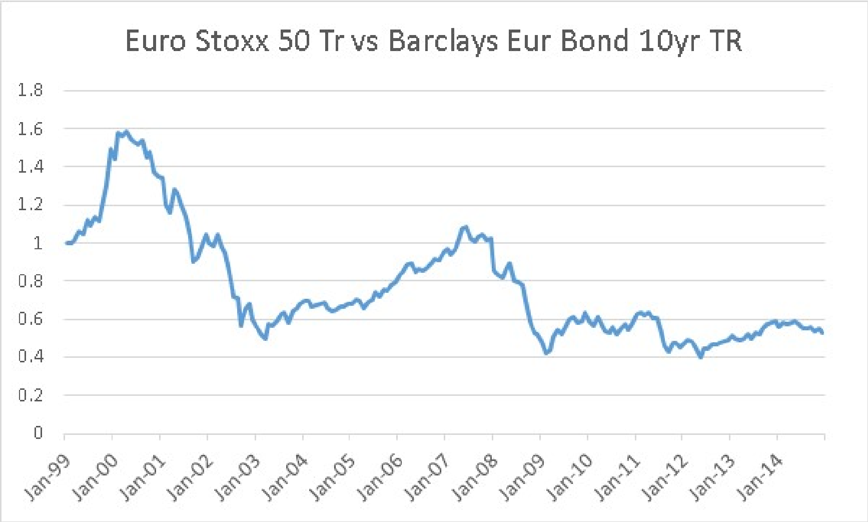
When investors are asked about long term returns of equities versus bonds, most investors would expect equities to outperform. A commonly cited reason for this is that stocks involve more risk, and hence must have a higher longer term return. However, when we look at the MSCI Total Return World Index in USD versus the JPM Global Bond Index in USD from 1988 onwards we can see that the relative performance of stocks versus bonds, is very dependent upon which point in time you are looking at.



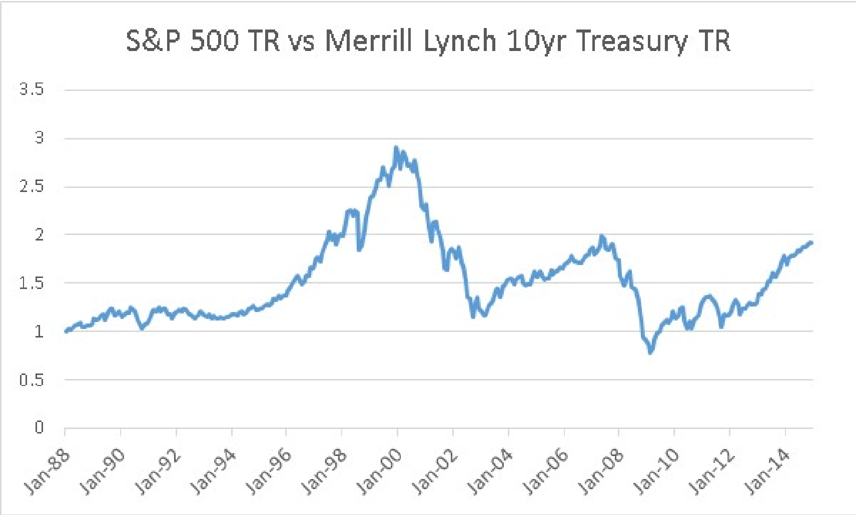
I suspect that a large part of this is driven by the Japanese market, which in the late 80s was the single largest equity market, and is now the world's largest bond market.



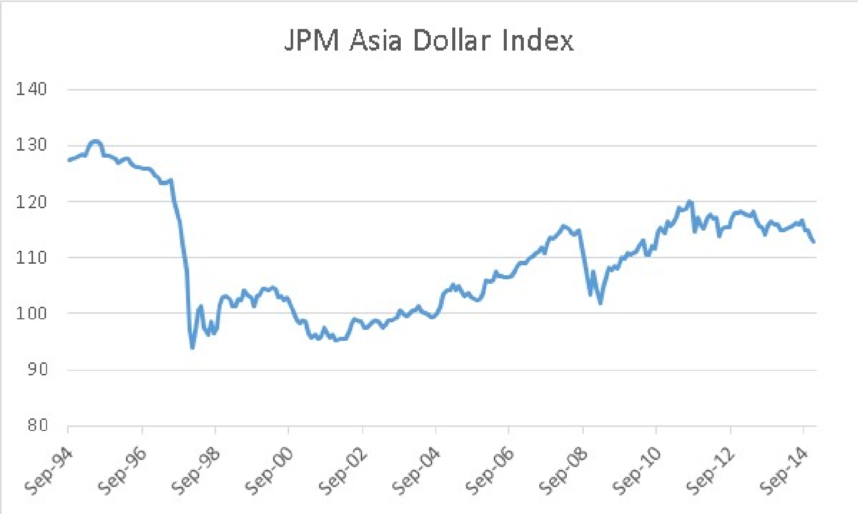
For Japanese investors, JGBs have been generally a good investment relative to equities over the years. Intriguingly, the ratio of equities versus bonds seems to give some advanced notice of equity market weakness, with bonds beginning to outperform equities for a few months before equities begin to fall in value. Market commentators increasingly refer to the Japanification of Europe. The performance of bonds versus equities seems to reinforce that message. Intriguingly, bonds have started to outperform equities recently in Europe.



US stocks have offered much better relative returns than bonds when compared to Japan or Europe.

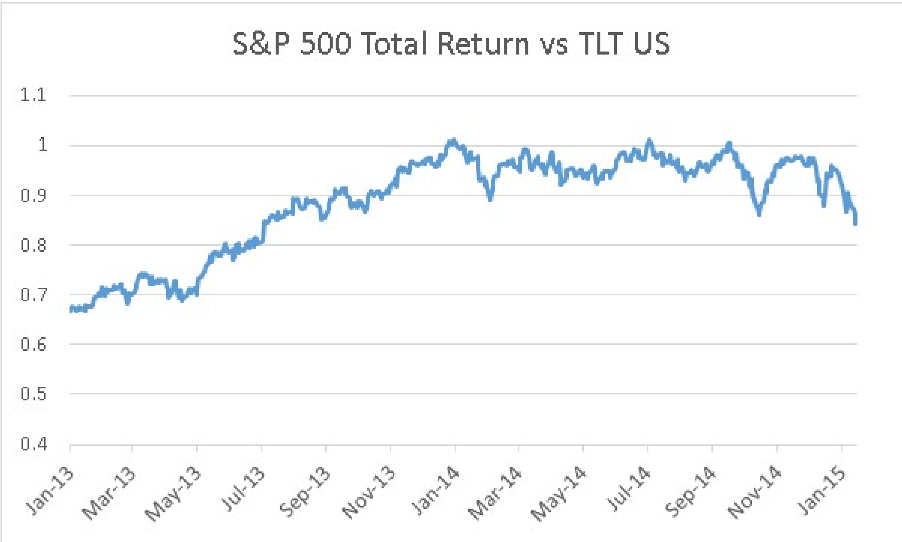


However as noted in my note titled "US Treasuries – The Buy Case" – movements in JPM Asia Dollar Index tend to be a good lead indicator on inflation pressures in the US. The JPM Morgan Asia Dollar Index has begun to breakdown, leading me to think that US bonds are poised to perform well.



Furthermore, margin debt balances in the US suggest investors are very long US stocks.

On a daily basis, even US stocks now look to be underperforming. We use TLT US – a widely held bond ETF.



One common argument is that as bond yields are so low, investors must buy equities. However, looking at the history of Japan, and movements in currencies and margin debts, investors look to be best served by being long bonds and short equities.

INFORMATION

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