The Great Rotation From Bonds To Stocks Has Yet To Happen

Key Bond Market Statistics *(12/31/06 vs. 6/30/17)*

Key Statistics/Indicators	As of 12/31/06	As of 6/30/17	Change
Federal Funds Target Rate (Upper Bound)	5.25%	1.25%	↓400 basis points
Yield on 10-Year Treasury Note	4.70%	2.31%	↓239 basis points
CPI Headline Rate (Y-O-Y)	2.54%	1.63%	↓91 basis points
Real Rate of Return (10-Yr. Treasury Yield Minus CPI)	2.16%	0.68%	↓148 basis points
BofA ML 7-10 Yr. U.S. Treasury Index (Total Return Index Value)	1,455.16	2,505.69	↑72.19% (5.31% Avg. Annualized)
Total Net Assets (Bond Mutual Funds)	$1.50 Trillion	$3.88 Trillion	↑$2.38 Trillion

Sources: Investment Company Institute (ICI), Bloomberg, Haver Analytics.
Past performance is no guarantee of future results.

View from the Observation Deck

1. Today's blog post features a snapshot of some key bond market statistics that can be used to support the theory that some of the capital currently invested in bonds, particularly bond mutual funds, could potentially shift to equities if interest rates were to rise moving forward.
2. The rise in interest rates would likely be driven by stronger economic activity, higher inflation and the gradual unwinding of the Federal Reserve's balance sheet over a number of years, in our opinion.
3. With respect to fixed-rate bonds, interest rates and bond prices tend to be inversely related. When interest rates rise, bond prices fall, and vice versa.
4. From 12/31/06 through 6/30/17, the BofA Merrill Lynch 7-10 Year U.S. Treasury Index posted an average annualized total return of 5.31%, which exceeded the 4.70% yield on the 10-Year Treasury note as of 12/31/06 (see chart).
5. The dilemma facing fixed-rate bondholders today is the yield on the 10-Year Treasury note closed at 2.31% on 6/30/17, less than half of where it stood on 12/31/06.
6. The aforementioned shift has been referred to as the "Great Rotation," due in part to the significant rise in total bond mutual fund assets since the end of 2006 (see chart). From 12/31/06-6/30/17, bond mutual funds reported net inflows totaling $1.36 trillion (not shown in chart), according to the ICI.
7. To be fair, this theory has been discussed for a number of years. While short-term interest rates have risen since the end of 2015 due to Federal Reserve rate hikes, intermediate and longer-term bond yields have not.
8. With most major U.S. stock indices trading near their respective all-time highs more than eight years into the second-longest bull market in history, some investors might be wondering where the capital could potentially come from to drive stock prices higher.
9. We believe that the bond market could be one possible source of capital moving forward. Here is an overview of the level of liquid assets held by equity mutual funds (click here to view).

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