Daiwa Securities

Daiwa's View

Possible factor behind simultaneous rise in stocks and bonds

➢ Could be portfolio investment flows

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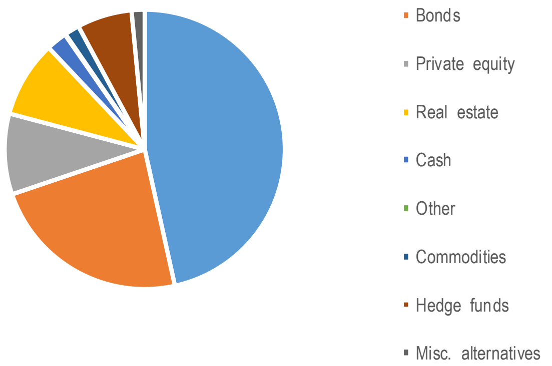
Possible factor behind simultaneous rise in stocks and bonds

Could be portfolio investment flows

Bonds and stocks have been rising together mainly in the US. One possible factor behind this could be the flows of investor groups managing portfolio investments. This is because we suspect that it could be due to their profit taking due to higher stock prices as well as bond purchases on the other side. In this report, we examine asset management at US public pension funds (investor groups managing portfolio investments) represented by entities such as CalPERS.

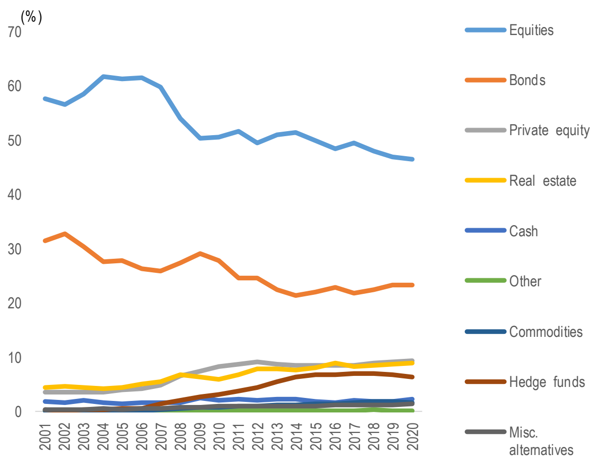
According to Public Plans Data (hereinafter referred to as PPD), there are 299 US public pension funds. In 2020, assets under management amounted to $4.5tn, slightly more than double the assets managed by the Government Pension Investment Fund of Japan. The asset mix in that year was as follows: equities 46.2%, bonds 23.5%, private equity 9.3%, and real estate 8.7% (left-hand chart below). We point out that the ratio of equities has declined over the past 20 years in contrast to an uptrend in the ultra-long term. The asset mix has not changed greatly over the past five years (right-hand chart below).

Asset Mix at US Public Pension Funds



Source: PPD; compiled by Daiwa Securities.

Trends of Asset Mix at US Public Pension Funds



Source: PPD; compiled by Daiwa Securities.

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Considering the past price trends of each asset, we presume the assets were rebalanced. Looking at data over the past five years since FY16[1], the percentage change of asset price indices was largely consistent with rebalancing during FY16-18. In FY19, US public pension funds bought bonds, despite the fact that the percentage change of bonds was higher than that of stocks. However, we need to consider the rise in private equity this year, which cannot be measured using indices[2]. In FY20, it was difficult to analyze data at the end of the fiscal year because of high volatility from the previous fiscal year.

This data was only updated until FY20. However, we presume that bonds were rebalanced more than usual in FY21 because the price of equities and real estate advanced sharply. Based on our assumption that rebalancing occurred at the end of the fiscal year, we estimate that the rebalancing flow to bonds was about $200bn[3] (chart below).

Percentage Change of Asset Indices by FY Ending end-Jun

(%)	Stocks	Bonds	Real estate
FY16	-5.72	8.87	10.64
FY17	16.48	-2.18	6.97
FY18	8.62	1.36	7.19
FY19	3.61	5.85	6.51
FY20	0.28	4.22	2.69
FY21	37.16	2.63	7.37

Source: Bloomberg; compiled by Daiwa Securities.
Note: MSCI ACWI Index was used for equities, Bloomberg Global Aggregate Index for bonds, and NCREIF Property Index for real estate.

Estimated Rebalancing at US Public Pension Funds

($ bn)	Stocks (actual value - estimated value)	Bonds (actual value - estimated value)
FY16	97	-14
FY17	-172	26
FY18	-103	62
FY19	-51	30
FY20	34	6
FY21	–320 ?	200 ?

Source: PPD, Bloomberg; compiled by Daiwa Securities.
Notes: 1) We presume that positive values indicate purchases of stocks and bonds, respectively.
2) Estimated values are calculated by multiplying amounts for stocks and bonds in previous fiscal year by their respective percentage change. We presume that actual trading is based on more detailed flows.
3) Due to insufficient data, we were unable to analyze all funds. We analyzed 77% of funds on a market cap basis (n=152), with figures for the remaining funds being estimated from derived figures.

We also consider another possible reason for bond purchases by public pension funds from the standpoint of assets and liabilities (future payments to pension fund members[4]). Although liabilities have been larger than assets, the funded ratio improved moderately towards FY20, hitting a bottom in FY16. For reference, we estimate that this ratio improved in FY21 due to a sharp rise in asset prices (left-hand chart on next page).

Of the 144 funds that can be analyzed by the funded ratio, only five funds posted a ratio of more than 1 as of end-FY20. However, when the percentage change of each index is applied, the number of funds with a funded ratio of more than 1 increased to 15 in FY21 (right-hand chart on next page). The improvement in the ratio may give pension funds an incentive for a conservative asset management stance in terms of risk-taking. If so, they are likely to raise the target ratio for bonds in their asset allocations. In fact, the bond allocation ratio rose slightly from 22.8% in 2016 to 23.5% in 2020.

Besides public pension funds, we presume that investor groups such as defined-benefit corporate pension funds and investment trusts also manage portfolio investments. It can be said that these groups are also currently selling equities and buying bonds via rebalancing.

Given the ongoing low market volatility despite the fact that the Jackson Hole conference implied tapering within the year, we forecast that the market will continue to post 'across-the-board purchases'—higher prices of stocks and bonds—for the time being. Meanwhile,

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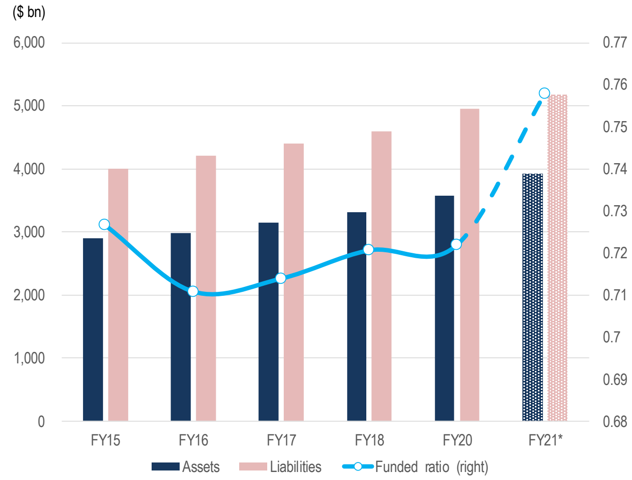
[1] The end of the fiscal (accounting) year (FY) differs depending on the fund. For about half the funds in the data published by PPD, the FY-end is end-Jun. In the analysis for this report, end-Jun is regarded as the end of the FY, and data for funds whose FY-end month is not Jun is adjusted based on asset prices.
[2] During Jul 2018-Jun 2019, many unicorn firms listed on the market, including Lyft, ZOOM, and Uber. It could be that the higher stock prices of these firms contributed to bond purchases via a surge in private equity that cannot be measured using indices.
[3] After subtracting members' pension premiums and benefits to members, excess payment amounted to $102.0bn. We calculated FY21 figures, assuming that excess payment was the same amount as in FY20.
[4] Unlike in corporate accounting, the present value of liabilities was calculated after discounting pensions that should be paid in the future by the projected rate of interest. According to PPD, even in FY19, the projected rate of interest was 7.18%, confirming a downtrend from 8.07% in FY00.

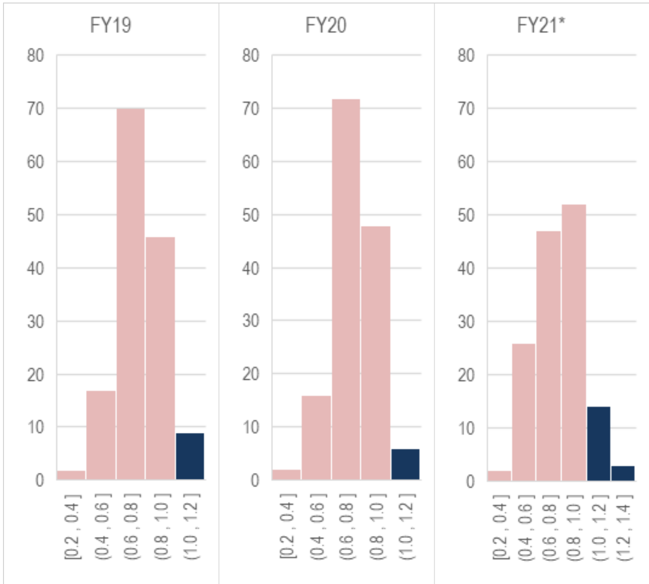
as a risk scenario, we should note the possibility that the selling of bonds could be triggered by a drop in the price of assets other than bonds.

Trends of Funded Ratio at 144 Targeted Funds



Source: Bloomberg; compiled by Daiwa Securities.
**Forecasts.*

Histogram of Funded Ratio at 144 Targeted Funds



Source: PPD, Bloomberg; compiled by Daiwa Securities.
Note: Pink bars indicate ratio of below 1, while dark blue bars show ratio of more than 1.
**Forecasts.*

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5: Underperform TOPIX/benchmark index by more than 15% over the next 12 months.

Benchmark index: TOPIX for Japan, S&P 500 for US, STOXX Europe 600 for Europe, HSI for Hong Kong, STI for Singapore, KOSPI for Korea, TWII for Taiwan, and S&P/ASX 200 for Australia.

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- There may be a difference between bid price etc. and ask price etc. of OTC derivatives handled by our company.
- Before engaging in any trading, please thoroughly confirm accounting and tax treatments regarding your trading in financial instruments with such experts as certified public accountants.

* The amount of the trading commission cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.
** The ratio of margin requirements etc. to the amount of the transaction cannot be stated here in advance because it will be determined between our company and you based on current market conditions and the content of each transaction etc.

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