Advisers warn against fleeing stocks in favor of bonds

Flight to quality overlooks the risks to fixed income that come with rising interest rates

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By **Jeff Benjamin**

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Investors continue to favor fixed-income strategies over equities, which is contrary to what most financial advisers consider prudent at this point in the market cycle and suggests investors are anxious.

The latest data from **ETF.com** show that more than half of the $4.2 billion that moved into U.S.-listed ETFs in the week ended last Thursday went into bond strategies.

Three of the five most popular ETF strategies last week were bond funds. The $34.5 billion iShares iBoxx

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Investment Grade Corporate Bond ETF (LQD) had more than $756 million in net inflows last week.

Meanwhile, the biggest outflows, totaling $2.1 billion, were from the $271 billion SPDR S&P 500 ETF (SPY).

"Interest rates are going up, so investors are heading into fixed income?" quipped Tim Holsworth, president of AHP Financial Services.

"We are, and have been, minimizing our fixed-income holdings for the past several years," Mr. Holsworth said.

The **Investment Company Institute,** whose data combine flows into mutual funds and ETFs, also shows a steady trend of investors fleeing equities and migrating toward the perceived safety of bonds. For the week ended last Wednesday, ICI reported $5.5 billion worth of equity-fund outflows, which includes $7 billion of outflows from domestic equity funds and $1.4 billion of inflows into world equity funds.

Bond funds, meanwhile, saw $3.5 billion worth of inflows during the week.

Todd Rosenbluth, director of mutual fund and ETF research at CRFA, is not surprised by the pattern of money moving out of stocks and into bonds because he thinks investors are more focused on stock market levels than they are on the effect of rising interest rates on bonds.

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"Demand for fixed income has been strong in 2018 as investors have favored low-cost investment-grade securities," he said. "As the equity markets become more elevated, a rotation toward more stable strategies is appropriate."

With the S&P 500 up more than 10% from the start of the year, and up more than 325% since the March 2009 market low, it's not surprising that investors are starting to **show signs of caution.**

But the general trend in asset flows suggests investors might be missing the risk that's building on the bond side, according to Paul Schatz, president of Heritage Capital.

"It's counterintuitive," Mr. Schatz said. "The next crisis for retirees is going to be their loss of principal in the bond market."

Mr. Schatz said the 35-year bull market for bonds is over, citing the July 2016 bottom in 10-year and 30-year Treasury securities, and he expects to see moderately rising interest rates, which drives down the value of bonds, over the next couple of decades.

"The average retiree buying bond market indexes will be in for a world of hurt," he said. "In this environment right now, people should look at limited-duration bond funds as well as the less aggressive floating-rate bond funds. You've got a better economy that is accelerating, and in

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that environment, those two types of bond funds will do better."

Kashif Ahmed, president of American Private Wealth, agrees that exiting equities is a mistake that could come back to haunt investors.

"What this may be saying is that some investors may be succumbing to the narrative that the markets may be nearing a top, or that the headline risk is more of a threat than others believe," he said. "If investors are heading for the exits and piling into fixed income and still have plenty more life left in which they will need their money not to lose its purchasing power, then they are doing themselves a disservice."

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