

## What's the problem? Why the sharemarket can't make 5000

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### Philip Baker

Stocks have recovered from the lows reached in March 2009, thanks to China, low interest rates and the assistance of the federal government.

But still the performance of shares for many investors has been disappointing.

It's been a fine ride if your stocks were only linked to the resources boom but those investors who tried to do the right thing by diversifying their portfolios have missed out.

The unappealing fact is that the benchmark S&P/ASX 200 Index has delivered a small loss over the past five years. And how will risky assets perform when the US Federal Reserve ends its ultra loose monetary policy in June?

Yet amid all the worries about the oil price, a renewed slump in the US housing market and the effects of rising interest rates in China, one market mantra is making a comeback of sorts.

Every now and then you hear a broker describing the day's trading as a good one thanks to the ever growing flows of superannuation funds. The theory goes that a chunk of this money has to be invested in shares and so the market will rise.

It's known as the "weight of money argument" and before the global financial crisis it was commonly used to explain why stocks made record gains.

Back then, a few bullish brokers would even argue that this upward gravity would mean an end to downturns. The recent rebound in stocks has encouraged the optimists to point to the enormous levels of cash sitting on the sidelines of super funds just waiting to be invested.

Shares have rebounded 7.14 per cent since the middle of March when news of the Japanese nuclear and earthquake disaster first broke. Not a bad performance given that in this period investors also faced ongoing tensions in the Middle East, a spike in the oil price, more worries about sovereign debt issues in Europe, inflation concerns in Asia, the likely end of very loose monetary policy in the United States and higher interest rates in China.

In days gone by, any one of these events might have sparked a significant sell-off. But shares are showing signs of resilience. Rather than plummeting, they are treading water.

Certainly they're not racing away – the major S&P ASX 200 Index has slipped 3 per cent over the past 12 months, and risen 1.1 per cent over the past 18 months – but they're not falling either. Yet there has been a lot more bad news than good news. Could the weight of money explain this?

UBS Wealth Management's head of investment strategy and consulting, George Boubouras, thinks it does.

"It's not just the cash coming in from superannuation," he says. "There has been an enormous amount of caution around and it's not just investors but it extends to consumers and business as well. But when investors get cautious the level of cash holdings becomes very high which is it is right now. It's just sitting on the sidelines waiting to be invested so every time there is a dip, some of that cash gets spent and it tends to support the sharemarket."

According to financial services research company, Rainmaker, local fund managers are sitting on about \$170 billion of cash that has been hoarded away since the credit crisis started to hammer stocks in 2008.

Funds have about 12 per cent of their portfolio in cash right now, down from as high as 17 per cent when the crisis was in full flight but still way above the long-term average of about 5 per cent.

In anyone's language it's a considerable sum and doesn't include the compulsory contributions from super.

It's worth noting that the 9 per cent super levy accounts for slightly less than half of all contributions into super so while total contributions to super last year were \$108 billion, just \$49 billion came from the compulsory contribution.



George Boubouras Photo: James Davies

But Australian shares are about 30 per cent of all superannuation assets so in broad terms about \$32 billion each year potentially finds its way into local equities, meaning managers get about \$600 million each week to invest.

The size of the local superannuation industry is also set to grow from \$1.3 trillion to as much as \$6 trillion by 2035 in future dollar terms implying there will always be money seeking a home. But not everyone is convinced it's enough to keep the sharemarket in positive territory.

"Our general view is that the weight of money argument isn't a particularly strong one," Deutsche Bank's equity strategist, Tim Baker, says. "Flows certainly make a difference at the margin, and certainly can be very important for individual stocks, but for the market I think we've seen numerous examples in recent years of fundamentals mattering more than flows."

Wilson Asset Management's portfolio manager, Chris Stott, goes one step further and believes the global financial crisis proved the weight of money argument didn't hold up.

"Back then the market plunged and everyone was still putting their 9 per cent in and it had no effect," Stott says. "Other factors are way more important such as the level of employment, general economic conditions and, of course, interest rates. Maybe all that cash coming in can keep the market up for a certain amount of time but if the basic fundamentals of earnings don't come through then stocks can slump. Over time the fundamentals must win out."

FIIG Securities, the retail bond broker, says that in the self-managed super fund space there were investments worth \$420 billion as at December 31, 2010. Cash and term deposits were the second-largest asset class with \$112 billion or 26.6 per cent invested of total funds, signalling there is plenty of scope for further buying of shares and other assets.

One of the problems with the weight of money argument is it implies there will be an ever-increasing demand for stocks and this will lead to rising prices. That's not completely logical. If the supply of a product is fixed and the demand increases, so will the price.

The weight of money argument might have more legs to it if there was an increasing demand for shares but the supply was fixed. But that's not the case. The supply of shares available for investment can increase, while existing companies can also issue new stock. Companies raised more than \$100 billion to bolster their balance sheets in the wake of the financial crisis.

According to Goldman Sachs there has been, on average, about \$12 billion of new supply of shares through initial public offerings each year over the past decade.

Another source of new share creation is the trend to reward senior executives with options, that is, the right to buy new shares in the company.

The weight of money argument would also make more sense if it could be proved that, over time, the increase in demand for sharemarket investments outstrips the increase in supply. The theory also overlooks the alternative products available to investors – shares do have some competition. Term deposits are now paying very attractive rates of interest and is one reason why the four major banks have experienced a 17 per cent increase in their term deposits over the past year.

If the weight of money, or any other factor, drives share prices too far investors can put their money in alternative investments, such as government bonds, cash and property.

Yet for some reason the weight of money argument is only ever applied to the sharemarket although those super contributions mean other asset classes also stand to benefit. If demand inevitably pushes prices higher surely this applies equally to property and bonds or any other asset class in a super fund?

The managing partner of Family Office Research and Management, Tom Murphy, looks after wealthy families and individuals. He says other asset classes are driven by other factors, in particular sovereign bonds, which are the domain of global central banks.

"The property market is linked more to interest rates and a low unemployment rate," he says.

A portion of superannuation savings flows into a range of other assets including emerging markets, private equity and alternative assets such as hedge funds. If the weight of money argument were true then no asset class would ever decline. All markets are subject to whims or fashion, although some of these can be quite enduring.

History shows there are times when the sharemarket enjoys a burst of investor interest followed by periods when it is less popular. Shares suffered an image problem in the wake of the 1987 crash. Property then became hot.

At the end of the 1990s, technology stocks were the investment du jour but didn't last.

Russell Investments strategist Andrew Pease believes there is an air of frustration with the local sharemarket as it has gone nowhere in the past year or so.

"Investors here, however, can get 6.5 per cent in term deposits and so it's a bigger step to invest," he says. "In offshore markets the alternative is 0.3 per cent with a term deposit so for them it's a no brainer."

He says when it comes to what really drives shares it's all about profits. "Investing is all about what price you are willing to pay to get your hands on whatever profits there will be in the future."

The Australian Financial Review

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