

# Money

## Stocking Up. Why mutual-fund money is flooding into equities—three years late

By Bill Saporito

RECENTLY, INVESTORS DISCOVERED AN amazing new asset class: stocks. Nearly \$44 billion flowed into equity mutual funds this year through the week ending Feb. 6, according to the Investment Company Institute (ICI)—the biggest swing in years. But the eureka moment came way too late for many stock-averse investors, who missed earlier opportunities to repair their portfolios in the wake of the recession.

One of the frustrations expressed by financial planners is that we investors are perfectly willing to buy socks on sale but not stocks. Look at the history: After equities' prices cratered 50% in 2009, reaching a low in March, the S&P 500 rallied to return 26% that year. The current three-year average annual return is 14.67%, and so far this year, the market is up more than 6.5%. "You've got this big rise in total return, yet you didn't see a resurgence to equities," says Sarah Holden, ICI's senior director of retirement and investor research. "That was quite surprising given the historical pattern."

Rising prices usually attract more money, especially given that investors often act on a recency bias—meaning they place more weight on near-term results than is warranted. Instead, investors withdrew money from stocks disproportionately to the length of the recession. "Market ups last longer than you think, and the downturns go quicker," says Vinay Nadkarni, a managing director at ClearBridge Investments. "But psychologically, we haven't learned that lesson." Consider that the recession began in December 2007 and ended in June 2009—a relative blip in the grand scheme of things.

But a blip can feel like an eternity to baby boomers staring at retirement. After taking their lumps during the meltdown, boomers adopted a *No mas* strategy, moving to fixed-income investments and staying there. In previous downturns, like the 1987 crash, younger boomers got back into equities much sooner.

So why the shift now? Although the world doesn't look a whole lot different

from that of 2009—Europe's still a mess, the Middle East is aflame, and American budget issues are largely unresolved—there's certainly some postelection relief contributing to the push into stocks. There are some technical factors too, says ICI's Holden. People sold stocks before the congressional debate over the fiscal cliff, for instance, and rebought them when that threat was kicked down the road.

January bonuses and IRA contributions helped too, but that annual bump doesn't explain the size of the recent shift. There is ample speculation that the plunge into equities is the leading edge of something bigger: a phenomenon that analysts have labeled the Great Rotation. The thinking is that the two-decade bull market in fixed-income investing has run its course and we're about to enter an era that favors stocks. This hypothesis is far from certain, Holden cautions, given that we have only a couple of weeks of financial data on it. But there's a decent chance the trend will stick, according to Paul Glimcher, a neuroeconomist at New York University. The perfect market may be random, he says, but humans are environmentally programmed to look for signals

or patterns. Funds flowing back into equities could be sending such reinforcing signals, creating a feedback loop of sorts.

Up until this point, many postmeltdown retail investors were willing to accept negative returns on Treasury bonds rather than diving into stocks. That kind of skittishness has changed the way financial planners talk about stocks. Instead of recommending a stock-allocation percentage by a formula—say, 100 minus your age—planners are simply trying to get clients to commit to a single path. "If we would normally advocate 70% to 80% equities, and you are comfortable with 40%, do it," says Christine Fahlund, a senior financial planner at T. Rowe Price. "We've just got to pound into their heads that you've got to come up with a solution." And stick to it.

The data says that it still pays over the long term to be disciplined about investing through both up and down markets. What it doesn't show is how difficult that has been for so many of us after experiencing an economic crisis. The current flow of money suggests that investors are losing their fear of equities. But we won't know if that's for real until the next downturn happens—and it will happen. ■



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