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Monkey Bar Slip

When I was in elementary, my friends and I would frequent the monkey bar in the playground. It was a great place to dunk a basketball and hang upside down using our legs. The great challenge was crossing the bars and dueling it out with our leg inflicted bear hugs, American Gladiator style once we collided in the middle. The bars were probably 6 feet high, which felt monstrous when we were only 4 feet tall. The greatest fear was missing the next bar once we were in full swinging motion and falling flat on our face.

Monkey bars may be a childish analogy of the step by step progression taking place in a lot of the multi-asset asset management firms, but it is a good illustration demonstrating the need to move from one bar to the next in the right time. The 1st bar investors swung to was investing into the fixed income market back in 2008, which was selling at a discount after the Lehman crisis, and provided stable coupon payments to compensate for the risk. The bull market for fixed income probably ended around 2012, once news of tapering started to hit the news. Investors started to parade around a term “Great Rotation”, referring to the switch from fixed income into equities, with many skeptics questioning the timing for the move in late 2012.

I would imagine a minority of the fixed income investors, made the next swing on to the 2nd bar to ride the 24% YTD S&P return. Global high yield bonds have performed poorly in 2013, relative to the performance in the past 4 years, only eking out 4% on average. This small group took off like bandits, benefiting from the double digit returns made off of the fixed income market from 2009 to 2012, and then reaping from the equity rally in 2013.

Now, the majority of the investors, who sat out on the sidelines, idly sitting on their fixed income investments, are now having to make a riskier lunge on to the 3rd bar. The 3rd bar represents the equity market at the current juncture, having rallied 24%. Fixed income funds are bound to continue their decline, with higher interest rates in the horizon and greater concerns related to the US budgetary issues. Also, a lot of the individual bonds have regained their pricing footing near par, essentially limiting potential capital gain in the total return.

So, these investors who are holding on to the 1st monkey bar, bypassed the 2nd bar, and somewhat forced to lunge to the 3rd bar, which is inherently risky at the higher pricing. Granted, the fixed income market is holding its’ own and the investors may still have time to scope out the investment landscape. However, if the fixed income market is a drag, the equity market is at a high, then what other markets are available besides the real estate market and commodities? So, if the 1st monkey bar holders want to bypass the 3rd bar, then they will make their final leap to the 4th bar, which is the murky real estate market. We have never really felt confident in the real estate recovery story because it was a credit infused bubble to begin with, and so a recovery trending the pre-2007 prices seems unwarranted.

There is no room for regrets. Possibly, the equity market rally is still a developing story so it may not be as risky as I propose. Likewise, with a healthier market sentiment, the real estate market may ride on the coat tails of the equity market. If not, those cautious 1st bar investors, may lose momentum and be left hanging on to what they have, until their limbs give way. Or, they may make the big lunge and fall flat on their face, as they lose their grip on the nth bar.