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Market Ethos

The latest market insights from Richardson Wealth

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RICHARDSON Wealth

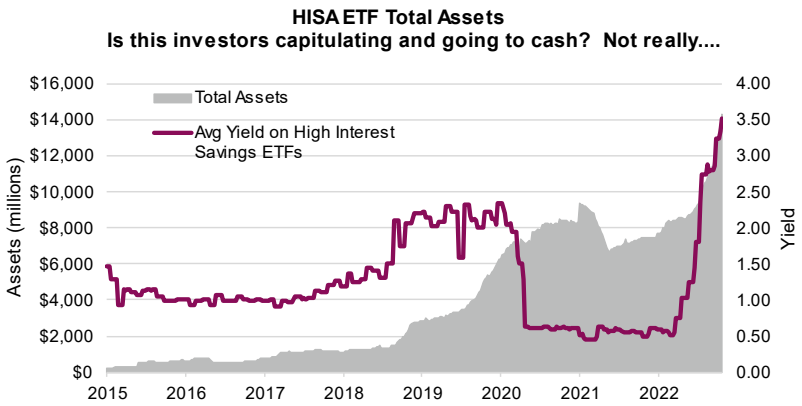
No white flag just yet

After posting its third consecutive quarter of declines, the stock market has managed to stay slightly positive so far in October—despite bond yields continuing to climb. Both Canadian and U.S. 10-year bond yields posted new highs this past week with U.S. 10-years rising to 4.25%. With yields rising at a frenzied pace, market volatility continues to be a grisly backdrop for both the stock and bond market.

Bad news for the bond market is rarely a good sign for stocks. Although we saw a fresh low on October 13, a so-far so-good earnings season has eased some of the fear, with some arguing that we're nearing a point of capitulation. **In this Market Ethos, we examine fund flows to see if they confirm any signs of a market bottom.**

Markets were oversold at the end of September, where more than 40% of companies in the S&P 500 had an RSI below 30, which may indicate a technical bottoming. These types of oversold markets often lead to some near-term consolidation. Any bear market rally or seasonal surge will at some point have to come to terms with the rising cost of capital and compete with an emerging 'new' asset class.

What is this new asset class that is competing with stocks? It's not private debt, or a new digital currency – it's plain old cash. A shelter from the volatility, with an attractive yield as well. **TINA (there is no alternative) left and packed her bags after TARA (there are reasonable alternatives) moved to town.**



Cash Is popular again

Over the past week, three of the top five inflows of any Canadian listed ETF were into high interest savings options. Not only does cash pay, its gaining in popularity, as you can see from the tremendous growth in the chart above.

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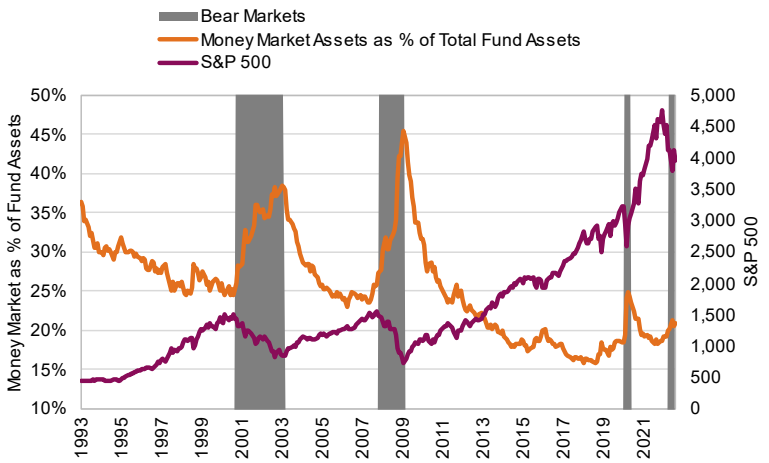
It's not exactly easy to see where these flows are coming from, or if in isolation these moves are a sign of capitulation. **Fleeing to cash and out of equities would be classic capitulation behavior, which becomes evident in many bear markets near the bottom.** The outflows often continue well into the next bull cycle, but that is another topic. However, it's impossible to say that the move into cash products is a sign of de-risking or simply investors deciding that with liquid cash alternatives yielding so much, they are putting to work idle cash that had been earning a pittance in bank accounts. It is also a potential destination for proceeds from tax loss selling fixed-income securities.

Where the money's going

The surge into high interest savings account (HISA) products is noteworthy, but their existence is simply too short to draw any conclusions as to whether it's a sign of investor capitulation and potentially a market bottom. To get a better picture of fund flows, the chart on the right is from the U.S. market and is the percentage of fund assets in money market funds. We have to point out in the 2000 and 2008 bear markets, there were much fewer cash-like alternatives as there are today, which explains the relatively low weighting in money market funds. Still, the chart has value as **in each bear there is a spike of some sort for money market assets**. So far in this bear we have seen more of a gentle rise. Maybe there won't be a spike given flows into so many cash vehicles from HISA, GICs, CDs, etc.

Bulls, Bears and Money Market Allocations



Source: Bloomberg, Purpose Investments

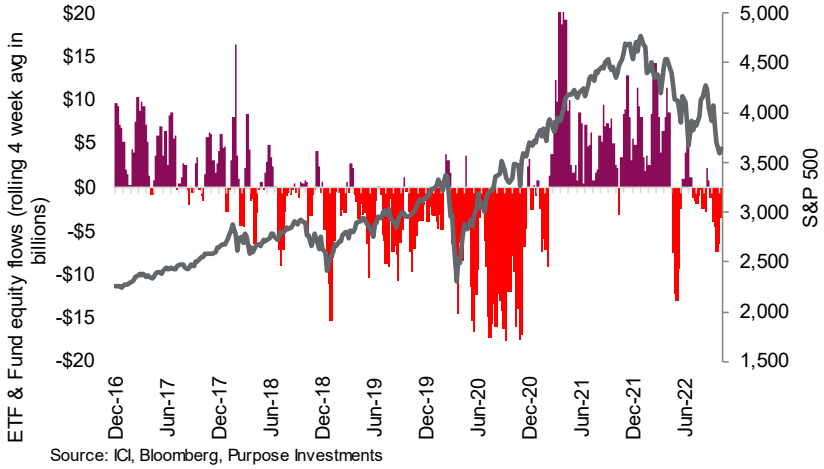
Stocks and bonds

Looking back over the past six years with data from ICI Global, we can get a look at the total flow entering or leaving equity markets. Fund & ETF flows are a proxy for what individual investors are doing in the market. From the chart below, outflows have been consistently negative over most of the year; however, recent outflows have not eclipsed what we saw in the spring or even come close to 2020. **The lack of any major spike in outflows coinciding with the most recent low in the S&P 500 does not confirm a capitulation low.**

Looking just at ETFs over the past couple of months, flows are still surprisingly positive. It's worth keeping in mind that the ETF space continues to grow, benefitting from the long structural shift towards ETFs over funds and single securities. This growth as a percentage of AUM would be considered subpar in terms of expected flows for most asset managers. **Overall, buying behavior for U.S.-listed equity ETFs remains broad based, with a large cap tilt.**

Many sector ETFs are getting hit, but interestingly it's not because investors are dialing back on risk. The chart below shows that following a spike mid-September, flows into defensive sectors have turned

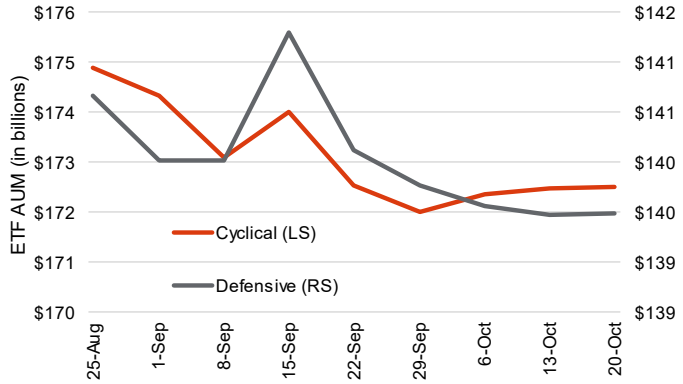
Equity ETF & Fund flows - certainly not buying low and selling high



Source: ICI, Bloomberg, Purpose Investments

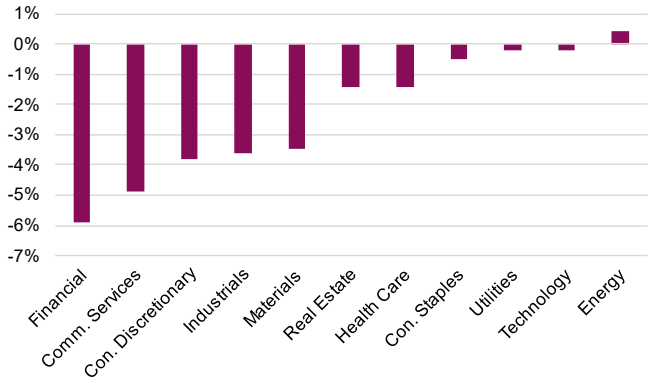
negative. Flows into cyclical sectors turned positive in October, driven by strong flows into the Energy sector. Meanwhile, outflows in Discretionary and Industrials have tempered the cyclical rebound. Over the past two months, all sectoral ETFs saw outflows except for Energy led by Financials and Communication Services. Sector flows have been far from uniform.

Defensive positioning retreating in sector ETFs



Source: Bloomberg, Purpose Investments, N. Americanlisted ETFs over $1B AUM

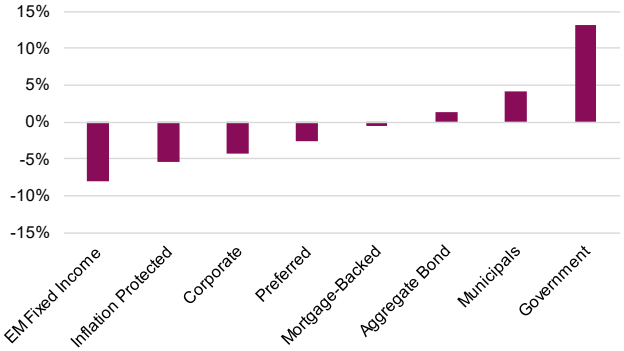
Equity Sectoral ETF Flows over the past two months as a % of AUM



Source: Bloomberg, Purpose Investments, N. Americanlisted ETFs over $1B AUM

It's hard to see any clear defensive shift from a sector perspective, though it's clearly depicted in bond flows. Government bonds remain in high demand. **Inflation-protection securities are no longer seeing strong demand, with outflows in that segment nearly as bad as emerging market debt.** Corporate bond funds continue to face outflows as investors seek to limit credit risk.

Fixed Income ETF Flows over the past two months as a % of AUM



Source: Bloomberg, Purpose Investments, N. Americanlisted ETFs over $1B AUM

Impact on portfolios

Fear of losing and fear of missing out are at two opposite ends of a spectrum. Based on where capital is flowing, the fear of losing is still bigger than investors' fear of missing out (on the recovery). And while one could point to HISA and other flows into cash products as signs of final capitulation, we remain unconvinced.

A year ago, if you had $10k in your bank account, you could have made $50 a year by moving it into a HISA or other paying instruments. It was hardly worth the bother. Today, you will make $350—okay, even the lazy may act with that reward. We would also like to point out there doesn't have to be a capitulation event: all cycles are different.

This bear market is now over 10 months old, it is oversold, sentiment is very negative, and valuations have become more appealing. Still, inflation has not started to improve, and there is no shortage of recession talk. Bear markets have bear market rallies, and the last bear market rally will prove to be the start of the next bull. We will only know which is which well after the fact.

From a flow perspective, we're not seeing any clear signs of capitulation, or complete surrender to this bear. Simply put, there is no white flag.

Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

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