US Equities

Wall Street titans grow wary of ageing rally in US stocks

Investors look to buy protection and increase cash levels amid high valuations

© AP

YESTERDAY by Robin Wigglesworth and Nicole Bullock in New York

Fund managers are hoarding cash and buying protection against turbulence despite the S&P 500 rally this week becoming the second-strongest bull run in US history, as some investors fear that markets' buoyancy and calm will be punctured.

Global equity and fixed-income markets have been on a tear in 2017, returning more than 13 per cent and 8 per cent respectively despite simmering worries about geopolitical tensions, economic growth and the withdrawal of central bank stimulus.

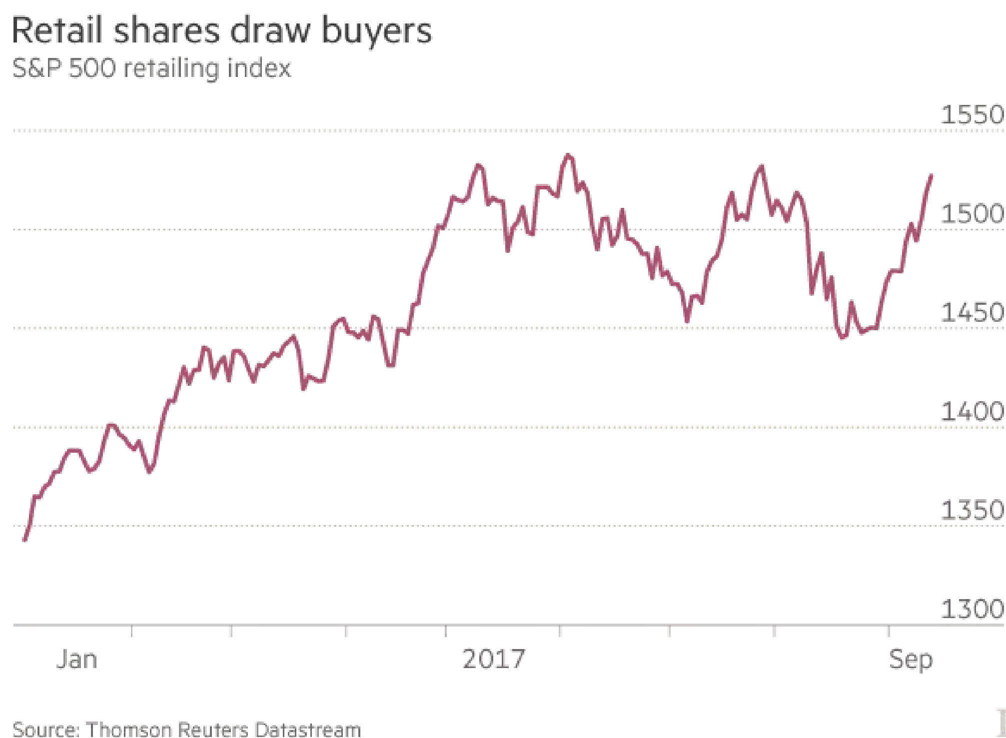
But valuations across bonds and equities are at or near historical highs, and the lack of serious volatility this year has spurred fears that a reversal is overdue.

These concerns came to the fore at a CNBC hedge fund conference in New York this week. Leon Cooperman, the head of Omega Advisors, said that while he did not expect a bear market, a 5 to 8 per cent correction could happen "any time", and added that bonds "look like they're in a bubble". Julian Robertson, the erstwhile founder of Tiger Management, said equity valuations were "very high" and worried about a bubble forming.

Big investors from Pimco's Dan Ivascyn to Pershing Square's Bill Ackman have revealed they are buying protection against turmoil. Bridgewater's Ray Dalio also said in August that the world's biggest hedge fund group was "reducing our risk" because of rising concerns about the political

environment. Seth Klarman, the founder of the $30bn asset manager Baupost, is holding 42 per cent of its assets in cash, according to a report this week.

A Bank of America survey of fund managers in September found a 9 percentage point jump in the net number by who said they had bought hedges against market downturns, the biggest one-month increase in 14 months.



The average cash balance reported by fund managers surveyed dipped to 4.8 per cent in September from 4.9 per cent in August, but that is still higher than the 10-year average of 4.5 per cent. Asset managers rarely hold more than 5 per cent in cash due to the drag on performance and institutional investors preferring that they stay invested in markets.

The S&P 500 on Monday surpassed the record high last touched in early August, and overtook the 1949-56 rally to become the second-strongest cyclical bull market in history, according to Bank of America Merrill Lynch — up almost 268 per cent from its March 9, 2009 low. The rally was already the second-longest on record.

That performance comes as the bank's latest monthly fund manager survey revealed the biggest jump in investors buying protection against equity slumps in more than a year, and while cash reserves have dipped slightly they remain higher than usual.

Concerns about an imminent reversal have abounded this year, with the S&P 500 suffering only a handful of 1 per cent declines in 2017, while the market normally suffers 5 per cent drops about four to five times a year. The record US equity bull run was in 1987-2000, which ended with the dotcom bubble bursting.

“Value is very hard to come by,” said Henry Peabody, a bond fund manager at Eaton Vance, whose funds are running cash balances of about 10-20 per cent. “There’s much more risk than returns right now. We’d rather be patient and wait for the market to come to us.”

Nonetheless, higher cash reserves than usual and investor pessimism tend to historically indicate that markets have further to run, rather than being primed for a slump. “Cash levels remain elevated, suggesting markets can remain in an Icarus upside mode for risk assets,” said Michael Hartnett, BAML’s chief investment strategist.

Indeed, some investors are undeterred. Bob Browne, chief investment officer at Northern Trust Asset Management, said: “We are overweight risk. That is an environment that we think can support current valuations and keep equities going — low rates, earnings growth supported by a solid economic backdrop.”

David Kostin, Goldman Sachs chief equity analyst, noted this week that while “clients keep asking about an impending equity downturn”, a correction was unlikely due to the strong economy, robust corporate earnings and buybacks, and the lack of excitement that typically presages market routs.

“‘Tormented bulls’ best describes investor mentality,” Mr Kostin wrote to clients. “Because investor euphoria is non-existent, an imminent start of a long decline seems unlikely.”

Copyright The Financial Times Limited 2017. All rights reserved. You may share using our article tools. Please don't copy articles from FT.com and redistribute by email or post to the web.