The QAM letter that highlights recent developments that we think either affect the markets or are important to understanding them.

"The difficulty lies, not in the new ideas, but in escaping from the old ones" - John Maynard Keynes

The "Great Rotation"

It is not such a bad feeling for Investors – particularly those with a higher component of Equities in their Asset Mix - to see quarterly statements that are way in the black and balances exceeding pre-crisis levels.

The media and some members of the industry are attributing this to the "Great Rotation", a shift in money flows from Bonds and into Equities.

Even though catchy and ingenious, we at QAM understand that the label "Great Rotation" is a little exaggerated and certainly premature.

According to the Investment Company Institute (the national association of U.S. investment companies), $60.9 billion has flowed into equity Mutual Funds this year up to mid-March, but almost as much - $60.4 billion- went into bond Mutual Funds. Equity ETFs have seen $33.5 billion in terms of net new issuance; bond ETFs have shown $2.3 billion of net new issuance, for the year ended February.

Holdings of U.S. Money-Market Funds, on the other hand, have seen redemptions of an estimated $82.1 billion in the year through mid-March, according to the Investment Company Institute. It is really this money that was sitting on the sideline that is now moving into equity funds, putting upward pressure on stock prices. Redemptions of $82.1 billion is a large number in absolute terms; but relative to average Money Market holdings of $2.6 trillion, not so much.

Notwithstanding continued fund flows into bonds – interest rate increases and corresponding downward price pressure is evident – particularly in long bonds.

The 10-year US government bond yield is close to 1.9% as we write this report – it was lower than 1.4% in mid-July 2012. The price of that bond went from 103.22 on July 25, 2012 to 100.84 on March 26, 2013. A 2.3% decline that illustrates how the price of regular bonds are inversely related to their yield.

The 30-year US government bond yield is close to 3.1% as we write this report – it was lower than 2.5% in mid-July 2012. The price of this bond went from 111.52 on July 25, 2012 to 99.18 on March 26, 2013. A 10.5% decline that illustrates how bonds' price sensitivity is higher for longer term bonds (more specifically higher duration bonds).

Not surprisingly, the story is similar for Government of Canada bonds. The yield in mid-July 2012 for the 10-year Government of Canada bond was 1.6% and close to 1.8% on March 26, 2013. For the 30-year Government of Canada bond the yield was 2.2% in mid-July 2012. As of March 26, 2013 it is 2.5%. Prices declined 2.5% and 6.0% respectively.

We have to be mindful that except maybe for the flow of funds driven by improving sentiment, not much has changed.

Not many analysts are talking about deflation anymore. The U.S. Treasury yield curve is becoming steeper. While correlations across risky assets are still high, the trend has been for lower correlations. Fundamentals are starting to emerge. Cash is slowly being deployed.

Some analysts are predicting the Fed will reach its goal of unemployment below 6.5% sooner than originally expected. If that happens, then expectations will change as the Fed would discontinue (or at least trim down) the accommodative monetary policy put in place.

Europe is still trying to work out its problems. Having avoided the "fiscal cliff", taxes are still increasing in the US. The growth pace of China and other emerging markets is a question mark. Global growth is still challenging.

Bonds are still overvalued and still represent substantial interest rate risk. Stocks are closer to their historical average valuation but still attractive, particularly on a relative basis as they continue to represent better value than bonds.

But sentiment is contagious and dominates in the short-run. Investors seem to be more concerned now with looking for potential returns and not spending so much time licking their wounds. Fear is receding and greed is on the rise. These powerful human sentiments tend to make markets overshoot. That could be the real "Great Rotation".

As Warren Buffet - one of the world's most successful investors - has said, investors should be greedy when others are fearful and fearful when others are greedy. Most investors cannot resist their feelings and therefore tend to follow prices as opposed to valuations. They leave the stock market at a loss and then miss out when stocks rebound. They will probably act similarly with bonds.

We at QAM remain firm in our belief that inflation protected growth in the long-run comes from holding high quality stocks, while liquidity requirements and stability has to be provided by a prudently selected Fixed Income position in the portfolio.