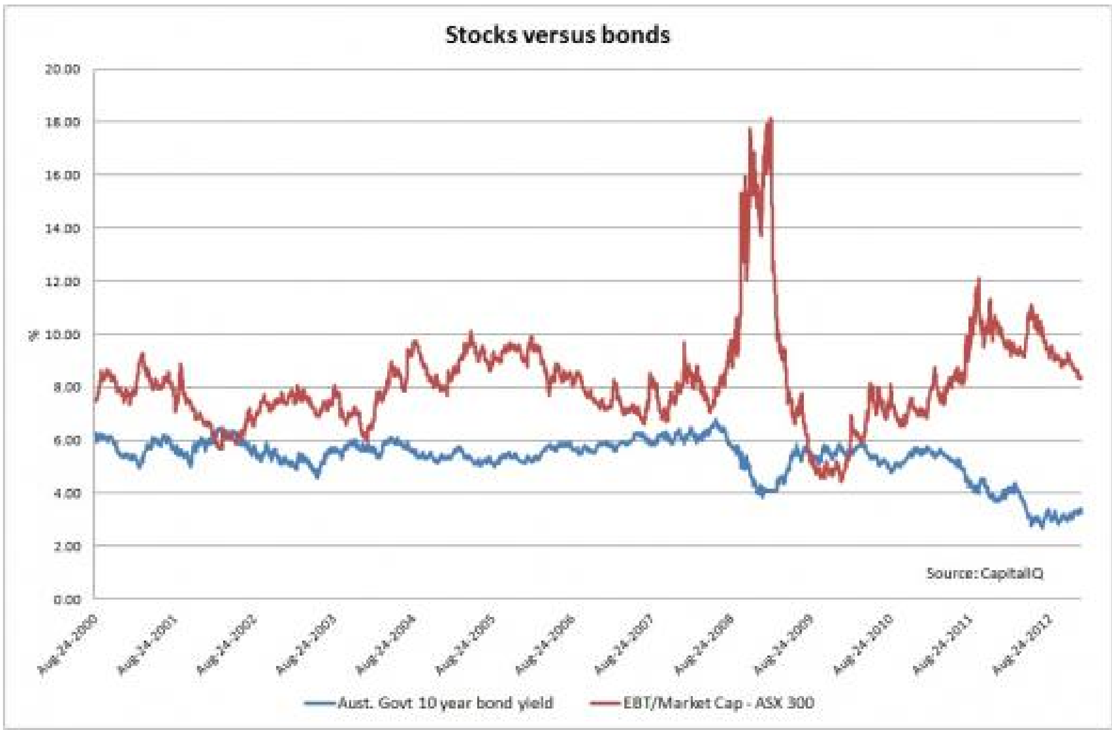
Don't Sell Your Stocks Just Yet

There's no doubt sentiment towards equities has changed quite dramatically over the past few months. The professionals are a lot more optimistic – 80% of fund managers surveyed by Bank of America Merrill Lynch are taking on 'more risk than usual'. Mums and dads are slowly dipping their toes back into the market. And margin lending is on the rise again (in the September 2012 quarter it hit its lowest absolute level since 2003).

Hopefully, like us, you had a good year of it in 2012. With **Vision Eye Institute** and **Astro Japan** working out well, we've started 2013 on the same note. But you're probably also asking the one big question we are: with the market rallying so hard, is it time to take some money off the table?

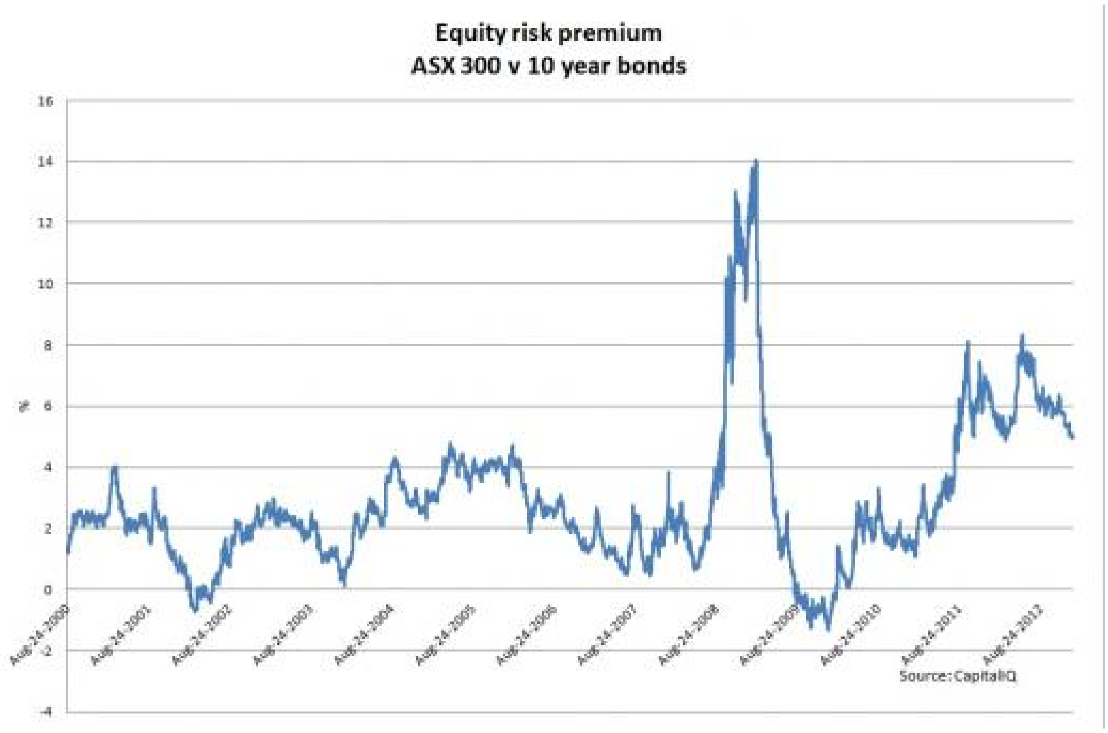
Every time value is realised on one of our holdings, we're finding it harder and harder to recycle the capital into new, equally attractive opportunities. So we're building up cash, and there's nothing wrong with that. But, despite the gains of the past 12 months, equities still look attractive.

Here's why. Yes, the market is up. But interest rates are down. As you can see in this graph, the earnings yield of the market (earnings before tax for the ASX 300 divided by the ASX 300 market capitalisation) hasn't fallen any more than the 10-year Australian Government bond yield.



The earnings yield has fallen from around 11% at its peak to just north of 8%, all thanks to a rising market. But the yield on 10-year government bonds has fallen from 6% to 3.5% over a similar period.

The gap between the two – the equity risk premium, or excess return you can expect for holding equities – is still at historical highs.



Not that this all means you should expect sensational returns from equities. Interest rates can go up. Earnings can go down. And equity risk premiums can expand. But relative to the returns you're getting everywhere else, the case for stocks still stacks up.