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11/15/11: Which is bigger: the global stock market or global bond market?

As investment professionals, we often talk more about stocks and the stock market than bonds and the bond market. "The stock market is so volatile!" " Buy low, sell high!" "Is this a good buying opportunity?", and my personal favorite (cough) "what is the next hot stock?" By the way we talk, you might think the stock market is not only more influential, but also much bigger in size than the bond market, and this is simply not true.

By recent estimates, the worldwide bond market's total value is approximately. $82 Trillion, while the worldwide stock market's value is approximately $45 - $50 Trillion, which is a little more than half the size of the bond market. Does this surprise you? I think this surprises a lot of investors, but there are good reasons for this size difference.

The bond market has many issuers, including governments, agencies, states and municipalities (taxable and tax-exempt), mortgage-related and asset-backed bonds, and corporations. Not all of these entities are in business to earn profits. The bond market is a massive, decentralized network of buyers and sellers. It is easier to issue new bonds than stocks; bond issuers simply establish the terms and bring the bond(s) to market. There are no stringent listing requirements or hurdles, such as there are with stocks. When you purchase a bond, you are lending your money to the bond issuer in exchange for a regular interest payment, and you expect the return of your loan amount when the bond matures. Bond market movements are influenced mostly by changes in interest rates, so is more of a current assessment of how our economy is doing now. There is more demand for bonds than stocks around the world, since bonds are generally less risky than stocks and provide a more stable return.

The stock market, on the other hand, is made up exclusively of public (as in "publicly-traded") corporations, and stocks are traded in a centralized marketplace consisting of only a few exchanges. To issue new stock, companies must provide detailed financial information including their net worth so that new shares of stock can be appropriately priced. When you purchase a stock, you are buying and therefore own a part (albeit small) of the company and there is no specific maturity date on your investment. As an owner of the company, you can vote on important shareholder issues, and you can own those shares as long as you like. A company's profitability is extremely influential on its stock price. Stock market movements are more of an indicator of where the economy might be headed, and is typically focused on predicting future earnings of companies. Consumer sentiment plays a huge role in how the stock market performs. Movements in the stock market tend to be more volatile, due to its perceived and actual risks being greater than those in the bond market, and therefore the expected returns for stocks are greater.

There are always exceptions to these general rules of thumb. Bonds do sometimes outperform stocks, (depends on type of bond, time period used, etc.) but generally, stocks are expected to outperform over longer periods of time.

So which market, stocks or bonds, is more influential around the world? It depends on your perspective of course, and how much you might own in each, but in terms of sheer value and size, the bond market is the clear winner.

Margie