



# Capital flows - possibly less to the US again?

Market Comment, May 2024

**In light of eventual changes in US monetary policy towards interest rate cuts, it would come as no surprise if the global capital flows of institutional investors were to shift away from the US and the greenback and move increasingly back towards non-US investments. Alongside European equities, emerging market equities could also increasingly benefit, especially if the US dollar were to weaken. During phases of US dollar corrections, emerging market and European equities, including Swiss stocks, have historically often recovered due to the fact that their US counterparts found themselves in less demand. A higher dividend yield could also lend more support to European, Swiss and emerging market equities relative to US stocks going forwards.**

For many years, US equities were the first choice of institutional investors, benefiting more than equities from other countries and regions from the coronavirus pandemic and the potential offered by artificial intelligence. By contrast, 2022 and 2023 proved to be years of correction for emerging markets, not only due to the regulation of technology companies, the real estate issues in China and Beijing's zero-COVID policy, but also because the greenback exhibited periods of strength.

Over history, a correlation has often been observed between a higher US dollar and weaker relative total returns generated by emerging market equities and currencies. The reason for this is the flows of capital into the supposed safe haven of the US dollar, despite the fact that the Swiss franc in fact performs a fundamentally better supported function as a safe haven. This is due to the healthier state of the country's public finances, the lower level of corporate debt in Switzerland relative to other countries and the much lower long-term rate of Swiss inflation by international standards.

If the recent strength of the US dollar, which reached almost extreme levels, subsides, capital flows could increasingly move back towards Europe and the emer-

ging markets and away from the US and US equities. Once the greenback reaches a certain peak in its development, many emerging markets that hold foreign debt denominated in US dollars are likely to receive relief again in the medium term, meaning they will be less burdened by the strength of the greenback. This is the fundamental context of the historically inverse correlation.

**“An attractive dividend yield could channel capital flows towards emerging markets and Europe, including Switzerland.”**

Gérard Piasko, Chief Investment Officer

It is also to be assumed that emerging markets will show some potential if China presents itself in a more market-friendly manner in terms of regulation or economic stimulus. Incidentally, during phases of historically high commodity prices, corporate results have often been better in emerging markets than they have been in other regions. This is due to the fact that the economic growth of some, albeit not all, emerging markets can be supported by higher commodity prices. However, emerging market equities, in particular, should benefit from an economic recovery in China if the Chinese government decides to provide greater economic stimulus, with the potential for such a move increasing. China is an important trading partner not only for Latin American countries (via demand for raw materials), but also for European countries (via tourism and demand for luxury goods), meaning that European equities could also benefit from an improved Chinese economy.

At the same time, the valuation of European and emerging market stocks appears interesting when viewed relative to both the world equity index and US equities. European and emerging market equities are not expensive relative to US stocks, with this especially being the case in terms of their so-called price/net asset ratio as well as

the familiar price/earnings ratio based on expected consensus earnings. After several years during which US equities have been particularly favoured by global investors, the interest of globally important institutional investors could therefore shift more towards Europe or emerging markets. The first signs of a change in capital flows towards emerging markets and Europe can already be observed, pointing to upside potential for these regions. European and emerging market stocks likewise offer a higher dividend yield than their US counterparts, making them more attractive and thus meaning that these regions are more interesting than the US market. However, Swiss equities, which as known also belong to the family of European stocks, likewise have an attractive di-

vidend yield. The dividend yield of US equities stands at only around half that of Swiss, Eurozone or emerging market stocks.

Gérard Piasko

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