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There's No Place Like U.S. in Hunt for Yield

Foreign investors pile into America's stocks and bonds at fastest pace in about a year

A survey of 224 fund managers said U.S. stocks are more desirable than their overseas peers in the next 12 months, according to Bank of America Merrill Lynch. PHOTO: MIKE SEGAR/REUTERS

Foreign investors are piling into U.S. stocks and bonds at the fastest pace in about a year, cashing in on a period of exceptional returns.

In a world dominated by tepid economic growth, mediocre returns and a mountain of negative-yielding debt, foreign investors say they see American assets as a haven: They bought nearly $64 billion of U.S. stocks and bonds in June, the largest sum since August 2018, according to the latest available Treasury Department data.

Despite slumping this month on trade tensions, the S&P 500 is up nearly 17% in 2019, compared with a 5% rise in the MSCI All Country World Index, excluding U.S. stocks. Treasurys, meanwhile, are among a dwindling number of government bonds with positive yields—even as they hover near multiyear lows—and the dollar has mostly strengthened this year against other major currencies.

Several analysts and investors are describing the buying spree by foreign investors as a revival in American exceptionalism—and they say they expect it to continue.

"I call this the new abnormal," said Yoram Lustig, head of multiasset solutions for Europe, the Middle East, Africa and Latin America at T. Rowe Price . "We have negative rates across the board, something that's never happened before. But the U.S. is doing much better than other regions."

There are downsides to the boom. U.S. stocks have risen more than equities in the rest of the world, making shares of American companies increasingly expensive.

Since 2010, the S&P 500 has beaten the MSCI all-country index by an average of 70 basis points a month, according to BlackRock , and analysts say that pace of outperformance isn't sustainable. Before 2010, stocks in the U.S. performed more in line with shares overseas.

The bond rally has pushed yields to near all-time lows. That has left Treasurys more susceptible to extreme swings in volatility depending on how investors interpret economic data and the development of U.S.-China trade talks, some analysts warned.

Despite pockets of weakness in manufacturing, the U.S. economy has remained relatively strong this year, giving markets a supportive backdrop. U.S. employers have been hiring at a robust pace, keeping the rate of unemployment near historically low levels, while consumer spending, which accounts for more than two-thirds of economic output, has been strong.

The U.S. trade war with China has dented growth, as a pullback in exports and a slowdown in business spending have crimped profit margins as well as sales at industrial manufacturers and other companies. But by some measures, the trade war has been more punishing for other regions, such as Europe and Asia, according to analysts.

Germany, which relies heavily on exports and manufacturing, said its economy contracted in the second quarter and the U.S. trade dispute with China was partly to blame. China, meanwhile, reported its slowest pace of economic growth in decades for the same period.

Money managers such as Andrew Milligan, head of global strategy at Aberdeen Standard Investments, say the stronger financial footing of the U.S., along with continuing corporate share buybacks and the Federal Reserve's moves to ease monetary policy, puts U.S. equities in a stronger position relative to the rest of the world. Aberdeen is "tactically" buying stocks, pouncing on depressed valuations, such as shares of American banks, Mr. Milligan said.

His firm isn't alone. After more than a year of consecutive monthly outflows, foreign investors purchased roughly $26.6 billion in U.S. stocks in June, according to Treasury Department data.

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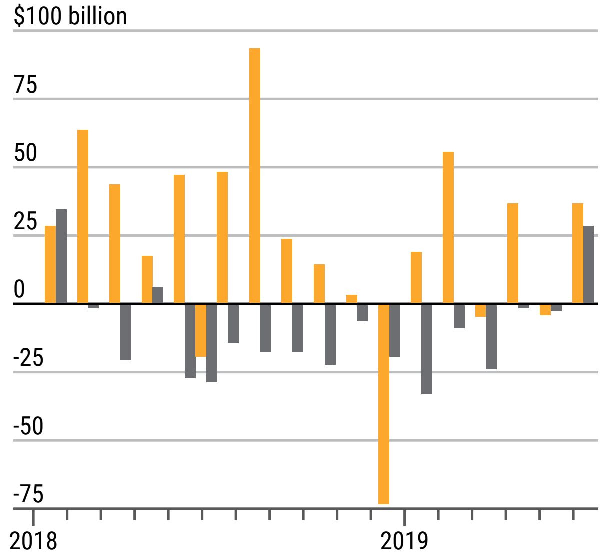
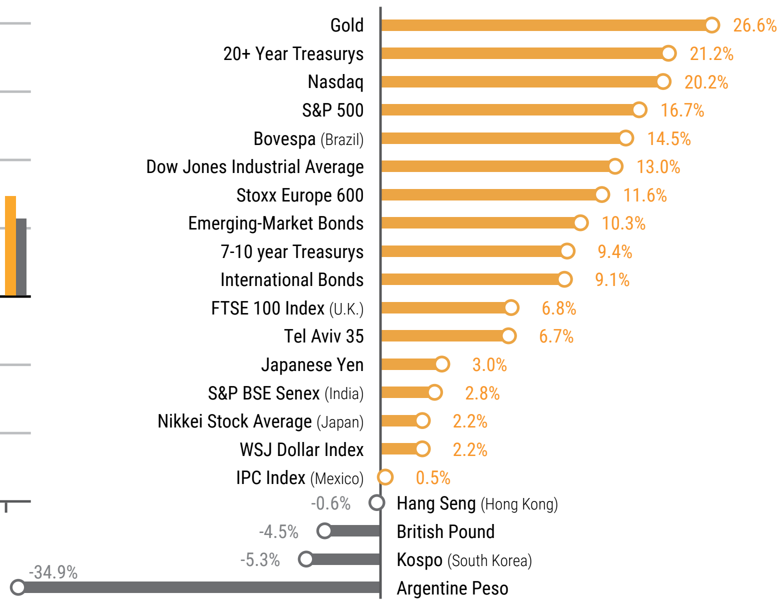
Back in Demand - U.S. stocks and bonds are among the best-performing assets in the world

Foreign investors' purchases of U.S. stocks and bonds monthy



Selected global stock index, bond ETF and curency performance, year-to-date



Sources: Treasury Department data compiled by Deutsche Bank (purchases); FactSet (stock indexes, bonds ETFs, commodities), Tullett Prebon (currencies)

A survey of 224 fund managers who manage $553 billion in assets said U.S. stocks are more desirable than their overseas peers during the next 12 months, and 15% said they are looking to bolster those positions, according to Bank of America Merrill Lynch. Still, more than three-quarters of respondents said U.S. stocks are already overvalued.

At the same time, investors bought about $37 billion of long-term U.S. debt securities in June, bringing the total through the first half of the year to about $136 billion. Although that is down from the first half of last year, flows picked up in June and are showing signs of strengthening further, analysts said.

That has contributed to a run-up in Treasury prices, bringing the yield on the benchmark 10-year U.S. Treasury to 1.520%, down more than a full percentage point from January and within striking distance of its all-time low of 1.366% set in 2016.

The diverging outlooks between the U.S. and the rest of the world have pushed T. Rowe Price's Mr. Lustig and other foreign investors to buy more Treasurys in recent months, while maintaining or adding to their positions in stocks. He said he favors the positive yields of Treasurys over the negative-yielding bonds offered by Germany, Japan, Sweden and other countries.

Mr. Lustig said he has also been using the strong dollar to boost his returns from Treasurys.

"For the first time in my career, I started buying U.S. Treasurys without hedging the dollar," he said. "Having unhedged U.S. Treasurys in portfolios gives you exposure to two safe-haven investments."

Traditionally, he said he hedged Treasury purchases to account for currency fluctuations, with the cost usually being the difference in short-term rates between the two countries. But the dollar has defied most analysts' expectations over the past 18 months.

The WSJ Dollar Index, which measures the greenback against a basket of international currencies, is up 2.2% this year.

"There aren't a lot of attractive outcomes," said Pepper Whitbeck, a senior portfolio manager at Axa Investment Managers who has been increasing his fund's exposure to U.S. debt. "It's about trying to find the least unattractive option, and that has the potential to drive large institutional global fund flows.