Global investors keep faith in US market

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One distinct financial trend has stood out clearly for more than a decade: US equities have been the best place to park your money.

The dominance of dazzling technology companies and US multinationals has seen Wall Street comprehensively outperform the rest of the world. But that allure faded in recent months as investors focused on a robust global economic recovery that benefits a broader range of companies and equity markets.

The FTSE All World index, excluding the S&P 500, has risen by a quarter since November, pipping a gain of one-fifth for the US benchmark.

“Investors are very confident about global reflation over the coming 12 months, including further improvements in business confidence and corporate earnings,” David Bowers, managing director at Absolute Strategy Research, said after the release of the firm’s latest quarterly survey of global asset allocators.

Upgrades about the scale of the unfolding economic recovery keep on coming. The latest fiscal package from Washington compelled the OECD to raise its global economy growth forecast to 5.6 per cent for 2021 from 4.2 per cent late last year.

Even stronger growth is expected in the US. This week, US Federal Reserve officials upped their US median growth forecast for 2021 to 6.5 per cent from a previous estimate of 4.2 per cent. Jay Powell, the central bank chair, maintained that the central bank would allow the economy to run hot, and would not look at tightening policy until officials were convinced that inflation was holding above 2 per cent and the jobs market was very tight.

The equity market fallout from the comments followed the recent trend of a rotation of investor positioning. The US benchmark S&P 500 initially set a fresh record and global shares rallied, supported by a shift into economically-sensitive sectors that include energy, banking, materials and industrials.

Technology sector shares were weaker, with their lofty valuations making them look less appealing when a global economic recovery is gathering pace. A rising 10-year interest rate reduces the expected value of future cash flows, especially the more speculative prospects that are full of promise but with actual profits some way off.

Given Wall Street's hefty weighting of tech compared with the rest of the world, a combination of strong growth and an orderly rise in bond market rates might be expected to extend the current equity market rotation.

However, global investors appear to be keeping the faith in their home market. Bowers said a surprise finding from their survey was the "reluctance among investors to underweight US equities within a global portfolio". He added expectations of Wall Street beating the rest of the world over the next 12 months, not far from being a "coin toss" at 46 per cent. Bowers said investors were mindful that US stimulus and the rollout of vaccinations was running well ahead of Europe at the moment.

Another factor is the resiliency of the US dollar in the past month, boosted by higher long-term interest rates. This makes it more attractive, of course, to hold dollar assets. In contrast, Wall Street typically lags behind the rest of the world when the reserve currency broadly weakens. A weaker US currency boosts global growth and corporate earnings by reducing financing costs. Rising local currencies bolster returns for global investors holding non-US equities, particularly in emerging markets.

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Chris Watling, founder of Longview Economics

This week, Citi's global asset allocation team wrote that they had increased their recommended portfolio weightings towards US and Japan, and away from Europe and emerging markets. The bank cited a "materially higher US growth outlook" from stimulus and added that dollar strength "is usually quite negative for emerging markets, across all asset classes". A firmer dollar tends to boost Japanese corporate earnings by boosting the value of export sales when translated back to yen.

Chris Watling, founder of Longview Economics, argues that worries of a stronger dollar undermining the case for shifting into global equities are misplaced. "US share market underperformance looks well established," and this reflects a shift towards an extended period of dollar weakness. "When the US consumer gets going, their demand for imports benefits global exporters in Asia, parts of Europe and among commodity producers."

But what might keep investors pointing towards Wall Street is a strong cycle of earnings growth, including those of large tech names this year, that vindicates high valuations.

"Valuations are higher and on average the fundamentals of large US companies are better than what you find elsewhere," says Tony Despirito, chief investment officer of US fundamental equities at BlackRock. One-quarter of his equity dividend fund are investments in global large companies. "The US has led global stimulus efforts and it does suggest a much stronger recovery for the economy," adds Despirito.

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