Yardeni Research

March 18, 2025

Morning Briefing

Trump 2.0 & Global Capital Markets

Check out the accompanying chart collection.

Executive Summary: Foreign investors held 37% of US equities last quarter. They've clearly sold some of that in the wake of the Trump 2.0 uncertainties. But might the US's perceived beggar-thy-neighbor policies actually reverse the tide of inflows into US assets? Eric explains why that fear is unlikely. … Also: While a goal of Trump 2.0 policy is to lower US Treasury bond yields, the administration's protectionism may work against that goal. US protectionism has motivated foreign economies, specifically China and Germany, to stimulate their domestic demand via deficit-financed fiscal easing, driving up their bond yields—which may limit how low US yields can go.

Weekly Webcast. If you missed Monday's live webcast, you can view a replay *here*.

Strategy I: Will Foreigners Dump US Assets? Some argue that foreign purchases of US assets have been a major driver of US stock market outperformance relative to the rest of the world for several decades. There is certainly supporting evidence for that thesis. As of Q4-2024, foreigners held roughly 37% of all American equities. That's less than half of what US households and nonprofits (including the hedge fund community) own, but foreigners' $34.2 trillion collective holding is a sizable chunk and could certainly move the needle (*Fig. 1*).

Some recent stories about foreign pension funds have sparked concerns. The Danish teachers' pension fund AkademikerPension, with roughly $20 billion of assets under management, said it would sell its remaining Tesla shares and exclude itself and external managers from buying them due mainly to Elon Musk's political interference. While it holds just 200 shares (approximately $48,000 worth), the fund said its stake was as large as $45 million at its peak. The UK government is also pressuring its pension funds to commit 10% of their assets to British equities (public and private), up from roughly 4% of total UK pension assets.

Will thorny trade negotiations and perceived beggar-thy-neighbor US policies prompt broader selling of US assets? Consider why foreigners buy US assets in the first place. It's a chicken-and-egg situation. The evidence suggests to us that foreign investors tend to chase US market outperformance, not drive it. So while the recent rally in overseas stock markets and the decline in the dollar's value suggest that foreigners have rebalanced their portfolios away from the US, we think much more than trade uncertainty would be necessary to cause a significant capital outflow attributable to foreign stock investors.

Consider the following:

(1) *Valuation gap*. US stocks trade at a substantial premium to equities abroad (*Fig. 2*). Arguably, that's because foreigners plow more cash into US equities than into their own home markets. Indeed, as of the four quarters ended Q3-2024, foreign investment flows into US assets totaled $1.4 trillion, whereas Americans bought only $321 billion of international assets (*Fig. 3*).

But that gap can also be partially attributed to changes in valuation. As foreign markets have outperformed US markets this quarter, we should see international asset flows balance a bit once the data are updated (*Fig. 4*).

(2) *It's just trade*. There's not much the world can do about its US investment position. That's because the US financial account deficit—driven by investments in US assets—is the reciprocal of the US current account deficit, driven by the greater importing of goods and services than exporting (*Fig. 5*). It's no surprise that the dollar tends to rise and fall as foreign countries' reserves and trade surpluses change (*Fig. 6*).

Arguably, the only way to prevent investment from flowing into US assets would be for the US to shrink its trade deficit. Coincidentally, that is a goal of Trump 2.0! But would that mean selling American stocks? It seems unlikely. Would any long-term investor with sizable assets feel comfortable not owning the world's biggest multinational corporations such as Apple and Microsoft? Anyway, investors abroad with the most flexibility (private investors) buy US bonds, not stocks (*Fig. 7*). Primarily, those investments tend to be in US Treasuries as well (*Fig. 8*).

This is more mechanical than discretionary. Even if the trade deficit shrinks and foreign investors demand fewer Treasuries, that would likely be accompanied by a smaller fiscal deficit because the US economy would need to finance fewer imports. Thus, the supply of Treasuries would also fall. In some respects, the rest of the world has no choice but to buy

US assets. Plus, the demand is unlikely to fall on its own when US assets yield much more than their foreign counterparts (*Fig. 9*).

(3) *Home bias*. It's still the case that foreign investors own more US assets than assets in their own domiciles. That's why the US stock market represents nearly three-fourths of the value of global equities, according to the MSCI indexes (*Fig. 10*). That raises the question, Could a coordinated dump of US assets occur over the short term, going against typical flows and depressing prices rapidly? It's doubtful: A broad-based pivot away from US investment would require so much coordination that a host of issues would have to be contended with first. Almost all investment into the US now comes from private sources, rather than government investment bodies (*Fig. 11*). So we'd caution against overly worrying about inflows into US assets reversing.

Strategy II: Global Bond Selloff. Treasury Secretary Scott Bessent is spearheading Trump 2.0's push to lower Treasury bond yields. Indeed, the Trump Put is likely on bonds rather than stocks. The campaigns to shrink the trade deficit, shrink the fiscal deficit, and lower energy prices all serve this overarching goal of lowering yields. One complication is that Trump 2.0's protectionist bent has compelled foreign economies to stimulate demand at home, largely through deficit-financed fiscal easing. That has triggered a runup in global bond yields that may limit how far Treasury yields can fall.

Consider some of the latest policy actions:

(1) *Europe*. Germany's "whatever it takes" government spending package is facing a last-minute hurdle in the courts but seems likely to go through. In essence, Trump 2.0 prodded German policymakers to wake up to the reality that the American security blanket will not be free of charge, instigating defense spending that isn't subject to standing debt brakes and a commitment to infrastructure spending to revitalize German industry and counter Russia. Of course, German manufacturing has been collapsing since 2019, mostly due to competition from China (*Fig. 12*). But better late than never.

That has raised the 10-year German bund yield to above 2.8%, roughly the highest since 2011. Bunds are probably the most comparable asset to Treasuries from a reserve standpoint. However, supply is constrained by German austerity and thus has been inadequate to meet demand. Along with slowing economic growth, bund yields have been suppressed. Even as the spread between Treasury and bund yields is considerable, they historically have traded in tandem.

(2) *China*. Chinese 10-year government bonds yields cratered toward 1.5% late last year due to a combination of slowing growth, a busted property bubble, and inadequate supply. However, Chinese yields appear to have bottomed and now are climbing back toward 2.0% as China is unleashing fiscal stimulus to boost domestic demand. Over the weekend, Beijing outlined arguably its biggest consumer-focused stimulus plan yet. While Chinese bonds trade differently than Treasuries, Chinese stimulus has a large impact on the global economy and reduces deflationary pressure weighing on financial markets. Ultimately, that has a lifting effect on US Treasury yields.

(3) *US debt still attractive*. As most global central banks are easing monetary policy, US debt is still relatively attractive to global investors. Plenty of investors invest on an unhedged basis and thus aren't constrained by high US funding rates. Meanwhile, those who invest while hedging their foreign exchange exposure are having some of their losses offset by the declining dollar. Japan is an exception, as the Bank of Japan has been raising interest rates, but thus far Japanese investors don't appear ready to shift away from US debt on a wholesale basis. And they're especially unlikely to do so if it would upset the Trump administration.

(4) *Fed policy lending a hand*. The Fed is likely to reinvest any principal proceeds from its agency debt and mortgage-backed securities (MBS) holdings (i.e., mortgage prepayments and maturing bonds) into Treasuries. All else equal, that should help contain Treasury yields by adding an extra source of buying pressure, even if the $2.2 trillion of agency debt and MBS take some time to roll off (*Fig. 13*). Furthermore, we expect quantitative tightening to be suspended and perhaps permanently ended during the first half of this year, which would remove some upward pressure from Treasury yields as well.

In fact, foreign private investors enjoy the extra yield they get from US MBS for essentially the same credit as the US government (*Fig. 14*). Those inflows are likely to continue, as MBS yields remain relatively elevated.

Calendars

US: Tues: Industrial Production 0.2%; Capacity Utilization 77.8%; Housing Starts & Building Permits 1.375mu & 1.450mu; Import Prices -0.1%. **Wed:** Fed Interest Rate Decision 4.50%; FOMC Economic Projections; MBA Mortgage Applications. (FXStreet estimates)

Global: Tues: Germany ZEW Economic Sentiment 35; Japan Machinery Orders -0.5%m/m

& 6.6%y/y; BoJ Interest Rate Decision 0.5%; Japan Industrial Production -1.1%. **Wed:** Eurozone Headline & Core CPI 2.4% & 2.6%y/y; Japan Industrial Production -1.1%; Japan Capacity Utilization; BoJ Press Conference. (FXStreet estimates)

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): During the March 14 week, forward earnings rose for two of these three indexes for a fourth straight week, after falling for all three simultaneously for two straight weeks for the first time in 14 months. LargeCap's forward earnings rose 0.2% w/w to its third record high since the January 31 week. MidCap's rose 0.2% w/w to 0.2% below its record high in early June 2022. SmallCap's posted its seventh straight weekly decline and its longest since it fell for 12 weeks through December 2022, as it fell 0.2% w/w to a 40-month low and is now 14.1% below its June 2022 record. LargeCap's forward earnings has soared 23.3% from its 54-week low during the week of February 1, 2023; MidCap's is 8.6% above its 55-week low during the week of March 10, 2023; and SmallCap's is now 0.6% below its 72-week low during the March 17, 2023 week. These three indexes' forward earnings downtrend from mid-2022 to early 2023 was relatively modest compared to their deep double-digit percentage declines during the Great Virus Crisis and the Great Financial Crisis. Here are the latest consensus earnings growth rates for 2024, 2025, and 2026: LargeCap (11.3%, 9.8%, 14.2%), MidCap (-0.7, 10.7, 16.1), and SmallCap (-11.7, 8.7, 19.6).

S&P 500/400/600 Valuation (*link*): Valuations fell again w/w for these three indexes. LargeCap's forward P/E tumbled 0.5pt w/w to a 28-week low of 20.2, and is now 2.1pts below its 43-month high of 22.3 during the December 6 week. It's up 3.2pts from a seven-month low of 17.0 during the October 27, 2023 week and 5.1pts from its 30-month low of 15.1 at the end of September 2022, which compares to an 11-year low of 11.1 during March 2020. MidCap's forward P/E fell 0.3pt w/w to a 60-week low of 14.7, and is now 2.3pts below its 40-month high of 17.1 during the November 29 week. It's up 2.4pts from a 12-month low of 12.3 at the end of October last year and compares to a record high of 22.9 in June 2020 and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E was down 0.4pts w/w to a 27-week low of 14.5, and is 2.6pts below its 41-month high of 17.1 during the November 29 week. It's up 3.9pts from its 14-year low of 10.6 in September 2022 and compares to a record low of 10.2 in November 2009 during the Great Financial Crisis. That also compares to its record high of 26.7 in early June 2020 when forward earnings was depressed. The forward P/Es for the SMidCaps have been mostly below LargeCap's since August 2018. MidCap's P/E is at a seven-month low 28% discount to LargeCap's P/E, which compares to a 19% discount during the March 2, 2023 week, which matched its best reading since October 14, 2021. It's well above its 25-year-low 29% discount during the July 5, 2024 week. SmallCap's P/E is at a 28% discount to LargeCap's P/E, up from a 17-week low 29% several weeks earlier, which compares to a 23% discount during the November 29 week; that was its best reading since the March 2, 2023 week. It's now 6ppts above its 24-year-low 34% discount during the July 5, 2024 week. SmallCap's P/E is a whisker of a discount below MidCap's—among the smallest such discount since July 2021. Prior to that, from 2003 to 2018, SmallCap's P/E had been mostly above MidCap's, and both were above LargeCap's.

US Economic Indicators

Retail Sales (*link*): Retail sales rose less than expected in February, though sales in the control group—which correlates closely with the consumer spending component of GDP—was stronger than expected during the month. *Retail sales* increased 0.2% in February, one-third the expected gain of 0.6%, following January's revised decline of 1.2%, which was steeper than the initial estimate of a 0.9% shortfall. January's data were impacted by winter storms in many parts of the country, as well as wildfires in California. Sales in the *control group*—which excludes autos, gasoline, building materials, and food services—rose 1.0% in February, stronger than the consensus estimate of 0.4%, following January's downwardly revised 1.0% decline, a couple of ticks weaker than the initial estimate of a 0.8% decrease. *Of the 13 nominal retail sales categories*, seven fell in February, while five rose and one was unchanged. *February sales performance versus that of a year ago*: non-store retailers (2.4% m/m & 6.5% y/y), health & personal care stores (1.7 & 6.7), food & beverage stores (0.4 & 3.9), general merchandise stores (0.2 & 3.4), building materials & garden equipment (0.2 & -0.7), furniture & home furnishings (0.0 & 5.5), food services & drinking places (-1.5 & 1.5), gasoline stations (-1.0 & -0.3), clothing & accessories stores (-0.6 & 1.0), sporting goods & hobby stores (-0.4 & -3.0), motor vehicles & parts (-0.4 & 3.1), electronics & appliance stores (-0.3 & -5.3), and miscellaneous store retailers (-0.3 & 5.0).

Business Sales (*link*): Both nominal and real business sales have been in volatile uptrends around record highs. *Nominal business sales* in January ticked down 0.8%, after reaching a new record high in December. Meanwhile, *real business sales* reached a new record high of $1.87 trillion in December, after hovering at $1.85 trillion the prior three months.

Regional M-PMI (*link*): The New York Fed was the first regional Fed bank to report on manufacturing activity for March, and it showed a sharp deterioration in business activity and an acceleration in prices. The *headline general business conditions* tumbled 25.7 points (to -20.0 from 5.7), with both the *new orders* (-14.9 from 11.4) and *shipments* (-8.5 from 14.2) measures plummeting 26.3 points and 22.7 points, respectively. Meanwhile, delivery times (1.0 from 5.4) and supply availability (-1.0 from -2.2) held fairly steady this month, while inventories (13.3 from 8.7) continued to accumulate. Turning to the *labor market*, conditions showed both *employment* (-4.1 from -3.6) and the average workweek (-2.5 from -1.2) continued to move slightly lower. *As for pricing*, both the *prices-paid* (44.9 from 40.2) and *prices-received* (22.4 from 19.6) measures climbed for the third successive month, with the former accelerating at the fastest pace in over two years, while the latter continued to pick up. *Looking ahead*, firms are growing less optimistic about the outlook, dropping 10 points this month, to 12.7, building on February's 15-point drop. The report notes that capital spending plans remained soft, while input price increases are expected to remain significant.

NAHB Housing Market Index (*link*): Homebuilder confidence sank in March to a seven-month low, erasing all the gains booked in the aftermath of the presidential election. "Construction firms are facing added cost pressures from tariffs," noted Robert Dietz, NAHB chief economist. "Data from the HMI March survey reveals that builders estimate a typical cost effect from recent tariff actions at $9,200 per home. Uncertainty on policy is also having a negative impact on home buyers and development decisions." March's *housing market index* (HMI) dropped back down to August's reading of 39—which was the lowest reading since December 2023—after climbing to a nine-month high of 47 during January. Two of the three HMI components moved lower in March, while *sales expectations* was unchanged at 47, down from its recent peak of 66 during December—which was the highest since April 2022. *Current sales* conditions sank for the second month from 50 in January to 43 this month—the lowest reading since December 2023—while *traffic of prospective buyers* dropped five points in March to a 15-month low of 24. (Any reading below 50 is considered negative.) The March survey indicates that the *share of builders cutting prices* rose to 29% in March, up from 26% in February. Meanwhile, 59% of builders used sales incentives this month, the same as last month but a slight decline from January's 61%.

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Eric Wallerstein, Chief Markets Strategist, 201-661-3575
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-241-6502
Melissa Tagg, Senior Global Investment Strategist, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432

Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102