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For investment professionals only

Ashmore

A multi-year tailwind for EM assets (Abridged)

We think the end of pro-cyclical fiscal expansion in the US will be the key macro trigger to start a diversification trend away from US assets. The US portfolio investment liability is currently **USD 33trn**.

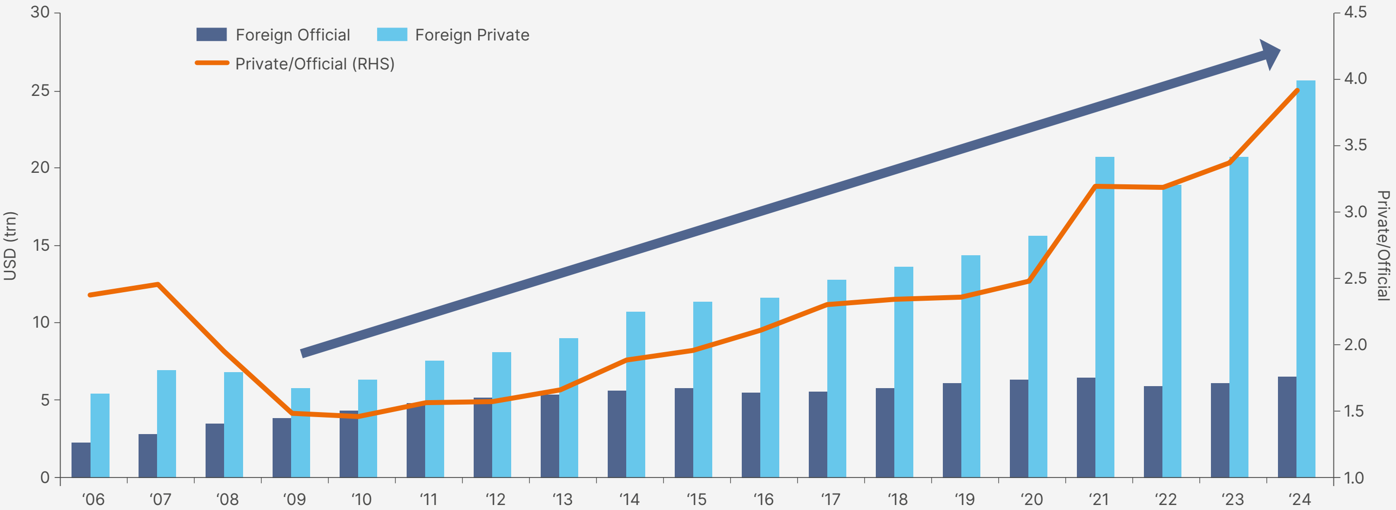
As some of this capital looks for a new home, emerging markets (EM) will be a natural beneficiary. As geopolitical tensions rise with large creditor partners, and with a growing perception of US institutional decay, this trend could well extend over multiple years. The large US fiscal and external imbalances mean the Dollar is no longer the 'safe haven' it once was.

Who holds US assets

The private sector

- The ratio of private/public foreign holdings of US securities rose from 1.5x in 2010 to 4.0x in 2025.
- Privately held assets rose from USD 5trn to USD 25trn over the period (Fig 1).
- We estimate that 1/3 of the increase was due to new flows and 2/3s due to higher US equity valuations.

Fig 1: **Foreign Portfolio Investment in US: Private vs. Official** (USD trn)



Source: US Treasury TIC Data, Ashmore. Data as at May 2025.

Europe

- Europeans now hold USD 14trn in US portfolio assets, of which, USD 9trn in equities.
- The improving European investment outlook and deteriorating US outlook should drive significant reallocation of capital back to Europe.
- The German EUR 1trn fiscal spending on infrastructure, energy, and defence is likely to lead to higher GDP growth.
- Higher growth is expected to drive a convergence of the German Bund to US Treasuries, which is positive for the Euro.

Asia

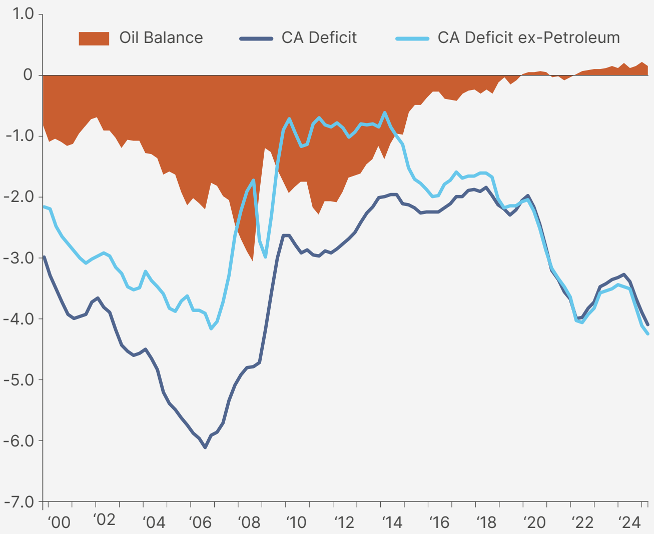
- Asian exporters have recycled their large trade surpluses back into US assets and hold USD 9trn in portfolio investments.
- More investments held by central banks/governments leads to a more conservative profile: 55% of holdings are bonds.
- Japan (USD 2.6trn) and China (USD 1.3trn) still have the largest holdings.
- Relative to their economies, Taiwan (USD 820bn) and South Korea (USD 750bn) also have significant positions.
- April's three-sigma spike in TWD and strong KRW shows high FX sensitivity to these largely unhedged USD positions.

Several narratives to drive diversification

The private sector

- **Weaponisation of USD** payment system via sanctions is encouraging non-aligned countries to seek alternatives.
- **Less open US economy:** Tariffs and coercing companies to manufacture in the US are likely to lead to higher prices and lower margins for US companies.
- **Combative foreign policy:** The current administration's bashing of both allies (Europe/Canada) and adversaries (China) mean these governments are mobilising to become more self-sufficient, driving investment opportunities at home.
- **External imbalances:** The US current account deficit, excluding oil, is at a record high of 5% (Fig 2).

Fig 2: **United States non-oil current account deficit – as % GDP**



Source: St Francisco Fed, Ashmore. Data as at May 2025.

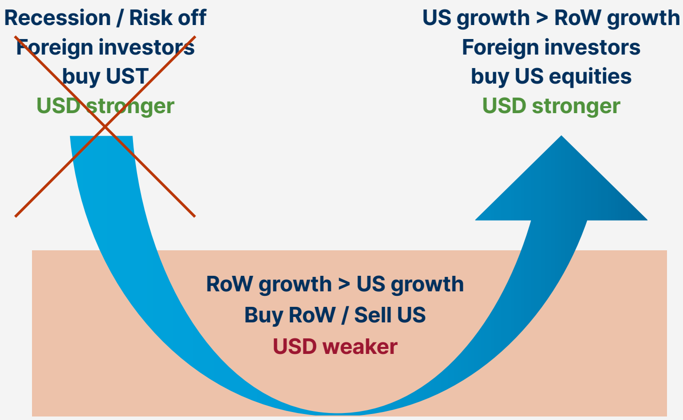
- **Institutions and the rule of law:** In our view, US institutional deterioration predates Trump. Congress has been transactional and dominated by interest groups. However, Trump's contempt for the central bank, Ivy League colleges, law firms, and judicial independence has brought this concern into the mainstream.
- **Unpredictable policymaking:** The extreme unpredictability of US policymaking under Trump is likely to increase the term premium in US assets.
- **Section 899:** If passed, this section of the 'Big Beautiful Bill' is likely to hike taxes on foreign investment income from 5% to 20% over four years, which could encourage outflows – particularly from fixed income assets.

Correlations breaking

From Dollar Smile to Dollar Frown

- Antifragile currencies (that strengthen in a recession), like Japan and Switzerland, have large net assets abroad.
- Since Alan Greenspan until last year, the USD strengthened when equities fell, due to inflows into US treasuries.
- In the 'good times', higher yields and equity inflows lead to Dollar appreciation: the 'Dollar Smile' (Fig 3).

Fig 3: **Dollar Smile no more**



- This relationship motivated foreign investors to hold US equities unhedged.
- However, this correlation broke down. The USD sold off with equities between February and the mid-April equity dive.
- Similarly, the UST yield curve steepened in April and May due to an increase in term premium. This normally leads to a stronger Dollar. This time, the USD weakened, due to rising concerns over US debt sustainability.
- The breakdown of the Dollar Smile should lead to both increased hedging of US assets, as well as repatriation flows.

Emerging markets already a beneficiary

- Even a modest shift in asset allocation to the US could have a disproportionate impact on assets.
- Last month, EM ex-China recorded the largest net inflow since 2023:

  India +USD 2.3bn / **Taiwan** +USD 7.6bn / **Brazil** +USD 2bn
- EM outperformance across asset classes YTD is indicative of a shifting trend, in our view:

  EM stocks +8.8% **vs. S&P 500** +2.1%

  EMFX +5% **vs. DXY index** -5.1%

  EMBI GD +7.8% **vs. Global Agg** +6.6%
- More inflows likely as valuations remain much more attractive in EM equities, bonds, and currencies.

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Read the full version of this paper on our website

Emerging View

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30 May 2025
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