

# ECONOMIC VIEWPOINT

## Strategic View: Influx or Exodus? Capital Flows in North America

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**Although headlines suggest foreign demand for US Treasuries has remained relatively stable, a deeper look points to a structural decline in interest for the paper.** Since the US presidential election, signs have emerged that this trend has accelerated, with the share of foreign countries purchasing US Treasuries falling sharply (graph 1).

**Graph 1**  
Some Signs Point to Investors Turning Away from US Treasuries

Share of countries purchasing US Treasuries\* over the past 6-months

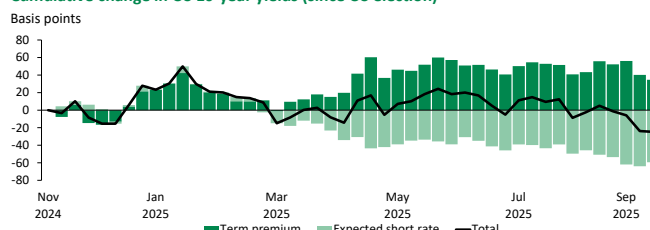


\*Excluding bills  
TIC and Desjardins Economic Studies

**That's left buying more concentrated, with remaining purchasers seemingly requiring greater compensation for holding US sovereign debt.** While Treasuries have rallied recently on expectations of further monetary policy easing, concerns around fiscal sustainability and institutional credibility have dogged US assets. This is clearly seen in the higher term premia embedded in Treasuries (graph 2).

**Graph 2**  
Term Premium Keeping US Treasury Yields from Falling Further

Cumulative change in US 10-year yields (since US election)

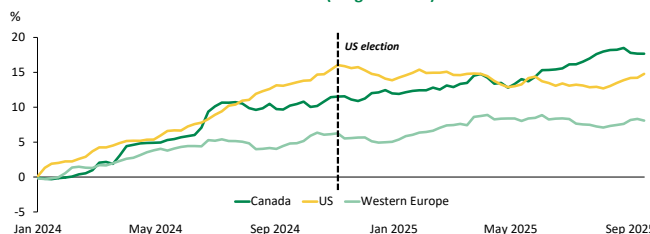


Decomposed using ACM term premium model  
Bloomberg and Desjardins Economic Studies

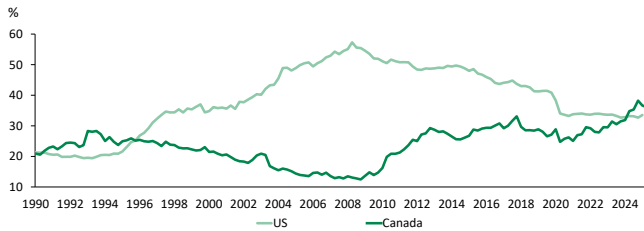
**Capital flows into US long-duration funds also turned negative around the US presidential election, with investors clearly showing more interest in Canadian long-term bonds (graph 3).** That said, foreign interest in Government of Canada bonds has been rising for some time. Since 2020, the foreign ownership share of the Treasury market has remained around the lowest levels seen since 2000 (graph 4 on page 2), reflecting in part a reduced role for the US dollar in global reserves over the past ten years.

**Graph 3**  
Investors Allocating More Capital to Canadian Duration

Cumulative fund flows as a share of AUM\* (long duration)

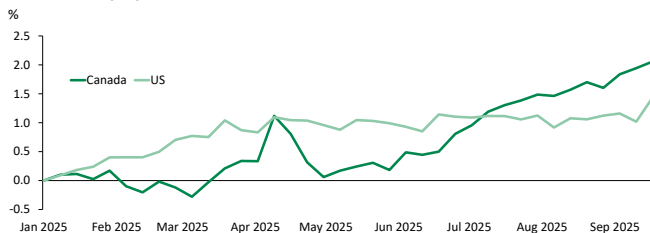


\*Assets under management  
EPFR and Desjardins Economic Studies

**Graph 4**
**Foreign Investors Now Own a Greater Share of Canadian Sovereign Debt**
**Foreign ownership of sovereign debt securities**


Statistics Canada, Federal Reserve, and Desjardins Economic Studies

**As foreign interest in US Treasuries wanes, Canada has emerged as a winner.** This view contrasts with claims that foreign portfolio outflows signal capital flight from Canada. As we showed, a more comprehensive perspective reveals robust demand for Canadian fixed income products. Moreover, there has also been strong interest in Canadian-listed equities. Fund flows into Canadian equities have been rising in recent months, outpacing those into US funds (graph 5).

**Graph 5**
**Canadian Equity Funds Seeing Large Increases in Fund Flows**
**Cumulative equity flows (share of AUM\*)**


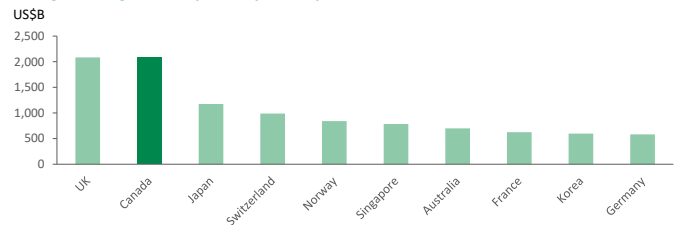
\*Assets under management  
EPFR and Desjardins Economic Studies

**Underweighting US equities has been costly in recent years.** US equity indexes have consistently outperformed global peers (graph 6), setting a high bar for portfolio managers hoping to rotate out of American stocks. But the outperformance of the TSX this year is making it easier for investors to think more broadly about equity exposure.

**Graph 6**
**It Is Rare to See Rest of World Equities Outperform the US**
**Cumulative total return in US vs RoW equities\***


\*S&P500 vs MSCI World Ex US  
Bloomberg and Desjardins Economic Studies

**As a result of domestic pension fund holdings, Canadians are one of largest foreign holders of US equities (graph 7).** A rotation out of US assets and into Canadian ones could be big news and it seems likely, based on commentary from leaders at these funds. They've signalled far greater interest in investing locally, given the prospect of new domestic opportunities and a seemingly greater willingness from the federal government to get projects across the finish line.

**Graph 7**
**Canada Is One of the Largest Holders of US Equities**
**Foreign holdings of US equities by country**


TIC and Desjardins Economic Studies

**In a world of great change, global perceptions of Canada as a safe and stable destination for capital will help attract funds.** The upcoming federal budget will be crucial to maintaining that view. If Canada can remain the "cleanest dirty shirt in the laundry basket" when it comes to G7 fiscal sustainability, there's ample scope for more investors to park more money in federal and provincial bonds. Similarly, the outperformance of Canadian equities relative to their US counterparts seems to reflect a growing consensus that portfolio managers can begin rotating away from US equities without fear of missing out on a huge rally. As it stands, there remains plenty of scope for foreign equity investors to increase exposure to Canada—and the relatively lower valuations on the TSX—while diversifying away from US AI themes. As such, we continue to see the TSX outpacing the S&P 500 into next year.