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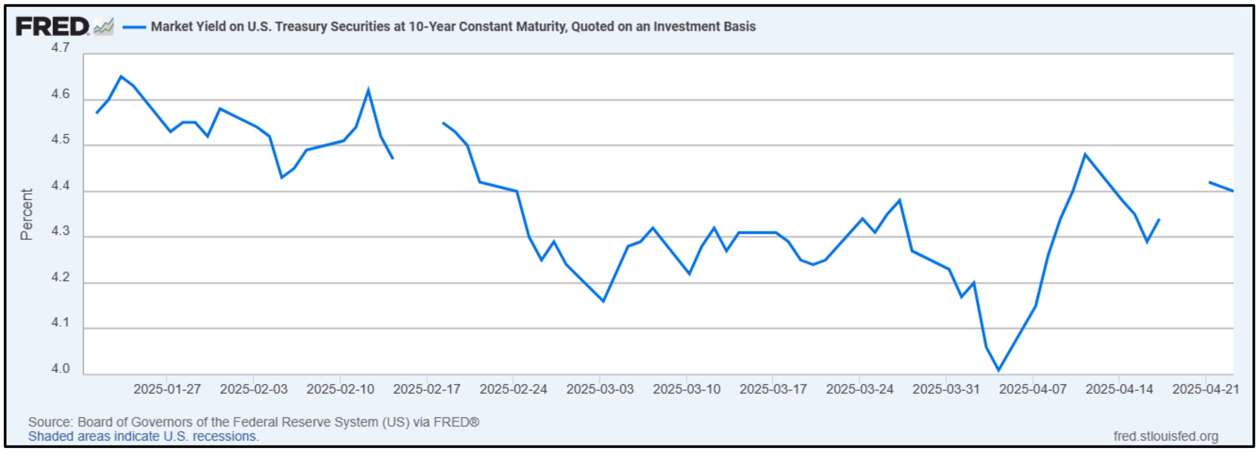
Confluence Investment Management offers various asset allocation products which are managed using "top down," or macro, analysis. We publish asset allocation thoughts on a bi-weekly basis, updating the report every other Monday, along with an accompanying podcast.

US Capital Flight and the Implications for Investors

May 5, 2025

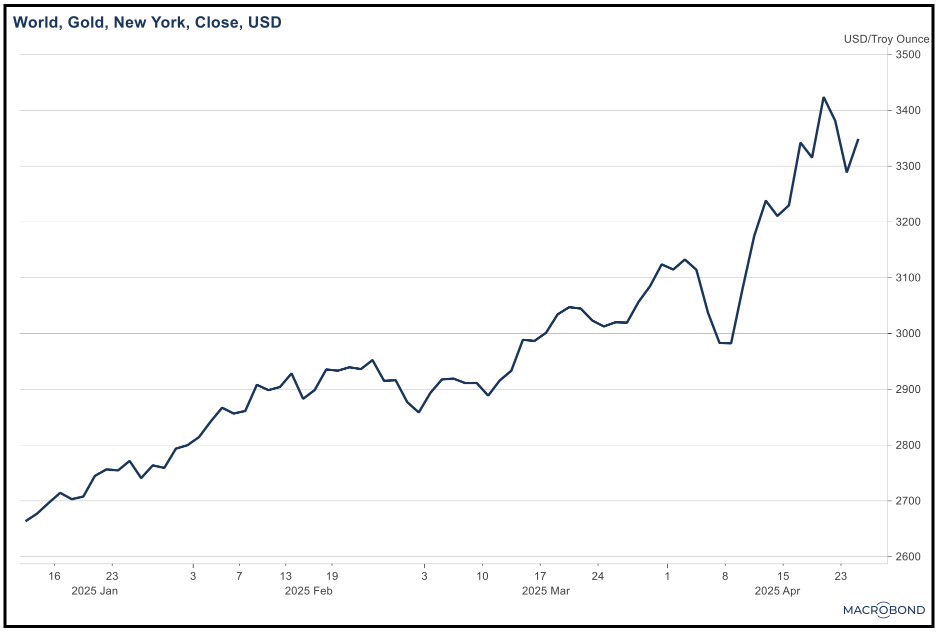
Oh, what a difference one calendar quarter can make! Shortly after Donald Trump was sworn in to his second term as president of the United States, we wrote that the US seemed to enjoy exceptional advantages versus the rest of the world in terms of its economic growth, political stability, and stock market returns. Other economists and market commentators echoed those views. However, just three months into Trump's new term, many investors seem to be losing confidence in the US's economic growth and management. As we discuss in this report, the evidence pointing in that direction includes a rise in the yields on US Treasury obligations, a depreciating dollar, and surging gold prices. Below, we discuss these trends and what they may mean for world financial markets going forward.

Reduced Bond Buying / Rising Bond Yields. As shown in the chart on the next page, the yield on the benchmark 10-year Treasury note stood at 4.57% on the first business day after Trump's inauguration in January. Investors continued to scoop up Treasurys in the weeks following the ceremony, driven by expectations of slower economic growth, easing inflation pressures, and further interest rate cuts by the Federal Reserve. As the administration revealed more about its tariff plans and other aspects of economic policy, growing concerns about the US economy pushed 10-year Treasury yields as low as 4.01% in early April. Since then, however, Treasurys have sold off sharply. Importantly, it appears that foreign institutions in Japan and elsewhere have been a big part of the sell-off. In any case, 10-year Treasury yields have spiked to more than 4.40% since mid-April. The yield on 30-year Treasurys has spiked to as high as 4.91%.



A Depreciating Dollar. Just as US Treasurys have sold off, the dollar has depreciated against many key currencies. The chart below shows the Fed's nominal US Dollar Index, which tracks the value of the greenback against a broad range of foreign currencies. The broad index shows the dollar has lost about 4.10% of its value since Inauguration Day, with an especially sharp drop since Trump announced the pause in his "reciprocal" tariffs on April 9. The dollar has especially fallen sharply against developed country currencies, such as the euro.

Rising Gold Prices. Rising bond yields and a falling dollar point to falling confidence in the US among global investors, so it should be no surprise that gold — the quintessential safe haven — has appreciated sharply. As shown in the next chart, gold prices have even reached a record high above $3,400 per ounce, with much of the increase coming since early April.



Of course, many long-term investors have been more focused on the recent volatility in US risk assets, especially stocks. In our view, the unique combination of market forces described above may be the more important underlying story. The rise in US bond yields, the decline in the dollar, and the surge in gold represent a rare alignment of market trends that may indicate some measure of capital flight from the US. This pattern of market moves suggests that global and even some domestic investors are trying to cut their exposure to US assets and the dollar. The likely culprit is the administration's effort to rapidly and fundamentally change the US economic relationship with the rest of the world. As long as that endeavor continues, and investors are unsure of where the to-and-fro of policymaking will take them, these trends are likely to remain in place. Therefore, over the coming months and quarters, the most attractive assets may be much different than what we and other observers had expected at the start of the year. In particular, any continued US capital flight is likely to favor foreign equities, foreign currencies, and gold in the near term.