Investors are favoring U.S. stocks over emerging markets by the most ever as fund flows and volatility measures show institutions are increasingly seeking the relative safety of American equities.

Almost $95 billion was poured into exchange-traded funds of American shares this year, while developing-nation ETFs saw withdrawals of $8.4 billion, according to data compiled by Bloomberg. The Standard & Poor's 500 Index (SPX) trades at 16 times profit, 70 percent more than the MSCI Emerging Markets Index. A measure of historical price swings indicates the U.S. market is the calmest in more than six years compared with shares from China, Brazil, India and Russia.

Cash is draining from emerging-market ETFs and flowing into U.S. stock funds at the fastest rate on record as bulls say an unprecedented third year of higher earnings growth will support the S&P 500 even as the Federal Reserve begins to remove stimulus. Developing-nation investors say the ETFs will lure more cash after equity valuations reached a four-year low.

“The weakness in emerging markets and the associated economic troubles have encouraged some investors to reallocate from the emerging world to the U.S.,” James Gaul, a fund manager at Boston Advisors LLC, which oversees about $2.3 billion from Boston, said by phone on Aug. 15. “The U.S. is seen as the most stable economy at the moment, and the equity market is viewed as having better prospects than the rest of the world.”

**ETF Deposits**

The S&P 500 slid 2.1 percent to 1,655.83 last week, paring its gain this year to 16 percent, as data on rising retail sales, subdued inflation and a drop in jobless claims fueled speculation the Fed will cut monetary stimulus, known as quantitative easing. The central bank will probably reduce the $85 billion in monthly bond purchases next month, according to 65 percent of economists surveyed by Bloomberg. Futures on the S&P 500 rose 0.2 percent at 7:55 a.m. in London today.

Brazil, Argentina and South Africa led developing nations higher last week, driving the MSCI index up 0.7 percent for the first advance since July. The equity gauge has fallen 9.2 percent this year.

Investors have sent cash to U.S. equity ETFs every month since November, with deposits totaling $32 billion in July, the most since September 2008, according to data compiled by Bloomberg from about 1,500 funds. There have been withdrawals from emerging-market stock ETFs in five of the past six months, on pace for the biggest annual outflow since Bloomberg began tracking the data in 2000.

**Revenue Exposure**

U.S. companies that generate the most sales from Brazil, Russia, India and China have trailed the S&P 500. Firms taking in at least 20 percent of revenue from those countries climbed a median 13 percent this year, according to data compiled by Bloomberg on the 41 companies that disclosed financial data from the so-called BRIC nations.

Yum! Brands (YUM) Inc., the owner of the KFC and Pizza Hut chains, counts on China for half its sales. The Louisville, Kentucky-based company slid 3 percent last week and posted a 13 percent decline in July same-store sales from China as diners remained reluctant to eat chicken amid an outbreak of avian flu.

Mosaic (MOS) Co., the second-largest North American potash producer, has dropped 24 percent this year as Russia’s OAO Uralkali abandoned limits on output that underpinned prices and quit a trading venture with Belarus that controlled supplies from the former Soviet Union. Mosaic, based in Plymouth, Minnesota, gets about a third of its revenue from BRICs.

**Stock Swings**

As money shifted away from emerging markets, volatility diminished in U.S. equities. The S&P 500’s 30-day historic
movement dropped 29 percent to 8.75 this year, while the measure for the MSCI measure of 21 developing nations surged 83 percent to 13.3, data compiled by Bloomberg show.

"Investors are going to go where they're treated best and right now the U.S. stands out," Bruce Bittles, chief investment strategist at RW Baird & Co., said by phone from Sarasota, Florida, on Aug. 15. His firm oversees $100 billion. "A lot of bearish sentiment is building in emerging markets. Eventually once it reaches extreme, which I don't think it has yet, it will provide a strong base for the markets to rally from."

Cisco Systems Inc., the biggest maker of networking equipment, said last week that it's cutting about 5 percent of its workforce amid weaker sales from overseas including China. The company's ability to meet its long-term growth target of 5 percent to 7 percent a year will partly depend on emerging markets, according to Chief Executive Officer John Chambers.

San Jose, California-based Cisco generates about 42 percent of revenue outside the U.S. and Canada. The stock tumbled 6.8 percent last week, the most since May 2012.

‘Inconsistent Growth’

"The changes in macroeconomic conditions in the emerging markets, both positive and negative, are driving more inconsistent growth," Chambers said on an Aug. 14 conference call. "We need some consistency there. We're not seeing it."

Capital is fleeing developing nations as China’s economy grows at the slowest pace in 13 years, India’s current-account deficit widens to a record, and persistent inflation in Brazil erodes purchasing power. The share losses are a reversal from the past decade, when the countries led gains during a commodity boom and rising consumption from the middle class.

The potential reduction in U.S. stimulus has strengthened the dollar against 14 of the world’s 16 major currencies this year, attracting global investors to appreciating asset values. In countries such as Brazil, the weaker exchange rate makes imports more expensive and threatens to drive prices for consumers higher. The Indian central bank raised two interest rates in July to contain the rupee’s decline. The currency touched an unprecedented 62.0050 per dollar last week.

More Inflation

"Slow growth, more inflation and tightening central bank policy is not a good combination," Michelle Gibley, director of international research at San Francisco-based Charles Schwab Corp., said by phone on Aug. 14. The firm manages $2.12 trillion in client assets. "Part of the whole idea of QE was to push investors into riskier assets, and now they’re doing the opposite."

The U.S. rally pushed the S&P 500’s valuation up 13 percent to 16 times reported operating earnings, close to the highest level since May 2010, data compiled by Bloomberg show. Declines from Chile to Turkey left the MSCI index’s multiple at 9.4, down 7.5 percent since the end of last year and close to the lowest since 2009.

Developing nations are attractive because concern about less Fed stimulus is overdone, said Chris Hyzy, who helps oversee about $325 billion as chief investment officer of U.S. Trust. Samsung Electronics Co. shares trade at the biggest discount to Apple Inc. in two years, data compiled by Bloomberg show.

Alive, Well

"The outflows occurring in emerging markets have more to do with the nervousness over less liquidity than the actual economic cycle," Hyzy, based in New York, said by phone on Aug. 15. "The bull market is alive and well."

The last time U.S. shares traded at such a premium and volatility versus emerging-markets was similar to now, was in June 2004, when the Fed started to raise interest rates from a 45-year low of 1 percent. Emerging markets rallied 29 percentage points more than the S&P 500 in the next 12 months, according to Bloomberg data.

Investors are rewarding U.S. equities with a higher premium after executives generated bigger profits even as global growth remained sluggish. Analysts forecast an 8.9 percent rise in S&P 500 profits in 2013, compared with a 4 percent increase for stocks in developing countries, based on the average of more than 11,000 estimates compiled by Bloomberg.

More Certainty
Should the projections come true, it would mark a third year of faster earnings growth by American corporations, the longest run in data going back to 1995.

U.S. “earnings have delivered and there is more certainty going forward,” Andres Garcia-Amaya, global market strategist at JPMorgan Chase & Co. (JPM)’s mutual funds unit, said in an Aug. 8 telephone interview from New York. The firm oversees $400 billion. “I’m OK paying up for more certainty, rather than having cheaper valuation while having a lot more uncertainty.”

JPMorgan Chase shares have rallied in 2013 as CEO Jamie Dimon led the company to record earnings over the past three years. Shares of the New York-based bank are trading at 8.4 times reported operating earnings and analysts’ estimates show the lender will boost profit by 9 percent in 2013, data compiled by Bloomberg show.

**Higher Premium**

Industrial & Commercial Bank of China Ltd. (1398)’s profit growth is projected to slow to 7 percent in 2014 from 8 percent this year, according to analysts’ estimates. The stock trades at 5.9 times earnings, near a record low, amid concern that an economic slowdown will increase bad loans and the government’s plan to loosen its grip on interest rates will hurt lending margins at the Beijing-based bank.

The U.S. economy will expand 3 percent in 2015, almost double from this year’s pace, according to the median estimates of 89 economists compiled by Bloomberg. Over the same period, combined gross domestic product in BRICs will stay the same at a growth rate near 5.9 percent and the Chinese economy will decelerate to 7.2 percent from 7.5 percent.

“That really creates an inflection point,” Jerry Braakman, the chief investment officer of First American Trust in Santa Ana, California, said in an Aug. 13 phone interview. His firm oversees $1 billion. “China hasn’t fallen off the wagon yet, but it’s getting dangerously close and that’s what scares people. If you’re trying to hide away from that Chinese impact, then buying U.S. assets might be a safety net.”

To contact the reporter on this story: Lu Wang in New York at lwang8@bloomberg.net

To contact the editor responsible for this story: Lynn Thomasson at lthomasson@bloomberg.net

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