

US Dollar Decline

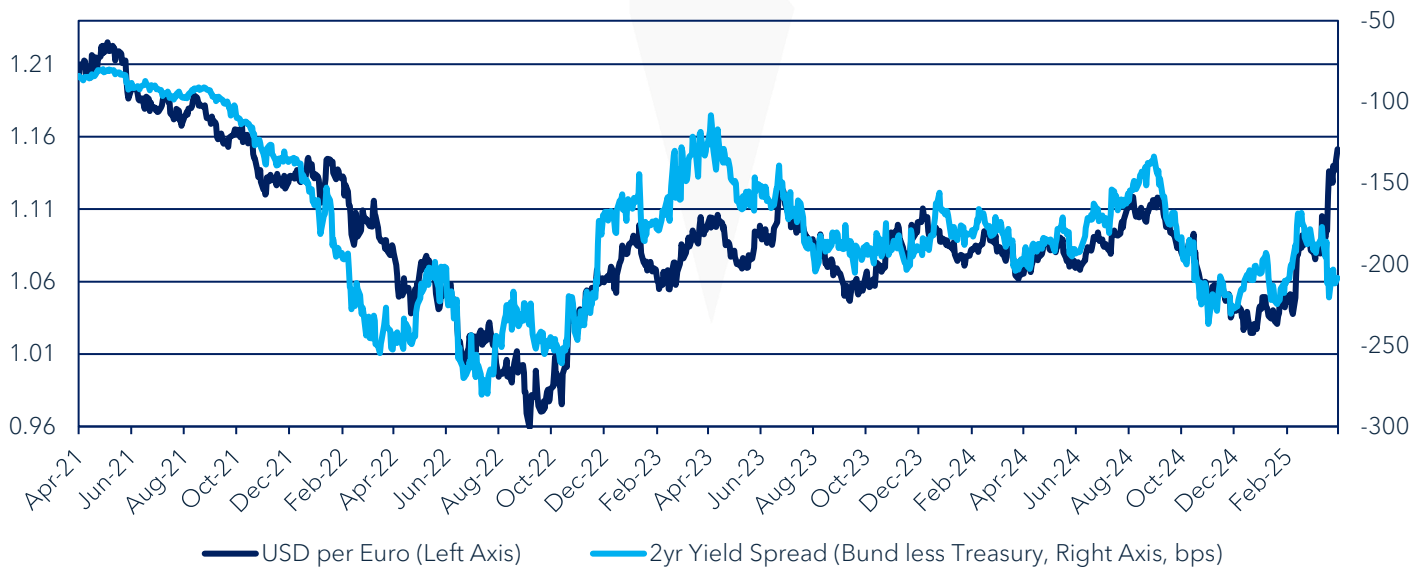
The US dollar is the world's most widely held reserve currency. In effect, it is the currency predominantly used globally for international trade, contracts, and central bank reserves. For the US, this comes with the advantages of lower borrowing costs (there will always be a buyer for USD denominated bonds) and the tendency for the dollar to appreciate during periods of economic stress. However, President Trump's administration believes that this excess demand for the US dollar has led to the currency being too strong, hence making those goods manufactured in the US more expensive and contributing to the decline of the industry. Therefore, in order to make domestically produced goods more competitive at home, they are introducing trade tariffs on imports to make them more expensive.

This strategy is risky and, although, it may prove fruitful over the long-term, at least near-term, applying trade tariffs on US trade partners places a tax on US consumers and provides a headwind for consumer spending and corporate profits, something which is reflected in US sentiment data. Therefore, with the fear of an economic slowdown rising, investors have been selling US stocks. Historically, during adverse periods for US stocks, the US dollar shoots higher and US Treasury bond yields drop sharply. This is because, as the world's reserve currency, the US dollar and US bonds tend to be sought after as a store of value. This reaction can be helpful as it dampens the economic hit for US consumers. A stronger currency gives consumers more purchasing power, as imported goods become cheaper, and lower bond yields typically translate into lower mortgage rates. In turn, this limits the adverse impact on consumer spending which is relatively beneficial for corporate earnings.

However, the current situation is different. US stocks have declined sharply this month but so has the currency and bond yields are higher, not lower. The US dollar is down 9% year-to-date against the other major currencies, with more than half the decline occurring so far this month. In turn, this means higher prices for imported goods in the US, on top of the cost of tariffs, and upward pressure on borrowing costs. In short, investors are now turning negative on all US assets, even those traditionally used as a store of value. This is a situation that is highly unusual for the US, the world's most important economy, but is common in emerging markets and which was also evident, for a short period, in the UK during the Truss debacle in 2022.

During periods of stress in asset markets, the Swiss Franc and gold also typically strengthen alongside the US dollar. Switzerland is a preferred tax haven and a politically neutral, highly wealthy nation. Meanwhile gold's limited supply and low correlation to stocks and bonds make it attractive. As a result, the Swiss Franc is up 11% and gold is up 26% year-to-date. However, the Euro has also been appreciating, and this is unusual during stress periods. As the Eurozone engages in a large amount of global trade, shocks to large global economies, such as the US, tend to have a negative impact on the Euro. This unusual scenario can be observed in the chart below where higher yields in the US relative to Europe have recently coincided with a weaker US dollar, a break from the norm.

2yr Yield Spread and EUR/USD, 4-years



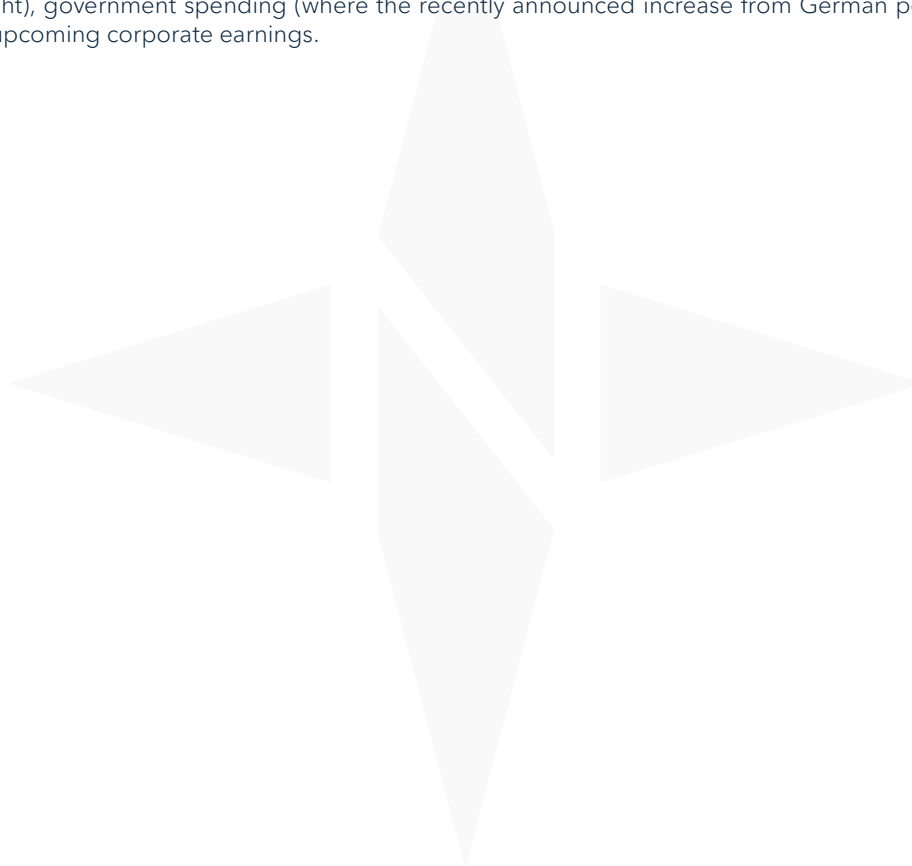
Source: LSEG Datastream, North Capital Management. As at 21 April 2025.



Investor and Portfolio Implications

Non-US investors have benefitted hugely from the appreciation of US assets over the last decade. For example, over the decade to the end of 2024, for UK investors, US stock indices gained more than 300% compared with 80% for UK and 120% for European stocks. However, the recent rise in yields, weakening US dollar and underperformance of US stocks suggest an exodus of non-US investors to other regions. Given all the changes instigated by President Trump, there is a significant risk that these investors further reduce their holdings of US assets. Business confidence in the US has declined amidst import tariffs announcements and erratic decision making. Additionally, President Trump's criticism of US Federal Reserve Chair Powell has raised concerns about future independence of the central bank and the sanctity of politically independent, long-term decision making. Moreover, the aggressive rhetoric from the US administration against the rest of the world make the region less attractive. All this uncertainty makes it more likely that non-US investors will continue to strategically reduce their holdings of US assets.

Therefore, we remain underweight US assets via underweights in US equities, Global equities (which are dominated by the US) and sovereign bonds relative to cash, European equities and gold. When UK investors allocate to US equities, they are also exposed to the US dollar. Therefore, by reducing exposure to US and Global equities, we have also reduced exposure to the US dollar. We remain agile and focused on changes in market drivers such as government trade policies (where recent changes in the US have driven our underweight), government spending (where the recently announced increase from German politicians has influenced our overweight) and upcoming corporate earnings.



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