



DIVERSIFICATION

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Avenues for diversifying out of the USD

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While US equities have recovered from the sharp fall in April on trade policy fears, the USD remains weak as doubts about US policymaking remain. We expect the de-dollarization trend to persist, and the EUR, JPY, AUD, NZD and CNY should gain against the USD over the coming 12 months. Investors looking to diversify their portfolios out of excessive USD exposure might consider segments of EUR-, JPY- and CNY-denominated equities. In fixed income, we believe AUD- and NZD-denominated bonds provide attractive avenues for diversification.

Before the resurgence of Middle East tensions, the S&P 500 was a mere 1.6% off the February high. Even with the elevated geopolitical risks, it remains up 2.7% year-to-date and up over 21% from its 8 April trough. Market optimism over the resilience of the US labor market and benign US inflation thus far have proved supportive, as have expectations of lower eventual tariff levels.

Notwithstanding this positive sentiment in the stock market, the USD (DXY index) is down 9.9% year-to-date and down 11% from its January peak, just before financial markets started to price in tariff risks. Concerns about US policymaking have only continued to grow, and we favor reducing excess USD exposure. Below, we highlight some non-USD assets that we like that investors—especially those in the Asia Pacific (APAC) region—can use to reduce the USD exposure of their portfolios.

Add quality European equities. We expect the EUR—as the most liquid alternative to the USD—to be a key beneficiary of the de-dollarization trend. We expect EURUSD to climb steadily toward 1.20 by June 2026. Beyond diversifying cash holdings, investors could also consider using the current market volatility to buy European quality stocks, which we believe are well suited to portfolio diversification and increasing exposure to European equities. The quality investment style

focuses on businesses that are highly profitable and have stable earnings and robust balance sheets. Quality tends to work well in volatile, slow growth periods, and the late stage of the business cycle is often a good time to add quality stocks.

A few factors make this a good time to target European quality stocks. The European quality style has underperformed MSCI Europe in total return terms over the last 12 months and since its relative peak in October 2020 by 9 and 15 percentage points respectively. For context, the MSCI Europe Quality index has outperformed the MSCI Europe index by 2% per year on average over the last 35 years with lower volatility. Although not cheap, the P/E valuation premium has fallen over the last 18 months to slightly below its 10-year average.

Select exposure to JPY and CNY equities. We expect both currencies to remain resilient over the coming months, with the USDJPY and USDCNY declining to 136 and 7.00 respectively by June 2026. For Japanese equities, we currently maintain a balanced portfolio, combining selected oversold cyclical names with those with high returns on equity in health care, machinery, and technology. We prefer domestically-oriented sectors such as parts of IT services, which are enjoying stable order flows thanks to strong demand for digital transformation initiatives. In China, we favor A-share sectors that provide stable cash flows with attractive dividend yields, like banks, insurance companies, utilities, and telcos—where payout ratios remain steady and earnings visibility is high. High-dividend-yielding stocks have been gaining traction amid declining yields in China. Insurance funds and regulatory support for higher equity allocations have been driving new inflows. Record cash dividend payouts and rising payout ratios are further supporting this yield pursuit. Investors, especially those in APAC, might consider these preferences when diversifying the FX exposure of their portfolios.

AUD and NZD bonds also look attractive. Within the fixed income space, there are also suitable diversification options in the form of AUD- and NZD-denominated bonds. We expect the AUDUSD and NZDUSD to climb to 0.70 and 0.64, respectively, by June 2026. We also expect some mild downside in 10-year AUD and NZD treasury bond yields.

Australia boasts a very solid sovereign debt profile, with a debt ratio of 55% to 60% of GDP in recent years, and a net-interest-to-government revenues ratio of about 4.5% (versus over 12% for the US). Australia's policymaking bodies have a history of fiscal discipline, and that credibility helps bolster the AAA rating of its sovereign debt. For AUD bonds, we prefer investment grade and high grade bonds in the mid-duration segment. We see the best value in defensive sectors such as telecommunications, utilities, consumer staples, and financials, given the slowing economy, trade risks, tight spreads, and the absence of a cyclical premium.

As a small and open economy, New Zealand experiences greater volatility in economic growth, interest rates, and FX than larger developed market peers. However, these risks are offset by a low and highly affordable government debt burden, as well as robust policy institutions. New Zealand currently spends only around 4% of government revenues on servicing the general government debt burden, which amounted to 47% of GDP in 2024. These underpin the Aaa/AAA rating on New Zealand's sovereign bonds, which are all NZD-denominated.

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