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Reduce excess dollar exposure

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- **Why?** (1) Despite periods of market uncertainty, the US dollar has continued to weaken this year. (2) As the Fed cuts rates and other major central banks near the end of their cutting cycles, the yield differentials should lead to continued dollar weakness. (3) We believe that investors should review their USD holdings and align them with liabilities or spending plans for today, their lifetimes, and beyond.
- **Why now?** (1) We expect 100bps of Fed rate cuts over the 12 months from September, which may weaken the USD compared to peers where cuts have stopped. (2) Weaker US activity and labor data may spur worries of a sharper growth slowdown, steeper rate cuts, and a swifter USD depreciation. (3) Uncertainty around trade policy and a high government deficit may weigh on the USD, as has been the case so far this year.

We believe that investors should consider diversifying excess US dollar holdings, amid slowing US growth and ahead of potential Fed rate cuts.

The Dollar Index (DXY), which tracks the US currency against a basket of six major peers, has fallen by roughly 9% this year. We expect the US dollar to depreciate further over the course of 2025 as US growth moderates and the Federal Reserve cuts rates. We target EURUSD at 1.23 and USDCHF at 0.76 by September 2026.

Investors can consider various ways to reduce, diversify, or hedge excess dollar exposure:

Hedge US dollar exposure implicit in US assets

Investors can consider putting money to work into balanced portfolios of stocks, bonds, and alternative assets that are hedged in their desired currencies. Alternatively, we like shifting investment grade fixed income holdings into underallocated currencies relative to long-term currency goals, and hedging equity exposures can help close currency gaps. For sophisticated investors, currency forwards, options, and structured solutions can provide flexible exposure, though these instruments introduce additional risks such as leverage and margin calls.

Increase allocations to EUR, NOK, and AUD

EUR: As the most liquid alternative to the US dollar, the euro is likely to be a key beneficiary as investors seek to diversify away from the USD. The euro could find additional support with the Fed set to resume rate cuts just as the European Central Bank ends its easing, ongoing negotiations to end the Russia-Ukraine war, and Middle East tensions receding, which may favor Europe as an energy importer. One key factor to monitor is the US economy: If data is stronger than expected, EURUSD could consolidate; if the US weakens, the pair may move more quickly toward our September 2026 forecast of 1.23.

NOK: The Norwegian krone is one of Europe's most growth-sensitive currencies. We therefore expect it to benefit disproportionately from any acceleration in European activity spurred by front-loaded fiscal expenditures in Germany and on joint European defense. Domestic factors can also support the NOK. Although the Norges Bank surprised markets with a rate cut in June, recent economic

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data have raised questions about whether the central bank may have already reached the end of its easing cycle. We foresee EURNOK at 11.00 by next September.

AUD: We think that Australia's rising real household incomes and higher house prices—potential precursors for a modest domestic recovery—alongside easing US-China frictions should lift AUDUSD. Notwithstanding some near-term softness in labor data, the Reserve Bank of Australia still looks on track to cut rates by 75 basis points through the first quarter of 2026 (versus 100bps for the Fed). Continued government stimulus may result in stronger-than-expected economic data. With US-China trade tensions easing, we expect AUDUSD to rise toward 0.70 in the first half of 2026.

Review currency allocations

While we expect the US dollar's decline to continue over the coming year, the significant interest rate differential between the USD and the euro and Swiss franc in particular means that hedging or underweighting the US dollar comes at a cost. We believe this is an important time for investors to ensure their strategic currency allocations are appropriate for their personal situations, and we recently published a guide on how to do this (see "A practical guide to currency allocation" for more).

Switch USD bond holdings to EUR IG

Another avenue to reduce the USD exposure of portfolios is to switch USD bond holdings to those denominated in EUR. We hold an Attractive view on investment grade (IG) bonds, including EUR IG. We find the outright level of yields (over 3%) appealing, as they are still elevated versus historical levels. Fundamentals generally remain solid, and we expect limited credit quality deterioration in the medium term.

Appendix

Risk information
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