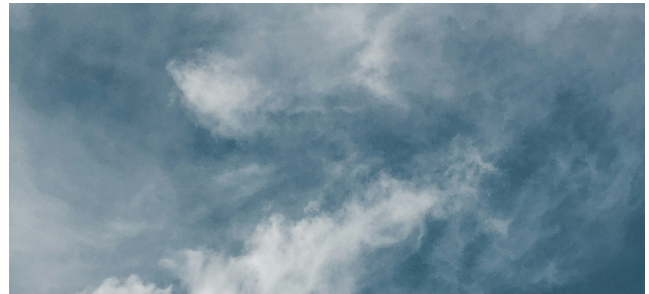


Reduce excess dollar exposure

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- **Why?** (1) Despite periods of market uncertainty, the US dollar has continued to weaken this year. (2) A further 75bps of Fed cuts rates while other major central banks near the end of their cutting cycles should narrow yield differentials, driving 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) Currently, G10 foreign investors hold an estimated USD 14 trillion in unhedged dollar positions, auguring potential USD selling. (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 fiscal and trade deficits 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, particularly as the Fed cuts rates. Source: Unsplash

Tactical: Opportunities in the euro, Norwegian krone, and Australian dollar

EUR: As the most liquid alternative to the US dollar, the euro is likely to benefit as investors diversify away from the dollar. The euro could find additional support with the Fed set to resume rate cuts just as the European Central Bank ends its easing, and amid ongoing negotiations to end the Russia-Ukraine war. 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 and may benefit from any acceleration in European activity spurred by front-loaded fiscal expenditures in Germany and joint European defense spending. Domestic factors can also support the krone. Although the Norges Bank surprised markets with rate cuts in June and September, it has signalled that it would be cautious about reducing rates further. We foresee EURNOK at 11.00 by next September.

AUD: 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. Despite some near-term softness in labor data, we expect the Reserve Bank of Australia to cut rates by 75 basis points through the first quarter of 2026 (versus 100bps for the Fed including September's cut). 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.

Strategic: Review currency allocations and consider hedging US dollar exposure implicit in US assets

As regions pursue different strategies for managing debt, the effects are likely to manifest in currency markets. That means it is an important time for investors to ensure strategic currency allocations are appropriate for their personal situations (see "A practical guide to currency allocation" for more).

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Many investors have accumulated more US dollar exposure than needed, driven by attractive opportunities in US capital markets, relatively higher interest rates, and the dollar's reputation as a "safe haven." Currently, G10 foreign investors hold an estimated USD 14 trillion in unhedged dollar positions.

But with potential dollar weakness ahead, it may be a good time for investors to reassess their currency mix, review dollar allocations, and consider hedging or rebalancing strategies to bring portfolios into better balance.

One option for reducing dollar exposure is to switch US dollar bond holdings to those denominated in euros, as we hold an Attractive view on the currency. We also like investment grade bonds, including EUR investment grade. The outright level of yields in euros (over 3%) is appealing, fundamentals generally remain solid, and we expect limited credit quality deterioration in the medium term.

Currency hedging overseas equity exposures can also 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.

Appendix

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