CIO believes investors should review their currency allocations to ensure they match future liabilities and spending needs. (UBS)

What should I do with my dollar exposure?

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The US dollar has strengthened despite the 25-basis-point interest rate cut by the Federal Reserve. But CIO don't expect a sustained rebound.

The Fed has signaled there will be further easing, while most other central banks are nearing the end of their rate-cutting cycles. We favor strategies to diversify excess USD exposure ahead of likely further dollar declines.

The US dollar has rebounded following the Fed's rate cut at its September policy meeting.

- The DXY dollar index has risen over 1% since the FOMC meeting concluded on 17 September.
- With just one vote for a more aggressive easing, and Fed Chair Powell's reiteration that future policy moves are data-dependent, markets have judged the decision as a "hawkish cut."
- Data released following the rate cut also signaled resilient economic growth, prompting investors to reassess the outlook for further easing.

But we think the dollar would resume its downward trend, and investors should review their currency allocations.

- The Fed's "dot plot" indicated two additional 25-basis-point cuts are expected this year. As the Fed cuts rates and other major central banks near the end of their cutting cycles, yield differentials should lead to continued USD weakness.

- The US's twin current and fiscal deficits mean that the path of least resistance for the dollar is lower.
- Investors should align their US dollar holdings with liabilities or spending plans for today, their lifetimes, and beyond.

We like the euro, the Norwegian krone, and the Australian dollar.

- Increasing allocations to alternative currencies—especially the euro, Norwegian krone, and Australian dollar—can help diversify portfolios and reduce dollar exposure.
- Another way to reduce dollar exposure is to switch USD bond holdings to those denominated in euros, as we hold an Attractive view on that currency.
- Investors can also consider putting money to work into balanced portfolios of stocks, bonds, and alternative assets that are hedged in their desired currencies.

Did you know?

- Global central banks are diversifying away from the US dollar, a structural trend that is likely to weaken the dollar as demand for alternative currencies grows.
- 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.
- 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.

Investment view

With the Fed set to cut interest rates more quickly than other central banks, a high outstanding volume of unhedged overseas investment in the US, and still-significant current and fiscal deficits, we believe the path of least resistance for the greenback is lower. Tactically, we prefer the euro, Australian dollar, and Norwegian krone. Strategically, we believe investors should review their currency allocations to ensure they match future liabilities and spending needs.

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