With the dollar's interest rate advantage over other currencies set to narrow further over the coming year, CIO expects the greenback to continue to depreciate. (UBS)

Is it time to reduce exposure to the US dollar?

30 September 2024, 3:39 pm CEST, written by UBS Editorial Team

CIO expects lower US interest rates and fiscal deficit fears to weaken the US dollar over the medium term.

CIO believe investors should therefore reduce US dollar exposure by partially hedging dollar assets, adding international exposure, switching USD cash and fixed income exposure for those in other G10 currencies, or by using options. We also believe gold can be an effective diversifier.

The US dollar weakness should continue over the medium term.

- Since its near-term peak in late June, the DXY dollar index has fallen over 5%.
- With the dollar's interest rate advantage over other currencies set to narrow further over the coming year, we expect the greenback to continue to depreciate.
- We also believe a renewed focus on the US fiscal deficit could weigh on the currency once the US election is over.

Investors should reduce their USD exposure.

- Many global investors hold large unhedged US equity and bond positions and should consider the potential impact of a depreciating dollar on their portfolios.
- We recommend using bouts of dollar strength to hedge US positions via currency futures, swaps, options, or structures or by switching to hedged share classes.
- We like the euro, British pound, and the Australian dollar.

We also like the Swiss franc, and see higher gold prices.

- We expect just one more cut by the Swiss National Bank in this cycle, while the Fed has significantly further to go in lowering rates.
- Uncertainty over the US election outcome, still-elevated short CHF speculative positions, and (in our view) excessive expectations for SNB rate cuts should also support the franc.
- Gold prices are likely to rise even higher amid lower interest rates, economic and geopolitical uncertainty, and central bank reserve asset diversification away from the US dollar.

Did you know?

- In an international context, borrowing in Swiss franc has often looked appealing given low nominal interest rates in Switzerland compared to other G10 currencies. But as we think the franc is set to appreciate further, in particular against the US dollar, international borrowers with outstanding Swiss franc loans should get ready to manage franc loans more actively.
- Geopolitical tensions could likely extend well beyond 4Q, with the next US government (and its policies) uncertain and conflicts in Ukraine and the Middle East ongoing. A weaker dollar and lower US interest rates is typically supportive of gold prices. We expect demand to remain robust in the coming months, from central banks and gold ETFs.
- We expect the euro to benefit from a strong recovery in the Eurozone's trade balance, while the Reserve Bank of Australia might not cut rates until next year.

Investment view

Investors should reduce their USD holdings as the currency is likely to weaken further over the medium term. We like the Swiss franc, the euro, the British pound, and the Australian dollar. We also recommend an allocation to gold of up to 5% within a balanced USD portfolio.

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Original report: **Can the US dollar fall further?, 30 September 2024.**