Chart of the Week

November 17, 2020

The Dollar Returns to Trend (and Could Go Lower)

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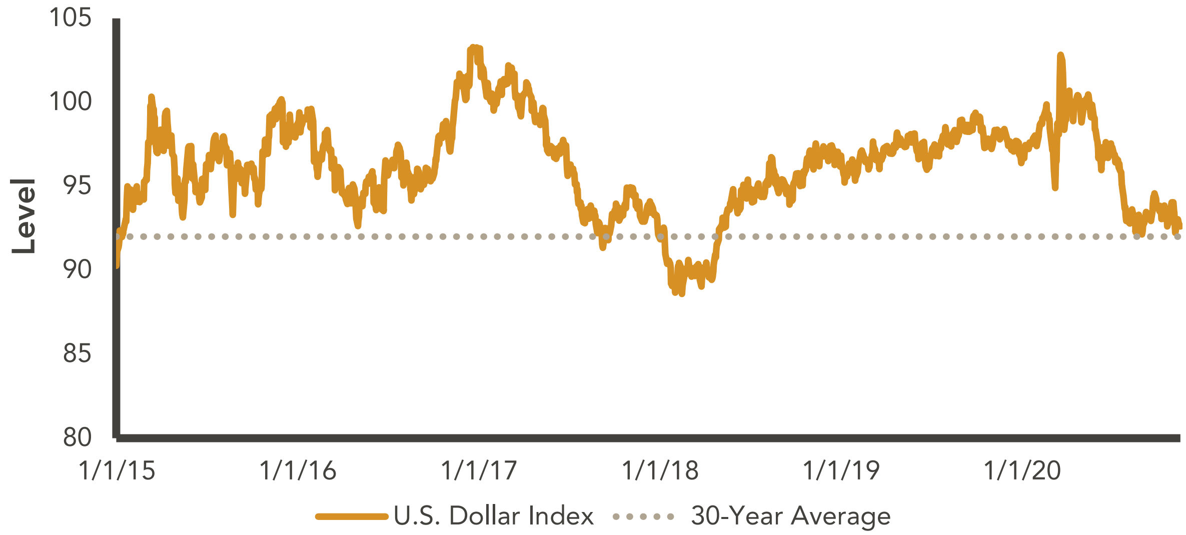
The U.S. Dollar Index, elevated since 2015, nears long-term average



Source: Bloomberg as of November 16, 2020

The dollar has enjoyed an impressive run during the last few years on the backs of trade restrictions, off-cycle expansionary fiscal policy, and muted inflation. That said, the currency has weakened in recent months, as the U.S. Dollar Index — which measures the strength of the greenback relative to a basket of several international currencies — has dropped nearly 10% since the end of March. The index is now nearing its 30-year average of 91.2.

The dollar could fall even further in the near term given the current landscape. While it is unclear exactly how President-elect Joe Biden will govern along the political spectrum, the new administration will almost certainly take a more dovish approach with respect to international trade. A de-escalation of Trump-era tariff wars would be a boon to emerging market equities, which could create trouble for the dollar. Additionally, the lack of additional fiscal stimulus in the United States after the passage of the CARES Act in March, coupled with unprecedented expansionary efforts by the Federal Reserve, is a harbinger of a weaker greenback. Even a new relief package that is more modest in size may not be enough to prevent a further slide in the dollar given the extraordinary scope of the Fed's support and a sustained low interest rate environment.

It is important to remember that a declining dollar does not necessarily spell doom for the U.S. economy. Goods produced in the United States become more attractive to consumers when the domestic currency is weak, which can lead to job creation in the manufacturing sector and economic growth. Increased global

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demand for American goods can also lead to trade deficit reductions. If current trends continue, investors will have to weigh these benefits against the costs of a weakening greenback, which include inflation and subsequent increases in commodity prices, as well as lower relative returns for dollar-denominated assets. Now more than ever, allocators should stress the importance of international and style diversification.

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