The dollar could lose some of its shine

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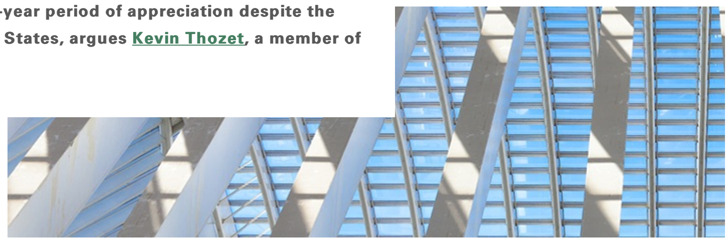
There are several factors behind the current slide in the dollar, and that trend may well continue, putting an end to a several-year period of appreciation despite the powerful economic upswing in the United States, argues Kevin Thozet, a member of Carmignac's Investment Committee.



The dollar has been losing ground for several weeks against other currencies – despite the powerful economic upswing in the US. Doesn't that seem counterintuitive?

Kevin Thozet : Yes, it does. Normally speaking, stronger economic growth in a given country should boost that country's currency. Yet in the past few weeks, the dollar has surrendered the gains it made in the first quarter, even with the current US economic upturn. The same shift can be seen in the US equity market, where the rally is subsiding. But this paradox is less surprising than it looks at first blush.

How so?

K.T. : A number of US economic statistics – aside from the employment data – and corporate earnings guidance seem to bear witness to the powerful rebound in GDP growth. In addition, the $6 trillion the Federal government plans to spend in 2022 to sustain the US economy suggest that growth will remain strong beyond this year. The trouble is that all that government spending – which won't necessarily go to capital investment – and the debt load required to finance it are set to hit record highs. That's a first reason for concern, even if the US Congress may not ultimately pass the stimulus programmes advocated by President Biden.

You mentioned employment as an exception. Is that a further reason for concern?

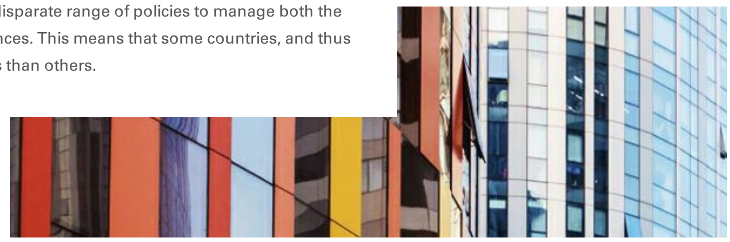
K.T. : The job market could also rattle investors somewhat, given that the latest employment figures fall short of expectations. Some of the unemployed seem to be in no hurry to look for a job at this stage, after pocketing the generous benefits that have been paid out. This could result in an upward drift in wages as companies struggle to attract workers – even though that struggle may not reflect a more robust economy.

So do these various factors explain the current dollar depreciation?

K.T. : I see additional forces driving the greenback down. A number of factors have emerged that could put an end to the years of dollar appreciation against other currencies. We may be entering a new phase marked by a much weaker dollar, though that doesn't preclude possible short-lived upward jolts.

What factors do you have in mind?

K.T. : For starters, the global economic environment is far from homogenous. Not all world regions are emerging from the pandemic-induced slump with the same growth momentum. The reason is that the various countries adopted a disparate range of policies to manage both the public health crisis and its economic consequences. This means that some countries, and thus their currencies, are more attractive to investors than others.



So even with the powerful economic upswing in the US, some countries may be of greater interest to investors?

K.T. : Exactly. Europe is a good example. Thanks to enhanced political cooperation, the region has become more attractive. It also offers ample opportunity for investment, with a large number of companies that stand to gain from the recovery in such sectors as consumer goods, travel, finance and even commodities. In fact, European equities have recently outperformed their US counterparts without being hindered by a higher euro. That hadn't happened in a long time, and this trend stands a good chance of continuing. Eurozone companies will likely be buoyed by the region's comparatively more promising growth momentum than in the US, as economic re-opening has only just begun.

Have you identified other regions that are more attractive than the US?

K.T. : Yes: commodity-exporting countries. Though the global recovery has pushed commodity prices back up to levels seen five years ago, the currencies of countries exporting raw materials that are essential to the unfolding economic upturn seem to be stalled. And those countries enjoy greater credibility today than they did a few years ago. So sound economic fundamentals and disciplined economic policies should strengthen their currencies. We at Carmignac have gained selective exposure to them.

What about Asia?

K.T. : China has handled the pandemic much better than the United States and has a good long-term outlook, because the country has continued to invest in the technologies shaping the future. **Asia is in the vanguard of the fourth industrial revolution**. Interest rates are higher than elsewhere, which attracts investors and supports local currencies, as is already the case in **China**. The yuan, China's currency, has risen significantly, reflecting both good macroeconomic news and the interest-rate oasis that the country offers, given how low rates have been for years in the rest of the world. And for the time being, Beijing seems to have adopted a somewhat permissive stance on these movements.

Won't the economic upturn eventually lead the US central bank to lift interest rates in an effort to hold prices in check, and won't that strengthen the dollar?

K.T. : In today's heterogeneous global economy, the various central banks – which adjust interest rates with the aim of regulating the state of the economy and price levels – are pursuing different policies. The US Federal Reserve seems for now to be sticking with a patient, or even wait-and-see stance on the assumption that the current price increases are transitory, meaning there is no compelling reason to start tightening policy yet.

How do you at Carmignac deal with those issues?

K.T. : Diversification is central to our portfolio construction process. We combine our long-term convictions with shorter-term convictions. The current period of desynchronised global growth is conducive to diversification, which is a key performance driver for our funds. But we also hedge the risks to our portfolios, for example, **interest-rate risk** and currency risk. And we've observed over the past few months that the current economic environment calls for an **active approach** to managing savings.

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Source : Carmignac, Bloomberg, 07/06/2021