APOLLON

US Dollar Outlook

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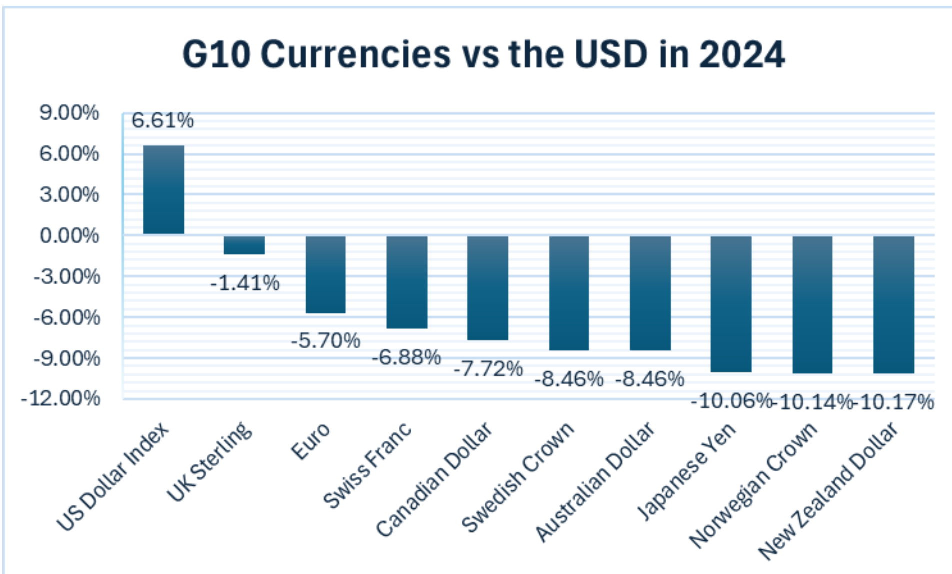
US Dollar Shines in 2024

The US Dollar started the first day of trading in 2025 by hitting a two year high, building on 2024's strong gains.



Source: LSEG Datastream as of 12/31/24

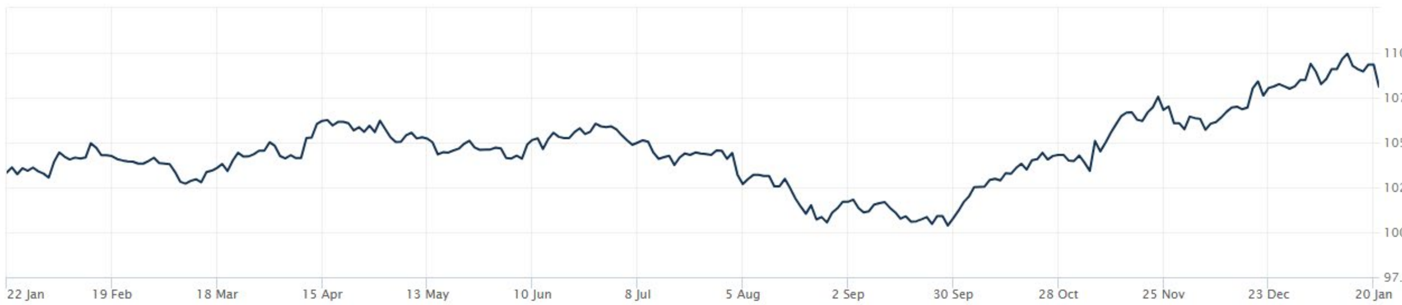
The US Dollar's rise can be attributed to the strength of the US economy and US interest rates remaining high as compared to international economies. The US Fed has expressed more hawkish views on projected interest rate cuts due to stubborn inflation and the resiliency of the US markets, while international central banks have been more dovish as their consumers and economies have witnessed more relative weakness.

European Central Bank's policymakers have projected the ECB to cut rates to 2% by the Fall of 2025 from the current level of 3%. The US Dollar hit a 5-month high against the Japanese Yen in late December, which further applies pressure to the Bank of Japan to potentially raise rates in 2025. China's Yuan is near 14-month lows against the USD as concerns regarding the Chinese economy deepen.

2025 Outlook

The strong US Dollar run appears to have more legs to rally into 2025. The US election results have widened the projected growth gaps between the US and the rest of the world and have also pushed the forecasts of the terminal Fed funds rate higher. Additionally, Trump's plans to implement tariffs on other countries is adding more strength to the US dollar and more weakness to international currencies.

US Dollar Index (DXY) and Its Rally Post US Elections



Source: WSJ as of 1/21/25

The Euro, on the other hand, continues to face headwinds due to anticipated trade conflicts and a more bearish outlook on its economy. While the UK Sterling had the best performing currency against the dollar in 2024, the UK faces similar challenges with a weaker growth outlook and expectations of a more dovish Bank of England. Finally, the Japanese Yen may struggle to gain upward traction due to weak productivity growth.

Investment Implications

I continue to advocate for investors to tilt more towards US equities to start the year due to its superior corporate profits outlook and the resiliency of its labor markets and consumer. Investors should maintain some exposure to international equities for diversification. Additionally, international equity valuations are very attractive right now as compared to US equities. While valuations are typically a poor predictor of short-term market movements, valuations can serve as useful data points when determining long-term potential returns.

If the US Dollar continues to march higher in 2025, we could see exporting companies' profits struggle as domestically produced goods become relatively more expensive abroad. Additionally, some emerging market equities may face headwinds as foreign governments that require US dollar reserves will be paying more for those dollars. From a sector perspective, Industrials, Materials, Consumer Staples, and Technology are most sensitive to a stronger dollar.

On the other hand, US importers may benefit from a strengthening US dollar as the cost of goods produced overseas will be relatively cheaper. From a sector perspective, Financials, Utilities, and REITs are more insulated from any negative consequences of a strong US dollar.

Of course, the projected path of major currencies is simply one macroeconomic factor, and investors should consider other factors when constructing portfolios. The best plan is to remain diversified and stay invested.