



RBC BlueBay
Asset Management

Diversifying from Dollars

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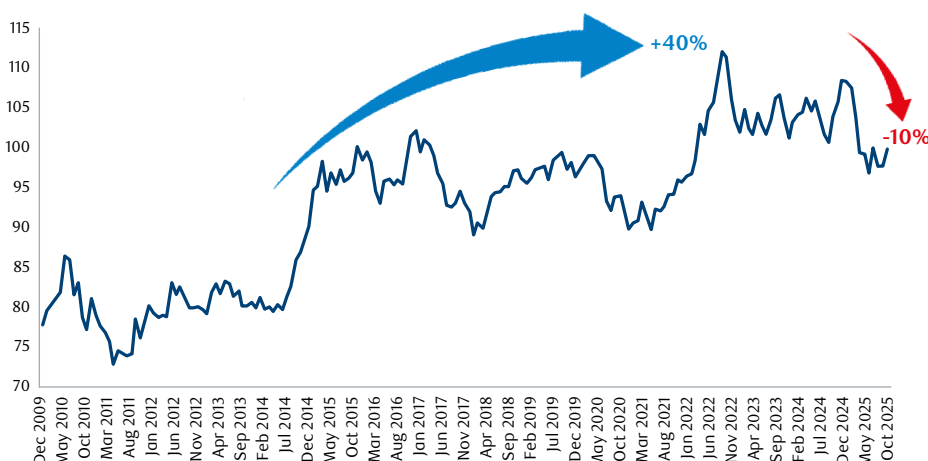
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“In the 15 years from the end of 2009 to the end of 2024, the Dollar Index rose nearly 40%, turbocharging returns for overseas investors on their exposure to US assets, both equities and fixed income.”

Since the financial crisis in 2008, the US dollar has exhibited considerable strength relative to other major currencies, including both the euro and most emerging market (EM) currencies.

In the 15 years from the end of 2009 to the end of 2024, the Dollar Index rose nearly 40% (Chart 1), turbocharging returns for overseas investors on their exposure to US assets, both equities and fixed income. With the re-election of President Trump, and his Make America Great Again (MAGA) agenda, many observers were predicting further strength for the dollar. However, the reverse has happened and since 1st January the dollar fell around 10% which, for unhedged euro-based investors, wiped out 50% of the returns made in US equities, in euro terms, and led to losses on core US fixed income investments.

Chart 1: US Dollar Index



Source: Bloomberg, as at 31 October 2025.

After such a prolonged period of outperformance, it is possible that factors are aligning for a sustained period of dollar weakness and that investors may wish to consider rebalancing their portfolios away from US assets. We note attractive opportunities exist in both EM equities and debt, and that an increased weighting to Eurozone debt provides an appealing alternative for investors in core government bond markets.

Why could the dollar weaken further?

The factors that may lead to further dollar weakness are as follows:

Firstly, after holding rates steady for 12 months, the Fed cut by 25bps in September, an additional 25bps in October and has signalled that further reductions are likely. These actions are happening despite inflation (at 3.0% in September) remaining significantly above their target of 2%. The Fed pursues a dual mandate of achieving stable prices and maximising sustainable employment, and recent signs of weakness in employment statistics appear to have triggered its action.

However, the unemployment rate remains at 4.3%, well below the long-term average of 5.67%¹, so the Fed appears to be prepared to accommodate higher inflation, which may unsettle holders of US dollar assets.

Additionally, concerns around the Fed's independence have risen markedly, with President Trump's attempt to fire Governor Cook, and speculation regarding a potential plan for the administration to gain increased influence over the central bank via the district president confirmation process in February 2026. These combined concerns have raised worries amongst some investors that further weakness in the US dollar will occur over the medium term.

Which assets will benefit from dollar weakness?

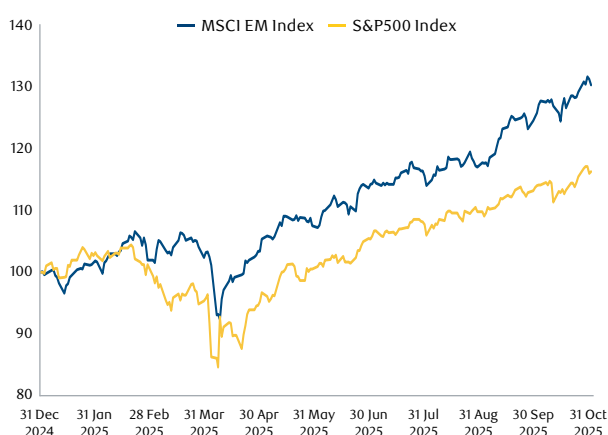
We believe three core asset groups are set to benefit from both improved fundamentals and asset inflows:

- Emerging market equities
- Emerging market fixed income
- European fixed income

Emerging Markets - Equities and Fixed Income

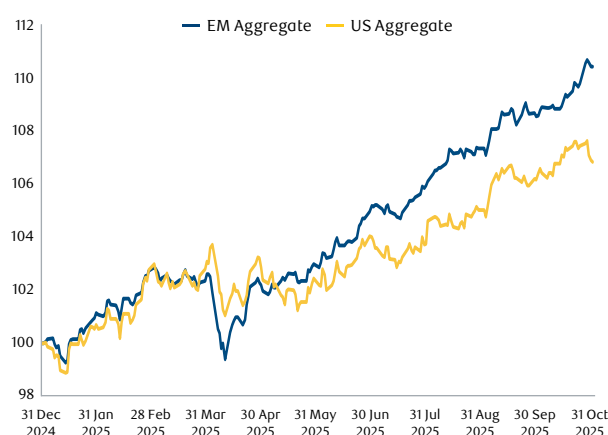
After over a decade of underperformance, EM equities have outperformed US equities by around 13% year-to-date, while EM debt has also outperformed equivalent US fixed income assets (Charts 2 and 3).

Chart 2: MSCI EM Index versus S&P500



Source: Bloomberg, as at 31 October 2025.

Chart 3: EM Aggregate versus US Aggregate



Source: Bloomberg, as at 31 October 2025.

A weaker US dollar and lower US interest rates are supportive to EM assets through four main mechanisms:

- The structural decline of the dollar allows EM central banks to prioritise growth, supported by anchored inflation and elevated real rates, creating room for policy easing and enhances the appeal of both EM equities and debt.
- Many EM sovereign and corporate bonds are denominated in US dollars so the cost of servicing their debts drops, which improves balance sheets and creditworthiness. This creates a positive dynamic for both governments and individual companies.
- A weaker dollar also supports higher commodity prices, benefiting many EM countries reliant on commodity exports. This leads to improved situations both fiscally and externally, and generates greater earnings for corporations in these sectors.
- Capital reallocation from US assets to EM bolsters demand for local rates and currencies, providing a supportive backdrop for EM performance. This can create a virtuous cycle whereby robust performance attracts additional investors, pushing asset prices higher.

¹ [Civilian unemployment rate \(US Bureau of Labor Statistics\)](#).

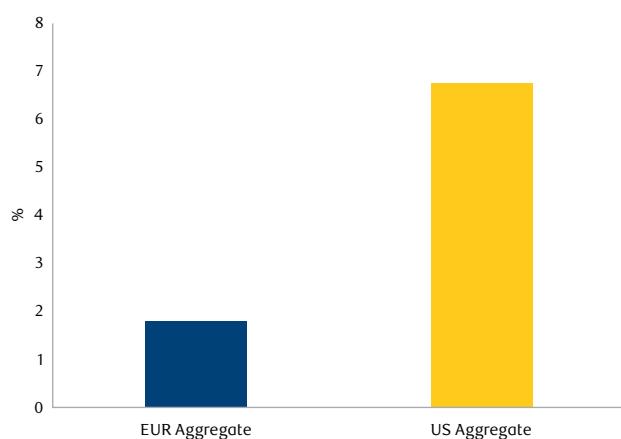
European fixed income

Investors should consider increasing their exposure to euro-denominated bonds to mitigate against the risk of losses due to a further devaluation of the dollar against the euro. Although existing for only a quarter of a century, the euro now makes up over 20% of official foreign exchange reserves². Despite the US dollar remaining the dominant global reserve currency, allocations to it will have decreased again in 2025 due to the depreciation of the US currency alone. Euro assets offer investors a very liquid, high-grade investment opportunity as an alternative to US bonds, and should provide income and protection from a sell-off in the dollar. One component that attracts investors to US bonds is the higher level of yields available; currently the US 10-year government bond yields 4.08% versus the German 10-year government bond at 2.63%.

However, when looking at overall returns, one should consider the impact of FX movements as these can significantly reduce overall returns depending on an investor's base currency.

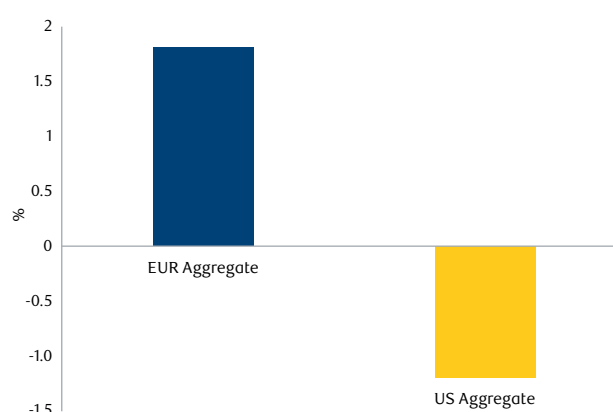
Charts 4 and 5 show how although the nominal returns for US fixed income markets have generally been higher than those in the Eurozone in 2025, when one takes into account the impact of the steep decline in the dollar against the euro, these profits are turned into significant losses for an unhedged euro-based investor. Although it is possible to enter foreign exchange overlays to hedge portfolios, this can be costly and could make them unviable as an alternative solution.

Chart 4: Total return in local currency



Source: Bloomberg, as at 31 October 2025.

Chart 5: Total return in EUR



Source: Bloomberg, as at 31 October 2025.

Summary

After over a decade of outperformance, the dollar has exhibited notable weakness in 2025, and there are several factors in place that could potentially lead to sustained further depreciation. If investors wish to diversify away from exposure to the dollar, we believe they should consider raising their allocations to EM equities and debt and to European fixed income assets.

² *International Monetary Fund, as at 31 December 2024.

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