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Market Commentary

Weekly perspective on current market sentiment **June 28, 2023**

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Last week's S&P 500 Index: -1.4%

Doubting the dollar's dominance? Don't.

Key takeaways

- Investors have been hearing about the potential for the dollar's demise for a long time.
- But we do not see another currency with the liquidity and widespread acceptance to knock the dollar off its reserve status perch.

Even during the big dollar rally that occurred from mid-2021 into the fall of 2022, we were frequently getting questions from clients as to whether or not the U.S. currency was about to lose its "reserve" status. Over that relatively short time frame, the U.S. Dollar Index (DXY), made up of a basket of currencies including the euro, Japanese yen, and British pound sterling, rallied nearly 27%. Investors have been hearing about the potential for the dollar's demise for a long time, but the geopolitical volatility of the last handful of years has brought the topic once again to the front burner.

From a historical perspective, the U.S. dollar (USD) has been considered the world's reserve currency since World War II. According to the International Monetary Fund, the USD makes up nearly 60% of all foreign central bank reserves, more than double that of the euro. The percentage was higher prior to the introduction of the eurozone's currency in 1999. As global trade has greatly expanded and the viability of the euro has grown, it makes sense that central banks would move to diversify some of their holdings out of dollars and into other liquid currencies.

The USD is the currency of choice in the global economy. According to Reuters, the dollar was on one side of 88% of all foreign exchange trades in the first quarter of last year. U.S. financial markets are considered the deepest, most highly liquid, and most efficient in the world by most international investors. The U.S. government is considered stable, and the rule of law is generally considered to be strong. As a result, the dollar holds a perceived "safe haven" status in the international financial community. In times of global turmoil, the dollar has often benefitted due to its status and the U.S. has seen investment inflows from abroad.

Some have pointed out recent agreements between Saudi Arabia, Russia, and China to price some oil transactions in Chinese yuan as a sign that the dollar's dominance is nearing an end. Some investors worry that countries may abandon the dollar out of fear of suffering U.S. economic sanctions, as Russia has experienced. Others are talking about the broader acceptance of cryptocurrencies and potential eventual widespread use of these instruments for use in global trade transactions. We disagree. The dollar's dominance in global finance and as a global medium of account is backed by the perception that it is a "safe haven" and a store of value. The size of the U.S. Treasury market, estimated to be $51 trillion by the most recent data available from the Bank for International Settlements, dwarfs any other sovereign market on the planet. China's sovereign debt market, in comparison, is the second largest at $21 trillion, even as the Chinese central bank limits the yuan's trading around the world.

We do not see another currency with the liquidity and widespread acceptance to knock the dollar off its perch. We believe U.S. dollar investors should take comfort that the dollar is still the world's reserve currency.

Risk considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Foreign investing** has additional risks including those associated with currency fluctuation, political and economic instability, and different accounting standards. These risks are heightened in emerging markets. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates. Although **Treasuries** are considered free from credit risk they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate.

Currency risk is the risk that foreign currencies will decline in value relative to that of the U.S. dollar. Exchange rate movement between the U.S. dollar and foreign currencies may cause the value of a portfolio's investments to decline.

Definitions

U.S. Dollar Index measures the value of the U.S. dollar relative to majority of its most significant trading partners. This index is similar to other trade-weighted indexes, which also use the exchange rates from the same major currencies.

An index is unmanaged and not available for direct investment.

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