Daily: Positioning beyond US dollar resilience

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From the studio

Podcast: AI's impact on the economy, Fed, and portfolios. Listen on Apple or Spotify (7 mins)Video: Three reasons why we find Japanese equities attractive (6 mins)Video: CIO's James Cheo on the case for Singapore equities (5 mins)

Thought of the day

The US dollar has strengthened slightly this week, even though moderating inflation data have prompted markets to scale back expectations for Federal Reserve rate hikes and led to a decline in US Treasury yields. The DXY dollar index has risen 0.3%, while the rate-sensitive 2-year yield has fallen 5 basis points over the week. Fed funds futures now point to a 35% probability of a September hike, down from 55% a week ago.

The stability of the US dollar is supported by an ongoing hawkish Fed bias, where policymakers likely require more evidence of softer US inflation data before dialing back on their hawkish rhetoric.

But we continue to expect the US dollar to soften over time as fiscal concerns persist. On Thursday, the US government sold 30-year bonds at a yield of 5.216%, the highest since 2001 as investors demanded greater compensation to finance the country's growing deficit. These fiscal headwinds, coupled with already elevated investor allocations to US dollar assets, remain structural headwinds for the US dollar. In addition, as US data moderate further in the coming months, we would expect Fed members to signal comfort with keeping policy rates unchanged, which should prompt a further decline in US yields and lead to broader USD weakening.

Against this backdrop, we think investors can position selectively through currencies and broad commodities to benefit from eventual dollar weakness.

High-yielding currencies can offer carry in a rangebound FX market. High-yielding currencies remain our strategy of choice in the current environment from a total return perspective. In Europe, we favor the British pound and the Norwegian krone, while in Asia Pacific we prefer the Australian dollar and New Zealand dollar. These currencies also offer carry opportunities, supported by favorable interest-rate differentials. Separately, we think the Chinese yuan could continue to gain. Upcoming economic data from China may point to subdued domestic demand and a slowdown in export growth, but China's annual trade surplus (at around USD 1.2tr) provides scope for further yuan strength, as USD surpluses are being recycled into CNY. We expect the USDCNY to move toward 6.50 by June next year.

Gold should stay supported by central bank demand and a steady Fed policy. We remain constructive on gold over the coming quarters, as central bank demand remains an important source of price support. In fact, given central banks' long-term desire to reduce exposure to the US dollar, we estimate annual central bank purchases to remain elevated. Investment demand should also recover if, as we expect, the Fed softens its hawkish rhetoric. While we continue to see gold as a strategic portfolio diversifier, we also see opportunities to sell downside price risks in gold for yield pickup.

Broad commodities can benefit from USD weakness and supply-side risks. A weakening dollar also reinforces the appeal of broad commodities, and we believe fundamentals are supportive across the complex. The US National Oceanic and Atmospheric Administration this week forecast a nearly 70% chance that the developing Super El Niño will be the strongest such event on record. This should reintroduce a meaningful risk premium into agricultural commodities, as weather disruptions could tighten supplies and increase price volatility. Industrial metals should benefit from continued investment in AI and electrification, while geopolitical uncertainty in the Middle East is likely to keep energy prices supported.

So, while there is limited scope for directional moves in major currencies in the near term, in our view, we continue to see carry and yield pickup opportunities. We also think exposure to broad commodities can take advantage of a weakening US dollar while offering a differentiated source of portfolio returns.

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