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Dollar Weakness and International Exposure

Are We Looking at a Secular Opportunity?

We've been getting a lot of questions about the dollar and international equities. The main focus is whether we are on the cusp of a secular shift toward international equities, similar to the trend seen in the early 2000s when the dollar fell and international stocks outperformed. Given that dollar weakness benefits U.S. investors in international equities, we thought it would be helpful to review that period to assess any parallels.

The US dollar peaked in early 2002 and troughed in 2008. Several factors contributed to its decline:

- **Large and growing US trade deficit:** A widening trade deficit increases the supply of dollars abroad, creating a supply/demand imbalance. *In the first quarter of 2025 our trade deficit widened by the greatest amount ever. This was partly due to gold imports as well as companies stockpiling goods before the tariffs. We believe it is unlikely the trade balance will worsen significantly from here due to tariffs.*
- **Growing US fiscal deficit:** 2001 tax cuts and increased military spending expanded the fiscal deficit. A growing fiscal deficit can create uncertainty about a country's financial condition and its commitment to servicing its debt. *Today, we see near-term risk of a budget deal that could further widen the deficit. We believe that a widening deficit is unsustainable longer-term, though we have yet to see the political will to address this issue.*
- **Loose monetary policy:** The Fed cut rates from 6.5% in 2000 down to 1% in 2003, making US Treasuries less attractive. *Currently the Fed characterizes policy as 'restrictive' and is moving toward rate normalization – not full-on stimulation – which is a key difference. Meanwhile the ECB appears to be on a more aggressive easing path which is likely to keep their rates lower than in the US.*
- **Emerging market boom:** China's rapid industrialization lifted commodity prices and drove emerging market strength, contributing to a rotation away from the dollar. *No comparable dynamic exists today, with China facing structural headwinds and significant tariffs.*
- **Emergence of the euro:** Introduced in 2002, the euro provided a new credible alternative to the dollar. *The euro has not dethroned the dollar mainly due to the lack of a single bond market for the euro; investors still face country-specific risk.*
- **Value of the dollar:** In the early 2000s estimates of fair value indicate the dollar was overvalued versus most currencies. *Today, the dollar looks similarly overvalued on a fair value basis, though based on shorter term drivers (e.g. interest rate differentials) the dollar should be trading higher.*

Other Factors to Consider:

- **Dot-com bust:** The collapse of tech stocks reduced foreign appetite for US equities. *There are some parallels today with AI and the Mag-7, but today's correction lacks the severity and widespread bankruptcies seen during the dot-com bust.*
- **Economic recovery:** By 2003, the global economy was beginning an extended recovery favoring the Value style—boosting materials, energy, and financials. International indexes, with heavier value tilts, outperformed US stocks. *Today, international indexes still lean toward value, but the macroeconomic backdrop is notably different.*
- **Relative valuation:** Both US and international stocks were washed out by 2003. Relative valuation was not a driver of international stock outperformance. *Today, the relative valuation picture favors international stocks.*

Conclusion

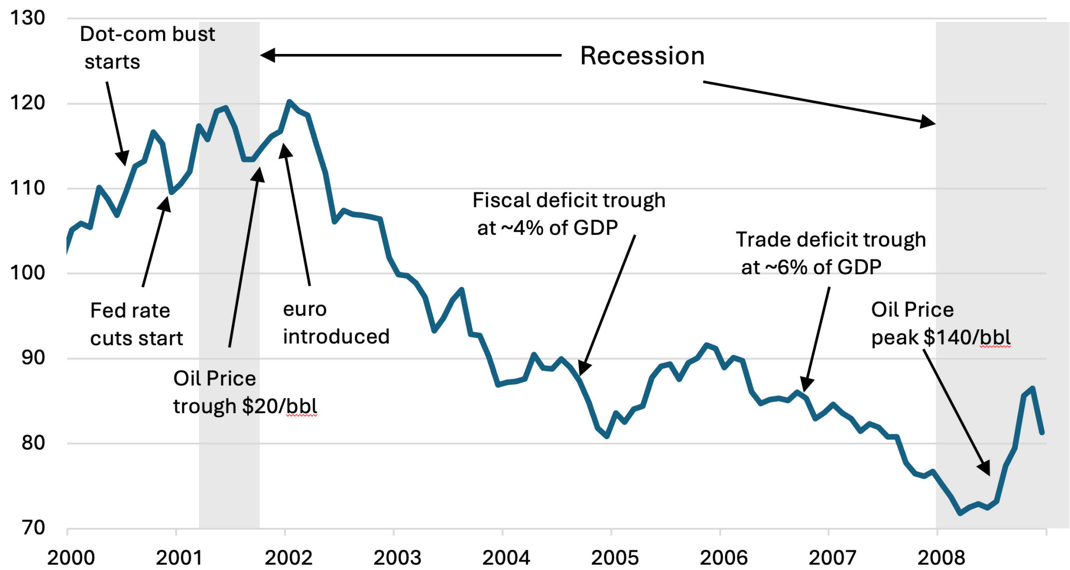
While there are a few parallels to the early 2000s, they are not compelling enough to suggest a repeat. Although we have seen dollar outflows, they are mainly concentrated in Europe – not broad based. We see our growing fiscal deficit (and debt burden) as the most relevant parallel today.

Unlike the early 2000s, we believe the main driver behind the recent dollar weakness is the aggressive, isolationist stance the Trump administration has taken with US allies. It is likely that this is partly as a reflection of Trump's negotiation style—which is to come in hard at the start and then ease off during negotiations. We believe that the trend from here is likely to be less brash though Trump's approach may have created some lasting damage.

The world does appear to be moving toward greater multipolarity, and many parties are searching for a way to reduce dollar dependance. Global fragmentation remains a risk, however, there are no obvious dollar substitutes, suggesting a more glacial pace away from the dollar.

Even if we don't see a repeat of the early 2000s, that doesn't mean investors should avoid international equities. While the dollar may not enter a period of secular decline, it is unlikely to re-initiate a steady march higher that would impair returns for US investors in foreign stocks. We believe international diversification is important, especially in the current environment.

U.S. Dollar Index During the Early 2000s



Source: Bloomberg. Monthly data from 2000 through 2008

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