

The US Dollar Free Lunch Is Over. What Now?

NOK Investors

- We expect a multiyear US dollar bear market to develop, in which we expect the currency to drop at least 15% in the face of waning US economic exceptionalism and political reliability.
- Given this view, we recommend that Norwegian kroner-based investors aggressively hedge the US dollar.
- We suggest a dynamic, differentiated currency hedging framework that customizes hedge ratios by currency, as we believe the kroner's performance will vary across currencies outside the US dollar.

Investors who are unhedged to the US dollar have enjoyed a long period of higher returns and lower risk, but the dynamics have changed in 2025 and we believe the “new normal” will persist.

Over a decade-long bull market, the US dollar's real value increased against a broad range of currencies. Solid relative GDP growth and exceptional corporate earnings growth supported strong capital inflows, high US interest rates relative to other major countries, and the widespread view of the US dollar as a safe haven. The US Federal Reserve's broad trade-weighted US dollar index rose 46.1% from its trough in 2011 to its peak in January 2025. For much of this period, the dollar also enjoyed historically negative correlations to risky assets.

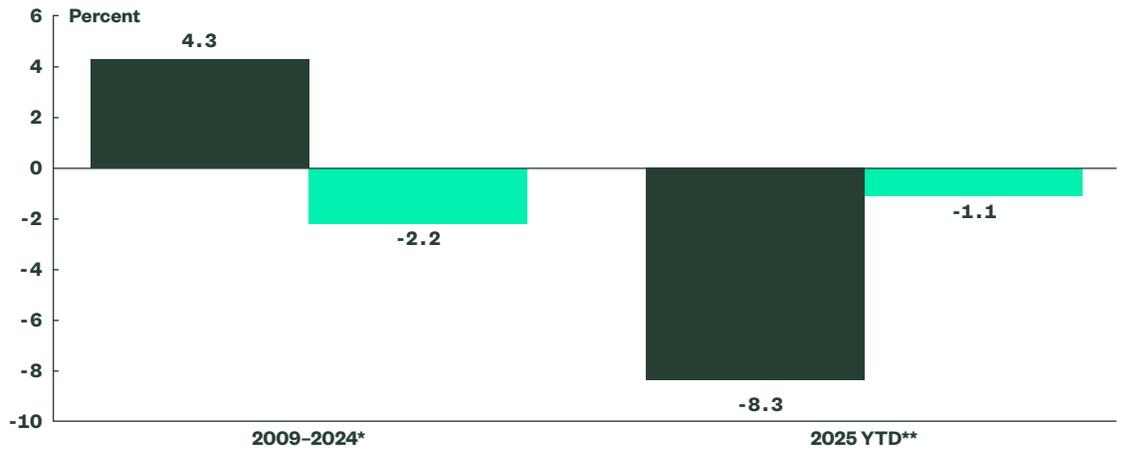
However, it is exceptionally difficult for us to see how the performance of the last 15 years can persist for the next 10 to 15 years — or even the next three to five. We believe this US dollar free lunch era is over.

In fact, we believe the US dollar is headed toward a multiyear bear market that will see it underperform most global currencies. In addition, we expect the US dollar's negative correlation with equity markets to diminish, as investors' perception of the dollar as a safe haven weakens.

This scenario would mark a seismic change for non-US investors. Over the last 15 years, unhedged US dollar positions offered strong gains, as well as diversification benefits when the US dollar rose as equities fell. The result was an appealing combination of higher returns and lower risk (Figure 1). This impact was amplified by the increasingly large role US assets play in most global portfolios — US assets make up more than 70% of the MSCI World Index, to take just one example.¹

Figure 1
**Currency Impact on
 US S&P 500 Portfolio:
 NOK Investors**

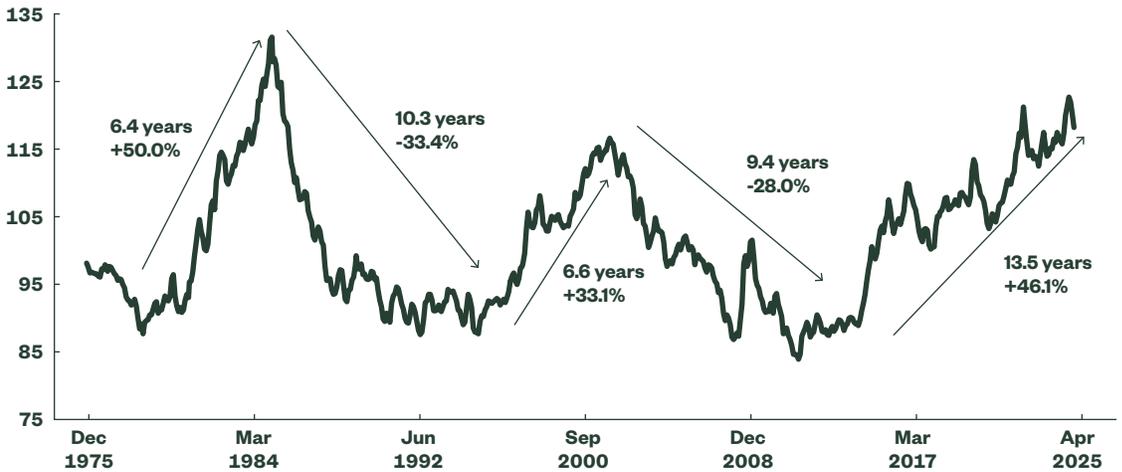
Return Impact
 Volatility Impact



Source: State Street Global Advisors/Bloomberg.
 *Annualized.
 **YTD through June 24, 2025.

While the US dollar has been weak in 2025, on a trade-weighted basis it remains extremely overvalued. A typical bear market could see the dollar fall 25%–35% over the next decade (Figure 2). In an environment in which the US dollar is a less reliable source of diversification and a potential source of outright losses, investors should consider hedging more of their global portfolios, including both equity and fixed income. Norwegian investors in particular should hedge the US dollar aggressively based on our outlook.

Figure 2
**Real Trade-Weighted
 US Dollar Index**
 The US Dollar is Expensive!



Source: US Federal Reserve. State Street Global Advisors.

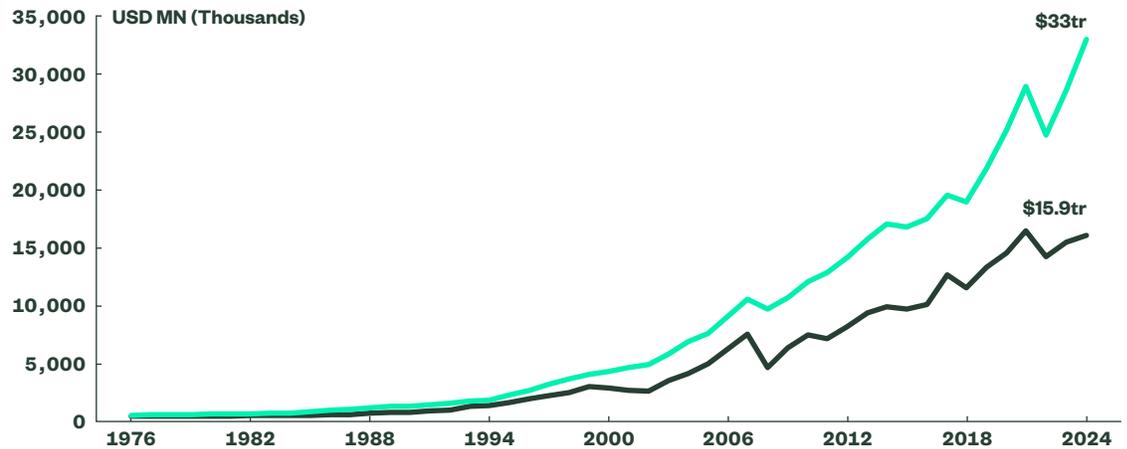
The Case and Catalysts for a US Dollar Bear Market

Most of the world has a concentrated exposure to US assets, a considerable portion of which is not currency hedged. As a result, the US dollar is the largest single exposure in many investors' portfolios. At the same time, we see the US dollar as extremely expensive by historical standards and believe the fundamental economic and political foundations of US exceptionalism are weakening. Yet the US dollar and US equity markets are priced at a premium, as though US exceptionalism will remain as robust for the next 10 to 15 years as it has been for the last decade-plus. By contrast, investors have for years fully priced in the chronic productivity problems and headwinds to growth in regions including Canada, the UK, and the EU.

Currency-unhedged investments have vast potential to unwind over the next several years. According to the US Bureau of Economic Analysis, non-US investors hold nearly \$63 trillion in US assets, about \$33 trillion of which is in portfolio investments (see Figure 3). A mere 10% increase in the average dollar hedge ratio would require \$3.3 trillion in US dollar sales, more than enough to support a prolonged US dollar bear market. If US investors rotate into more balanced global portfolios on these signals, or if the combined rotation and US dollar hedge increase by non-US investors exceeds 10%, the impact could be much larger.

Figure 3
**Non-US Investors’
 Holdings in US Assets**

■ US Portfolio Assets
 ■ US Portfolio Liabilities



Source: US Bureau of Economic Analysis (BEA).

Some may decide to continue to hold concentrated positions in US assets. Still, the high debt, policy uncertainty, and institutional uncertainty warrant an increase in US dollar currency hedge ratios in our eyes.

Why? The US faces projected fiscal deficits exceeding 70% of GDP for the ten years ended 2027, pushing the debt-to-GDP ratio above 100%. During the pandemic, US households and corporations secured a huge amount of financing at near-zero rates, shielding them from recent monetary tightening unlike global counterparts dependent on variable-rate debt. This unique combination of fiscal expansion and lower net interest expense drove exceptional US economic and corporate earnings outperformance that is unlikely to continue.

In the decade ahead, we expect to see a return to reality in which the US may still lead the world but by a substantially smaller margin. During this period, the US government will likely implement significant fiscal consolidation measures in response to the deficits. At the same time, US households and corporations face rising net interest expenses — even if the Federal Reserve cuts rates aggressively in the near term.

And then there is the impact of the Trump administration's protectionist trade policies, reduced international cooperation, and overuse of sanctions, which make the US a distinctly less attractive trade, financial, and political partner in the eyes of the rest of the world. At the same time, they encourage greater cooperation among countries outside the US on trade, supply-side investments, and deregulation. A global turn away from the US is likely to further raise the cost of capital, slow potential growth, and hasten and deepen the fall of the US dollar.

Taking the Long View on the US Dollar's Prospects

While we have strong conviction in a US dollar bear market over the next several years, we are not calling for the demise of the dollar as the global reserve currency. The dollar has been the world's reserve currency for decades. It maintained that status during the 1985–1995 dollar bear market, which saw its trade-weighted value drop 33%, and the 2002–2011 dollar bear market, during which its value dropped 28%.

Replacing the US dollar as the reserve currency would require an entirely new ecosystem of deep, liquid markets for assets and liabilities, as well as payment networks outside the US banking system. Tail risks to the dollar's role have increased, but there is unlikely to be a suitable alternative over the next decade or two. Instead, we expect the US dollar to gradually become a weaker, less dependable reserve currency.

We also see this US dollar bear market as a multiyear process, rather than a straight-line plunge, because the forces likely to drive it will take time to play out.

The Norwegian Economic and Currency Outlook

Over the next three to five years, we expect the Norwegian kroner to appreciate more than 20% versus the US dollar, from around 10.10 kroner per dollar currently to around 8.00 kroner per dollar. While this view primarily relies on the deterioration of the US outlook described above, medium- to long-term Norwegian fundamentals are an important part of the story.

Norway has low sovereign debt levels, a strong net international investment position, a robust current account surplus, and plenty of room for fiscal and monetary policy flexibility. These strong structural features make the kroner among the best-positioned currencies to deal with the potential changes and uncertainties we see over the next decade, including high global sovereign debt levels (especially US debt levels), increased protectionism, and heightened geopolitical risks.

The wrinkle in the story is that the Norwegian kroner tends to be highly correlated to equity and oil markets. It is also prone to outsized moves due to its lower liquidity. As a result, unhedged exposure to the US dollar and other major currencies tends to provide diversification benefits for kroner-denominated portfolios of risky assets, such as equities and credit.

Conversely, hedging US dollar asset exposure is likely to increase total portfolio risk. We see the US dollar as a far less reliable risk hedge going forward, but hedging it is still likely to at least marginally increase portfolio risk. The expected gains from hedging during a bear market, plus the expected reduction in US dollar diversification benefit, greatly increase the optimal dollar hedge ratio despite the slight expected increase in expected portfolio risk.

US dollar hedges back to the kroner have already gained nearly 12% in 2025. But it's not too late. The kroner remains extremely cheap relative to our measures of fair value and its historical average real effective exchange rate, and we expect interest rate carry to be flat to slightly positive for US dollar hedges. There is plenty of room for hedging gains to continue over the years ahead.

The remainder of this year is a bit less certain. In the second half of 2025, some challenges will likely limit the kroner rally. Oil prices may struggle due to increased OPEC oil production and the risk that US tariffs slow global growth and, by extension, global oil demand. More supply and less demand is not a great scenario for oil, which creates a headwind for the kroner. Additional bouts of equity market volatility during this highly uncertain period would further weigh on the currency.

Offsetting these near-term headwinds, we see slower-than-expected US labor markets, a solid chance for three Federal Reserve rate cuts, and softer growth weighing on the US dollar during the second half of 2025. On balance, we expect the kroner to hold its gains from the first half of the year but struggle to move materially higher this year, though we concede that risks around this baseline are skewed to the upside.

How Norwegian Investors Can Approach Currency Hedging

Norwegian investors have enjoyed very strong gains from holding US assets on an unhedged basis over the past 15 years. In addition, the US dollar has tended to rise, often dramatically, whenever equity and credit markets correct lower, providing outsized risk-reducing diversification benefits.

As we've discussed, we see glaring problems that suggest the next 10 to 15 years will be very different. As a result, we recommend aggressively hedging the US dollar. Yet one hedge strategy will not fit all: It will be increasingly important to differentiate hedging policies across currencies, each of which has a different risk/reward profile.

An active strategy that differentiates hedge ratios across currencies can help investors minimize risk in this uncertain environment. In particular, our longer-term, value-based Dynamic Strategic Hedging (DSH) strategy can help calibrate differing hedge ratios across currencies with a three- to five-year horizon. We see the Norwegian kroner as broadly cheap versus most G10 currencies, suggesting high hedge ratios at or near 100%. However, that is not universally true. We suggest moderately lower hedge ratios on the Japanese yen and Swedish krona.

Many investors have experienced short-lived but severe currency fluctuations that make further volatility particularly concerning. The current uncertain environment, combined with disruptive US policy decisions, complicates hedging decisions. This is particularly important for Norwegian investors given the kroner's tendency to fall sharply during global risk events.

Investors whose concerns include shorter-horizon volatility may want to consider our Enhanced DSH strategy. This multi-strategy, multi-horizon approach is anchored by long-term value while also calibrating hedge ratios with an eye to broad risk regimes, relative economic performance, and cross-market technical factors in equity and commodity markets. This approach seeks to set hedge ratios with some attention to forces that drive currencies over a one- to 12-month horizon.

Endnote

1 <https://msci.com/indexes/index/990100>.

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* This figure is presented as of June 30, 2025 and includes ETF AUM of \$1,689.83 billion USD of which approximately \$116.05 billion USD in gold assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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