

# The US Dollar Free Lunch Is Over. What Now?

## CHF 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.
- However, we also view the Swiss franc as highly overvalued and recognize the very high cost of carry that must be paid on currency hedges back to the franc.
- Therefore, we recommend that Swiss franc-based investors cautiously hedge the US dollar to reduce portfolio risk, with an expectation of flat to negative US dollar hedge returns despite our broad dollar bear market view.
- We also recommend that Swiss investors materially under-hedge currencies outside the US dollar.

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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.

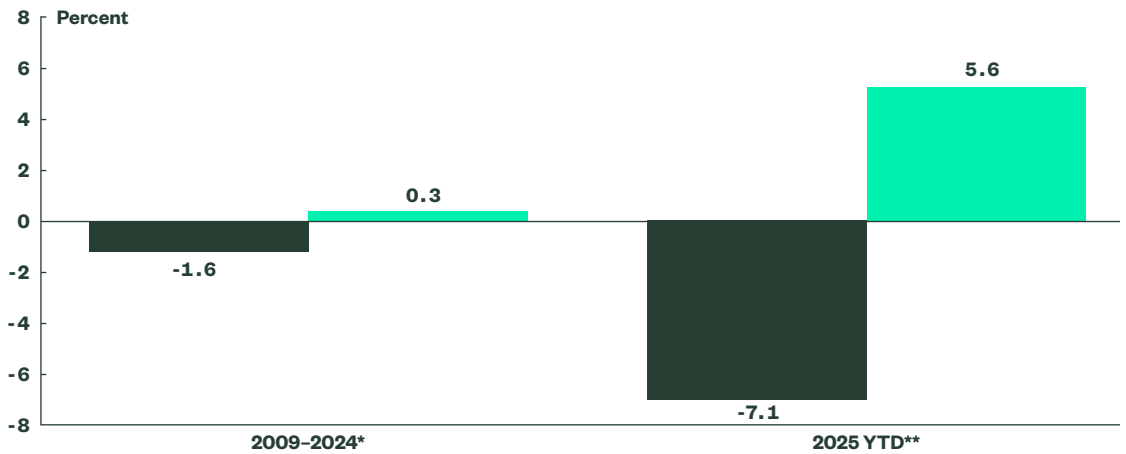
However, it is exceptionally difficult for us to see how the performance of the last 15 years can persist for the next 10 to 15 years — or even the next three to five. We believe this US dollar free lunch era is over.

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.<sup>1</sup>

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

■ Return Impact  
 ■ Volatility Impact



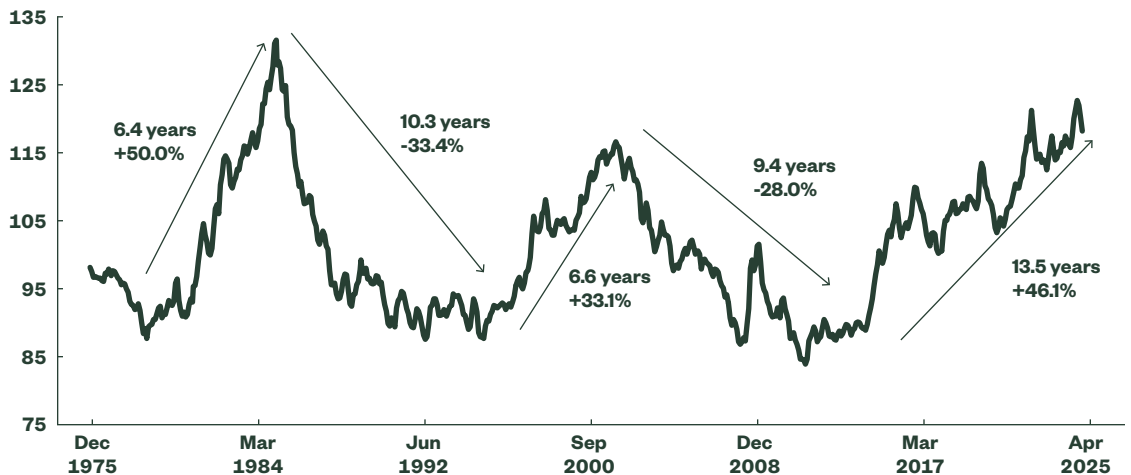
Source: State Street Global Advisors/Bloomberg.

\*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).

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



Source: US Federal Reserve/State Street Global Advisors.

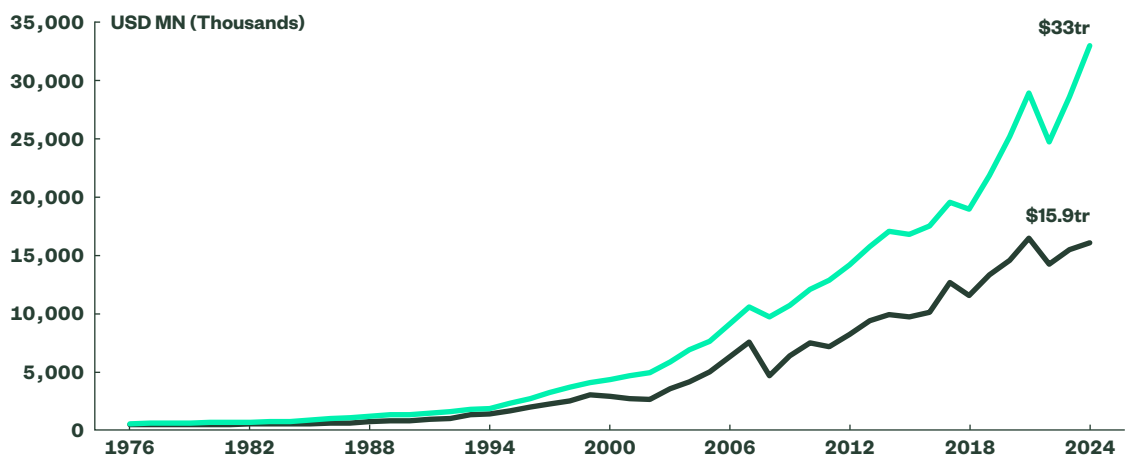
## The Case and Catalysts for a US Dollar Bear Market

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 expense — even if the Federal Reserve cuts rates aggressively in the near term.

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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.

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## 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.

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## The Swiss Economic and Currency Outlook

The Swiss franc is the most expensive G10 currency according to our estimates of long-run fair value, and Switzerland has the lowest yields and inflation in the G10. The risk of higher US tariffs, including specific pharmaceutical sector tariffs, is likely to be a further drag on growth and inflation. We expect the Swiss National Bank to respond by becoming more amenable to direct currency market intervention to limit franc strength in the second half of the year. It may be forced to move to negative policy rates.

We do not expect portfolio rebalancing away from the US dollar over the next one to three years to be as beneficial for the franc as we expect it to be for other currencies. Swiss investors already tend to hedge a large percentage of their foreign exchange risk. That means there is not as much room for US dollar hedge ratio increases. In simpler terms, there is less scope for US dollar selling and franc buying.

On a total return basis, accounting for the increasingly negative interest rate carry in long Swiss franc positions, it is difficult to see the franc outperforming the US dollar or other G10 currencies over the next three to five years.

Even with our prediction of a US dollar bear market, the franc would have to gain at least another 10%–15% over the next three to five years just to overcome the negative interest rate carry — and that is a conservative estimate. We think it unlikely that the franc gains more than 10% versus the dollar, not enough to overcome the 10%–15% negative carry. As a result, we expect a flat to negative return on US dollar hedges for Swiss investors over the next three to five years.

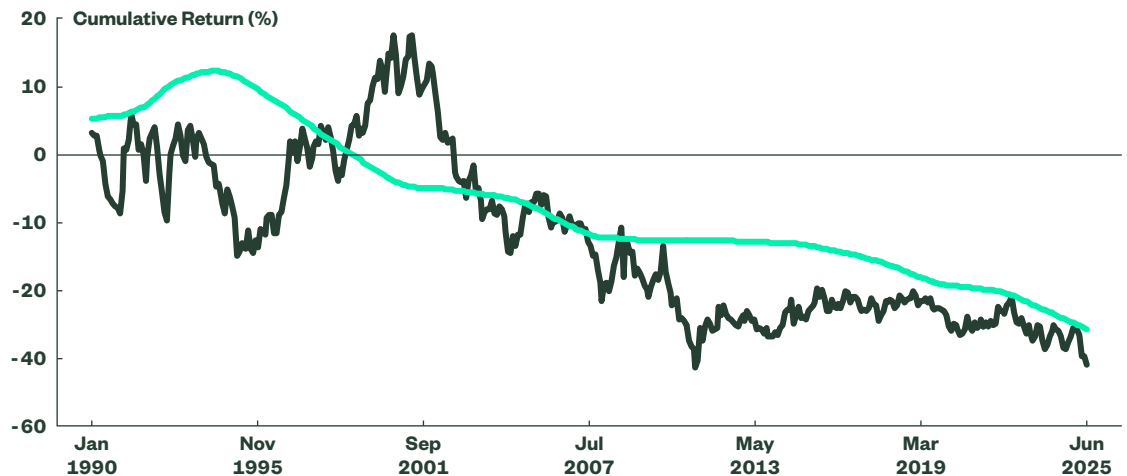
On the bright side, the risk benefits of hedging are likely to be much stronger over the coming three to five years. We believe the US dollar will be a less reliable safe haven currency, whereas the Swiss franc is likely to remain one of the favorites during negative market environments. As a result, hedging the US dollar is likely to deliver greater risk reduction to a portfolio of risky assets than it has over the past decade. More risk-sensitive investors may be willing to accept losses on currency hedges in exchange for that risk reduction.

## How Swiss Investors Can Approach Currency Hedging

Unlike most other currency bases, Swiss franc-based investors have experienced currency losses on unhedged US investments over the past 15 years. Over that same period, franc-based investors also enjoyed less risk reduction than those in other base currencies due to the franc's safe haven properties. Unfortunately, currency hedging didn't help on the return side. Hedging the US dollar provided some risk reduction, but the losses on the cost of carry embedded in the hedge were about the same size as the losses on unhedged dollar exposure. In other words, the hedged currency return and unhedged currency return were negative by about the same amount.

Figure 4  
Hedged vs. Unhedged USD Returns for a Swiss Franc Investor

■ Unhedged USD  
■ 100% Hedged Return (Hedged + Unhedged USD)



Source: State Street Global Advisors.

An active strategy that differentiates hedge ratios across currencies and balances valuation and the cost of carry may help Swiss investors better manage currency risk in this uncertain environment. 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 franc as expensive versus all G10 currencies with negative carry, suggesting Swiss investors should adopt below-average hedge ratios.

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. For a safe haven currency such as the Swiss franc, it can be useful to focus on managing severe market risks by increasing hedge ratios during periods of turmoil.

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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