

The US dollar free lunch is over. What now?

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Contents

3 Summary

4 A turning point for the US dollar

5 The case and catalysts for a US dollar bear market

6 Taking the long view on the US dollar's prospects

6 Asian currency hedging outlook

8 The remainder of 2025 is less certain

9 Currency-specific considerations

9 South Korean won

9 Thai baht

9 Taiwan dollar

10 Malaysian ringgit

10 Singapore dollar

Summary

- 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.
- Under these conditions, we also expect that the US dollar will be a far less reliable safe haven currency.
- Given this view, we recommend Asian-based investors adopt higher US dollar hedge ratios from their strategic hedging ratio on equity and fixed income portfolios and near 100% hedge ratios on US debt portfolios.
- For a closer look at our longer-term strategic hedging ratio recommendations, read [How to manage strategic currency exposure](#)
- Specifically, with respect to risky assets, we recommend investors based in South Korea and Malaysia aggressively hedge the US dollar; Thai baht and Singapore dollar-based investors moderately increase US dollar hedge ratios; and Taiwan dollar-based investors modestly increase US dollar hedge ratios.
- At the same time, we suggest materially lowering hedge ratios across all other G10 currencies outside the US dollar, particularly on the euro, Japanese yen, and Swiss franc, which we expect to provide better safe haven behavior to hedge risky asset exposures.

A turning point for 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, according to Federal Reserve Economic Data.

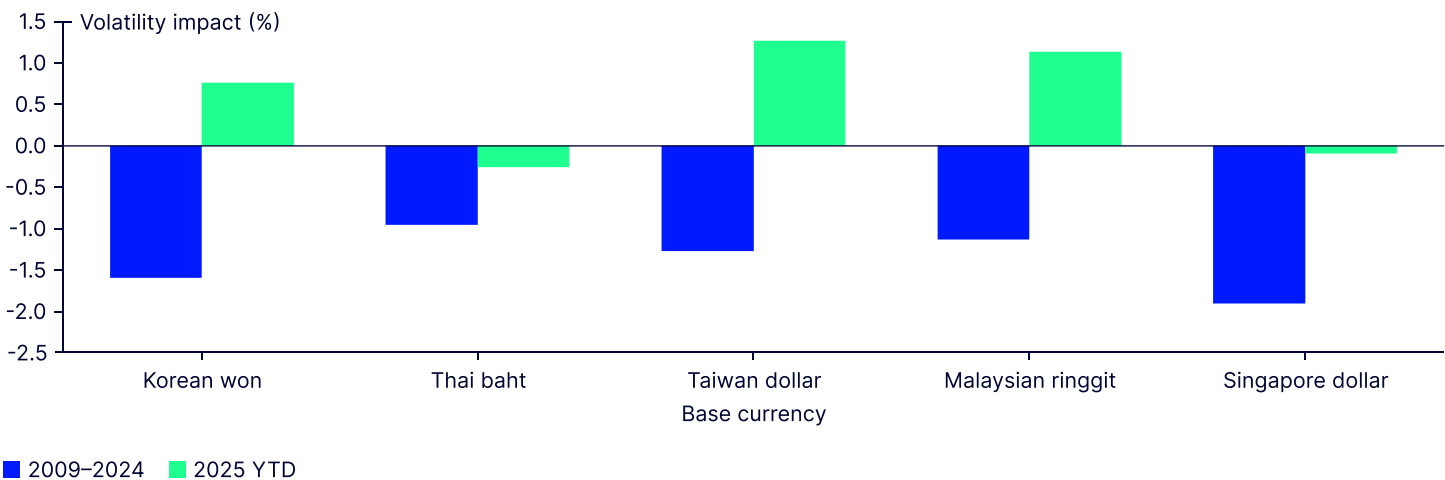
However, it is exceptionally difficult for us to see how the performance of the last 15 years can persist for the next 10 to 15 years—or even the next three to five. We believe this US dollar “free lunch era” is over.

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 but also lower risk. 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

A typical bear market could see the dollar fall 25%–35% over the next decade. 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. Asian investors should increase hedges on the US dollar based on our outlook.

Figure 1: The US dollar has been a much less reliable safe haven in 2025



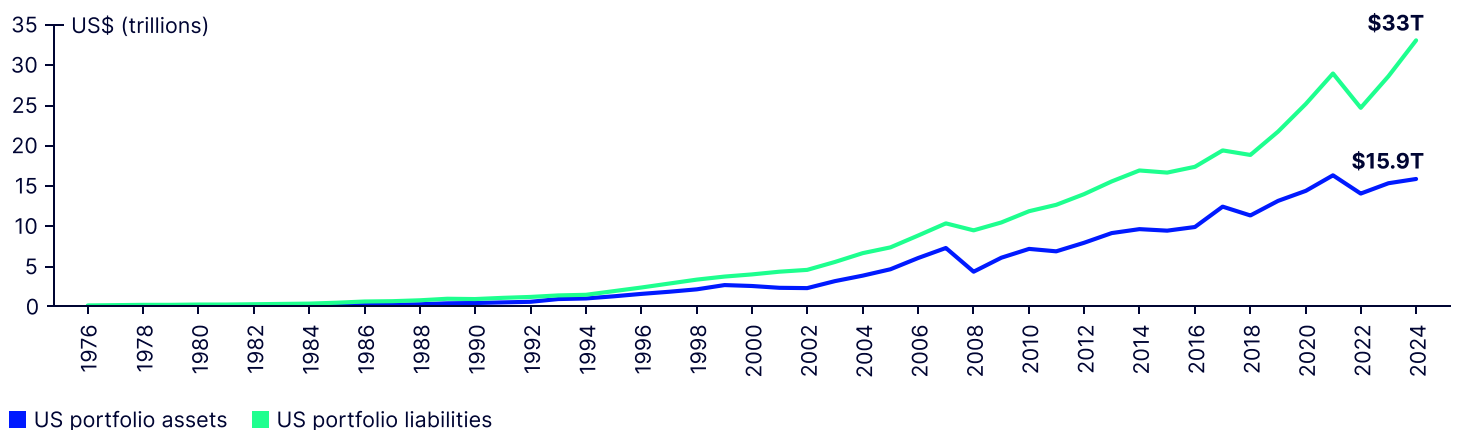
Source: State Street Investment Management/Bloomberg. Annualized, YTD data through June 24, 2025.

Figure 2: The US dollar is expensive!



Source: US Federal Reserve, as of April 30, 2025.

Figure 3: The impact of currency activity can be larger



Source: US Federal Reserve, as of April 30, 2025.

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 for the last decade-plus. By contrast, investors for years have 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. 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.

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

Why? The US faces projected cumulative 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 a 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.

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, these policies 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%, per Federal Reserve Economic Data.

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. However, as we saw with the two-day, +8% TWD rally on May 2 and 3 2025, it can happen fast.

Asian currency hedging outlook

In light of our US dollar bear market outlook, we recommend that Asian investors strategically increase US dollar hedge ratios).

Figure 4 outlines our expected target levels for major Asian exchange rates over the next 5 years.

Figure 4: Five year expected hedge returns

Base Currency	Current exchange rate	Target exchange rate	USD return (%)	Hedge cost of carry (%)	Expected hedge return (%)
Korean won	1349.60	1100.00	-18.5	-7.1	11.4
Thai baht	32.4700	28.50	-12.2	-11.4	0.8
Taiwan dollar	29.2120	25.00	-14.4	-15.8	-1.4
Malaysian ringgit	4.2105	3.75	-10.9	-5.0	5.9
Singapore dollar	1.2737	1.15	-9.7	-9.1	0.6

Source: State Street Investment Management, July 2025.

We derive the 5-year target exchange rates from a combination of quantitative factors and qualitative judgement. We anchor our estimate on long-run purchasing power parity (PPP) fair value. However, we must make qualitative adjustments to account for the high estimate error of PPP fair values and the relatively short 5-year horizon, given that PPP valuation cycles typically span 15-20 years.

Our qualitative adjustments include variables such as fiscal sustainability, the impact of the net international investment position, current account balance/stability, and potential medium-term impacts of the US tariff policy. Following the discussion of broad macro forces shaping the Asian regional currency outlook, we provide a brief discussion of these qualitative factors for each country.

We also include the cost of interest rate carry, which must be paid when hedging, to come up with a baseline 5-year expected return from hedging US dollar exposure. With the exception of the Taiwan and Singapore dollars, we expected hedging the US dollar to result in a 1-2% annual return after the cost of carry. Importantly, we believe the risks are skewed toward more pronounced or accelerated US dollar depreciation, suggesting potential upside risks to these baseline hedging gains estimates.

This projected currency appreciation may seem dramatic after more than a decade of sustained US dollar gains reset investor's frame of reference. However, by historical standards, our predictions are relatively moderate. Typically, the US dollar cycle tends to run 15-20 years. The last bull market was a bit longer than usual, but remains within historical norms. And once the US dollar enters a bear market, it generally trades 15-20% below fair value. In contrast, our projections suggest the US dollar will average just 3% undervalued relative to Asian currencies.

Our US dollar bear market thesis provides the primary rationale behind our expectations for Asian currency strength. But Asian fundamentals and currency positioning is also an important part of the story.

Large concentrated positions in unhedged US dollar assets set the stage for outsized Asian currency appreciation.

Asian 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 whenever equity and credit markets correct lower, providing risk-reducing diversification benefits. At the same time, we know that Asian investors have substantially increased the size of their foreign investment portfolios. Assuming an allocation similar to major global equity and fixed income indices, it is highly likely this led to a steady increase in unhedged US dollar exposure over the past decade. That highly concentrated US dollar risk sets the stage for a substantial reversal over the next 3-5 years.

US tariffs present an important challenge, but over time Asia should handle it well.

We do not yet know the full extent of US tariffs or the length of time they are likely to be in force. But we assume that they will be substantial for most countries in Asia and will be difficult to reverse, even if the Republican party loses the next presidential election.

There is no doubt that the tariffs will slow economic growth, particularly over the next 6-12 months. But there are a number of forces that should help Asian economies and currencies weather the storm.

- Intra-Asian trade has grown significantly and provides some cushion, even accounting for the fact that a portion of that trade is ultimately connected to exports to the US.
- The cost and efficiency savings of Asian exports to the US, relative to US production, are large enough that anything less than truly draconian tariffs will likely not be enough for a rapid re-shoring of production to the US. And draconian tariffs would likely hit the US dollar hard due to the long-run damage to potential growth and the ability to sustain its fiscal deficits and debt.
- Asian countries will be incentivized to increase trade cooperation with all countries other than the US. Over time, that likely fuels a long-run improvement in potential growth relative to the US.

Strong net international investment position, manageable fiscal deficits, and low inflation provide policy flexibility.

In this time of change, the flexibility offered by large net international investment balances (with the exception of Thailand), positive current accounts, and manageable fiscal deficits/total debt levels should allow the region to implement the policies necessary to adapt. That does not mean those adaptations will be easy or painless, and political forces will surely add some noise, but the potential is there. Equally important is the lower risk of sudden foreign capital flight that we see with high debt/deficit economies such as LATAM and South Africa. Low inflation, policy rates comfortably above the zero bound, and high levels of foreign reserves also provide monetary flexibility via both the rates and FX channels.

The remainder of 2025 is less certain

While the long-term outlook for Asian currencies remains constructive, the remainder of 2025 is likely to be more uncertain as near-term headwinds from tariffs, US fiscal policy, and yield differentials weigh on the US dollar.

Asian currencies have already enjoyed rapid appreciation in 2025. As US tariffs come into effect, it seems highly likely that investors would begin to worry more about the short-term negative growth impacts of those tariffs on smaller open economies. In contrast, the short-run negative impacts to the US will likely be smaller and slower to present in the data. Another consideration is the recently passed US budget resolution. Pain from large fiscal debt is a key pillar of our US bear market story, but the budget clearly shows that the US is not ready to take that pain yet. Thus, the US fiscal impulse will remain stable over the remainder of the year.

Monetary policy in the wake of tariffs matters as well. The shock to the US is more stagflationary, while the impact in Asia is deflationary. This should keep near-term US yields well above Asia and discourage increased USD hedging at the margin. We expect Asian currencies to hold their gains and add a bit, but nothing like we saw in the first half of 2025. The larger appreciation we expect is a multiyear story, though we believe risks to our view are skewed toward greater USD weakness.

Differentiate your hedge ratios: We recommend increasing US dollar hedge ratios, and for most Asian investors, consider lower hedge ratios on non-USD G10 currencies.

We also expect strong appreciation for most G10 currencies relative to the US dollar. In fact, if investors gradually rotate away from a highly concentrated US portfolio to a somewhat more balanced global portfolio, it implies a rotation from the US with the majority of the flows moving into other larger regions, which are mostly developed markets. Thus, there is a strong case to be made that the G10 ex-US will outperform.

Another feature of our US dollar bear market thesis is the reduced reliability of the dollar as a safe haven currency. Investors should look for replacements. In the currency space, that suggests greater unhedged exposure to the euro, Japanese yen, and to some extent the Swiss franc. The franc has maintained an excellent safe haven profile, but we believe it is expensive relative to both long-run fair value and its ultra-low interest rates.

The bottom line is that we believe Asian investors should differentiate their hedging policy based on the valuation, interest rates, and safe haven properties of each currency globally. And, based on that, it suggests materially lowering hedge ratios on most G10 currencies relative to the US dollar for most Asian currencies.

Currency-specific considerations

Below are our currency-specific considerations for South Korean Won, Thai Baht, Taiwanese Dollar, Malaysian Ringgit and Singapore Dollar regarding 5-year external currency hedging.

South Korean won

We estimate the long-run fair value of KRW vs. the US dollar at 1137.00 (vs. current levels near 1350.00), implying significant scope for won appreciation. We further adjust our expectation toward even greater strength, targeting 1,100 based on a more optimistic tariff and capital flow outlook.

We believe that US tariff policy will be disruptive and weigh on South Korean growth for a time. However, the most likely outcome is for a less dramatic tariff regime given the current KORUS free trade agreement (FTA) from 2012. Like the USMCA North American free trade agreement, KORUS anchors the US-South Korean trade relationship. As a result, the most likely medium-term outlook is for a renegotiated version of the KORUS FTA that largely preserves free trade with the US, though on modestly less attractive terms. After a tough negotiation period and some adjustment, South Korea should be able to maintain stable growth levels versus our expectations of slowing US potential growth.

Liberalization of the capital account and foreign exchange trading rules also make it very likely that South Korea will be added to all developed market equity indices over the coming years, particularly MSCI indices. This should positively impact capital flows and help further support the won.

Thai baht

We estimate the long run fair value of THB vs. the US dollar at 29.65 (vs. current levels near 32.50), implying scope for modest baht appreciation. We further adjust our expectation toward even greater strength, targeting 28.50—just barely enough to cover the high cost of hedging the US dollar. Moreover, we see the risks to our forecast skewed toward a weaker baht.

Of the currencies covered in this paper, the Thai baht has the greatest potential to undershoot our projections. Gross debt/GDP is on a path to exceed 70% over the next several years, with fiscal deficits projected to be in the mid-3% range. The net international investment position is negative—not alarmingly so, but it does suggest greater risk and less potential for net US divestment/hedging.

The current account is positive and projected to remain so through the early 2030's, according to IMF WEO forecasts.² However, it has dipped into negative territory on many occasions over the past decade. This makes Thailand more likely to be dependent on foreign financing which, along with high fiscal debt levels, suggests a higher country-risk premium than other countries covered here.

The history of political discord also warrants a higher risk premium and weaker currency, and threatens the ability of the government to adopt policies in response to changing domestic and international economic and financial conditions—the US tariffs being front and center.

These negative factors are included in our baseline forecast, but even so, the risks to those forecasts skew toward a cheaper Thai baht.

Taiwan dollar

Our base case forecast calls for a near-flat hedge return on US dollar hedges back to TWD, a strong appreciation of 15% on the TWD spot exchange rate over 5 years, offset by roughly a 15% negative cost of carry in the hedge. Risks to our forecast are skewed to higher hedge gains, that is, a stronger TWD relative to the cost of carry. Taiwan has a massive, US-centric, overseas portfolio, implying ample room for higher US dollar hedge ratios and/or a rotation to a more balanced foreign currency exposure.

While newly proposed US tariffs on Taiwanese exports present a headline risk, we believe their long-term impact on the TWD will be limited. The proposed 32% tariffs on Taiwanese exports to the US is a serious

headwind, but we believe that over time the impact will be muted through a lower target rate, carveouts, or the inelasticity of demand. The US very much needs high-end semiconductors from Taiwan and the semiconductor industry has proven willing to build some manufacturing in the US. This puts Taiwan in a good negotiating position. At the very least, we may see carveouts for some of the highest-value exports. Also, the immense demand for components required to build out AI datacenters means that demand for Taiwanese imports may be less sensitive to higher prices from tariffs. Improvements in the expected impact of tariffs may skew TWD slightly higher than our base case estimate.

We also see strong potential for diversification away from USD toward other currencies, which could still support steady—if less pronounced—TWD appreciation through broader USD weakness. Offsetting the potential for positive tariff-related news, unhedged foreign currency exposure is a good hedge against a potentially sharp depreciation of TWD in case of a conflict with mainland China over the next 5 years. However, even if the average hedge ratio on foreign exposure is limited by such concerns, we see a strong potential for the substitution of the euro, Swiss franc, and Japanese yen over the US dollar as a hedge. A rotation away from USD to alternative foreign currencies limits direct TWD appreciation vs. USD, but contributes to general USD weakness—which is likely to spill over to steady, albeit less dramatic, TWD strength.

Given the above, we recommend a cautious increase in TWD hedge ratios.

Malaysian ringgit

We have a conservative 5-year forecast for the Malaysian ringgit of 3.75 vs. US dollar, despite our expectation for a US dollar bear market. For context, we expect MYR to remain on the cheap side of our estimate of long-run PPP fair value of 3.36. Malaysia's negative net foreign investment position, high sovereign debt levels, and recurring historical periods of political uncertainty may limit MYR appreciation. In addition, we think that the US may apply more pressure to trade negotiations compared to other Asian countries, specifically in an attempt to limit Malaysia's trade relationship with China.

Still, the higher interest rates in Malaysia suggest a smaller cost of carry, resulting in an estimated gain of

more than 1% per year from hedging US dollar versus not hedging. And we view the risks to this forecast as balanced to modestly skewed toward a stronger ringgit or higher hedging gains. The IMF projects gross sovereign debt levels at around 70%, a comfortable level given the positive current account projections and the consistency of positive currency account balances for the past 25 years. Debt levels are also less concerning due to strong projected growth in the mid 4% range, which is materially higher than real interest rates, supporting debt sustainability.

Therefore, while our base case forecast is conservative, we recommend Malaysian investors materially increase US dollar hedge ratios.

Singapore dollar

We expect the Singapore dollar to move above fair value in the next 5 years. We estimate the long-run fair value of SGD vs. the US dollar at 1.26 (vs. current levels near 1.27), implying the Singapore dollar is roughly at fair value. We expect SGD to move to 1.15, nearly 10% over fair value, based on the strong foreign investment position, solid fiscal outlook, massive sustained current account surplus, moderate expected US tariff impact monetary policy considerations, and expected interest rate carry reversion.

Singapore's fundamentals remain exceptionally strong, and its future tariff burden is expected to be limited. Singapore has a massive current account surplus, a strong sovereign balance sheet, and a balanced budget. The existing free trade agreement with the US has been helpful in limiting new US tariffs to 10% (although unfortunately, unlike treatment for Canada under the USMCA trade agreement, goods covered by the US-Singapore FTA are not exempt from the new US tariffs) However, the tariff burden remains manageable and we expect the existence of the current FTA to mitigate Singapore's future US tariff risks.

Our expectation of a large, broad-based US dollar bear market further implies a stronger Singapore dollar. Because USD is only around 25% of the nominal effective exchange rate basket (SNEER), if SGD were to remain at current levels against a sharply depreciating US dollar while other currencies in the basket appreciate, then the SNEER would fall, implying monetary policy loosening to an unacceptable level. Thus, we expect SGD to appreciate given our US dollar view.

We also think that current yields in Singapore are unusually low relative to the US, and expect a reversion over time. We suspect that they will revert such that cumulative 5-year carry is closer to -3 to 5% range rather than -9% implied by the current market. This would result in a near 1% expected annual return from hedging USD compared to no hedging over the period.

Overall, we believe SGD based investors should modestly increase USD hedge ratios and reduce hedges on non-USD G10 currencies. There is ample room for inflows under the de-dollarization regime even if those are largely the result of increased USD hedges. However, Singapore currently has historically low interest rates vs. the US and SNEER is at the top end of its band. As a result, we see moderate currency strength over the next 5 years to be largely offset by negative carry resulting in modest gains of 15-20bps per year from hedging US dollar. This suggests Singapore dollar-based investors should only modestly increase USD hedge ratios. Alternatively, we would expect hedges on the G10 ex-US to experience material losses, suggesting that Singapore dollar-based investors significantly reduce hedge ratios for those exposures.

Endnotes

- 1 <https://www.msci.com/indexes/index/990100>
- 2 Source: International Monetary Fund.

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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 Investment Management are affiliated. Please note all AUM is unaudited.

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