7 reasons for a weaker US dollar and stronger international stocks

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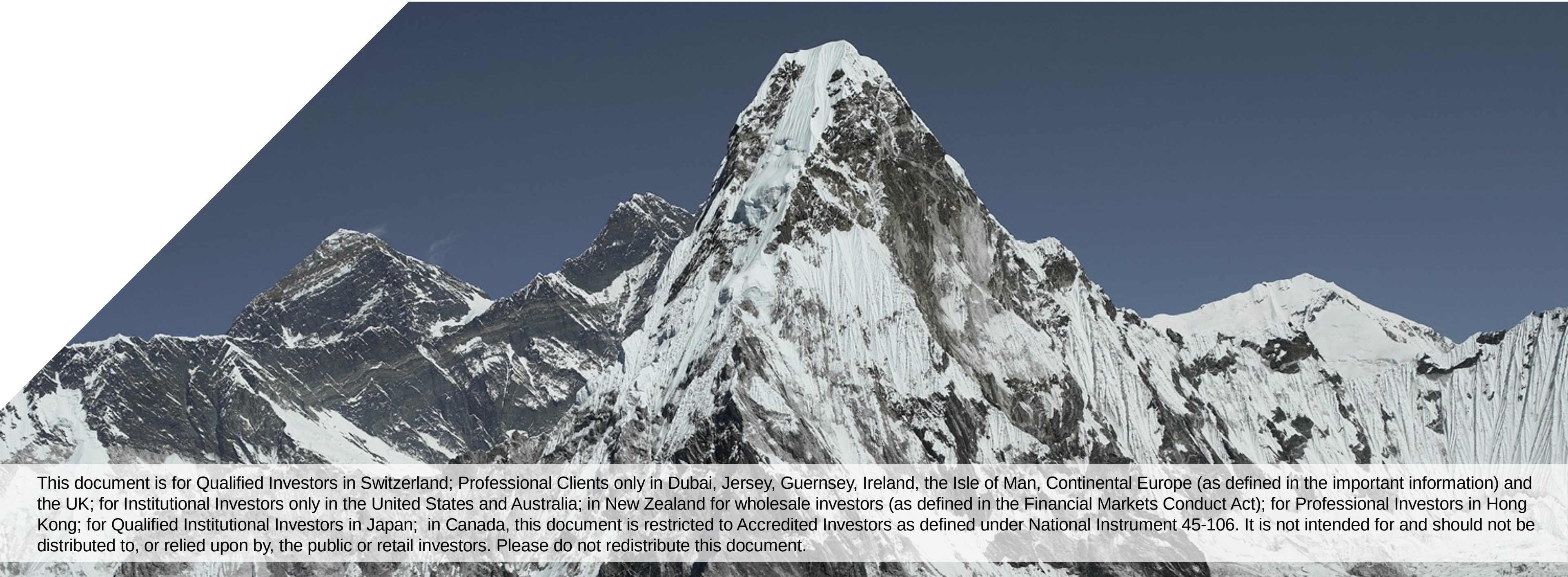


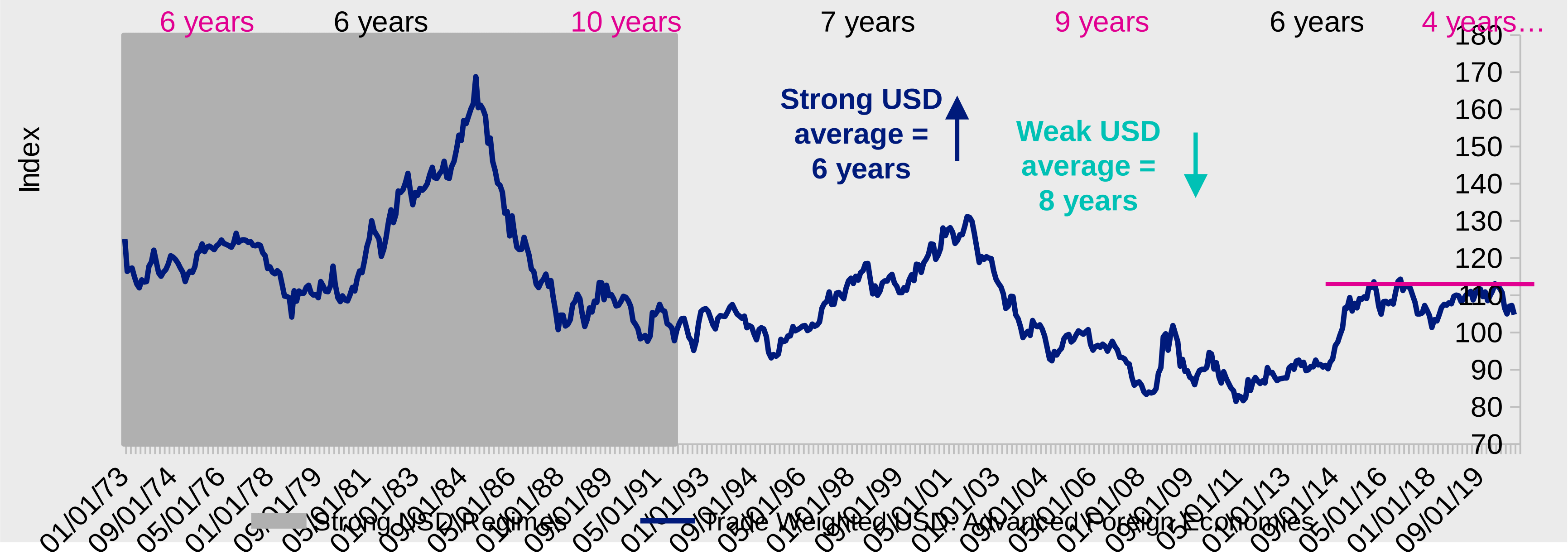
7 reasons for a weaker US dollar

1. **Cycles** – weak dollar regime
2. **Valuations** – stretched
3. **Deficits** – ballooning
4. **Fed** – dovish
5. **Liquidity** – abundant
6. **Rates** – less attractive
7. **Technicals** – overbought

Invesco

It seems the "greenback" is only four years into the current weak dollar cycle. On average, such cycles have lasted about eight years (i.e., twice as long), the longest having been roughly 10 years.

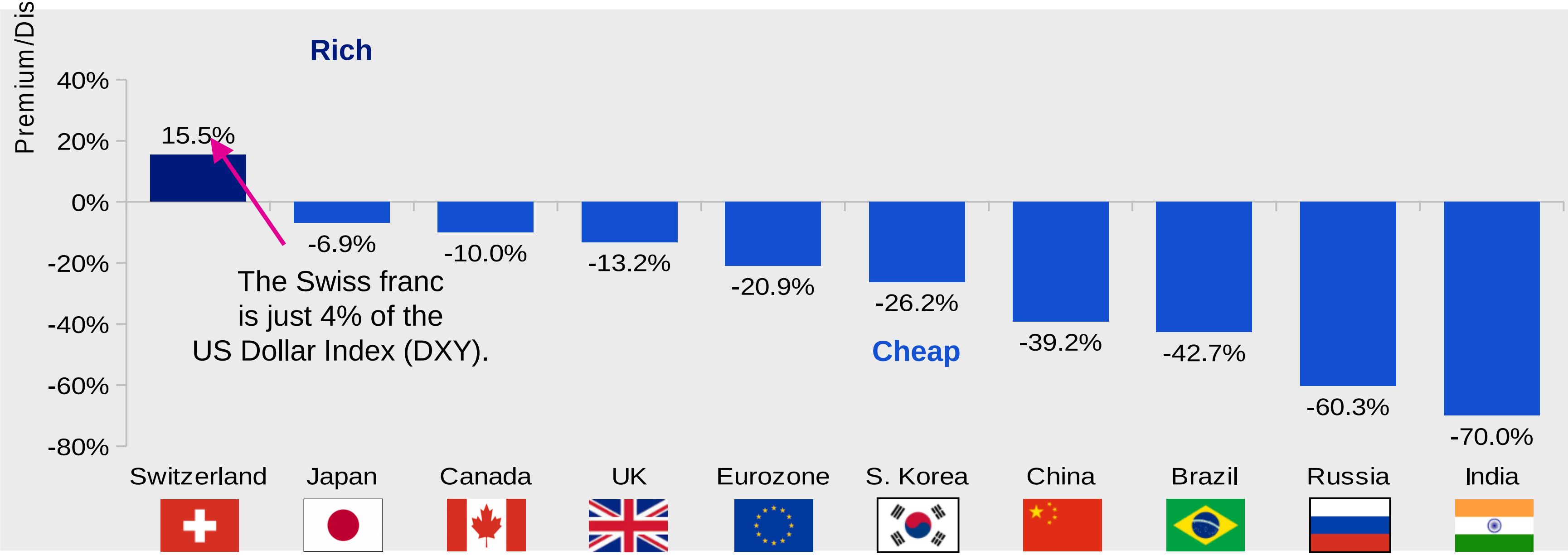
The US dollar relative to advanced foreign economy currencies since 1973



Source: Bloomberg L.P., Invesco, 11/30/20. Notes: USD = Trade Weighted US Dollar Index: Advanced Foreign Economies (AFE), Goods and Services = A weighted average of the foreign exchange value of the US dollar against a subset of the broad index currencies that are advanced foreign economies. The AFE dollar index contains seven currencies from the Euro Area (euro), Canada (dollar), Japan (yen), the UK (pound), Switzerland (franc), Australia (dollar) and Sweden (krona). Shaded areas denote strong USD regimes. Index definitions can be found on page 15. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**

A wide range of countries and their currencies are trading at substantial discounts to theoretical parity, most notably emerging markets, suggesting broad scope for further weakness in the US dollar.

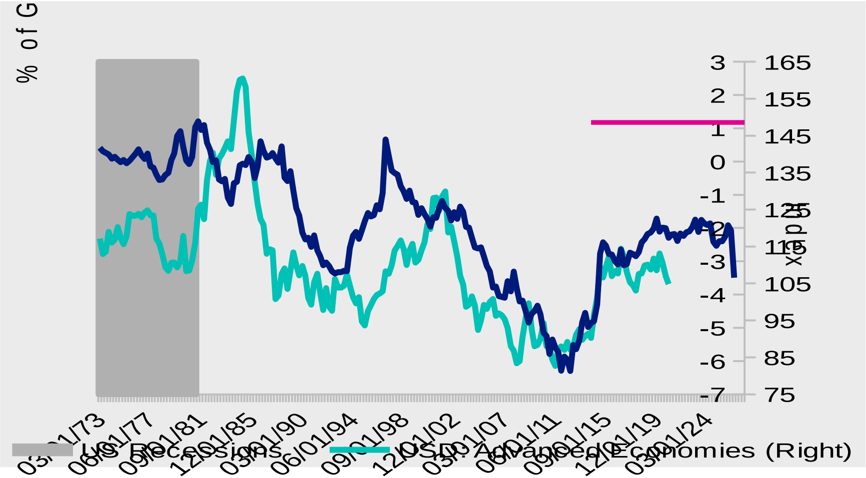
Currencies relative to their purchasing power parities (% premium/discount)



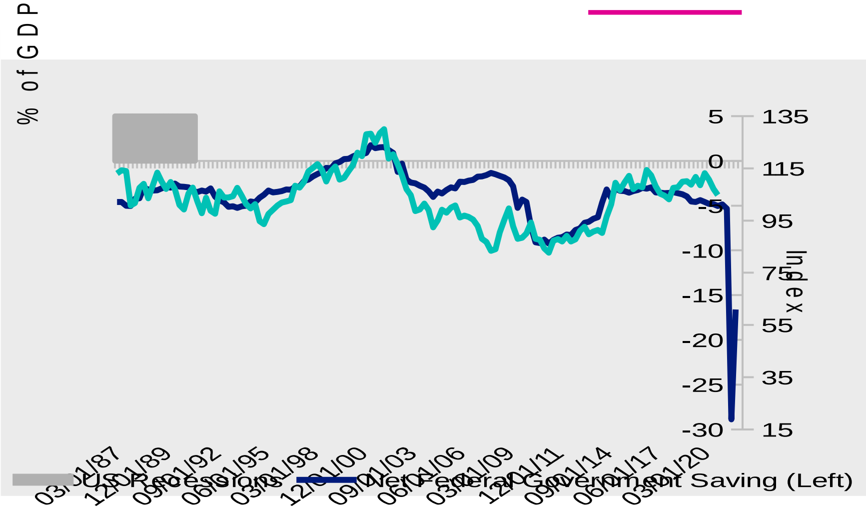
Source: OECD, Invesco, 12/31/19. Notes: Purchasing power parities (PPPs) are the rates of currency conversion that try to equalize the purchasing power of different currencies by eliminating the differences in price levels between countries. The basket of goods and services priced is a sample of all those that are part of final expenditures. This indicator is measured in terms of US dollars per national currency. An investment cannot be made in an index. **Past performance does not guarantee future results.**

The twin deficits are stiff fundamental headwinds for the US dollar.

Net international transactions (pushed forward, left-axis) and the US dollar (right-axis) since 1973



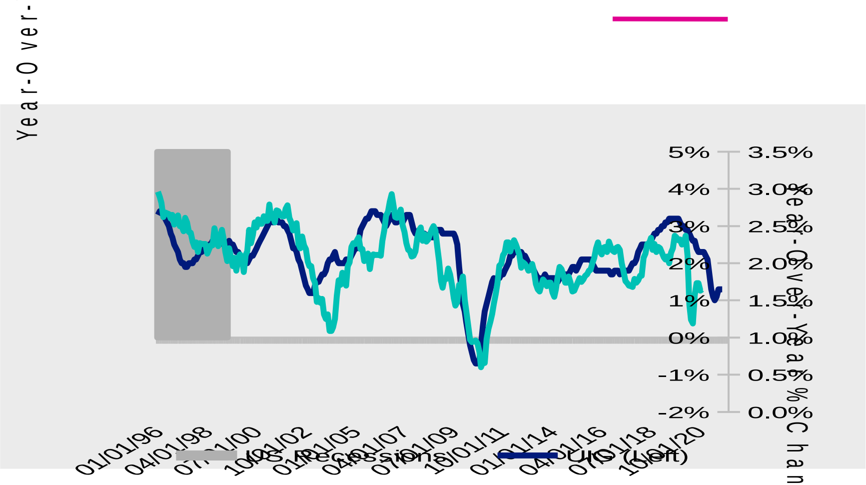
Federal government budget (pushed forward, left-axis) and the US dollar (right-axis) since 1987



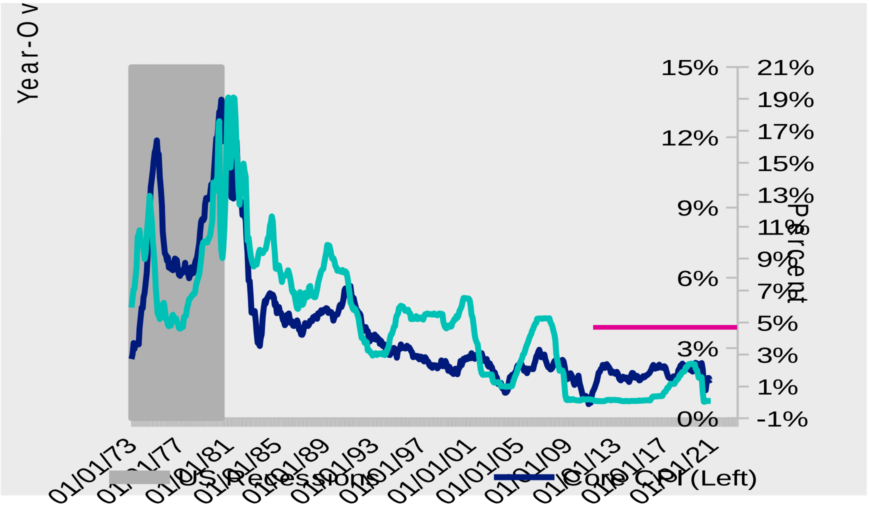
Source: FRED, Invesco, 11/30/20. Notes: CA = Current Account = Exports of goods and services and income receipts (credits) less Imports of goods and services and income payments (debits). Net federal government saving = Current receipts minus current expenditures. Shaded areas denote NBER-defined US economic recessions. Index definitions can be found on page 15. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**

Leading economic and inflation indicators imply the Fed should stay dovish and policy rates may remain low.

Underlying inflation gauge (pushed forward, left-axis) and core consumer price inflation (right-axis) since 1996



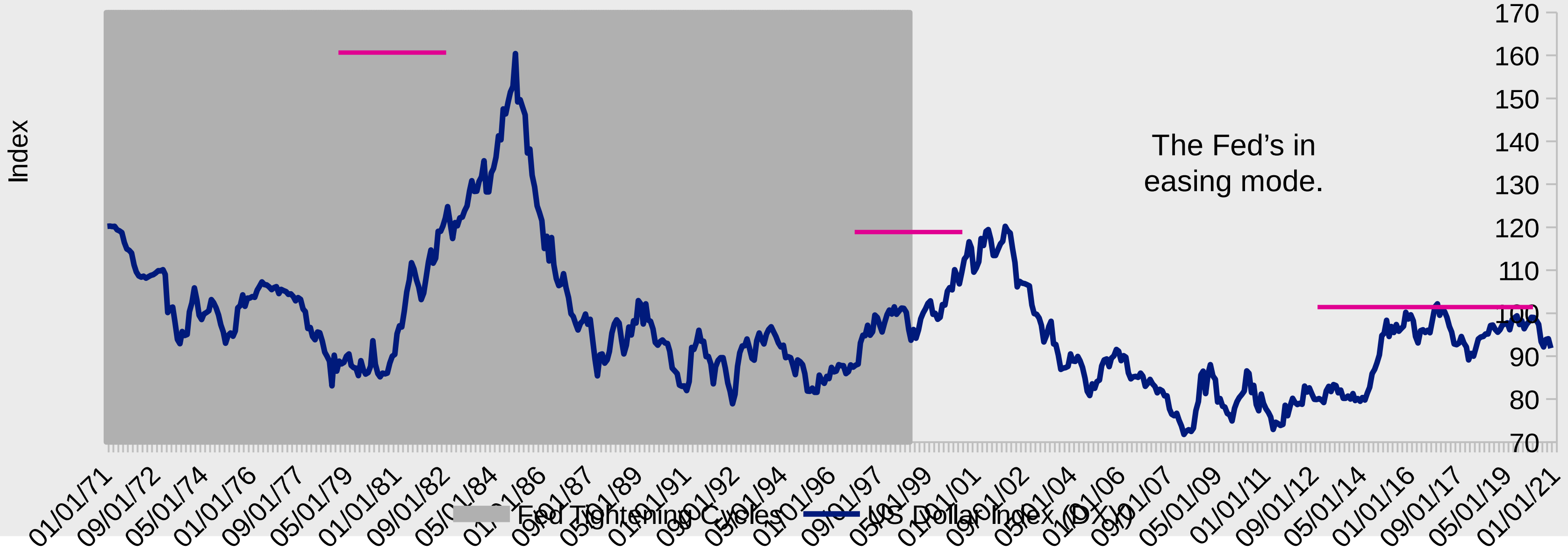
Core consumer price inflation (left-axis) and the federal funds rate (right-axis) since 1973



Source: Federal Reserve Bank of New York, FRED, Invesco, 11/30/20. Notes: CPI = Consumer Price Index. Core = All items less food and energy. UIG = Underlying inflation gauge. The UIG captures sustained movements in inflation from information contained in a broad set of price, real activity and financial data. The UIG estimates trend inflation, derived from a large number of price series in the CPI as well as macroeconomic and financial variables. FFR = Federal funds rate. Dark gray areas denote NBER-defined US economic recessions. Index definitions can be found on page 15.

In general, strong dollar cycles end when Fed tightening cycles end.

US dollar and Federal Reserve tightening cycles since 1976



Source: Bloomberg L.P., Invesco, 11/30/20. Notes: The US Dollar Index (DXY) contains six currencies from the Eurozone (euro), Japan (yen), UK (pound), Canada (dollar), Sweden (krona) and Switzerland (franc). Shaded areas denote Fed tightening cycles. Index definitions can be found on page 15. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**

Cycles | Valuations | Deficits | Fed | Liquidity | Rates | Technicals

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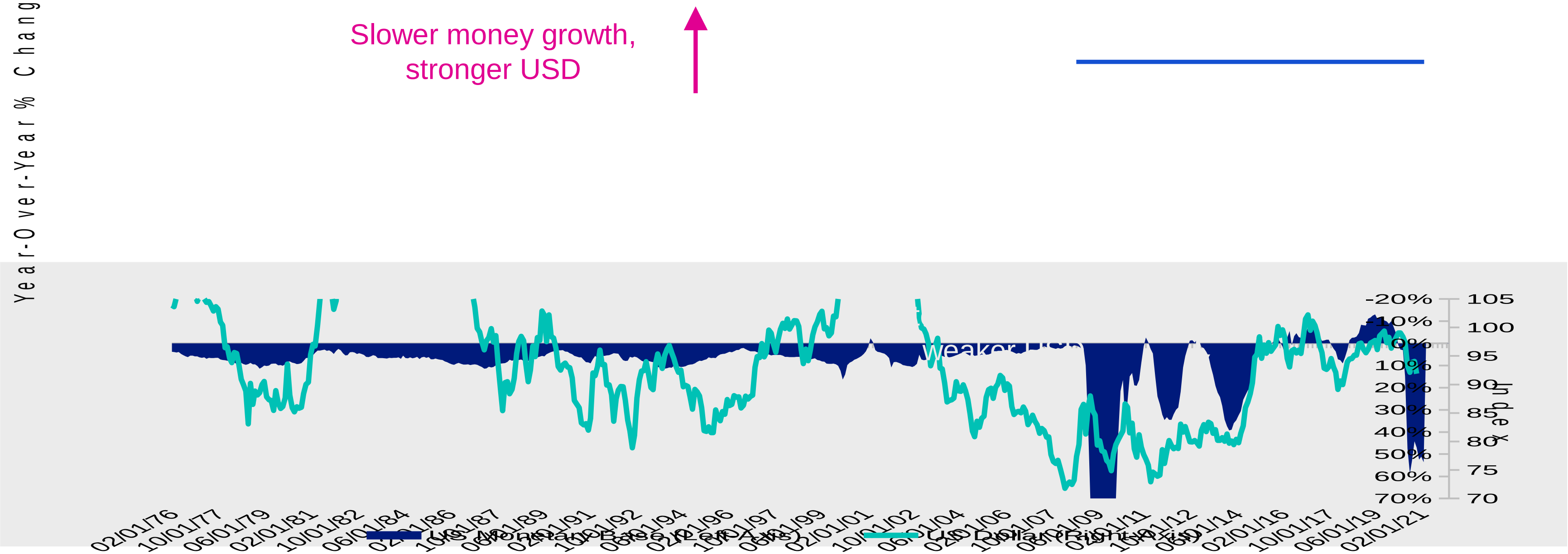
The Fed has inflated the monetary base at the expense of the currency.

US money growth (left-axis, inverted, pushed forward) and the US dollar (right-axis) since 2011

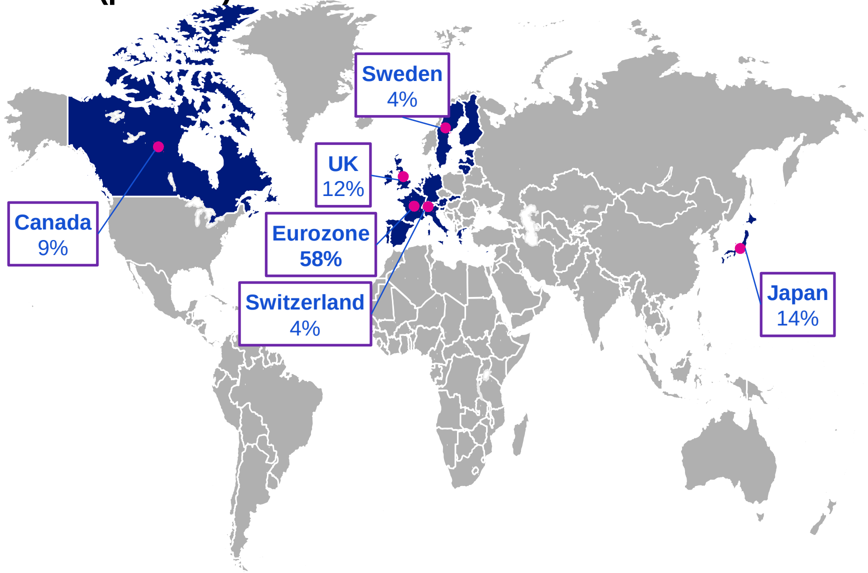
Slower money growth, stronger USD



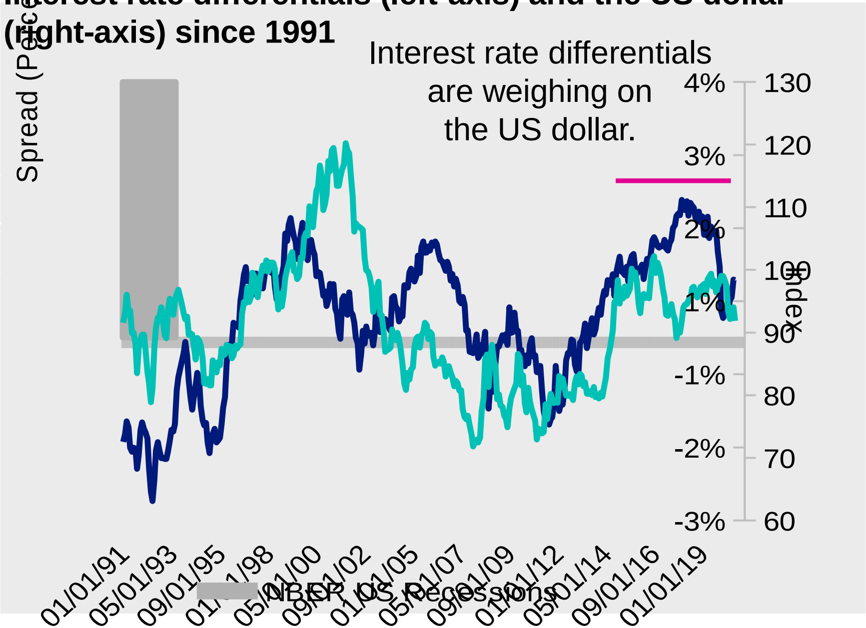
Source: Bloomberg L.P., FRED, Invesco, 11/30/20. Notes: The monetary base is the sum of currency in circulation outside a nation's central bank and its Treasury, plus deposits held by financial institutions at the central bank. Central banks control the monetary base by buying and selling assets. Asset purchases increase the monetary base when the central bank pays for them with currency or increased central bank deposits/liabilities. Index definitions can be found on page 15. An investment cannot be made in an index. **Past performance does not guarantee future results.**

Money goes to where it's best treated, and the United States' interest rate advantage has narrowed considerably over the past couple of years.

Regions/countries and their weights in the US Dollar Index (percent)



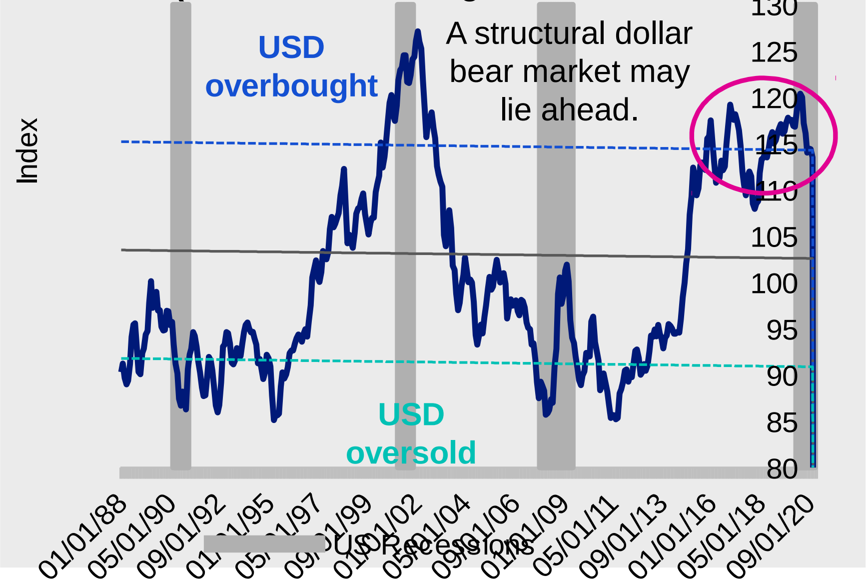
Interest rate differentials (left-axis) and the US dollar (right-axis) since 1991



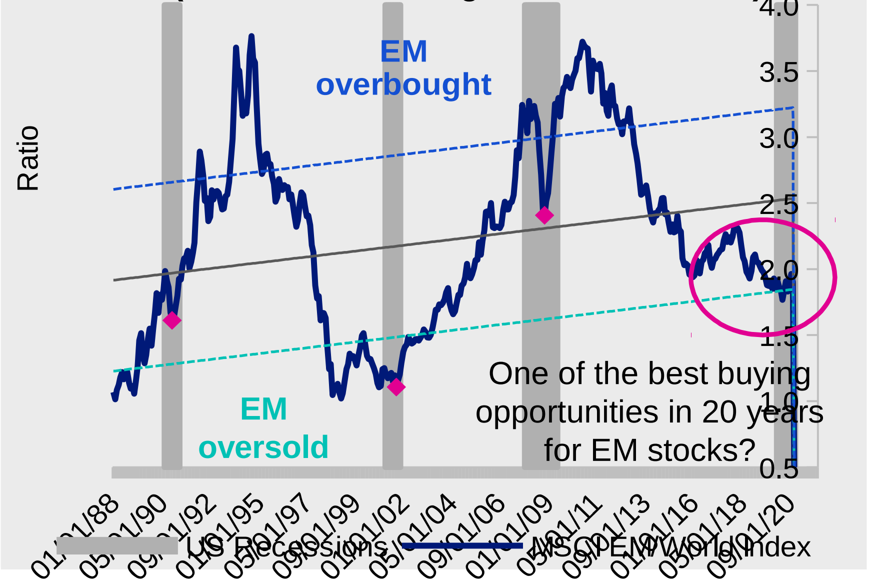
Source: Bloomberg L.P., Invesco, 11/30/20. Notes: In the right chart, shaded areas denote NBER-defined US recessions. G6 = Eurozone (euro), Japan (yen), UK (pound), Canada (dollar), Sweden (krona) and Switzerland (franc). Bond yields = 10-year government. USD = US Dollar Index (DXY). Index definitions can be found on page 15. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**

The US dollar remains structurally *overbought*, the flipside of which is structurally *oversold* EM stocks.

The US dollar relative to advanced foreign economies since 1988 (trend and overbought/sold thresholds)



Emerging market relative to developed market stocks since 1988 (trend and overbought/sold thresholds)

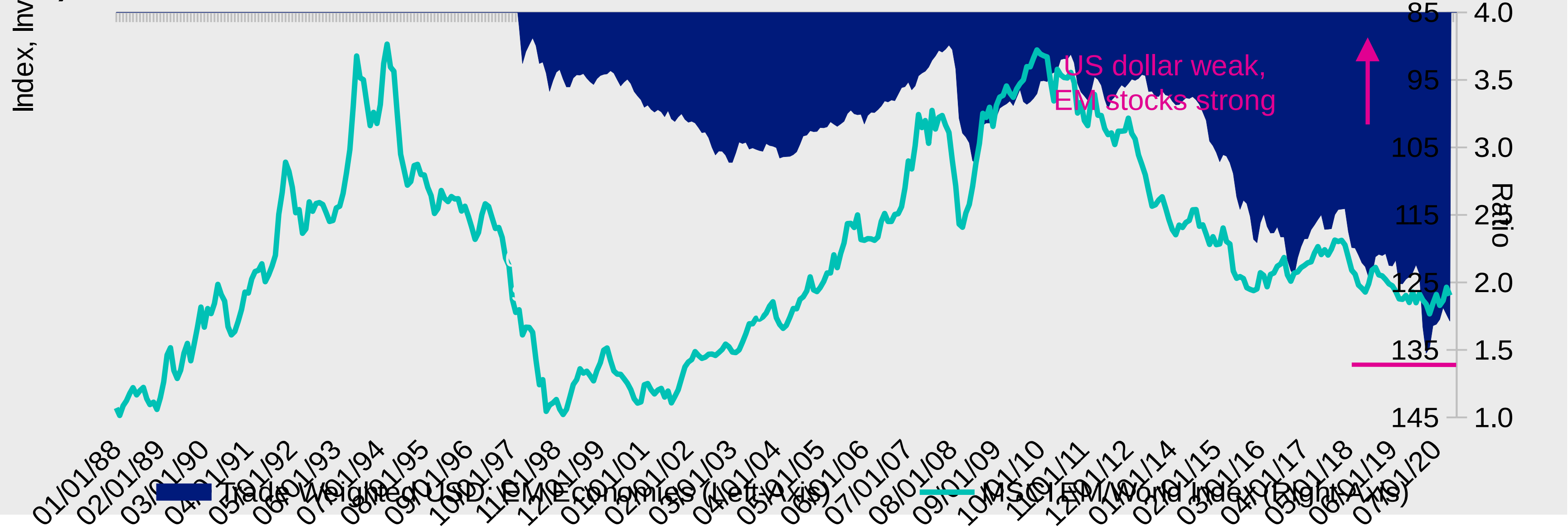


Source: Bloomberg L.P., FRED, Invesco, 11/30/20. Notes: USD = Real Trade Weighted US Dollar Index: Advanced Foreign Economies, Goods and Services. Real = Inflation adjusted. Price indices in US dollars. SE = Standard error. Shaded areas denote NBER-defined US economic recessions. EM = Emerging markets. DM = Developed markets = MSCI World Index. MSCI EM and World price indices in US dollars. Index definitions can be found on page 15. An investment cannot be made in an index. **Past performance does not guarantee future results.**

Conclusion

Emerging market stocks have outperformed developed market stocks when the US dollar weakens relative to EM currencies.

US dollar relative to EM currencies (inverted, left-axis) and emerging relative to developed market stocks (right-axis) since 2006

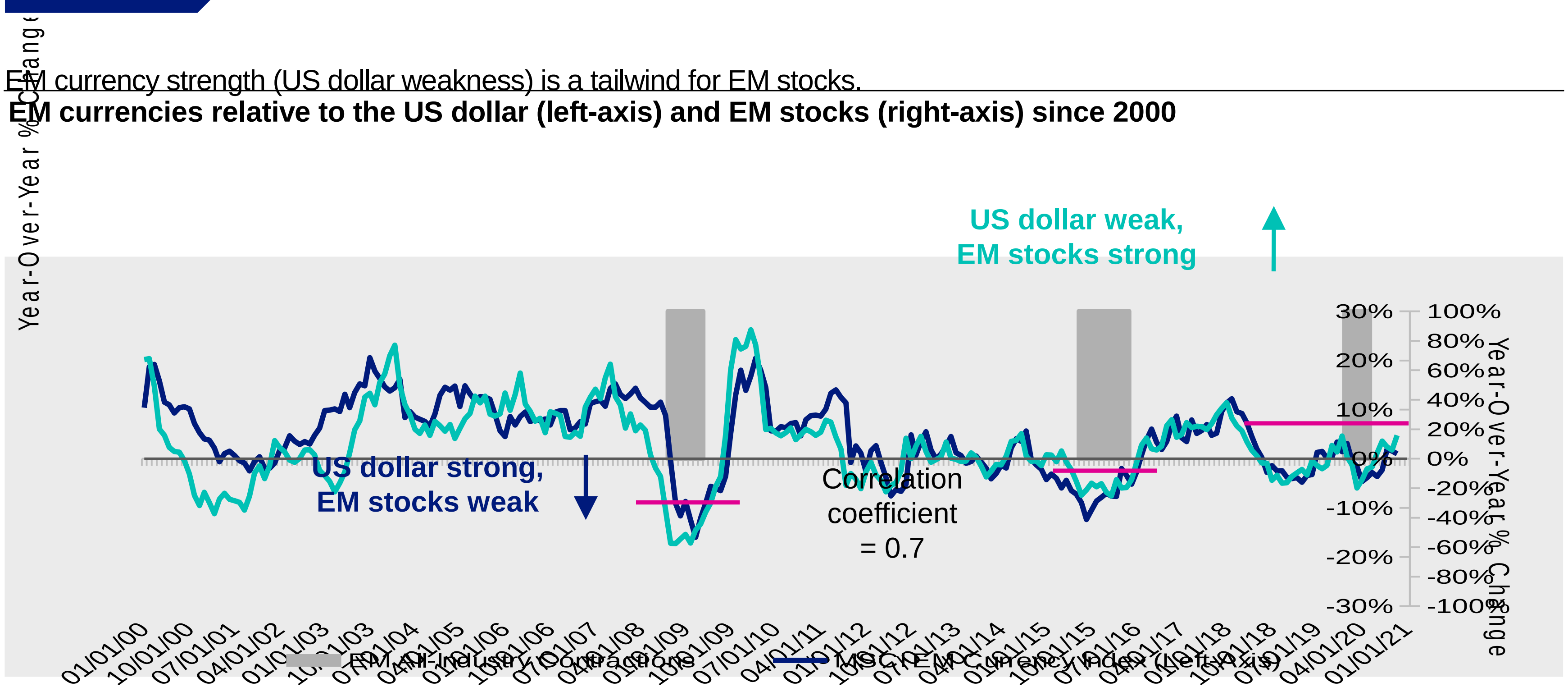


Source: Bloomberg L.P., FRED, Invesco, 11/30/20. Notes: USD = Trade Weighted USD Index: Emerging Markets Economies (EME), Goods and Services = A weighted average of the foreign exchange value of the US dollar against a subset of the broad index currencies that are emerging market economies. EM = Emerging markets. DM = Developed markets = MSCI World Index. MSCI EM and World price indices in US dollars. Index definitions can be found on page 15. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**

Conclusion

EM currency strength (US dollar weakness) is a tailwind for EM stocks.

EM currencies relative to the US dollar (left-axis) and EM stocks (right-axis) since 2000

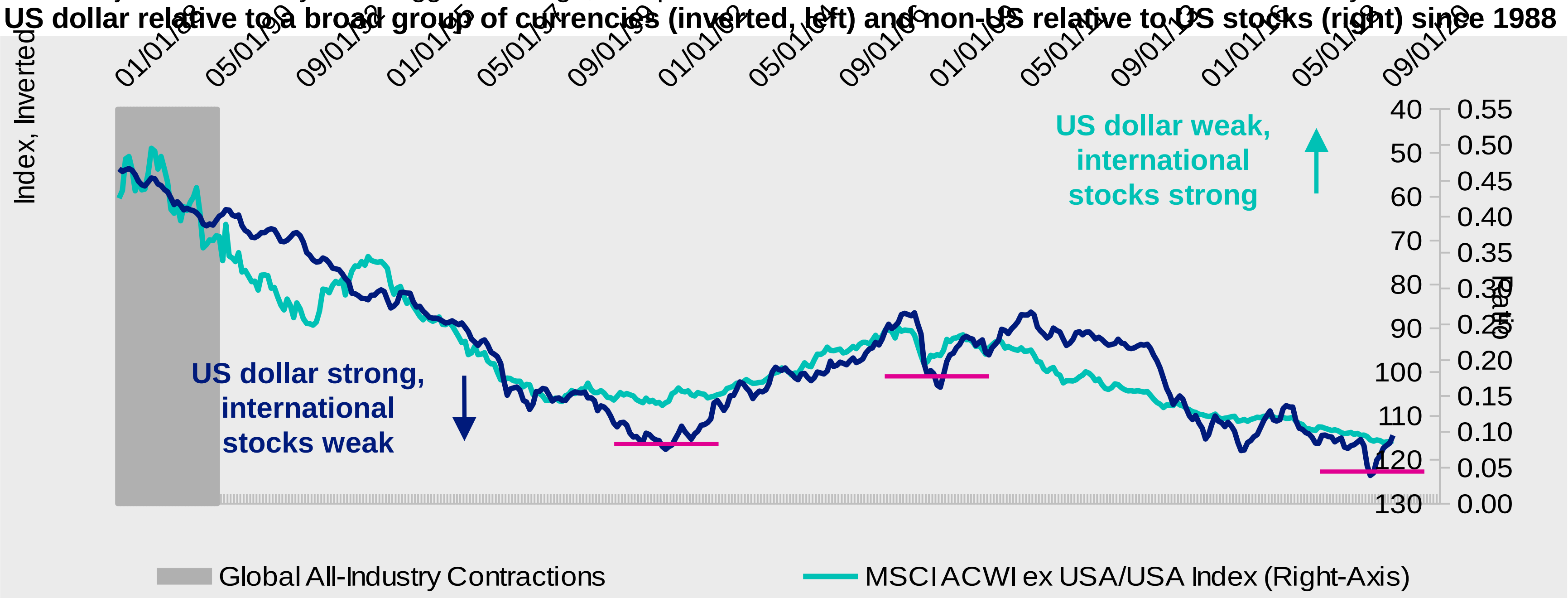


Source: Bloomberg L.P., Invesco, 11/30/20. Notes: MSCI EM Index price returns in US dollars. The countries in the currency index exactly match those in the equity index. Shaded areas denote EM all-industry contractions. Index definitions can be found on page 15. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**

Conclusion

This isn't just an EM story. It's a bigger message, with positive ramifications for international stocks more broadly.

US dollar relative to a broad group of currencies (inverted, left) and non-US relative to US stocks (right) since 1988



Source: Bloomberg L.P., FRED, Invesco, 11/30/20. Notes: USD = Trade Weighted USD Index: Broad, Goods and Services = A weighted average of the foreign exchange value of the US dollar against the currencies of a broad group of major US trading partners. ACWI = All Country World Index. MSCI USA and ACWI ex USA price indices in US dollars. Shaded areas denote global all-industry contractions. Index definitions can be found on page 15. An investment cannot be made directly in an index. **Past performance does not guarantee future results.**

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Talley Léger is the Senior Investment Strategist for the Global Thought Leadership team. In this role, he is responsible for formulating and communicating macro and investment insights, with a focus on equities. Mr. Léger is involved with macro research, cross-market strategy and equity strategy.

Mr. Léger joined Invesco when the firm combined with OppenheimerFunds in 2019. At OppenheimerFunds, he was the equity strategist. Prior to OppenheimerFunds, he was the founder of Macro Vision Research and held strategist roles at Barclays Capital, ISI, Merrill Lynch, RBC Capital Markets and Brown Brothers Harriman. Mr. Léger has been in the industry since 2000.

He is the co-author of the revised second edition of the book, *From Bear to Bull with ETFs*.* Mr. Léger has been a guest columnist for *The Big Picture* and *Data Watch* on *Bloomberg Brief Economics*, as well as a contributing author on Seeking Alpha (seekingalpha.com). He has been quoted in *Associated Press*, *Barron's*, *Bloomberg*, *Business Week*, *Dow Jones Newswires*, *The Financial Times*, *MarketWatch*, *Morningstar magazine*, *The New York Times* and *The Wall Street Journal*. Mr. Léger has appeared on Bloomberg TV, Canada's BNN Bloomberg, CNBC, Reuters TV, TD Ameritrade Network, The Street and Yahoo! Finance, and has spoken on Bloomberg Radio.

Mr. Léger earned an MS degree in financial economics and a Bachelor of Music from Boston University. He is a member of the Global Interdependence Center (GIC) and holds the Series 7 registration.

**From Bear to Bull with* ETFs (2nd ed.), by David R. Kotok and Talley Léger, published by Cumberland Advisors Publishing (2014).

Index definitions

Trade Weighted US Dollar Index: Broad, Goods and Services is a weighted average of the foreign exchange value of the US dollar against the currencies of a broad group of major US trading partners.

The Trade Weighted US Dollar Index: Advanced Foreign Economies (AFE), Goods and Services is a weighted average of the foreign exchange value of the US dollar against a subset of the broad index currencies that are advanced foreign economies.

Trade Weighted US Dollar Index: Emerging Markets Economies (EME), Goods and Services is a weighted average of the foreign exchange value of the US dollar against a subset of the broad index currencies that are emerging market economies.

The US Dollar Index (DXY) contains six currencies from the Eurozone (euro), Japan (yen), UK (pound), Canada (dollar), Sweden (krona) and Switzerland (franc).

The MSCI Emerging Markets Index is designed to measure large and mid market capitalization stocks in the emerging markets.

The MSCI World Index is designed to measure large and mid market capitalization stocks in the developed markets.

The MSCI Emerging Market Currency in USD measures the total return of 25 emerging market currencies relative to the US Dollar where the weight of each currency is equal to its country weight in the MSCI Emerging Markets Index.

The MSCI ACWI ex USA Index captures large and mid cap stocks across 22 of 23 Developed Markets (DM) countries (excluding the US) and 26 Emerging Markets (EM) countries.

The MSCI USA Index is designed to measure large and mid market capitalization stocks in the United States.

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