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PHILEQUITY CORNER

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Hedge America

Defying historical correlations, US stocks have staged a strong performance this year even as the US dollar has weakened. The decoupling of the US dollar from other US assets has become more apparent. As such, investors are hedging their US exposures to insulate these from the prevailing weakness of the US dollar.

From "Sell America" to "Sell the dollar"

Earlier this year, US stocks and bonds declined along with the US dollar. However, the performance of the US dollar diverged from other US assets since the market bloodbath in April. The S&P 500 rallied 37.4 percent from its bottom on April 7. Likewise, bonds recovered as the yield on the 10-year US Treasury declined to 4.17 percent after breaching 4.55 percent in April and May. On the other hand, the US dollar index (DXY) fell 5.2 percent over the same period.

Fundamental reasons behind the US dollar's decline

One of the main reasons behind the dollar's decline is the expectation of lower interest rates in the US. The Fed has signaled two more rate cuts for the rest of the year. In addition, the US has a wide fiscal deficit of $2 trillion as of end-August.

Trump's actions weaken the dollar

Aside from fundamental reasons, Trump's aggressive actions have dented confidence in the US government and contributed to the weakness of the dollar. We enumerate these below.

1. **Trade war and reciprocal tariffs.** Trump reignited a trade war by imposing steep reciprocal tariffs on US trading partners. He forced countries to initiate trade negotiations with the US and squeezed out concessions in an attempt to balance the US trade deficit.

2. **One Big Beautiful Bill.** Trump's tax cuts and spending plan is projected to add $3.4 trillion to US national debt over the next 10 years. This would worsen the fiscal position of the US as government debt currently stands at $37 trillion, equivalent to a debt-to-GDP ratio of 123 percent.

3. **Undermining the Fed's independence.** Trump repeatedly threatened to unseat Fed Chair Jerome Powell as the Fed refrained from cutting rates from January to August. He also made moves to fire Fed Governor Lisa Cook over allegations of mortgage fraud. These are perceived to be part of Trump's efforts to gain control of the Fed.

4. **Attacks on American institutions.** Trump has attacked key US institutions. He fired the head of the US Bureau of Labor Statistics. He also sacked the director of the Center for Disease Control and Prevention (CDC).

5. **Hawkish immigration policy.** Trump's aggressive immigration policy involves forceful raids and the deportation of illegal immigrants. Tourism has declined as tourists are deterred by Trump's hardline stance on immigration.

6. **Steep hike in H-1B visa fee.** Trump ordered a sharp increase in the fee for H-1B visas to $100,000 from $2,000 to $5,000. This would affect major US firms that employ skilled workers from India and China. It can lessen the competitive advantage of US companies especially tech firms. In the meantime, China introduced its K visa to attract international graduates and professionals in science and technology.

7. **Attack on schools.** Trump instructed a freeze in federal funding for Harvard University. Anecdotally, we have seen children of friends who are now studying in alternative destinations such as the UK, Europe, Canada, Singapore and Australia instead of going to American schools.

8. **Firing of a Microsoft executive.** Last Friday, Trump demanded the firing of Microsoft executive Lisa Monaco who served as deputy attorney general during the Biden administration.

De-dollarization underway

De-dollarization has been in play for many years. Based on Fed data, the share of US dollars in global foreign exchange reserves has declined from 71 percent in 2000 to the present level of 58 percent. In addition, foreign holdings of US government debt have fallen from 57 percent in 2008 to 32 percent currently. De-dollarization is gaining ground among BRICS and ASEAN countries that are promoting the use of their local currencies for trade and investments. Moreover, global central banks are increasing their gold purchases. This pushed gold to new all-time highs, resulting in a higher proportion of gold to total official reserves.

Hedging TINA

Despite the weakness of the US dollar, investors continue to flock to the US stock market as there is no alternative (TINA) for mega-cap US tech stocks. Nvidia, Apple, Microsoft, Alphabet, Amazon and Meta are the main beneficiaries and proponents of the game-changing AI revolution. Thus, they are expected to deliver strong revenue and earnings growth for the foreseeable future. As a result, investors have stayed in the US stock market but are hedging their US dollar exposure.

PSEi and peso sink on corruption scandal

Shocking details of the gargantuan scale of corruption reaching trillions of pesos are emerging from the Senate and Congressional hearings. Several leaders of the Senate and Congress are implicated and may face charges. As a result, the PSEi and peso have recently underperformed. The PSEi is now down 7.7 percent year-to-date and is hovering near the 6,000 support level. Meanwhile, the peso has depreciated and the USDPHP rate is now back to the 58 level even as the US dollar remains weak. After the Japanese yen, the peso is the worst performing Asian currency year-to-date. Due to the weakness of the peso, some investors and businessmen are hedging their currency exposure. Investors are concerned that the investigations will uncover a bigger scale of corruption. They are also wary that the country may experience heightened political turmoil such as what we have seen in Indonesia, Thailand and Nepal. Many Filipinos are becoming increasingly frustrated and angry with government corruption, culminating in huge protest rallies attended by businessmen, professionals, students and citizens from different sectors of society.