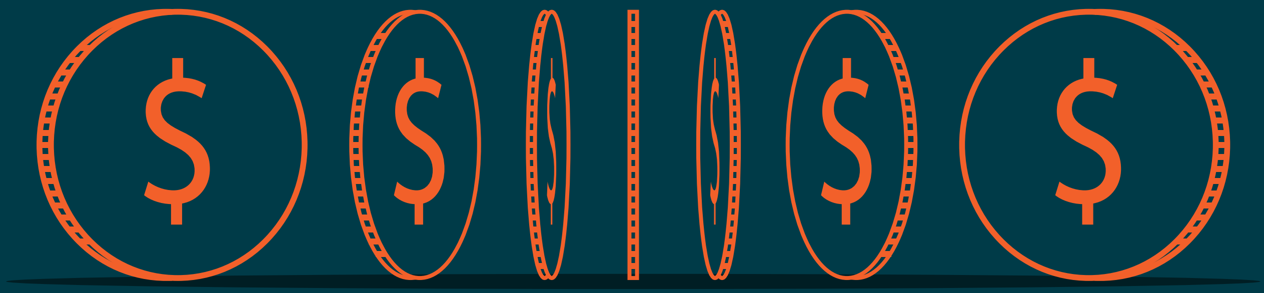

# The US Dollar & Emerging Markets


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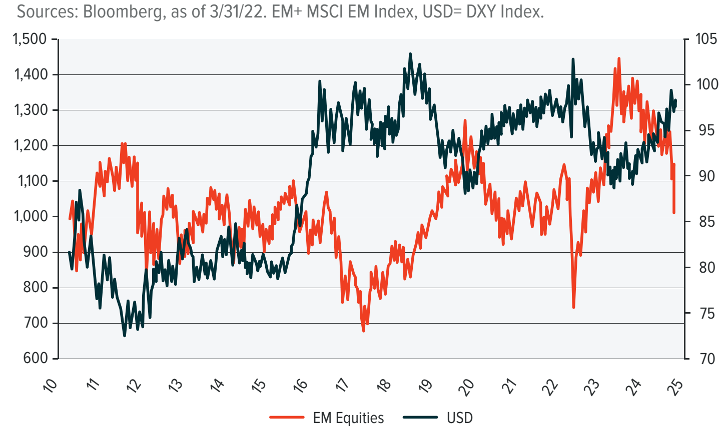
**Through June 30, 2022 the US dollar (USD) as measured by the DXY, has strengthened 9% since November 1 2021.[1] This came off a combination of (1) the "Fed Pivot" and Jerome Powell adjusting his rhetoric to a hawkish stance in terms of rate hikes and quantitative easing, and (2) a "flight to quality" corresponding with the war in Ukraine and the overwhelming sell-off across most asset classes. In this piece, we will explain the relationship between the USD and Emerging Markets (EM) equities.**

## The USD-EM Relationship

Historically, EM equities have shown a negative correlation with the dollar and have gained roughly 4% for each 1% of USD weakness. A strong USD translates into potentially weaker EM performance, as EM countries and the companies within them generally leverage themselves in USD denominated debt. Therefore, a stronger USD leads to larger balance sheet liabilities and negative earnings revisions as net interest expenses increase. Additionally, a stronger USD is normally negative for commodity prices, as they are priced in dollars, which further hurts commodity exporting countries. Note that we are not seeing that relationship this year due to the supply disruption from Eastern Europe. It's also important to point out that a strong USD can create challenges for China. Though export-based manufacturers are likely to benefit, one should also keep in mind that Renminbi weakness against the USD, in combination with low Chinese bond yields, translates into capital outflows from China. Outflows can lead to lower GDP growth, and this can spill over into other EM countries since China represents a significant portion of demand for EM goods.

**A REVERSAL OF THE USD COULD SUPPORT EM EQUITIES**

Sources: Bloomberg, as of 3/31/22. EM+ MSCI EM Index, USD= DXY Index.

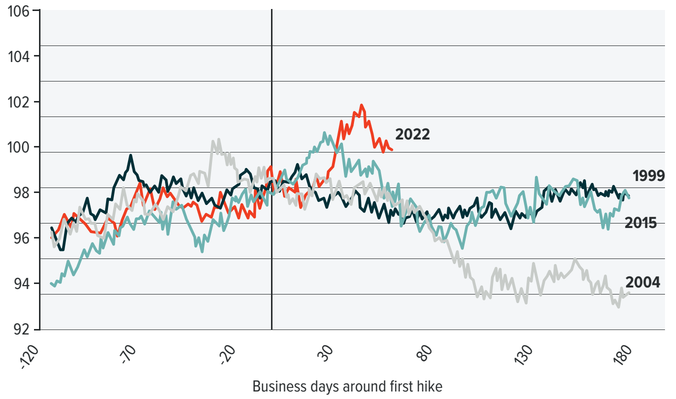



## In and Around Fed Rate Hiking Cycles

On the positive side, looking back at the past four US interest rate hiking cycles, we note that the USD has strengthened in the beginning of the hiking period but soon weakened following each cycle's initiation. This is due to the market pricing in higher rates, which inherently slows down economic growth, and eventually puts the breaks on central bank activity. If US inflation reaches its peak and the country's economic activity begins to slow down, this could bode negatively for USD strength and create a positive catalyst for EM assets. Looking back at data between 1999 and 2022, EM equities have outperformed, on average, by 11% and 10%, respectively, the following 6 and 12 months following initial Fed rate hikes.

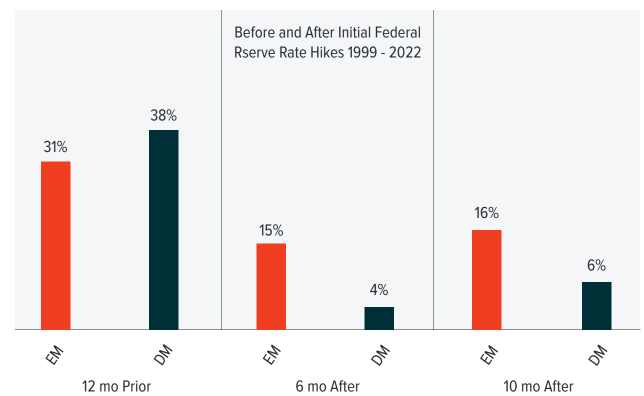
## USD INDEX AROUND THE LAST FOUR FED LIFTOFFS

Sources: JP Morgan, as of 6/3/22, JP Morgan Broad USD nominal exchange rate. Liftoff date=100.




## US RATE HIKES AND EM IMPACT

Sources: Bloomberg as of 3/16/22. EM= MSCI EM Index. DM= S&P 500 Index

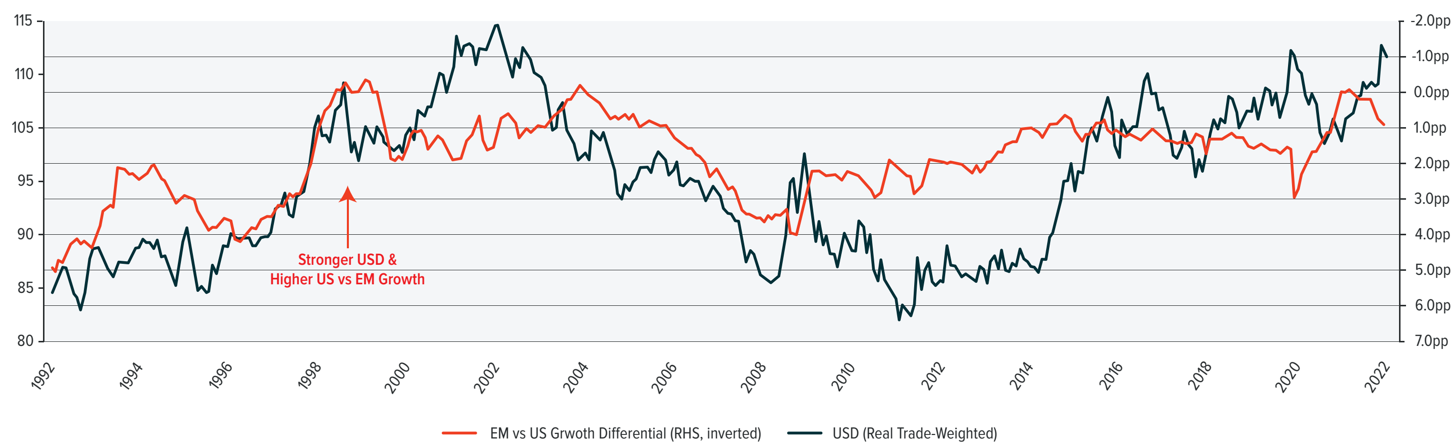



## Finding Peaks

It is also important and complimentary to note that growth differentials often act as key drivers for EM currency strength (compared to the USD). Thus, increasing EM growth relative to the US could signal a peak in USD strength. This is due to (1) the connection between higher US interest rates leading to a stronger dollar but lower growth, and (2) capital allocators looking for investments with growth potential.

## EM VS US GROWTH DIFFERENTIAL

Sources: FactSet, Consensus Economics, Goldman Sachs Global Investment Research, as of 5/31/22. RHS=right hand side. PP= percentage points.




Hence, as seen below, a peak in the USD has historically translated into EM equities outperforming DM peers over the following 12-month period. Again, this is due to a weaker US dollar acting as a strong tailwind for EM assets.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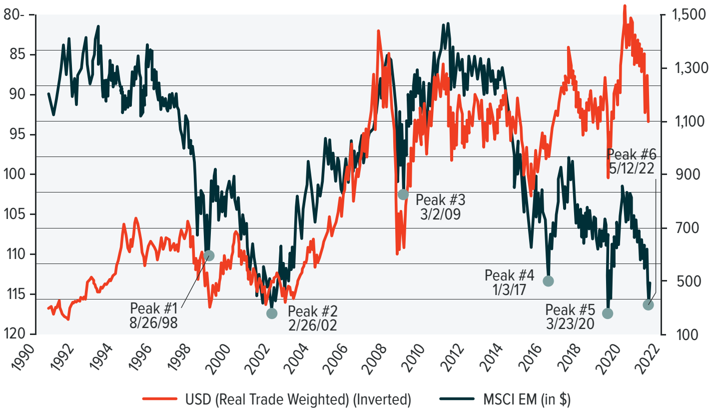
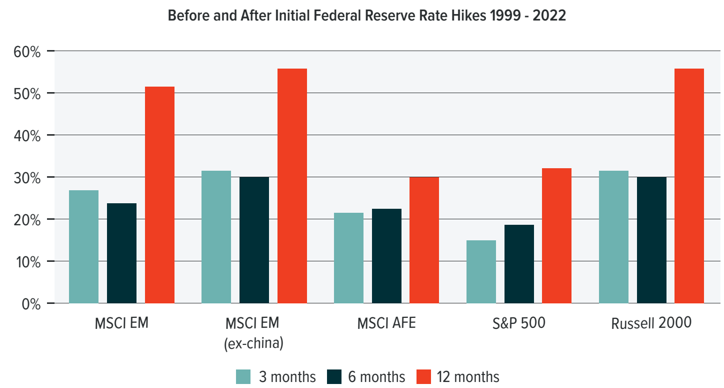
## USD VS MSCI EM PERFORMANCE SINCE 1990

Sources: FactSet, Consensus Economics, Goldman Sachs Global Investment Research, as of 5/25/22




## US OUTPERFORMS DM FOLLOWING DOLLAR PEAKS

Sources: FactSet, Bloomberg, Goldman Sachs Global Investment Research, Average Returns, as of 5/31/22




When looking at history, we note the following points:

- There is a clear inverse relationship between the US dollar and EM equities.
- The US dollar has tended to strengthen going into rate hiking cycles and weaken in the months following the initiation of hikes.
- Growth outlook differentials between EM and the US often act as indicators for peaks in US dollar strength.
- EM equities tend to outperform Developed Market (DM) peers following US dollar peaks.



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[1] Bloomberg, as of 6/6/22.

DEFINITIONS

DXY is the US dollar index is a measurement of the dollar's value relative to six foreign currencies as measured by their exchange rates. Gross domestic product (GDP) is the total monetary or market value of all the finished good and services produced within a country's borders in a specific time period. MSCI EAFE Index is an equity index which captures large and mid-cap representation across 21 Developed Markets countries around the world, excluding the US and Canada. MSCI Emerging Markets (EM) Index captures large and mid-cap representation across 24 Emerging Market countries. MSCI Emerging Markets ex-China Index captures large and mid-cap representation across 23 of the 24 Emerging Markets (EM) countries excluding China. Quantitative Easing (QE) is an unconventional monetary policy in which a central bank purchases government securities or other securities from the market in order to lower interest rates and increase the money supply. Russell 2000 Index tracks the performance of roughly 2,000 of the smallest publicly traded companies in the U.S. S&P 500 Index is a market-capitalization-weighted index of 500 leading publicly traded companies in the US. You cannot invest directly into the index.

IMPORTANT INFORMATION

Past performance is no guarantee of future results.

Investment Risk — There can be no guarantee that any investment strategy (risk management or otherwise) will be successful. All investing involves risk, including the potential of loss of principal. Emerging Markets Risk — The risks of foreign investments are typically greater in less developed countries, which are sometimes referred to as emerging markets. For example, legal, political and economic structures in these countries may be changing rapidly, which can cause instability and greater risk of loss. These countries are also more likely to experience higher levels of inflation, deflation or currency devaluation, which could hurt their economies and securities markets. For these and other reasons, investments in emerging markets are often considered speculative. Similarly, investors are also subject to foreign securities risks including, but not limited to, the fact that foreign investments may be subject to different and in some circumstances less stringent regulatory and disclosure standards than US investments.

An investor should consider the Fund's investment objectives, risks, charges and expenses carefully before investing. This and other important information about the investment company can be found in the Fund's prospectus and/or summary prospectus. To obtain a prospectus, please contact your financial advisor or call (888) 355 3417. Please read the prospectus carefully before investing.



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