USD as a currency & US as a financial market

US **Markets** (negative) – Inflation has emerged as key risk for global economy leading to increasing market expectations that monetary policy globally is set to become tighter. *High growth stocks tend to underperform* in a US rate hiking cycle with inflation scares leading to investors rotate away from high-multiple tech stocks and into sectors that hold up better in a rising rate environment (like EMs, financials, energy, industrials & real estate).

USD as **reserve currency** (Neutral) – Market experts and institutions like IMF have questioned the dominance of USD as reserve currency post Russia SWIFT sanctions. While, we agree to the fact that new world order will cause major re-shuffling of trade lines, we are not completely convinced that the rules have changed. It is still theoretically possible that a massive global depression and stock market crash followed by Fed's liquidity infusion could drive risk assets into USTs, driving yields down.

Fundamental requirement of reserve currency = backed by State + provide ***safe assets*** *to global investors* + ***easy to trade in times of crises***

Who could be contenders to the next reserve currency – **China** with opening up of its capital markets + strengthening ties with Saudi Arabia & Russia caused many investors to frame this a sign of Yuan strength & USD weakness. However, we believe this was done to address Chinese fundamental economic weakness as running persistent CAD could push China into economic slowdown or CNY currency crises.

Euro – Despite being used in 33% of cross border transactions and second only to USD, EURO has its own share of problems. From Greece/Italy bankruptcy issues, differences in underlying nations, huge deficits, rising inflation, energy fears, weaker economic performance due to lack of innovation. The bloc is known only to take crucial steps when its at brink of disaster(p.s. – Germany is finally doubling up its military spends and thinking about energy deficiency issues)

Gold - Gold continues to shine…atleast in cash flow terms. Gold miners are producing higher free cash flows than ever. Newmont mining, largest gold miner by market cap touched all time high this week after a gap of 34 years. This tells you that precious metals are ready to take leadership in changing world where US hegemony is getting threatened.

We believe next decade will be all about commodity centric countries taking the charge with multiple currency transactions floating globally including Gold settlement via futures trade; until any substantial currency establishes itself.

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Portfolio impact to De-Dollarization and safe guards employed

<u>Global economies</u> : Countries which were either (a) fast movers to hiking rates & now are well prepared to face inflation or (b) have faced crises earlier due to slow commodity markets & now are expected to reap benefits of cyclical change (c) are easing policy rates/QE in period where Fed is tightening, making currency depreciation advantageous to exporters are better alternatives.

Example – Japan, Brazil, Vietnam, China (Internet).

<u>Real Assets/Commodities</u> : Being asset heavy has gone from a bad thing to a good thing in this inflationary environment. 2010-2020 was all above asset light + growth model and cheap money from low interest rates attracted high valuation stocks (Tech). We believe next decade is all about asset heavy companies i.e., essentially industries which are capex intensive and see operating leverage kick in as volume increases. As for the fundamentals – energy's free cash flow yield is more than double that of tech & inflation makes all of its assets all the more worthwhile.

Example – Agriculture, Uranium, Platinum, Energy, Metals, Gold, Silver

<u>Live Example: EWZ – Brazil</u>

Brazilian markets have delivered YTD 41% absolute returns. Although these are held in USD; but, essentially returns are comprised of Brazilian real plus Bovespa return reflected in USD.

If Real moves up, then returns in USD also moves. So, its Real + Bovespa returns in 'USD' denominated ETF

While, certainly USD exposure and $ hegemony affects these underlying holdings; but, there are thematic ideations that can be very impactful portfolio plays with changing world dynamics. <u>Essentially, while portfolio is $ denominated the large part of the returns are not linked to US markets.</u>

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