Investment Strategy Update

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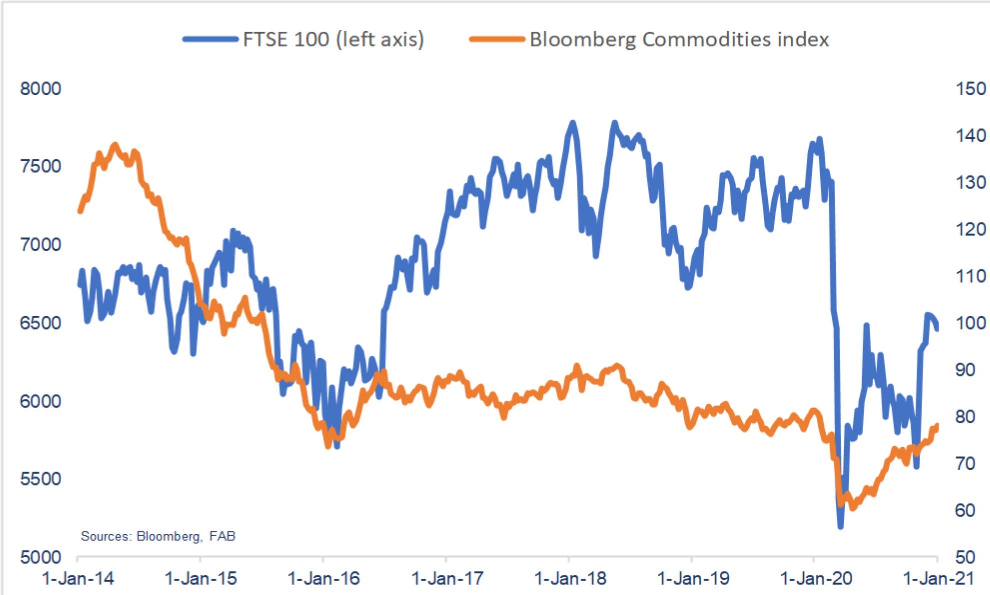
Continued dollar weakness could help commodities and the UK

- **The US dollar started the year confirming its weakening trend, with the dollar index down 0.46% today.**
- **The Bloomberg Commodity index is up by as much as 2.2% today, led by energy and precious metals.**
- **A weaker dollar and rising commodities could benefit EM, and eventually the UK stock index, which is tilted to mining and energy .**
- **The FAB AAC has a neutral position in equities, and is slightly overweight in IG and EM bonds, and gold.**



One of the most important events last year that perhaps did not receive as much media attention as deserved was the drop in the US dollar. The Dollar Index, which measures the its weighted value against its most liquid pairs, fell 6.69% in 2020, reversing the trend of the previous two years, during which the same gauge had rallied 4.63%.

If investors focus on the peaks and troughs, instead of calendar dates, the moves were even more intense. The Dollar Index recently peaked on 20 March at 102.817, and has since fallen 12.93%.

The performance of the US currency has a significant correlation to how most asset classes do, from stocks to bonds. However, commodities and emerging markets are the most sensitive to it.

Hence, it is no surprise that the Bloomberg Commodity index has gained 30.57% since 20 March, and that the MSCI Emerging Markets index is up 60.87% in the same period. As the dollar continues to weaken, these assets should perform well.

The asset class domino of the US dollar weakness will eventually hit the UK stock market, which was one of the worst performers among developed markets last year, partly because of the weight that cyclical sectors have in the FTSE 100, and because of Brexit-related uncertainty.

Financial companies are the second most important component of the that index, after consumer staples, with a 17% weight. Next comes materials, or all the metals and mining firms, with 13.6%. If energy were to be added to that, the total share of commodities would go to 22.4%.

That is in contrast with the S&P 500, for instance, which is heavily tilted to technology. It also helps explain why the US broad index rallied 16.26% last year, while its UK counterpart fell 14.34%.

The divergence, however, suggests there is room for some catch-up in the UK. Cyclical sectors could benefit if the world experiences a strong economic rebound in the second half of this year, as is likely to happen. That should benefit the UK market in particular, given its makeup.

Companies in the energy and materials sectors comprise 22.4% of the FTSE 100 index

One of the hurdles in the way of a very strong performance may be the British pound itself. Because so many of the UK large-cap companies are multinationals, whenever the country's currency strengthens, the translated revenues and profits of these companies are reduced in sterling terms.

For investors whose benchmarks are in US dollars, the impact is likely to be neutral and that could attract more foreign money into UK stocks, especially now that Brexit is done. With the dollar in retreat, global investors may even want some additional sterling exposure.

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