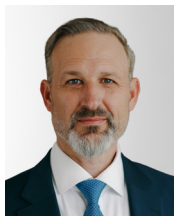




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The US dollar, oil and gold: changing dynamics?



Gregor MA Hirt
CIO, Multi Asset

The Middle East crisis has disrupted the market dynamics of the US dollar, oil and gold, underscoring the need for tactical flexibility and for investors to build resilient portfolios that are not necessarily reliant only on historic correlations.

The outbreak of the Middle East conflict has prompted a shakeout across markets, including a shift in the dynamics of three core global macro assets: the US dollar, oil, and gold.

Key takeaways

- Oil is trading as a geopolitical supply-risk asset, the US dollar has regained short-term safe-haven appeal, while gold has shifted to behave more like a tactical asset.
- Given increased volatility across markets, including currencies, commodities as well as equities, short-term price moves may be driven as much by flows and positioning as fundamentals.
- We see value in looking through the current market dynamics to consider more medium-term factors: we keep our longer-term forecast of a softer dollar and continue to view gold's medium-term outlook as shaped by durable structural shifts.

Traditionally, the US dollar and oil prices have often had an inverse relationship, meaning when the US dollar rises, oil prices tend to dip and vice versa. But the rise of both since the conflict began has served as a reminder of how the relationship can be unstable and prone to shifts during periods of shock, underlining the need for investors to build resilient portfolios that are not necessarily reliant only on historic correlations.

Meanwhile, the historically inverse relationship between the dollar and gold has been reinforced, with the dollar's ascent mirrored by a slide in gold. It marks a turnaround from prior to the conflict after a period of extended dollar weakness and sustained gold strength. So, what is behind the change?

- **Oil is now trading as a pure geopolitical supply-risk asset.** Oil's surge of around 60% in March reflected a significant threat to supply caused by blockages to the Strait of Hormuz and disruptions to energy production in the Middle East. Higher oil prices have contributed to inflationary pressures globally, further reinforcing the upward trend in energy prices.
- **The US dollar's safe-haven status was reactivated, at least in the short term.** The US currency has also benefited from higher energy prices. Because the US is now a major net oil exporter, higher energy prices tend to improve the US terms of trade relative to many peers and tighten global financial conditions, both of which favour the dollar in the short run. And the dollar has also been supported by carry trades, where investors take advantage of higher expected US interest rates compared to other major economies.
- **Gold's perceived status as a politically neutral asset that can serve as a refuge in a crisis has been tested.** In the short term, the metal is behaving more like a tactical asset, sensitive to liquidity, yields and positioning rather than headline geopolitical risk as it has slid along with other normally risk-off diversifiers including equities and bonds in a correlation crunch. In part, the underperformance reflects investors cashing in on the metal's strong run to build cash reserves or to cover margin calls on equity positions. Also, it seems that some central banks may have

sold large volumes. It may also reflect anticipation that central banks will have to raise interest rates to counter the inflationary impact of higher energy prices. Higher interest rates mean higher bond yields, making fixed income a more enticing alternative to gold in the eyes of some investors.

What do the changing dynamics mean for our investment convictions?

Stay flexible tactically as execution uncertainty remains high in the Middle East

We continue to maintain a constructive outlook for commodities, including oil, which is supported by an ongoing elevated risk premium, helping the commodity provide a geopolitical hedge in portfolios. The duration of the disruption will be key to determining how long oil prices remain high.

We keep our longer-term forecast of a softer dollar, reflecting fiscal pressures in the US and gradual diversification away from the country's assets. Though near-term dynamics have turned more supportive, we don't think they will last. As a result, tactical flexibility remains essential in currency positioning, even where the strategic outlook points in the opposite direction. For example, for non-US investors having US dollar exposure has helped somewhat in the current environment as the European economy appears more vulnerable to the impact of the crisis, pushing the euro lower.

Gold's medium-term outlook undimmed

Despite gold's recent fall, we continue to view gold's medium-term outlook as shaped by structural shifts including central bank demand, fiscal concerns, and de-dollarisation, as well as more traditional drivers – including a softening US dollar, a decline in real yields, and retail investor buying.

But for now, it is critical to watch shorter-term exchange-traded fund (ETF) flows from retail investors and technical signals. We may see attractive re-entry points at somewhat lower levels than today's gold price.

Volatility: an opportunity to reassess hedges

Given increased volatility across markets, including currencies, commodities as well as equities, short-term price moves may be driven as much by flows and positioning as by fundamentals.

This volatility has had implications for portfolio protection strategies. In many of our multi asset portfolios, protection options are now in the money following recent market moves. With uncertainty still high but risk premium having repriced meaningfully, we have begun to take profit on most of these option positions, locking in gains and reassessing the cost benefit of maintaining hedges at current levels.

Overall, the recent market shakeout serves as a reminder that familiar asset relationships cannot be taken for granted. Geopolitical shocks are now interacting with deeper structural shifts in the global economy, altering the forces driving gold, oil and the US dollar. For investors, the challenge is not only to recognise these changing dynamics, but to remain flexible enough to navigate them – balancing long-term convictions with short-term tactical discipline.

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