Lotos Asset Management

Quarterly Investment View

May we see a rebound in the USD?

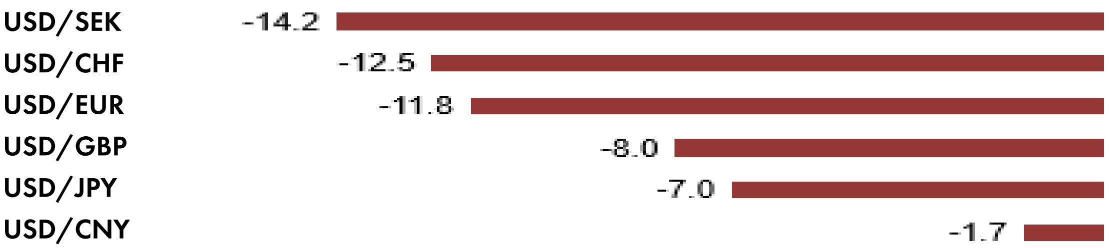
Financial market participants are currently deeply divided on how various asset classes will perform going forward. However, there is one point on which a consensus appears to be forming: the U.S. dollar is expected to continue weakening. Yet history has shown that when market sentiment becomes overly one-sided, outcomes often diverge from expectations. Could the U.S. dollar therefore be poised for a rebound?

At the beginning of the year, the outlook seemed full of promise. American exceptionalism was widely praised. But then President Trump shocked the world with outrageous tariff announcements. The United States experienced a massive capital outflow as investor confidence began to erode. The recent passage of the 'big beautiful bill' led to a further significant loss of trust as the legislation includes extensive tax cuts that will further increase the national debt, which is already alarmingly high. The responsible agency (nonpartisan Congressional Budget Office) projects that government debt, currently at 100% of GDP, could surge to 156% within the next twenty years. Even now, the government spends more on interest payments than on the military. President Trump, however, argues that the United States can more than make up for the lost tax revenue through economic growth.

Surging U.S. debt levels and persistent fiscal deficits appear to be among the most significant factors underpinning the current weakness in the U.S. dollar (see chart, top right). Over the medium to longer term, the gradual shift toward a more multipolar global trade environment—driven by ongoing tariff disruptions and the growing trend of de-dollarization, particularly among BRIC nations in both trade settlements and reserve composition—could contribute to a diversification away from the U.S. dollar's dominant role. That said, this remains a protracted and incremental process.

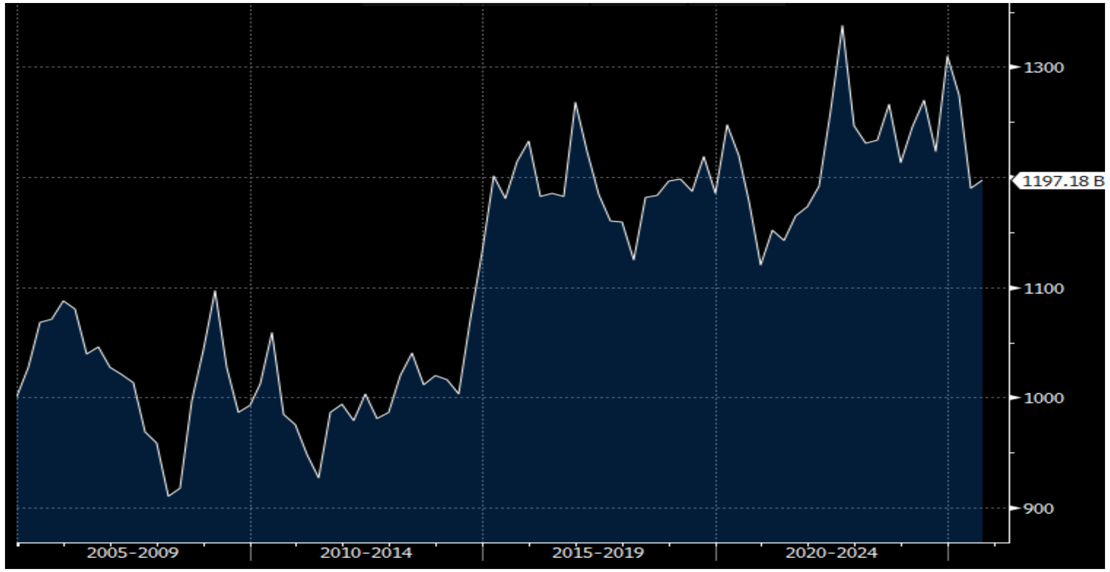
In the near term, however, no viable alternative exists to challenge the depth, liquidity, and institutional infrastructure of the U.S. dollar. It remains the unrivaled global reserve currency. The dollar is involved in an estimated 88% of all foreign exchange transactions. More than half of global trade is conducted in U.S. dollars, and nearly 60% of official foreign exchange reserves are still held in USD by central banks.

The US Dollar lost ground to all major currencies this year



Source: Bloomberg

US Dollar still strong longer term



Source: Bloomberg Dollar Spot Index

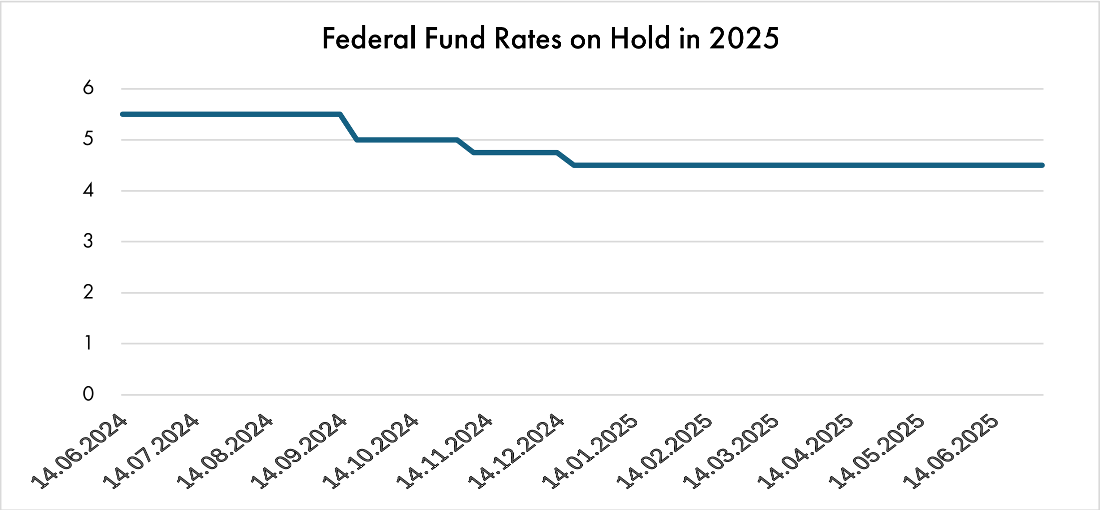
May we see a rebound in the USD?

U.S. Treasuries continue to be regarded as the safest and most liquid assets in the world. Even the rise of digital finance has not diminished the dollar's supremacy—on the contrary, the most widely used digital instruments, such as stablecoins, are predominantly backed by U.S. dollars or Treasury securities.

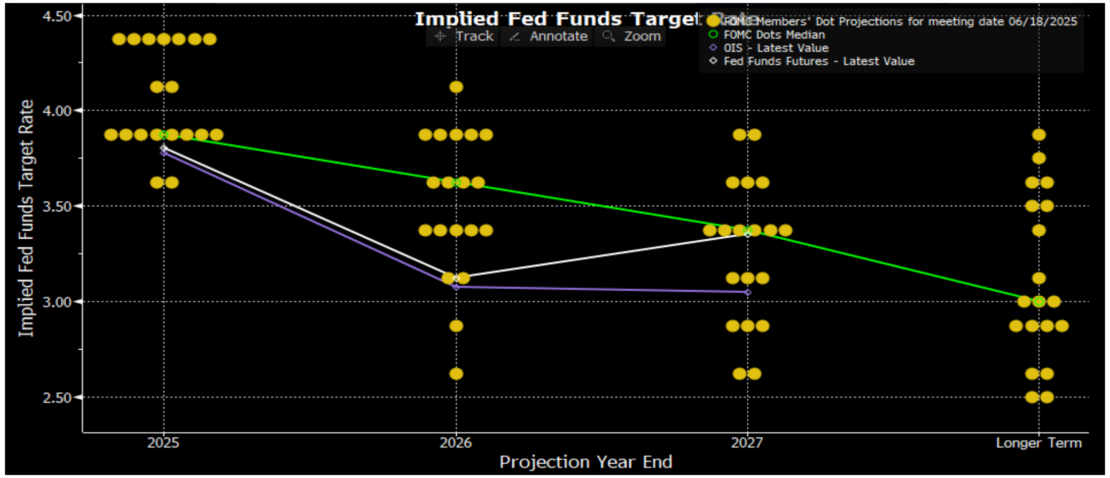
Whether the USD will strengthen again from here depends on several interrelated factors. One of the key factors are interest rates in an international context. Most interestingly, the USD has not recoupled with yield levels. This can be attributed to the heightened political uncertainty in the US. A particularly striking development is former President Donald Trump's designation of August 1 as a pivotal date in the ongoing tariff dispute. The U.S. Court of Appeals for the Federal Circuit had extended a previous reprieve on the implementation of tariffs until July 31. There is a non-negligible possibility that the tariffs—temporarily blocked in early June—could be permanently struck down, a scenario that would likely trigger an immediate and substantial rebound in the dollar.

The Federal Reserve, meanwhile, remains central to shaping the term structure of interest rates. Throughout 2025, Fed officials have opted to maintain policy rates, despite inflation consistently surprising to the downside. However, the outlook for future rate adjustments remains uncertain and internally divided—largely due to differing assessments of the inflationary impact of potential tariff measures under a renewed Trump administration. Of the 19 Federal Open Market Committee (FOMC) participants, ten appear to view the inflationary effects of tariffs as transitory and therefore support two to three rate cuts by year-end. Two policymakers anticipate a single cut, while seven prefer to keep rates unchanged.

In contrast, market pricing reflects a more aggressive easing path—potentially driven by growing expectations that Jerome Powell may be replaced as Fed Chair sooner than previously anticipated. It is essential to clarify, however, that while Powell's term as Chair concludes in May 2026, his tenure as a Federal Reserve Board Governor extends through January 31, 2028. Even if Powell were to relinquish his leadership role, his continued presence on the Board could temper any abrupt shifts in policy direction.



Source: Bloomberg



Source: Bloomberg

May we see a rebound in the USD?

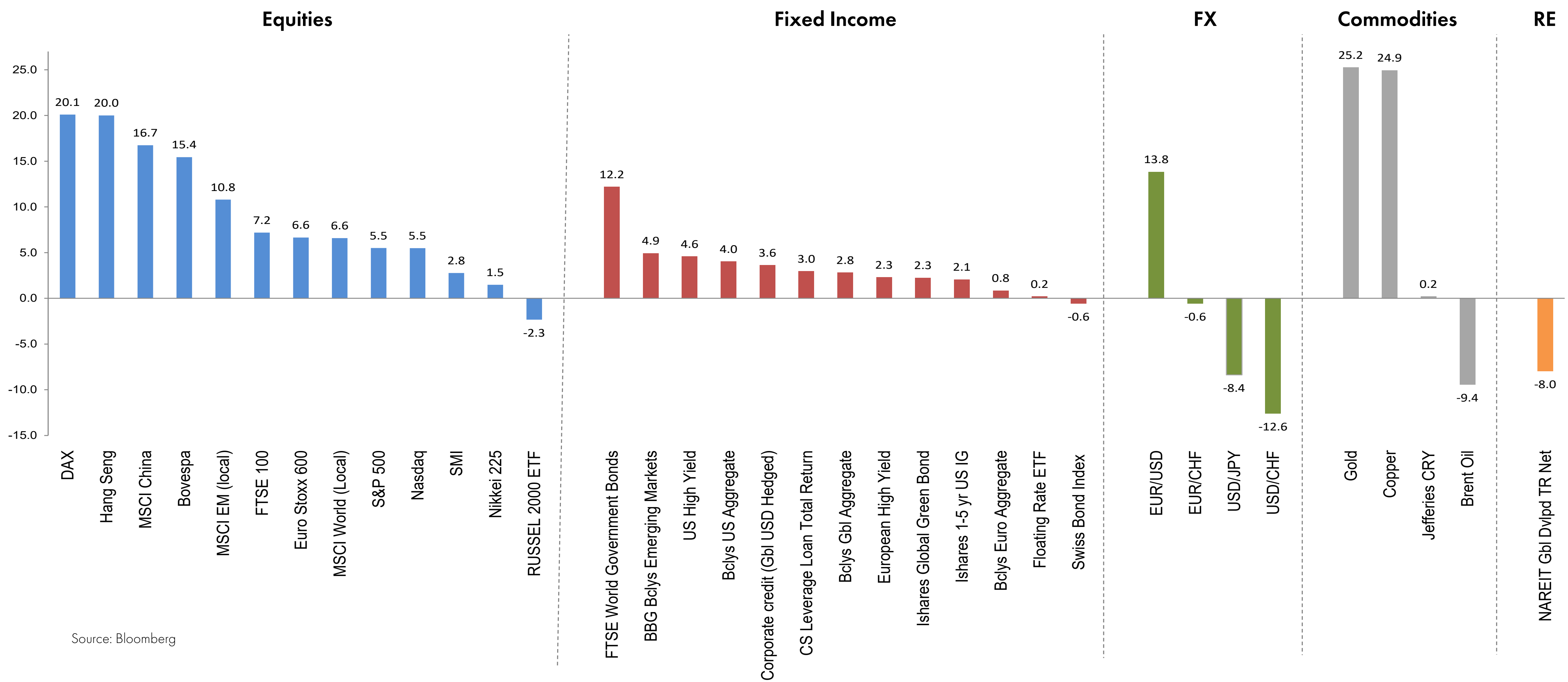
Moreover, decisions on interest rates require the support of a majority within the 12 voting members of the FOMC. A new Chair alone cannot unilaterally redirect monetary policy. Consequently, there is a credible risk that the Fed may ultimately deliver fewer rate cuts than currently priced in by markets. Should this scenario materialize, it would provide fundamental support for a stronger U.S. dollar.

Conclusion:

- The uncertainty remains elevated even through the market for now looks though the tariff noise.
- The eroding confidence of investors in the Trump administration is mainly reflected in the USD.
- Surging U.S. debt levels and persistent fiscal deficits appear to be among the most significant factors underpinning the current weakness in the U.S. dollar.
- Despite all these factors, the USD remains the undisputed world reserve currency – there is no alternative, yet.
- Despite the overly one-sided consensus of USD weakening there are certain factors that could trigger a turnaround.
- The nearest being the decision of the U.S. Court of Appeals scheduled for July 31.
- The potential Fed Chair replacement exercising less influence than market participants assume.
- We currently have a neutral view on the USD, thereby not sharing the negative consensus.

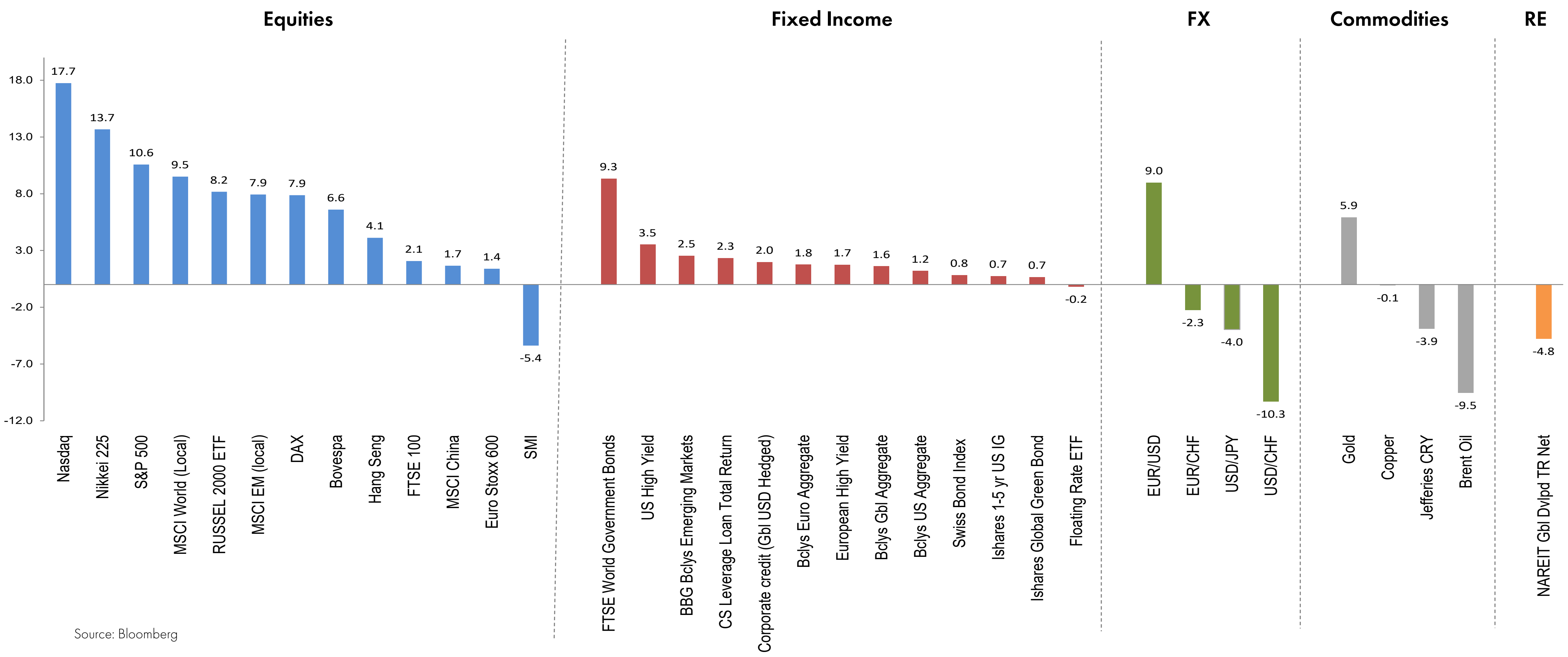
Please refer to the section “How are we invested and why” for further details.

YTD Performance of Major Asset Classes as of End-June 2025 (in Local Currencies)



Source: Bloomberg

Q2 2025 Performance of Major Asset Classes (in Local Currencies)



Source: Bloomberg

Performance major asset classes Q2 2025

- **Equities:** Following the dramatic collapse in equity markets triggered by former President Donald Trump's unexpected and sweeping tariff announcements, stocks staged a remarkable and rapid rebound. This powerful reversal hardly ever occurred in such a short period. It not only erased the losses incurred during the tariff-driven selloff but propelled major indices to fresh all-time highs. Markets appeared to discount the announced measures as politically motivated and unlikely to be implemented in full. While U.S. equities posted mid-single-digit gains YTD, Q2 was defined by a sharp acceleration with the Nasdaq surging an impressive 17.7%. Semiconductor jumped 52% in Q2. Our portfolios benefited from this momentum through exposure to the VanEck Semiconductor ETF. In Japan, the Nikkei 225 delivered one of its strongest quarterly performances in recent memory. The rally was primarily driven by pronounced yen weakness, which bolstered sentiment around export-oriented firms. In contrast, several regions that had led in Q1 faltered in Q2. European and emerging market equities lagged notably, with China in particular showing pronounced weakness. Swiss equities underperformed significantly, with the SMI declining by 5.4% in Q2. The strength of the Swiss franc weighed on multinational exporters, while the Swiss National Bank's rate cut dampened confidence in financials. Tariff uncertainty to the vital pharmaceutical sector further pressured the index.

- **Fixed Income:** The tariff shock also pressured the bond market as a spike in inflation was feared leading to elevated yields and wider credit spreads. Yet, weaker than expected inflation reports and dovish central banks buoyed bond prices later in the quarter. Spread compression across global credit (Investment Grade and High Yield) supported returns, especially in high-yield and emerging markets.

- **Commodities:** Gold continued its outperformance on geopolitical risks and a wave of purchases by central banks. Energy was quite choppy amid Middle East tensions and ended the quarter in negative territory.

- **Currencies:** The U.S. dollar dominance began to be increasingly scrutinized.

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