
DON'T COMPOUND A WEAK DOLLAR BET

Matt Wagner – Associate Director, Research
02/27/2024

We recently wrote about the [rising correlations between stocks and bonds](#), as well as the increasingly negative correlation between the U.S. dollar and stocks.

To rephrase the negative [correlation](#) between the U.S. dollar and the [S&P 500](#), an investment in U.S. equities is, in part, a bet against a strong dollar.

For global asset allocators, this raises an important question: why double down on a weak dollar exposure in U.S. equities when investing internationally?

In our view, currency-hedged positions should be considered more as a default and strategic allocation that is neutral on the dollar's direction, while unhedged investments compound an existing weak dollar bet investors already have within U.S. equities.

No Diversification from Being Unhedged

One of the most common arguments we hear in favor of unhedged international allocations is that there are diversification benefits from currency exposure.

The data does not support this greater diversification theory.

The correlation between U.S. dollar investments in the [EAFE \(Europe, Australasia and Far East\)](#) region (representative of unhedged) and local currency EAFE investments (representative of hedged) with respect to the S&P 500 is an identical 0.80. In other words, there is no significant diversification effect from having currency exposure.

Looking at the right-most column, we observe the correlations of each index with U.S. dollar returns.

- The S&P 500 and the [Russell 2000](#) exhibit correlations of -0.43 and -0.41, respectively. This shows the weak dollar bias of core U.S. equities exposures, even in small caps that have lower overseas earnings.
- The [MSCI EAFE \(USD\)](#) shows an even greater weak dollar bet during this period, with a -0.61 correlation to the dollar.
- The MSCI EAFE (Local) also has a negative correlation to the dollar, but its correlation of -0.29 is only half that of the MSCI EAFE (USD)

In summary, we believe that investing internationally without the currency hedge compounds the existing weak dollar bet that investors already have with their U.S. equities exposure.

Correlation Matrix: 12/31/08–12/31/23

	S&P 500	Russell 2000	U.S. Agg	Commod.	EAFE (USD)	EAFE (Local)	USD
S&P 500	1.00	0.90	0.02	0.44	0.80	0.80	-0.43
Russell 2000		1.00	-0.01	0.45	0.78	0.79	-0.41
U.S. Agg			1.00	-0.05	0.09	-0.06	-0.31
Commod.				1.00	0.49	0.41	-0.46
EAFE (USD)					1.00	0.93	-0.61
EAFE (Local)						1.00	-0.29
USD							1.00

Sources: WisdomTree, Russell, Bloomberg, S&P, MSCI, 12/31/08–12/31/23. Correlations based on weekly returns. Time period chosen based on data availability. You cannot invest directly in an index. Past performance is not indicative of future returns.

Over the long-run, returns are similar between the MSCI EAFE Index in USD and local currency—justifying the belief among many investors that currency returns are a wash over time.

Though returns are similar, we see higher [volatility](#) in every standard period from being unhedged, with the incremental volatility from [FX](#) increasing to more than 5% in the most recent three-year period.

Index Standard Deviation

Index	3-Years	5-Years	10-Years	Full Period
MSCI EAFE (USD)	16.8%	17.9%	15.2%	17.1%
MSCI EAFE (Local)	11.6%	14.0%	12.5%	14.7%
Incremental Vol. (FX)	5.2%	3.9%	2.7%	2.4%

Sources: WisdomTree, MSCI, 3/31/1986–1/31/2024. You cannot invest directly in an index. Past performance is not indicative of future returns.

For investors considering a currency-hedged allocation for international exposure, the [WisdomTree International Hedged Quality Dividend Growth Fund \(IHDG\)](#) has nearly 10 years of live track record.

The Fund has outperformed both the MSCI EAFE (USD) and MSCI EAFE (Local) indexes since its inception, doing so with 3% lower volatility than the MSCI EAFE (USD).

Performance as of 1/31/24

Name	1-Year	3-Years	5-Years	Full Period
IHDG	14.7%	8.8%	12.2%	9.3%
MSCI EAFE (USD)	10.0%	4.6%	6.9%	4.2%
MSCI EAFE (Local)	12.1%	9.7%	8.9%	7.1%

Sources: WisdomTree, MSCI. Full period 5/7/14–1/31/24. Inception date for the WisdomTree International Hedged Quality Dividend Growth Fund (IHDG) was 5/7/14.

Past performance is not indicative of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted.

For the most recent month-end and standardized performances and to download the Fund prospectus, click [here](#).

Important Risks Related to this Article

There are risks associated with investing, including the possible loss of principal.

Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. To the extent the Fund invests a significant portion of its assets in the securities of companies of a single country or region, it is likely to be impacted by the events or conditions affecting that country or region. Dividends are not guaranteed and a company currently paying dividends may cease paying dividends at any time. Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations. Derivative investments can be volatile and these investments may be less liquid than other securities, and more sensitive to the effect of varied economic conditions. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. The Fund invests in the securities included in, or representative of, its Index regardless of their investment merit and the Fund does not attempt to outperform its Index or take defensive positions in declining markets. Due to the investment strategy of this Fund it may make higher capital gain distributions than other ETFs. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.

For the top 10 holdings of IHDG please visit the Fund's fund detail page at <https://www.wisdomtree.com/investments/etfs/equity/ihdg>

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

Related Blogs

+ [Bond Diversification Is Falling: Portfolio Implications](#)

Related Funds

+ [WisdomTree International Hedged Quality Dividend Growth Fund](#)

For more investing insights, check out our [Economic & Market Outlook](#)

View the online version of this article [here](#).

IMPORTANT INFORMATION

U.S. investors only: Click [here](#) to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an “as is” basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the “MSCI Parties”) expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only. You cannot invest directly in an index.

DEFINITIONS

Correlation: Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

S&P 500 Index: Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

EAFE: Refers to the geographical area that is made up of Europe, Australasia and the Far East.

Russell 2000 Index: Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

MSCI EAFE Index: is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.

Volatility: A measure of the dispersion of actual returns around a particular average level.

Foreign Exchange (FOREX, FX): The exchange of one currency for another, or the conversion of one currency into another currency.