

Why currency diversification matters

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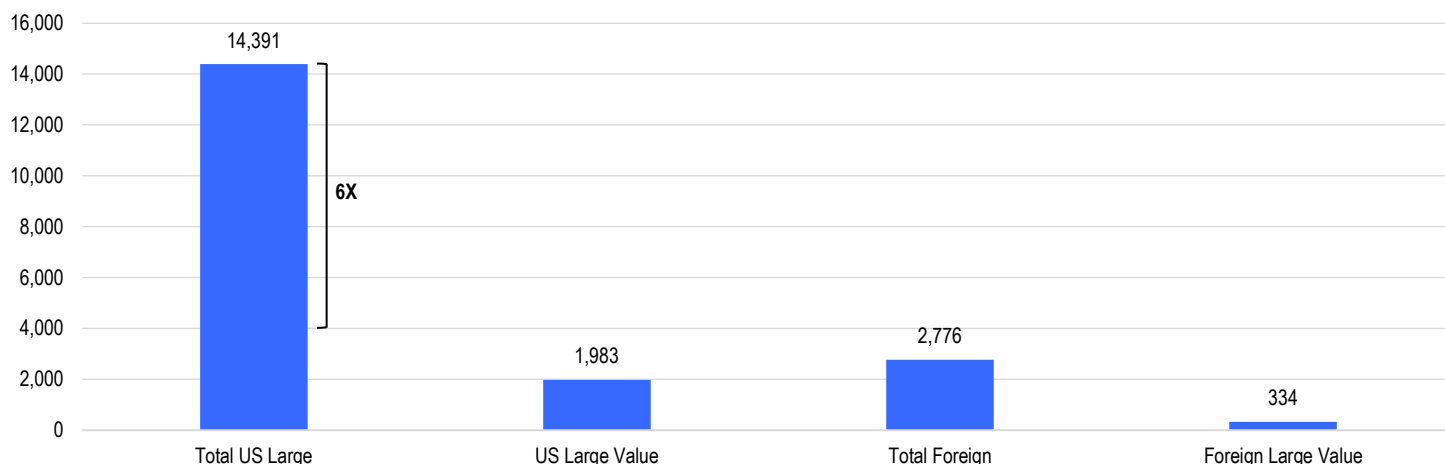
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Many US investors are overweight US equities, making them also overweight US-dollar exposure. Given recent international equity market outperformance versus US equities as well as a weakening greenback, could it be time to reconsider that asset mix? We think diversifying makes sense, particularly given the US-dollar headwinds from a potential increase in US debt-to-GDP (gross domestic product), lower interest rates, fading US exceptionalism and the strengthening of non-US economies such as Europe and Japan. These factors could reverse both the long-term strength of the US dollar and US outperformance trend, leaving behind the undiversified.

The US market: It's more concentrated than you think

It's no secret that US investors love US companies. In the United States, people have more than six times as much money invested in US names than in those domiciled overseas (Exhibit 1). As money has poured into large-capitalization companies, the S&P 500 Index has become increasingly concentrated in information technology companies, with the Magnificent Seven* big-tech names growing their share to a third of the overall index (Exhibit 2 on the next page). This concentration creates a lot of risk exposure to both the domestic business cycle and the US dollar (USD).

Exhibit 1: Investors Are Grossly Overweight US Large Cap... Assets by Morningstar Category (USD billions) as of June 30, 2025

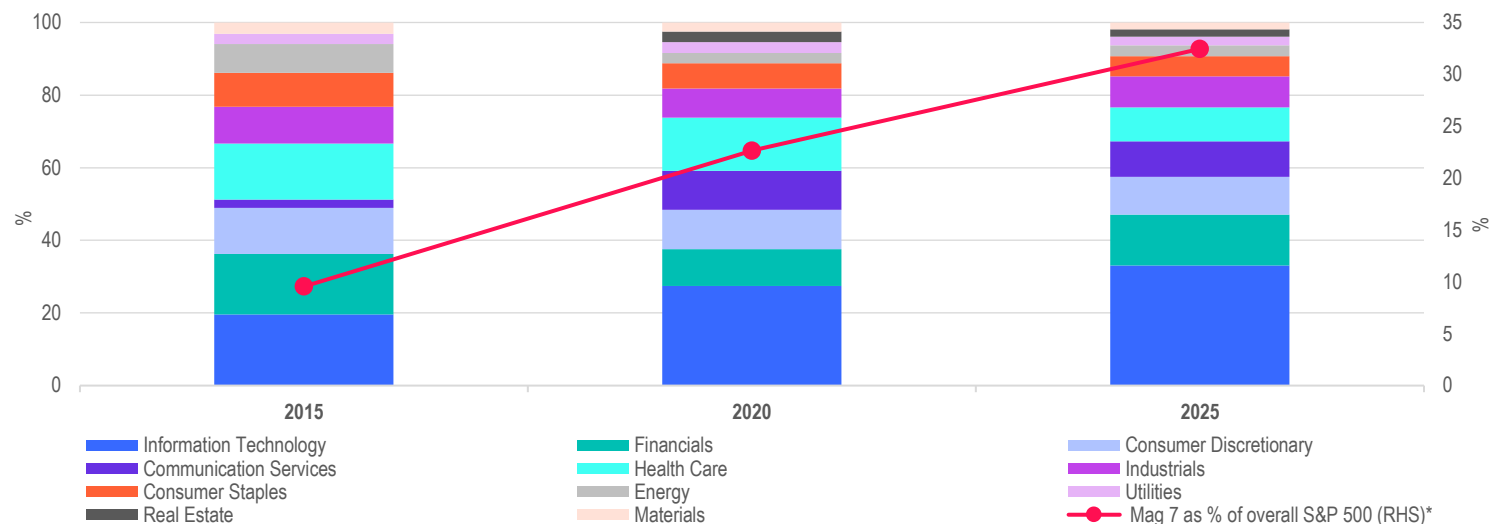


Source: Morningstar.

*The Magnificent Seven comprises Alphabet, Amazon, Apple, Meta, Microsoft, NVIDIA and Tesla.

Exhibit 2: ...And Increasingly Concentrated in Technology and Mag Seven Holdings

S&P 500 GICS Sector Weights. June 2015 vs. June 2020 vs. June 2025



Sources: FactSet, S&P Dow Jones Industries. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges.

Currency diversification casts a wider net for performance gains

In addition to country exposure, we believe diversifying by currency exposure is important. The greenback does not weaken in a vacuum and has an inverse relationship with other currencies, like the euro or Japanese yen—when the dollar weakens, the other currency strengthens. Owning something that is falling in value, while owning something else that is increasing in value, can smooth out the overall return of the portfolio over time.

Furthermore, equity returns have multiple components, including changes in asset price and underlying currency valuation. When the euro strengthens, for example, it can bolster euro-denominated equity prices. Diversifying away from US-based, dollar-denominated investments into non-US, local-currency investments not only can broaden country exposure but also help capture the currency component of total return.

As shown in Exhibit 3, when the dollar was stronger in 2024, currency effects reduced returns in non-US-dollar denominated markets. Year-to-date (YTD) 2025, a weakening US dollar has reversed that trend, giving non-US, local-currency returns a boost.

Exhibit 3: Local-Currency Returns Can Vary Widely from USD Returns

Total Performance by Region and Country as of July 31, 2025

Indexes	2024		YTD 2025	
	Local Currency Returns (%)	Converted to USD (%)	Local Currency Returns (%)	Converted to USD (%)
Regions				
US (S&P 500 Index)	-	25.0	-	8.6
MSCI AC World ex-US Index	13.2	6.1	11.4	18.0
MSCI EAFE Index	11.8	4.3	9.8	18.3
MSCI EMU (Eurozone) Index	10.3	3.4	14.7	26.7
MSCI Emerging Markets Index	13.7	8.1	14.9	17.9
Countries				
Japan	21.2	8.7	5.7	10.4
United Kingdom	9.5	7.5	13.8	20.3
France	1.8	-4.6	8.5	19.9
Canada	23.0	12.7	11.8	16.3
Germany	18.4	11.0	20.1	32.7
China	19.8	19.7	23.9	23.1
Taiwan	44.3	35.1	6.2	16.6
India	15.7	12.4	3.6	1.2
Brazil	-11.4	-29.5	10.7	20.6

Sources: FactSet, MSCI Indexes, S&P Dow Jones Industries. **Past performance is not an indicator or a guarantee of future performance.** Indexes are unmanaged and one cannot invest directly in an index. Important data provider notices and terms available at www.franklintempletondatasources.com.

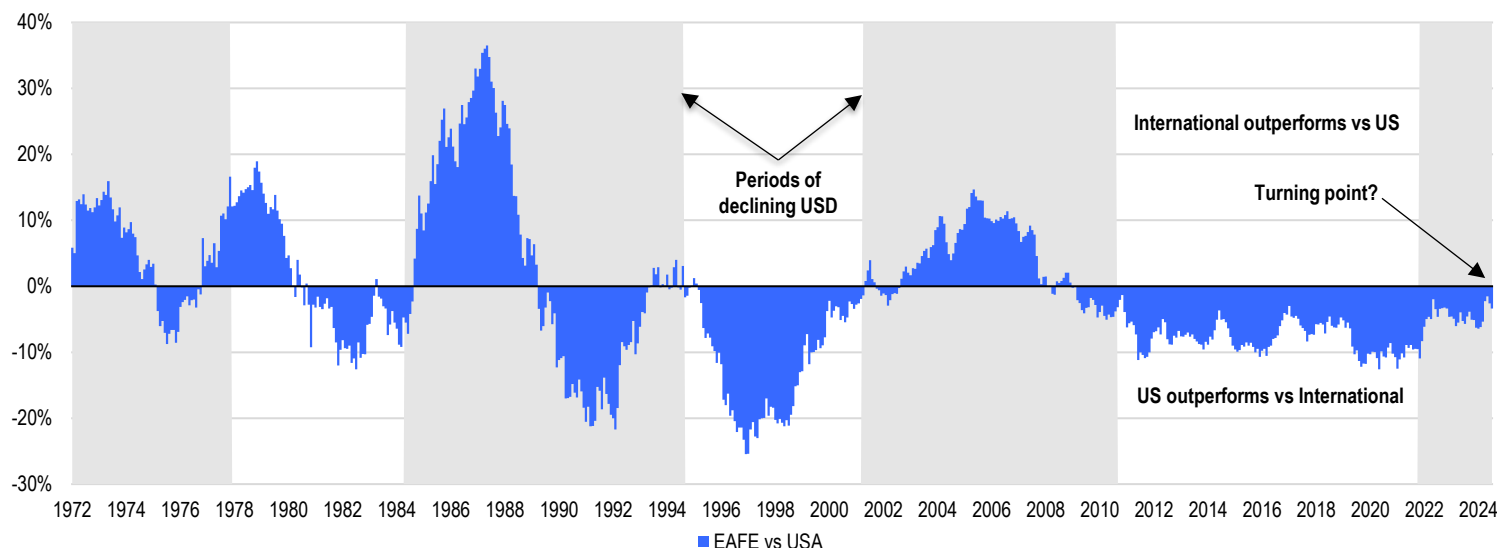
Our cyclicality, ourselves: US outperformance historically coincides with a strong US dollar

Whether or not you are bearish the US dollar, given its cyclicality, we think it is good to stay diversified regardless of the environment. US-dollar strength and related US equity market outperformance both tend to be cyclical, and top-performing equity markets are found across the globe. As shown in Exhibit 4, cycles of US equity outperformance come and go and have been closely related to periods of US-dollar strength. Because these cycles are difficult to predict, we believe maintaining global diversification is a prudent strategy. In our opinion, rather than trying to time currency or market movements, investors may benefit from maintaining broad positioning across countries and currencies.

Exhibit 4: US Underperformance Can Coincide with US-Dollar Weakness

MSCI EAFE Index vs. MSCI USA Index

Three-Year Rolling Excess Returns Annualized Returns for Periods Ending June 30, 2025



Sources: FactSet, MSCI. Returns in base currency. Gray shaded areas indicated periods of weakening USD. **Past performance is not an indicator or a guarantee of future performance.** Indexes are unmanaged and one cannot invest directly in an index. Important data provider notices and terms available at www.franklintempletondatasources.com.

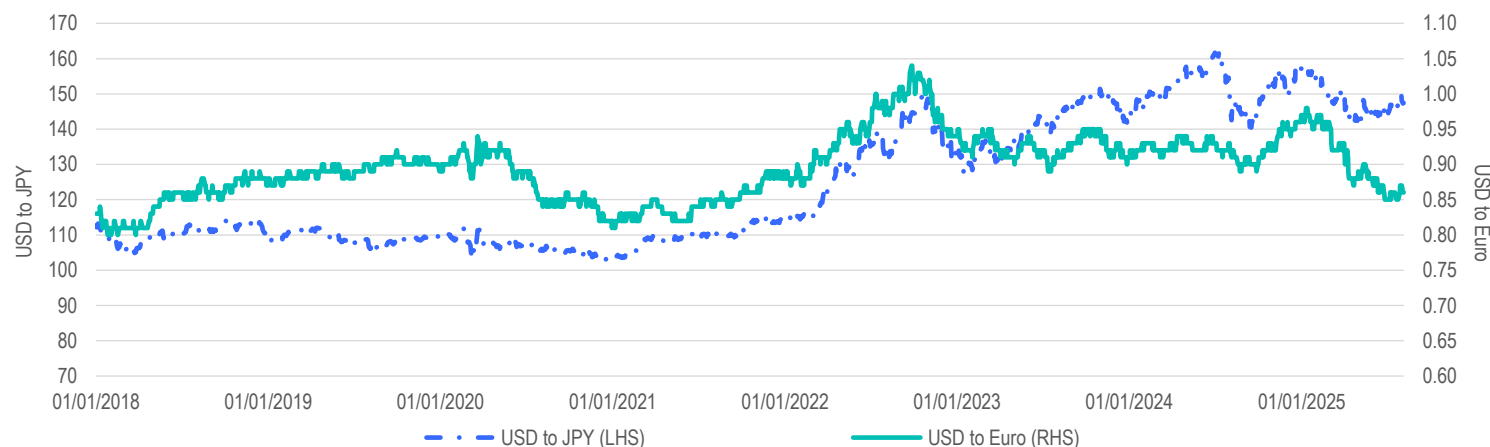
A "weaken"ings: sources of downward pressure for the US dollar

A sense of US exceptionalism, and possibly recency bias, has convinced some investors that the last decade of US-dollar strength can continue indefinitely. However, we believe the environment is changing. The US dollar has weakened versus the euro and yen for much of 2025 (Exhibit 5). Capital flows into the United States have been slowing, and demand for US dollars has fallen due to rising debt levels, the possibility for lower interest rates and a more unpredictable business and regulatory environment.

Exhibit 5: The US Dollar Has Weakened Versus Other Major Currencies YTD

USD/JPY and USD/EUR Exchange Rates

January 1, 2018–May 8, 2025



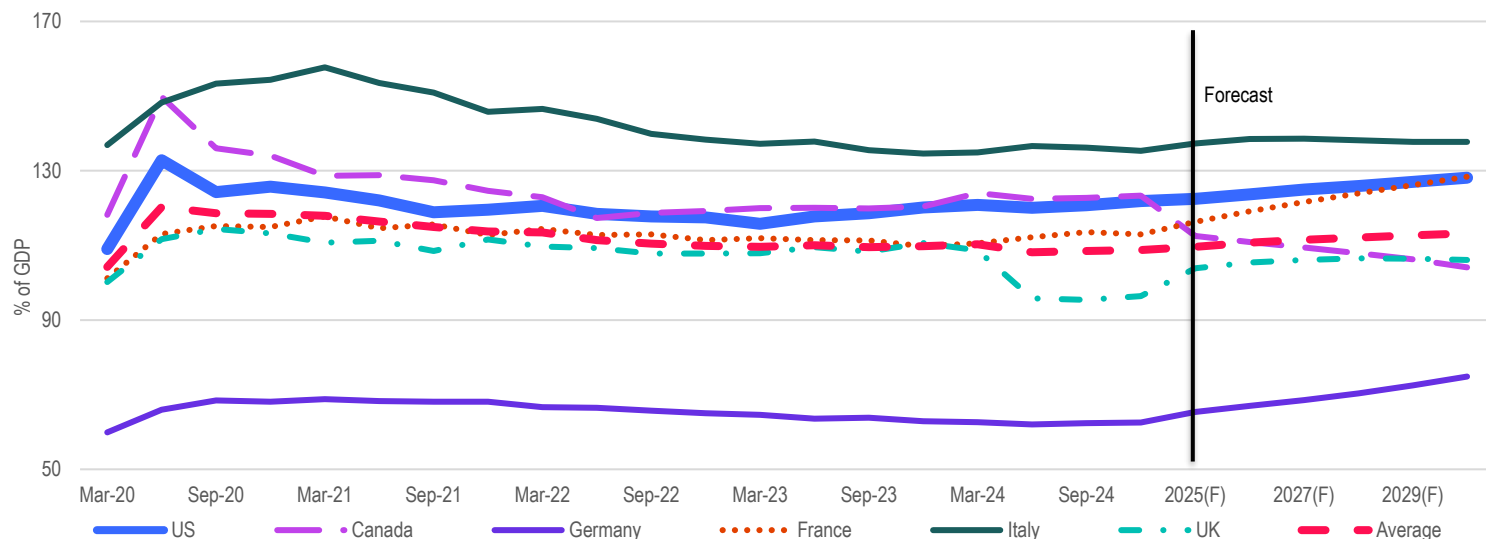
Source: FactSet. **Past performance is not an indicator or guarantee of future results.**

Most people understand debt-to-income ratios and how a higher ratio can negatively impact one's credit score. For countries, the equivalent measure is the debt-to-GDP ratio, which reflects national debt relative to economic output. The recent US tax bill includes several provisions which analysts expect to increase US debt-to-GDP. As shown in Exhibit 6, the United States has a higher-than-average debt ratio when compared to other major North American and European economies, and it is projected to increase. As it rises as a percentage of GDP, it signals increased risk, potentially making US debt less attractive to investors.

Exhibit 6: The US National Debt Burden Is Growing

Major Economies' Government Debt as a Percentage of GDP

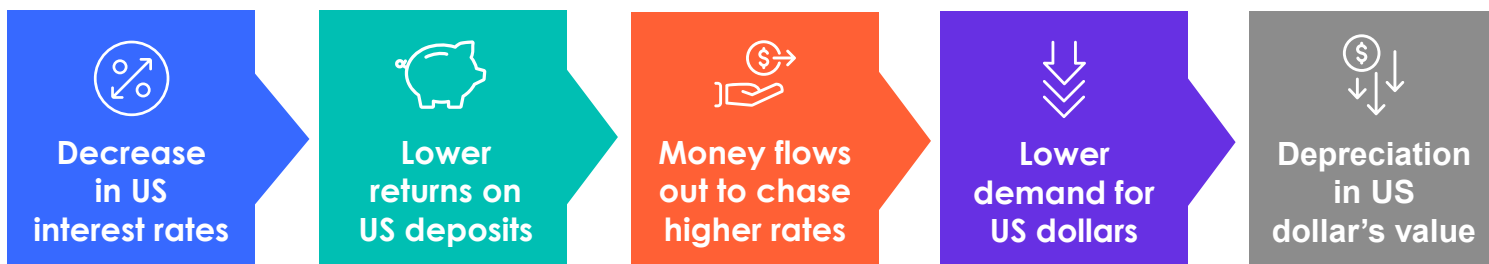
March 2020 to 2030 Forecast



Sources: FactSet, Federal Reserve, US Bureau of Economic Analysis, US Department of the Treasury, Statistics Canada, Deutsche Bundesbank, Statistics France, Eurostat, Office for National Statistics UK. There is no assurance that any estimate, forecast or projection will be realized.

Lower interest rates could also curb demand for the US dollar. Investors generally favor higher rates when investing in cash and debt instruments. If US rates fall below levels that are competitive, it could mean fewer capital inflows and further weakness (Exhibit 7).

Exhibit 7: Lower Interest Rates Can Lead to US-Dollar Weakness



For illustrative purposes only.

In addition to a strong fiscal position, US markets have long benefited from a stable regulatory environment, strong global relationships and robust trading alliances. However, if the United States becomes a less predictable global trading partner, it is possible that demand for US dollars will fall as countries do more trading in other currencies. As participation in global trade falls, the current administration may continue policies aimed at weakening the US dollar in an effort to make US exports more desirable. Furthermore, less faith in both US regulatory institutions and markets could also cut capital inflows. All these factors, either alone or in concert, could put pressure on the US dollar.

Meanwhile, other regions around the world are making efforts to improve their appeal. In Japan, the Tokyo Stock Exchange has been trying to make Japanese companies more investable, which can draw capital and increase demand for the yen. Efforts to increase competitiveness and boost spending on infrastructure and defense in Europe could lead to greater economic growth, further stock price appreciation and a stronger euro.

Currency Diversification to Mitigate US-Dollar Risk

Home-country bias, while it has worked well for US investors in past years, may not always lead to outsized returns. Markets are cyclical, and it is impossible to know when the trend will reverse. Rising US debt loads, lower interest rates, decreased enthusiasm about the United States as an economic partner, and the rising financial strength of other nations could keep downward pressure on the US dollar, in our opinion. Regardless of how the cycle plays out, we believe country and currency diversification are sound ways to mitigate risk should the US dollar continue to fall.

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Index Definitions

Past performance is not an indicator or a guarantee of future performance. Indexes are unmanaged and one cannot invest directly in an index. Important data provider notices and terms available at www.franklintempletondatasources.com.

1. The **Standard & Poor's® 500 Index (S&P 500®)** is a market capitalization-weighted index of 500 stocks designed to measure total US equity market performance.
2. The **MSCI ACWI ex US Index** represents the performance of large and mid-cap stocks across all developed and emerging markets, excluding those in the United States.
3. The **MSCI EAFE Index** is an equity index which captures large and mid cap representation across 21 developed markets countries around the world, excluding the US and Canada.
4. The **MSCI EMU Index** (European Economic and Monetary Union) captures large and mid cap representation across Eurozone.
5. The **MSCI EM Index** is a free float-adjusted, market capitalization-weighted index designed to measure the equity market performance of global emerging markets.
6. The **MSCI USA Index** is designed to measure the performance of the large and mid cap segments of the US market.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal.

Equity securities are subject to price fluctuation and possible loss of principal.

Large-capitalization companies may fall out of favor with investors based on market and economic conditions.

Fixed income securities involve interest rate, credit, inflation and reinvestment risks, and possible loss of principal. As interest rates rise, the value of fixed income securities falls.

Currency management strategies could result in losses if currencies do not perform as expected.

International investments are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in **emerging markets**.

Diversification does not guarantee a profit or protect against a loss.

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