Weekly round up (Week 19)

Markets remain in “risk-on” mode, but the recent weakness of the U.S. dollar is prompting investors to re-examine its role in the global system. This week, we look back at the history of the dollar to better understand what might lie ahead.

May is continuing the momentum that began in April, with price movements that continue to favor risky assets. Our preferred sentiment indicator, the VIX, continues its gradual decline, signaling a steady return of investor confidence. U.S. Treasury yields have remained relatively stable, trading within a narrow range, as strong economic data and weak signs of inflation spilling over into the labor market offset one another. Conversely, European sovereign debt continues to slightly outperform, with yield curves flattening in a “bull flattening” trend, against a backdrop of weak economic data and a still-fragile ceasefire in the Middle East, prompting investors to scale back their most pessimistic expectations regarding central bank monetary tightening.

Regarding the peace process, progress continues along the familiar pattern of two steps forward, one step back. Last week marked a step forward following the announcement that the United States and Iran were on the verge of agreeing to a one-page memorandum of understanding that could end the war and establish a framework for more detailed nuclear negotiations. The reported provisions include a moratorium on Iranian nuclear enrichment, with the United States lifting sanctions in return and unfreezing billions of dollars in Iranian funds, while both sides would ease restrictions around the Strait of Hormuz. The White House indicated that it believes a formal agreement is now within reach.

Corporate credit spreads continue to narrow gradually, supported by steady investment flows, a return of risk appetite, and a strong earnings season. With more than 80% of S&P 500 companies having now reported earnings, the positive earnings per share (EPS) surprise rate stands at 84%, well above the five-year average of 78%, while annual EPS growth is expected to reach 28%, its highest level since Q4 2021. High-yield bonds continue to outperform investment-grade bonds across all regions, with European high-yield being the best-performing credit segment since the start of the month.

Oil prices have pulled back from their highs, with Brent briefly dipping below $100 per barrel, in line with positive developments on the geopolitical front. Metals rebounded this week, with copper leading the gains among industrial metals and silver outperforming among precious metals, up nearly 8% since the start of the month. The London Metal Exchange index returned to its all-time high.

Stocks continued to rise, with technology remaining the dominant theme. The Philadelphia Semiconductor Index extended its rally by an additional 6%. Meanwhile, Asian markets—despite a shortened week due to holidays—displayed strong FOMO (Fear Of Missing Out) momentum: the Nikkei is up more than 5% for the month and South Korea's KOSPI has gained over 10%, as investors sought to avoid being left out.

The U.S. dollar generally appreciated in March at the start of the conflict in the Middle East, in line with its status as a safe-haven asset and the rapid rise in oil prices—a trend reinforced by the fact that this commodity is priced in dollars. Since April, however, this trend has reversed, and the movement continued into May.

The dollar's short-term weakness can be explained in part by several converging factors: improved market sentiment reducing the urgency to hold dollars as a safe haven; falling energy prices; and shifts in interest rate differentials unfavorable to the U.S. dollar, as the Federal Reserve appears significantly less willing to tighten monetary policy than its Western counterparts. This trend was reinforced last week when the Reserve Bank of Australia raised its policy rate by 25 basis points to 4.35%, marking its third consecutive hike and effectively reversing the three rate cuts implemented the previous year.

For medium-term investors, however, the most important question is whether this marks a resumption of the broader structural downtrend in the dollar that began in 2025 and was only temporarily interrupted by the outbreak of the conflict in the Middle East.

With more than 150 national currencies in circulation, the global economy needs a reliable unit of account and settlement asset so that countries can trade even when they do not trust their respective currencies. Since the end of World War II, the U.S. dollar has fulfilled this role.

The rise of the U.S. dollar was no accident. The United States emerged from World War II as the world's leading economic and military power; under what was called the "Pax Americana," it built an international order based on free trade, capital flows, and Western political values. Within this order, the United States served as the primary provider of security, liquidity, and financial stability. The institutional pillar of this structure was the 1944 Bretton Woods Agreement, which pegged the dollar to gold at a fixed rate, linked other member currencies to the dollar, and allowed foreign governments to exchange their dollar reserves for gold bullion.*

However, this system had a structural weakness from the outset. As global trade expanded, the world needed ever more dollars, and the United States eventually issued far more than its gold reserves could back. The imbalance gradually became unsustainable.

In 1971, President Nixon ended the dollar's convertibility into gold in what became known as the "Nixon Shock," and in 1973 the system of fixed exchange rates collapsed entirely, leaving major currencies to float freely against one another.

Deprived of its gold backing, the dollar found a new foundation in oil. In 1974, Treasury Secretary William Simon conducted secret negotiations with Saudi Arabia—discretion imposed by Riyadh's political sensitivity regarding a visible alliance with Washington given U.S. support for Israel—which led to a historic agreement. Saudi Arabia would agree to sell its oil exclusively in U.S. dollars, guarantee an uninterrupted supply to the United States (then its main customer), and reinvest the resulting revenues—the famous "petrodollars"—in U.S. Treasury bonds. In exchange, Washington would offer military protection and security guarantees, particularly for the defense of vital sea lanes through the Strait of Hormuz.

The two historical drivers of demand for dollars and U.S. Treasury bonds may now be losing importance. At the same time, investors are observing the U.S. government's reliance on budget deficits and cheap financing, a privilege directly linked to the dollar's status as the global reserve currency. The United States has recorded a budget deficit every year since 2002, with an average deficit of 5.2% of GDP over that period, with no credible path to fiscal consolidation in sight.[5]

A potential new source of structural demand could come from dollar-backed stablecoins, such as USDT (Tether) and USDC (USD Coin), which are required to hold U.S. Treasury bonds or cash equivalents in reserve for every token issued. Tether already holds more U.S. Treasury bills than many sovereign states, and U.S. legislation through the GENIUS Act has formalized stablecoins as a new category of structural buyers of U.S. debt by requiring full backing with short-term government securities.

However, this thesis currently has limitations. Demand linked to stablecoins remains low relative to the trillions of dollars in annual U.S. Treasury issuance. It is concentrated on short-term debt—rather than long-term debt, where U.S. funding pressures are strongest—and ultimately depends on sustained confidence in the United States itself.

All of this means that the trajectory of the U.S. dollar will increasingly depend on the underlying health of the U.S. economy and the confidence investors place in the administration leading it—making economic fundamentals, political credibility, and fiscal discipline the key drivers going forward.

The U.S. dollar will nevertheless retain its status as the global reserve currency, for lack of a credible alternative. The depth and liquidity of U.S. capital markets remain unmatched, the use of the dollar in global trade remains deeply entrenched, and the U.S. legal and institutional framework has no equivalent. However, its share of global reserves will likely shift in response to changes in trade dynamics and the formation of new regional alliances.

For investors, the U.S. dollar should increasingly be viewed as a currency moving toward its fundamental fair value. For policymakers, fiscal discipline and policy credibility are paramount.