

Insights Unwrapped

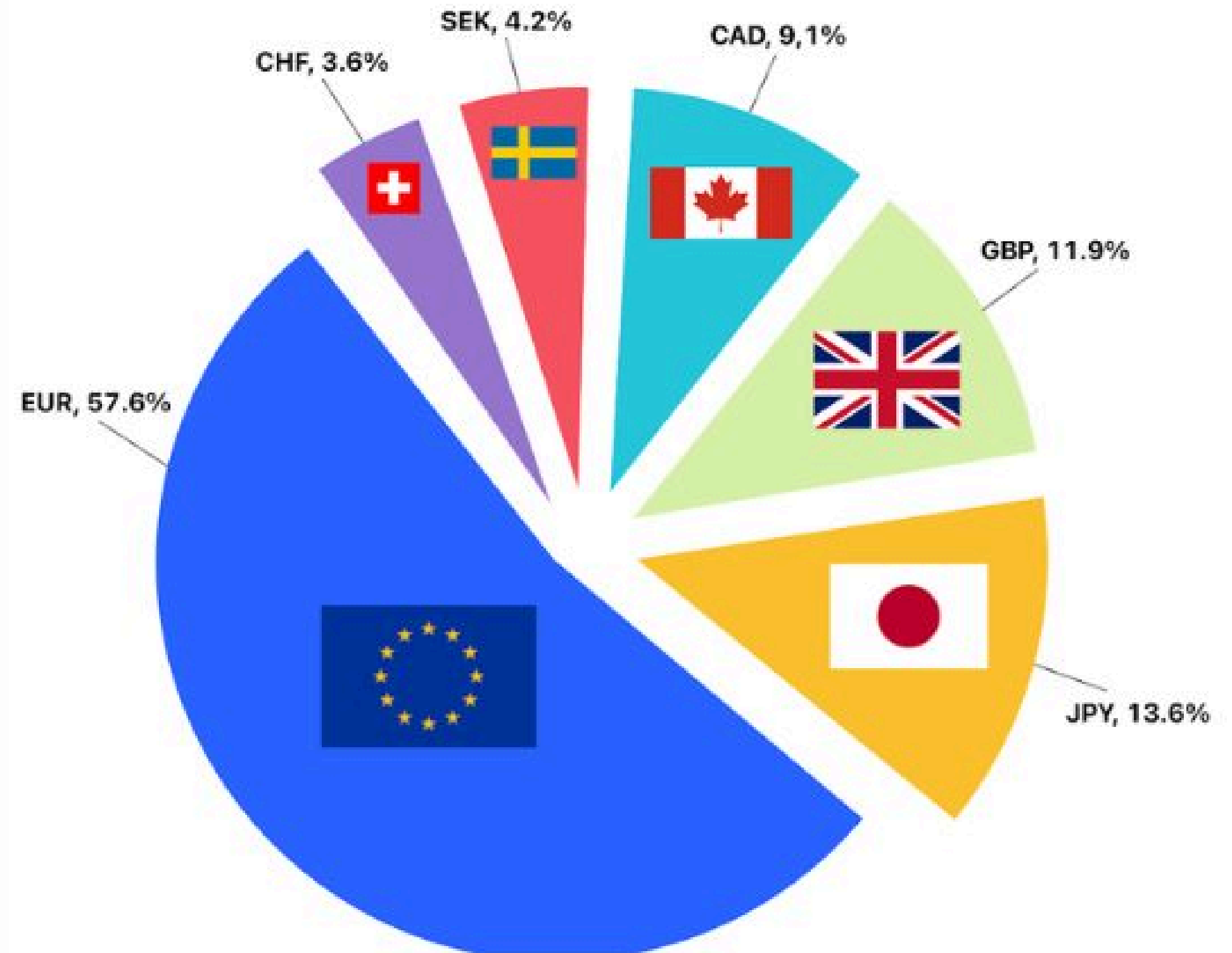
Impact of Dollar Index (DXY) on Sensex Returns

Implication of US Dollar Index (DXY)

- As the "invoicing" currency of the world, when the U.S. dollar appreciates, other currencies essentially depreciate.
- A strong dollar can make US exports more expensive, potentially impacting the profitability of multinational companies. It can also reduce the value of foreign investments denominated in US dollars. Conversely, a weak dollar can boost US exports and increase the value of foreign investments.
- International assets, including emerging market (EM) and Asian fixed income and equities, have historically benefited from a weaker USD.

Composition of US Dollar Index (DXY)

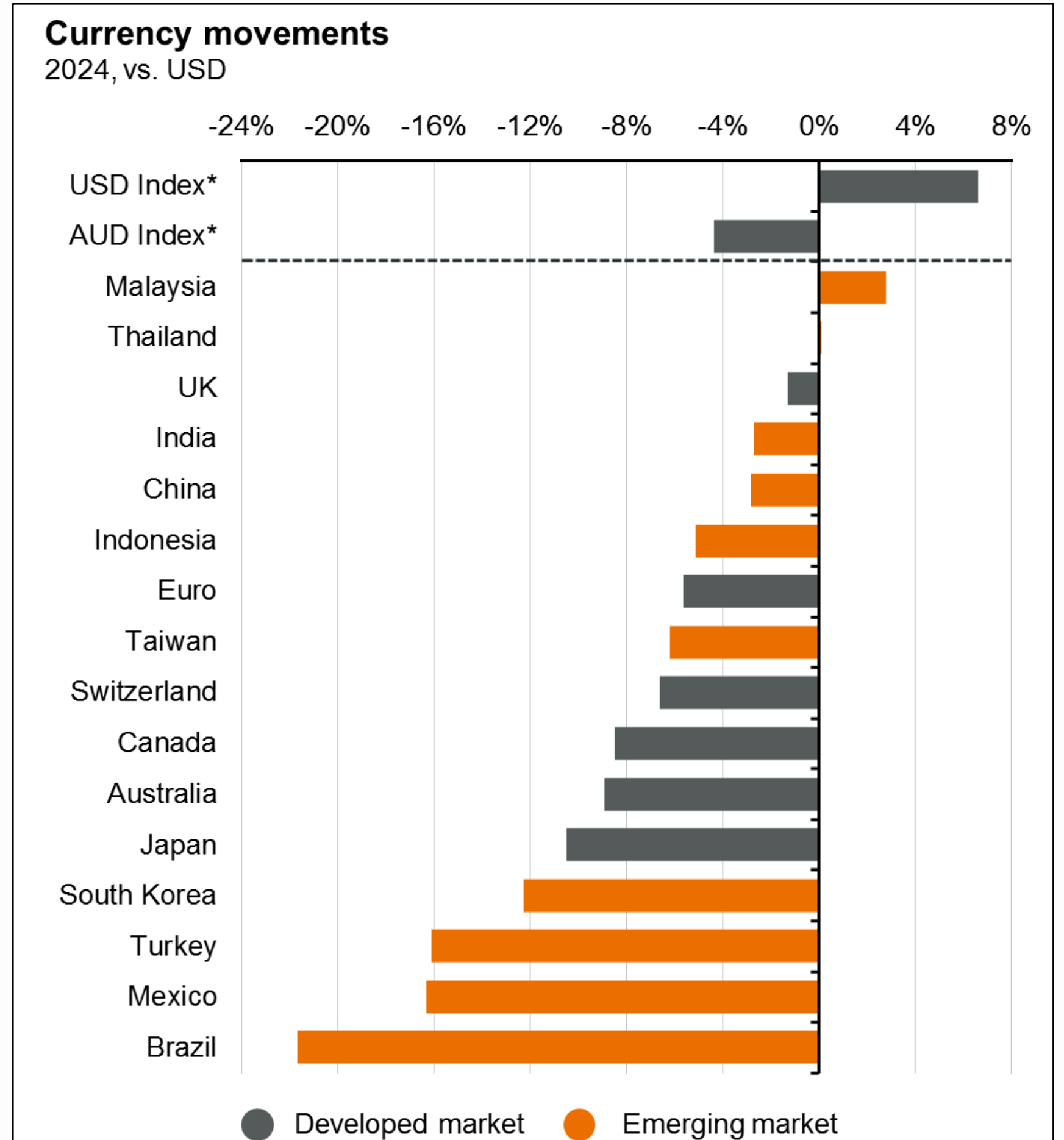
The US Dollar Index is a measure of the value of the United States Dollar (USD) relative to a basket of foreign currencies: **Euro (57.6% weight)**, **Japanese Yen (13.6%)**, **British Pound (11.9%)**, **Canadian Dollar (9.1%)**, **Swedish Krona (4.2%)** and **Swiss Franc (3.6%)**.



Why Indian Rupee (INR) did not depreciate in 2024 to align with other currencies?

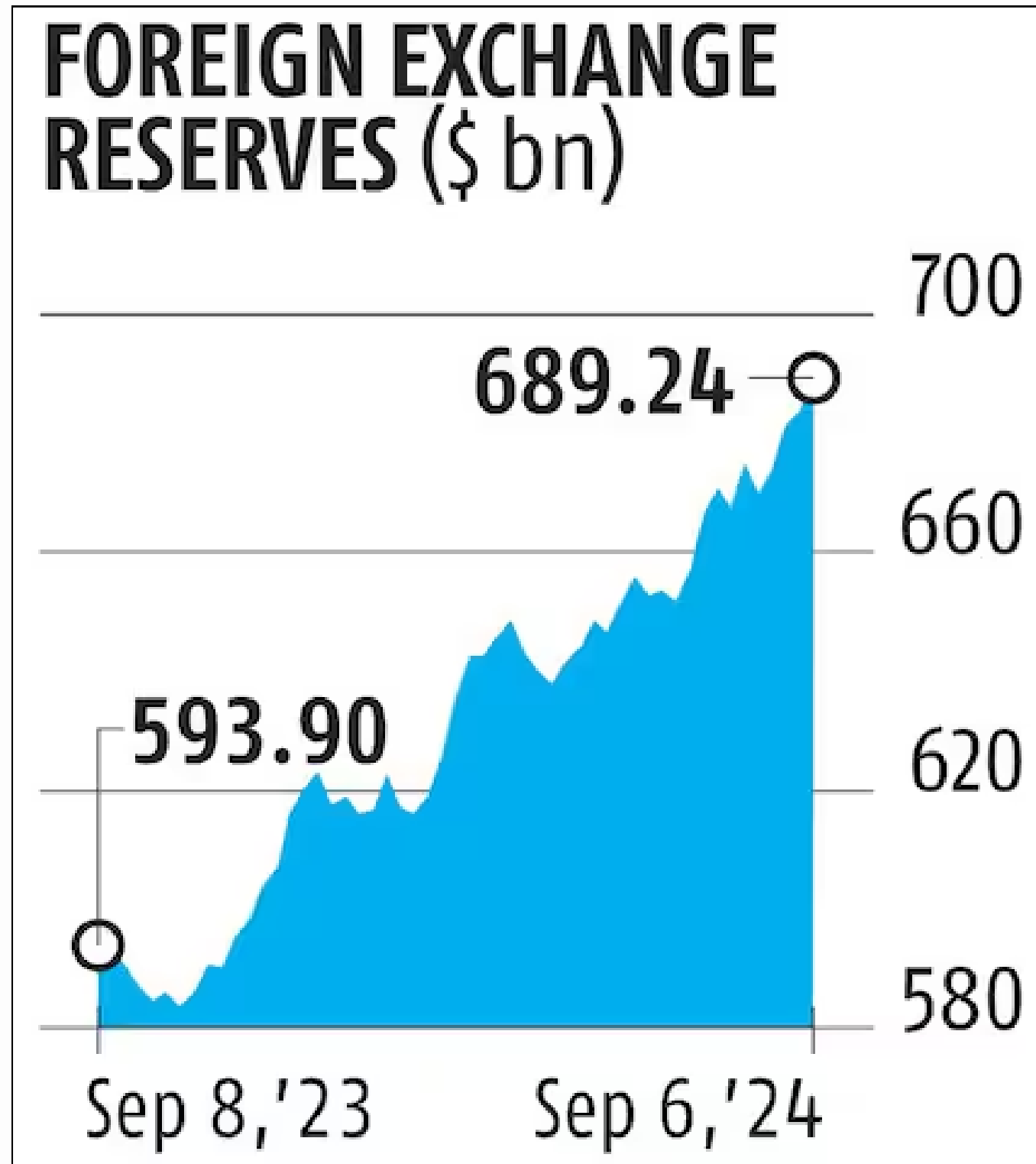
Since late 2022, the RBI has tried to intervene by controlling the rupee's exchange rate with the dollar. This brought stability via a rapid buildup of foreign exchange reserves, which rose by more than USD180bn in the two years to October'24. (Forex reserve source: Investing.com)

However, it also left the rupee overvalued against other trading partners, many of which allowed their currencies to adjust more fully.



Source: FactSet, J.P. Morgan Asset Management; (Left) Reserve Bank of Australia; (Right) OECD.
 *USD and AUD Index shows performance vs. a basket of trading partners. **DM is developed markets and the yield is a GDP-weighted average of the 10-year government bond yields of Australia, Canada, France, Germany, Italy, Japan, Switzerland and the UK. Past performance is not a reliable indicator of current and future results.
 Guide to the Markets – Australia. Data as of 31 December 2024.

India's Forex Reserves and RBI Interventions



- India's forex reserves, amounting to \$635 billion (*as of 10th Jan'25*), are substantial but sustained RBI intervention is not a viable long-term strategy.
- Since late 2022, the RBI has sought to curb currency volatility by managing the rupee's exchange rate against the dollar.
- However, this has resulted in the rupee being overvalued compared to other countries, many of which permitted greater adjustments in their currencies.

Significant US Dollar (DXY) rally since 2001

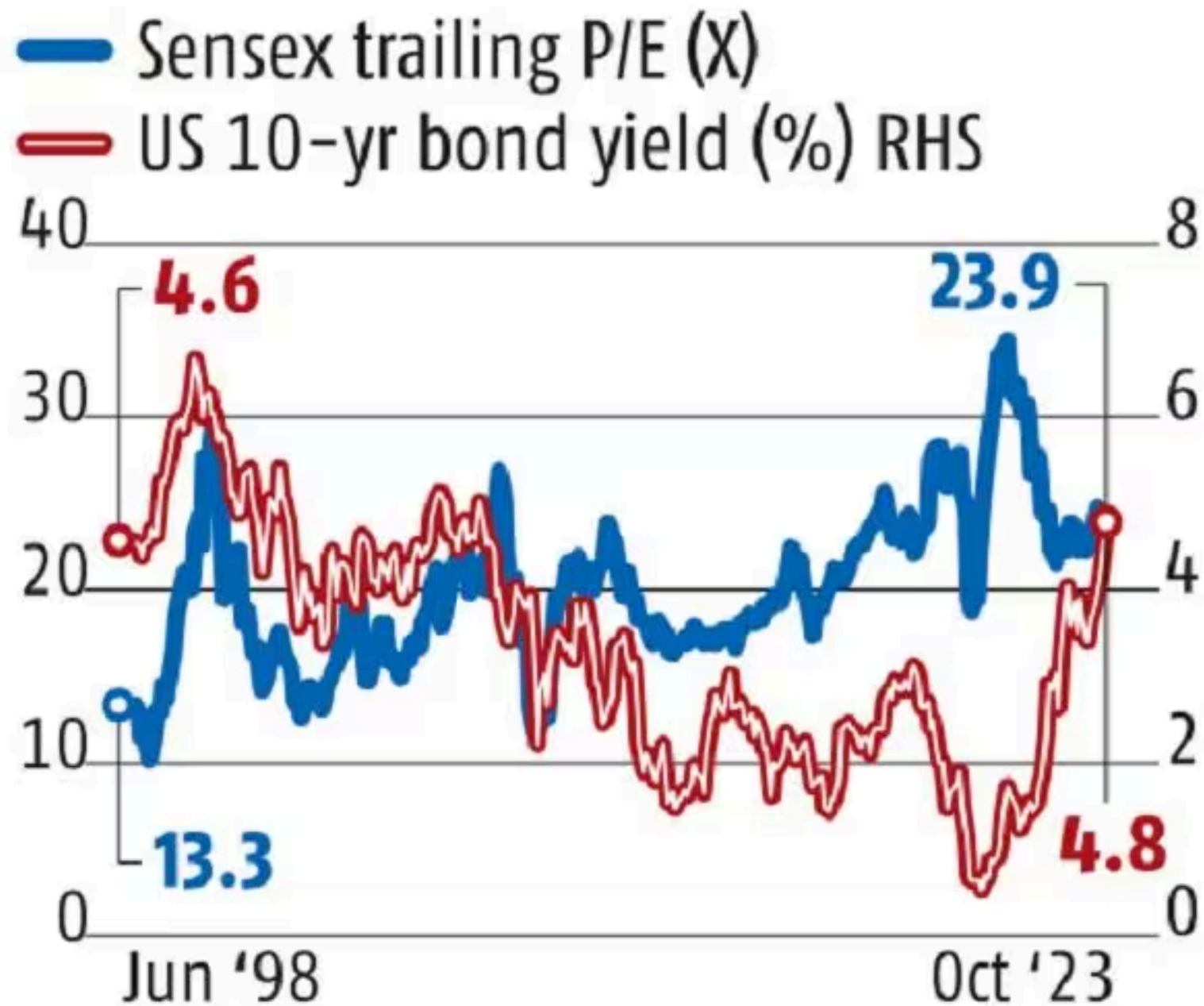
Duration	Time Range	US Dollar Index (DXY)			Sensex		USD/INR			Bond Yields		
		Trough	Peak	DXY Change %	Sensex Returns (%)	Sensex Returns in next 12 months (%)	Begin	End	Rupee Depreciation during this phase (%)	US - 10 Yr Bond Yield (%)	India - 10 Yr Bond Yield (%)	Yield Spread* (%)
Dec-04	Nov-05	80.9	91.6	13%	33%	56%	43.3	45.9	-5.6%	4.5%	7.1%	2.6%
Apr-08	Nov-08	72.5	86.5	19%	-47%	86%	40.4	49.6	-18.5%	2.9%	7.1%	4.2%
Nov-09	May-10	74.9	86.6	16%	0%	9%	46.5	46.4	0.2%	3.3%	7.6%	4.3%
Apr-11	May-12	72.9	83.0	14%	-15%	22%	44.3	56.2	-21.2%	1.6%	8.4%	6.8%
Jun-14	Mar-15	79.8	98.4	23%	10%	-9%	60.0	62.5	-4.0%	1.9%	7.7%	5.8%
Sep-16	Dec-16	95.5	102.4	7%	-4%	28%	66.8	67.9	-1.6%	2.4%	6.5%	4.1%
May-21	Sep-22	89.8	112.1	25%	11%	15%	72.4	81.5	-11.2%	3.8%	7.4%	3.6%
Sep-24	Jan-25	100.8	109.6	9%	-9%		83.7	86.5	-3.2%	4.8%	6.9%	2.2%
AVERAGE	9 months			17%	-2%	29%			-9%			3.9%

* Yield Spread: Interest rate Differential for India 10 Year Vs US 10-Yr yield

Source: RBI, Koyfin, WSJ

Whenever the yield spread falls below the average mean (i.e., when U.S. yields rise), the dollar strengthens, resulting in a sharp increase in the DXY. Consequently, the INR is likely to depreciate, triggering a flight of capital to risk-free asset classes.

DECLINING TRAJECTORY



Source: *Bloomberg*, BSE

Compiled by *BS Research Bureau*

It is common for rising bond yields in the U.S. to trigger a flight of capital from riskier assets, including those in emerging economies, which can result in a contraction of P/E multiples.

Currently, Nifty P/E forward is 21.5x (from the peak of 24.4x in Sept'24).

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TRUDENCE CAPITAL ADVISORS PRIVATE LIMITED

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Registration No.: INH000015747 **CIN:** U73200MH2024PTC417356

Registered office Address: FLT NO 63 1 F CTS NO. 168, KALPATARU, AURA BLDG, LBS MARG OPP R CITY MALL, MUMBAI, MAHARASHTRA, 400086

Contact No: 8224900841 **Email Id:** nitin@iiinsight.com

Compliance Officer: Nitin Mangal **Contact No:** 8224900841 **Email Id:** nitin@iiinsight.com

Grievance Officer: Nitin Mangal **Contact No:** 8224900841

Email ID: nitin@iiinsight.com

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