DoubleLine Views on the Dollar

Bill Campbell and Chris Stegemann | February 2023

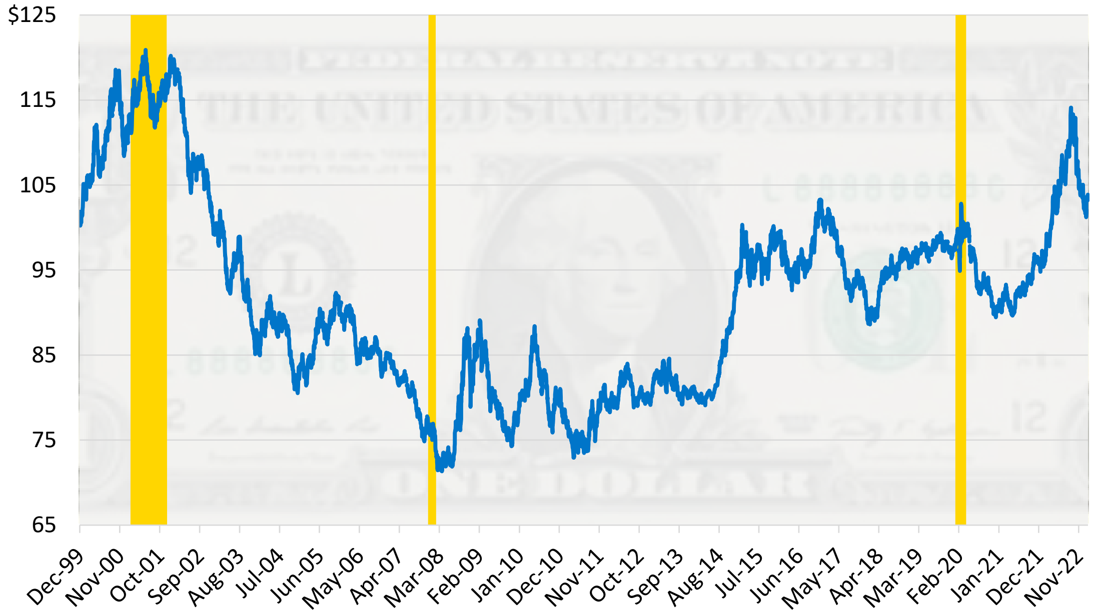

Figure 1
Source: DoubleLine, Bloomberg. US Dollar spot price as of February 15, 2023. Yellow shaded areas indicate recessionary periods.

Key Takeaways

- DoubleLine believes the U.S. dollar peaked in September 2022.
- While we see the disinflation trend continuing, inflation surprises or a flight-to-quality move could cause dollar strength in the near term.
  - DoubleLine would view any near-term strength in the dollar as an entry point to add to a short dollar position via emerging markets (EM) hard currency, EM local currency, non-dollar developed market bonds or foreign exchange (fx) forwards.
- DoubleLine believes the dollar will decline over the medium term.

Near Term

DoubleLine believes the dollar peaked in September 2022 but may exhibit a volatile and choppy range in the coming months.[1] *(Figure 1)* A major factor underpinning this view is our belief that inflation has similarly peaked for this cycle, bringing into view the end to the Federal Reserve's tightening cycle. While we see this disinflation trend continuing, the market's expectations for the terminal federal funds rate (FFR) are likely to continue to fluctuate, especially in response to any near-term inflation surprises and persistently tight labor market conditions. Tighter-than-expected monetary policy would be dollar positive in the near term. Additionally, the risk of slowing growth or recession would likely cause the dollar to temporarily rise in a flight-to-safety move. If either of these scenarios result in near-term dollar strength, we would view it as an entry point to add to a short dollar position.

Inflation also remains elevated across Europe, which has kept the European Central Bank (ECB) and, to a lesser extent, the Bank of England on hawkish policy paths that will likely keep the dollar from appreciating significantly in the near term. The market currently expects the Fed to hike interest rates another 25 basis points (bps) at both its March and May meetings while the ECB deposit rate is expected to be 100 bps higher by this summer.[2]

Views and opinions expressed herein are those of the investment team and do not necessarily reflect the views of DoubleLine Capital LP, its affiliate or employees.

[1] U.S. dollar as measured by the U.S. Dollar Index.
[2] Source: Bloomberg, World Interest Rate Probability Function

Medium Term

Potential factors that could lead to dollar weakness over the medium term include:

- **The Fed Easing Monetary Policy More Than the Market Expects:** Market participants expect the Fed to reach a terminal FFR of approximately 5.25% in 2023. The Fed has committed to keeping policy restrictive to combat elevated inflation in the near term, but cuts to the FFR in the medium term could occur either because growth materially slows or inflation recedes to the Fed's target for price stability. In either scenario, the likely end result of a Fed easing cycle, beyond what is already priced in, will cause dollar weakness.

- **Large Current Account/Trade Deficit:** The U.S. current account deficit and net international investment position (NIIP) are of particular importance to the dollar. *(Figure 2)* All else equal, by running a significant current account deficit, the U.S. imports far more than it exports. To make up for that deficit and limit dollar depreciation, the U.S. needs to attract foreign savings each year in the amount of, or more than, the imports. The U.S. has been accomplishing this by drawing significant portfolio and direct investment, largely due to an attractive growth rate.

- **Net International Investment Position:** While the current account shows recent flows, which could loosely be considered the country's income statement, the NIIP shows the stock, which could loosely be seen as a country's balance sheet. Our expectation is for the U.S. growth rate to come down. If portfolio investment continues to flatten as it did in 2022, this would be enough, in our opinion, to have a significant negative impact on the dollar in the medium term. *(Figures 3 and 4)* The decrease in both U.S. assets and liabilities reflected in 2022 data represents both price declines in portfolio and direct investment assets, and negative net financial transactions. Portfolio investment assets decreased $920.0 billion to $12.86 trillion in the third quarter of 2022, driven mainly by declines in foreign stock prices and depreciation of major currencies against the dollar that lowered the market value of these assets in dollar terms.[3] Direct investment assets decreased $639.3 billion to $8.38 trillion in the quarter, also driven by declines in foreign stock prices and depreciation of major currencies against the dollar that lowered the market value of these assets in dollar terms. We believe if portfolio and direct investment were to decline in a more dramatic manner, in addition to the price decreases, it would put negative pressure on the dollar.

[3] Source: U.S. Bureau of Economic Analysis. Fourth quarter 2022 data will be made available on March 29, 2023.

U.S. Net International Investment Position | As of Dec 31, 2022

Figure 2
Source: DoubleLine, U.S. Bureau of Economic Analysis. Not seasonally adjusted.

U.S. Assets by Category | As of Dec. 31, 2022

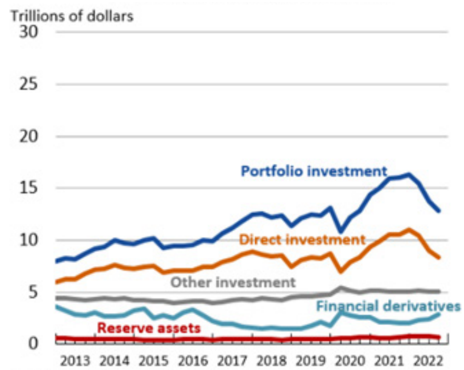

Figure 3
Source: U.S. Bureau of Economic Analysis. Not seasonally adjusted.

U.S. Liabilities by Category | As of Dec. 31, 2022

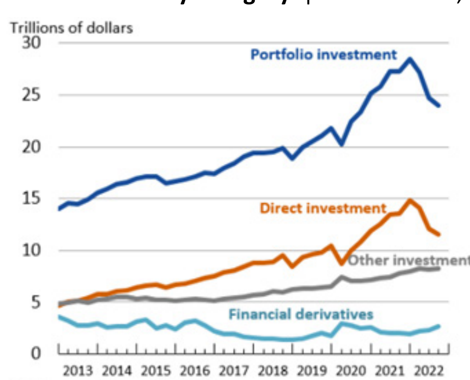

Figure 4
Source: U.S. Bureau of Economic Analysis. Not seasonally adjusted.

- **Cheaper International Valuations**: International equity market valuations are lower compared to U.S. market valuation. An example of this is the difference in the cyclically adjusted price-to-earnings (CAPE®) ratios between the U.S. and Europe. *(Figure 5)* Also, local yields now offer yield levels that have not been seen since the early 2000s. *(Figure 6)* Cheaper valuations and more-attractive yield levels in many areas outside of the U.S. could cause investor appetite for U.S. investments to fade relative to the past decade.

- **High Hedging Costs for International Investors**: International investors increased their holdings of U.S. securities over the past few decades, during a period in which low-interest-rate policy led to lower fx hedging costs. With the rise in central bank policy rates over the past year to combat high inflation, hedging costs have increased substantially for many international investors, especially in Japan and Europe. This creates a significant headwind to U.S. portfolio investment from international investors.

- **Lower Medium-Term U.S. Growth Rates**: Market expectations are for lower medium-term U.S. growth rates, which would be dollar negative.

- **Fiscal Deficit Spending**: DoubleLine expects a ramp-up in the fiscal deficit, especially in the next recession. The federal budget deficit was estimated to be $459 billion in the first four months of fiscal year 2023, which is $200 billion wider than the same period last year. If the economy were to enter a recession, the budget deficit would materially widen due to lower tax receipts and increased automatic unemployment insurance payments. Increased deficit spending is historically dollar negative, as it is essentially printing dollars, which in turn should debase the currency.

CAPE® Ratio | As of Dec. 31, 2022

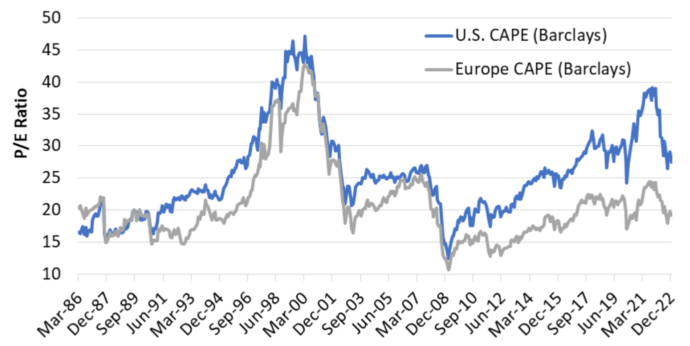

Figure 5
Source: DoubleLine, Barclays

10-Year Government Bond Yields | As of Feb. 15, 2023

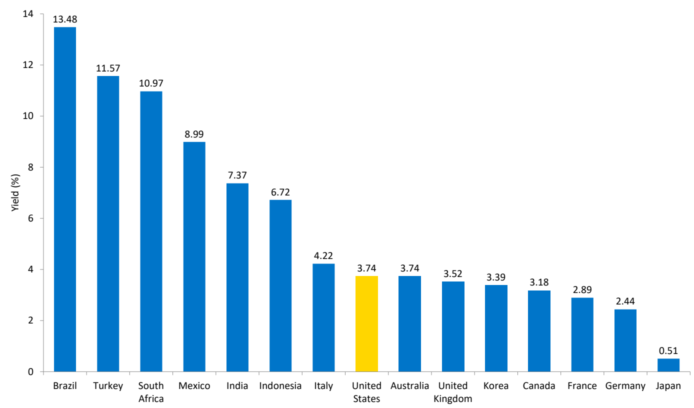

Figure 6
Source: DoubleLine, Barclays

Bill Campbell
Portfolio Manager
International Fixed Income

Mr. Campbell joined DoubleLine in 2013. He is a Portfolio Manager for the DoubleLine Global Bond Strategy and is a permanent member of the Fixed Income Asset Allocation Committee. He covers Developed Markets, Central & Eastern Europe, Middle East and Africa (CEEMEA), and China. Prior to DoubleLine, Mr. Campbell worked for Peridiem Global Investors as a Global Fixed Income Research Analyst and Portfolio Manager. Previous to that, he spent over five years with Nuveen Investment Management Company, first as a Quantitative Analyst in their Risk Management and Portfolio Construction Group, then as a Vice President in their Taxable Fixed Income Group. Mr. Campbell also worked at John Hancock Financial as an Investment Analyst. He holds a BS in Business Economics and International Business, as well as a BA in English, from Pennsylvania State University. Mr. Campbell holds an MA in Mathematics, with a focus on Mathematical Finance, from Boston University.

Chris Stegemann
Manager, Product Specialists

Mr. Stegemann joined DoubleLine in 2017. He is a member of the Product Specialist Team. In this capacity, he is responsible for various aspects of DoubleLine product marketing, investment strategy updates, portfolio communications and competitive analysis, with a focus on DoubleLine's International & Emerging Market Fixed Income strategies. Mr. Stegemann is also responsible for producing market commentary and dedicated strategy content. As part of the Product Specialist team he attends the Fixed Income Asset Allocation, Macro Asset Allocation, Emerging Market Fixed Income and Structured Product meetings. Prior to DoubleLine, Mr. Stegemann was in mutual fund distribution for Putnam Investments. He holds a BS in Finance and minors in Accounting and Economics from Elon University, Martha & Spencer Love School of Business. Mr. Stegemann also holds the Series 3, 6, 7, 63 and 65 Licenses.

A Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectus contain this and other important information about the investment company, and may be obtained by calling (877) 354-6311 / (877) DLINE11, or visiting www.doubleline.com. Read them carefully before investing.

Mutual fund investing involves risk. Principal loss is possible.

DoubleLine Funds are distributed by Quasar Distributors, LLC.

Basis Points (bps) – Basis points (or basis point (bp)) refer to a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01% or 0.0001, and is used to denote the percentage change in a financial instrument. The relationship between percentage changes and basis points can be summarized as: 1% change = 100 basis points; 0.01% = 1 basis point.

Bloomberg World Interest Rate Probability (WIRP) Function – Statistical function developed by Bloomberg that uses fed funds futures and options to assess the probability of future Federal Open Market Committee (FOMC) decisions. It seeks to calculate the chances of a rate hike at each of the FOMC meetings using futures trading data.

Cyclically Adjusted Price-to-Earnings (CAPE®) Ratio – This ratio measures valuation by using real earnings per share (EPS) over a 10-year period to smooth out fluctuations in corporate profits that occur during different periods of a business cycle. It is also known as the "Shiller P/E ratio" for Yale University Dr. Robert Shiller, who popularized its use.

Federal Funds Rate (FFR) – Target interest rate, set by the Federal Reserve at its Federal Open Market Committee (FOMC) meetings, at which commercial banks borrow and lend their excess reserves to each other overnight. The Fed sets a target federal funds rate eight times a year, based on prevailing economic conditions.

Net International Investment Position (NIIP) – includes overseas assets and liabilities held by a nation's government, private sector and citizens. The NIIP is analogous to net foreign assets (NFA), which determine whether a country is a creditor or debtor nation by measuring the difference in its external assets and liabilities.

Terminal Federal Funds Rate – This rate is what economists call the "natural" or "neutral" interest rate. It is the rate that is consistent with full employment and capacity utilization, and stable prices.

U.S. Dollar Index (DXY) – A weighted geometric mean of the U.S. dollar's value relative to a basket of six major foreign currencies: the euro, Japanese yen, British pound, Canadian dollar, Swedish krona and Swiss franc.

You cannot invest directly in an index.