HEMISPHERE CAPITAL MANAGEMENT INC.

Reflections

September 2022

THE DOLLAR SAFE HAVEN

The U.S. dollar has shown considerable strength after a flight-to-safety.

The recent strength of the U.S. dollar highlights the extraordinary flight-to-safety of international investors following Russia's invasion of Ukraine in February 2022. Since the invasion, the euro has declined 11% - a 20-year low. The British pound has fallen 14% - an astounding 37-year low. The Japanese yen, another major currency, has dropped 20% - a 24-year low (See Figure 1).

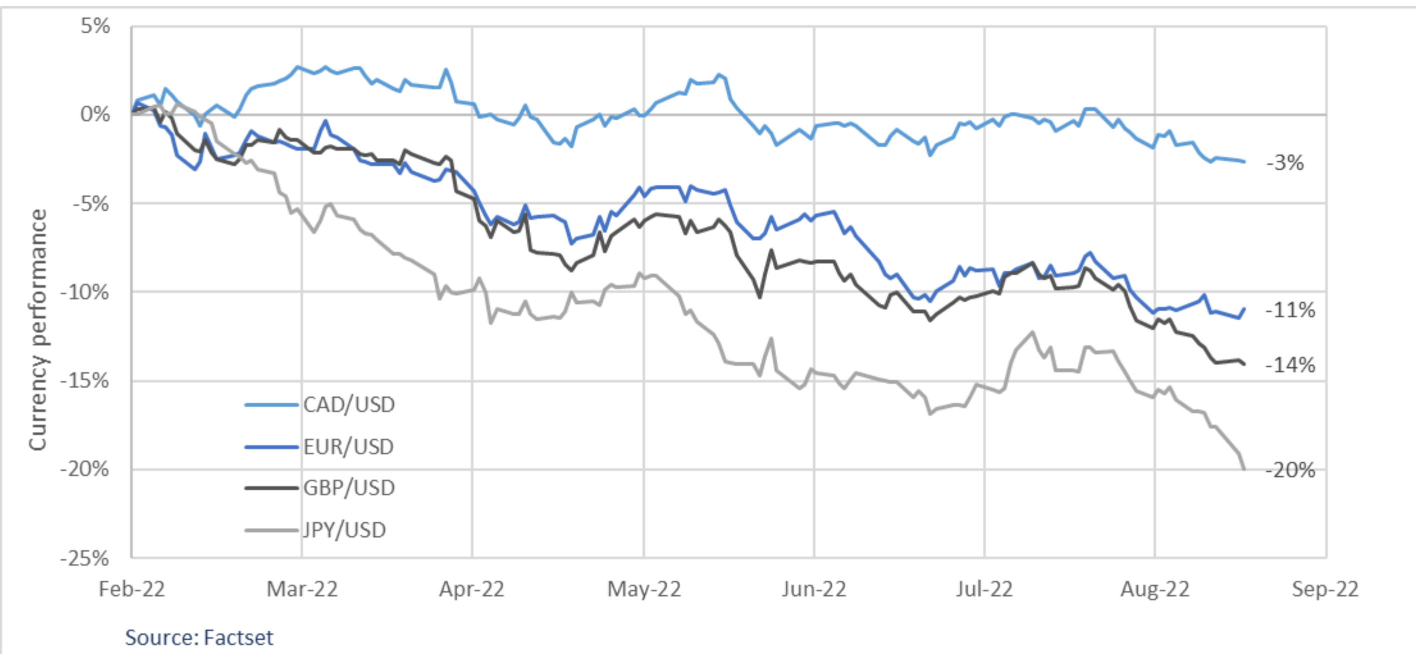

Figure 1: Select currency performance relative to the U.S. dollar since the Russian invasion of Ukraine

U.S. economic strength and rising interest rates have underpinned the strength of the U.S. dollar.

The U.S. dollar has been viewed as a safe haven asset because of the strength of the U.S. economy in light of the current inflationary and geopolitical trends. Persistent U.S. consumer demand and a tight U.S. labour market have led the U.S. Federal Reserve to raise interest rates in an effort to combat inflation. Since March, the U.S. Federal Reserve has raised interest rates from 0.25% to 2.5%, with an additional 0.75% increase expected in September 2022.

European nations and Japan have lagged in raising interest rates…

This contrasts to other developed nations who, due to economic concerns, have either lagged in raising interest rates (European nations) or have avoided raising interest rates altogether (Japan). The European Central Bank started raising interest rates in May, recently reaching a level of 0.75% after starting at -0.5%. The Bank of England was more proactive, initially raising interest rates in December 2021, but

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has taken a more moderate pace relative to the U.S. Federal Reserve. Interest rates in Britain have reached 1.75% after starting at 0%. The Bank of Japan has meanwhile elected to maintain an interest rate target of -0.1% to support consumer demand after decades of deflation starting in the 1990s. Though lagging interest rates have weighed on the euro and pound, the yen has suffered much more from the Bank of Japan's low interest rate strategy.

Energy security concerns in Europe may continue to weigh on the euro and pound.

Escalating energy security concerns as a result of the Russia-Ukraine war have also disproportionately impacted the European economy. Since the invasion, Russia has restricted natural gas flows to Europe in response to Western sanctions. Energy costs in Europe have climbed to record highs with the region urgently searching for alternative energy supplies and considering power price caps. Higher energy costs fuel inflation while limited energy supplies threaten to suppress growth. With winter approaching, the risk of more profound economic weakness as a result of an energy shortage may further weigh on the euro and pound.

The Canadian dollar has held up relatively well due to higher interest rates and more energy security.

Compared to other major currencies, the Canadian dollar has held up well on a relative basis – declining only 3% since the invasion. The Canadian economy has shown encouraging resilience allowing the Bank of Canada to move in parallel with the U.S. Federal Reserve. The Bank of Canada recently raised interest rates by 0.75% on September 7 to reach 3.25%. As an energy producing nation, Canada has largely been insulated from the exponentially rising energy prices that threaten Europe's economic stability.

The U.S. dollar looks set to continue its run of form with interest rates continuing to rise.

With the ongoing Russia-Ukraine war amplifying current inflationary and geopolitical concerns, the U.S. dollar looks poised to continue its recent run of form. The U.S. Federal Reserve has committed to continue raising interest rates in the face of high inflation, which risks widening the gap between U.S. interest rates and those of other developed nations. This may further weigh on the euro, pound and yen in the near-term. The Canadian dollar should continue to see support as the Bank of Canada raises interest rates. Since a stronger U.S. and Canadian dollar can adversely impact revenues for companies with larger overseas operations, there is additional justification for companies with higher North American exposure. At an aggregate level, a stronger U.S. and Canadian dollar also provides support for overall portfolio values on a relative basis.