Short dollar bets make cautious return after safe-haven rush

Cautious USD-weakening positions re-emerge despite return of natural ‘dollar smile’ hedge

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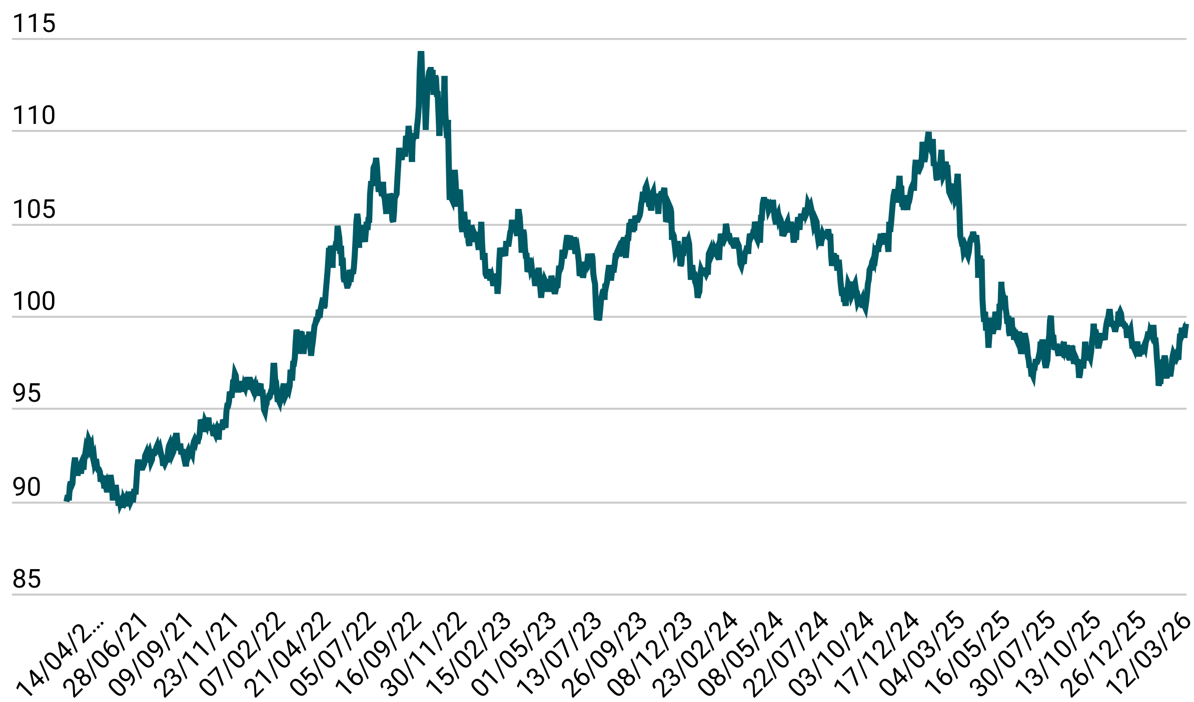
Recent US dollar strengthening in response to the escalating conflict in Iran has done little to temper many investors’ long-term bearish views on the greenback, with some buying into trades anticipating a rally in higher-yielding currencies.

The US dollar index (DXY), a measure of the dollar’s value against a basket of currencies, hit 99.683 on March 9, its highest level since November, and almost 4 points higher than the late-January lows.

During the first few days of the conflict, flow data collected by Citi show the biggest swing in positioning was in the Swiss franc – a traditional safe-haven currency – followed by USD.

Hedge funds **rushed to sell** once-profitable emerging market carry trades. A welcome return of the **dollar smile** phenomenon, in which a stronger USD acts as a natural hedge against falling US asset prices in stressed markets, led some firms to cut their dollar hedges by selling out of long euro/US dollar positions.

US dollar index (DXY)



Source: Bloomberg
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Since then, Donald Trump's comments that the war could be over much sooner fuelled some buy-side clients to buy back into high-beta currencies through both cash and derivatives.

"We are starting to see market participants wanting to put risk back on. Some hedge funds have been trying to fade the moves and get back to being long carry in emerging markets, and the Australian dollar has been the highest conviction G10 currency," says Sam Hewson, global head of FX sales at Citi.

"There's been cautious buying and they don't want to miss out if there is a rally in risk. Each time we get a pop or a spike in these pairs, we do see institutional clients coming in to fade these moves."

Traders have turned to the Australian dollar as a G10 haven, largely due to the country being an energy exporter and reflecting expectations for an interest rate hike next week. AUD/USD reached a yearly high of 0.718 on March 11, before dropping to 0.709 on March 12.

Other emerging market currencies such as the South African rand, Brazilian real and offshore Chinese renminbi have also strengthened since last week.

Citi's Hewson says some corporates with flexible hedging strategies have also become net sellers of USD, having been buyers at the start of the conflict in the Middle East.

"There have been corporates in Latam opportunistically selling USD and extending some hedges as USD appreciated," he says.

He adds that Japanese exporters have also been opportunistic USD sellers, as the yen reaches a level that previously triggered intervention by the Bank of Japan. On March 12, the yen hit 159.2 against the dollar, the highest level since January.

The influx of these two-way real money flows has helped market-makers recycle risk more effectively.

"In the first few days, it was more challenging because of that one-way traffic in dollar buying across the board. As of today, albeit with a bias, we are now seeing more two-way flow," says Hewson.

Rising ratios

Before the Iran conflict broke out, non-US investors had been adding to their US dollar hedges. Last year, dealers were largely **disappointed** by the lack of hedging flows from real money firms such as asset managers and pension funds.

Those flows were beginning to materialise. According to data from Nomura, Danish pension funds had increased their FX hedging ratios from roughly 62% in January 2025 to just over 72% at the start of this year. Its analysis of Swedish pension funds also shows a similar, but smaller pattern.

Thomas Kikis, head of markets for Americas at Standard Chartered, these firms have largely held on to these hedges, despite the latest bout of USD strengthening.

"In recent days, I haven't seen massive amounts of movement because I think these are structural hedges. They could perhaps adjust a little bit, but I think they've been putting these on strategically and locking into them for a while," says Kikis.

Van Luu, global head of FX and fixed income solutions strategy at Russell Investments, agrees the majority of European investors have yet to make any significant adjustments to their hedges but are keeping a close eye on how the conflict will unfold.

"Hedging hasn't been a top priority as clients wait to see how the conflict develops. If we get meaningful de-escalation, we expect to see investors re-engage in discussions around their hedging policy and potentially raise hedge ratios," says Luu.

However, hedge advisers say the rally in the greenback has enabled some clients to take profit on some trades that pay out for USD strength, enabling them to restrike at more favourable levels.

"We've certainly seen some clients who had hedges in place, and now that the dollar is strengthening again, they're taking it as an opportunity to cash in," says Jackie Bowie, a managing partner and head of Europe, the Middle East and Africa at hedging adviser Chatham Financial.

This should not be viewed as a major shift in hedging appetite or policy, she says, but more an opportunistic chance to look at existing positions, monetise gains and hedge at better levels.

Abishek Sachdev, chief executive of hedging adviser Vedanta Hedging, says its European and UK real money clients have topped up hedges where applicable.

For instance, the one-year EUR/USD forward rate dropped from 1.199 at the end of February to 1.179 on March 6.

Sachdev says clients hedged on a layered basis to protect against USD weakness, which may have had only 50% of their hedges in place, are now re-engaging at more attractive forward levels to hedge another 20–30% of anticipated USD cash flows.

"Instead of being hedged at 50%, this has taken clients up to 80% because suddenly we've seen these two big-figure movements and we have not seen that kind of movement in the last nine months. But you can only do that tactical bit once your core base is in place," he explains.

Editing by Helen Bartholomew