FROM THE DESK OF:

New York Life Investments' Global Market Strategy team

Dollar selloff: a reflection of global noise

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NEW YORK LIFE INVESTMENTS

January 28, 2026

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As of 9:00 am EST, 28 January 2026

Takeaways

- The dollar is currently down 2.5% *just this week* – having recovered from a sharper selloff of around 4.0%.
- This dollar selloff has two distinct drivers: (1) recent appreciation of the yen and the unwind of short yen positions and (2) the broader dollar debasement narrative amid geopolitical risk and White House preference for a weaker dollar.
- We believe the dollar will remain rangebound and volatile this year given opposing pressures on dollar performance, including U.S. economic outperformance (dollar bullish) vs. U.S. policy uncertainty (dollar bearish). This view is admittedly low conviction, and we favor a partial currency hedge for key global allocations.
- Gold continues to surge amid the selloff and rising geopolitical risks, but momentum-driven buying poses a risk.

Making sense of the hubbub around the dollar

The dollar is in the midst of a selloff, down approximately 2.5% on the week as of market open on January 28th – an improvement from being down -4.0% yesterday. This move has two distinct drivers.

First: Japan. Japan's bond market has experienced historic outflows triggered by the Prime Minister's call for snap parliamentary elections, intended to consolidate support for new fiscal spending. Given Japan's existing public debt burden of over 200% of GDP, the selloff signals a market rejection of additional spending, not dissimilar from the UK's "Liz Truss moment" in 2022.

> In response, both Japanese and U.S. officials signaled potential Treasury intervention to prop up the yen through direct purchasing. Such intervention is rare but not unheard of, and is a possibility because of the systemic impact of the "yen carry trade" in global markets. When the yen carry reverses (when investors can no longer borrow cheaply in Yen and invest in higher-yielding assets, like U.S. Treasuries), leveraged positions across FX, rates and equities have to shrink at once. This deleveraging lifts global yields, hits liquidity, and turns a Japan rates shock into a cross-asset risk event. Accordingly, we believe **any policy intervention at this stage would be more about stabilizing market liquidity than about exchange rate intervention for its own sake**.
>
> **But intervention may no longer be needed: in reaction to the *possibility* of intervention to strengthen the yen, there has been a rush to close out short yen positioning, driving the JPY to its strongest point in two months and creating a key source of downward pressure on the dollar.**

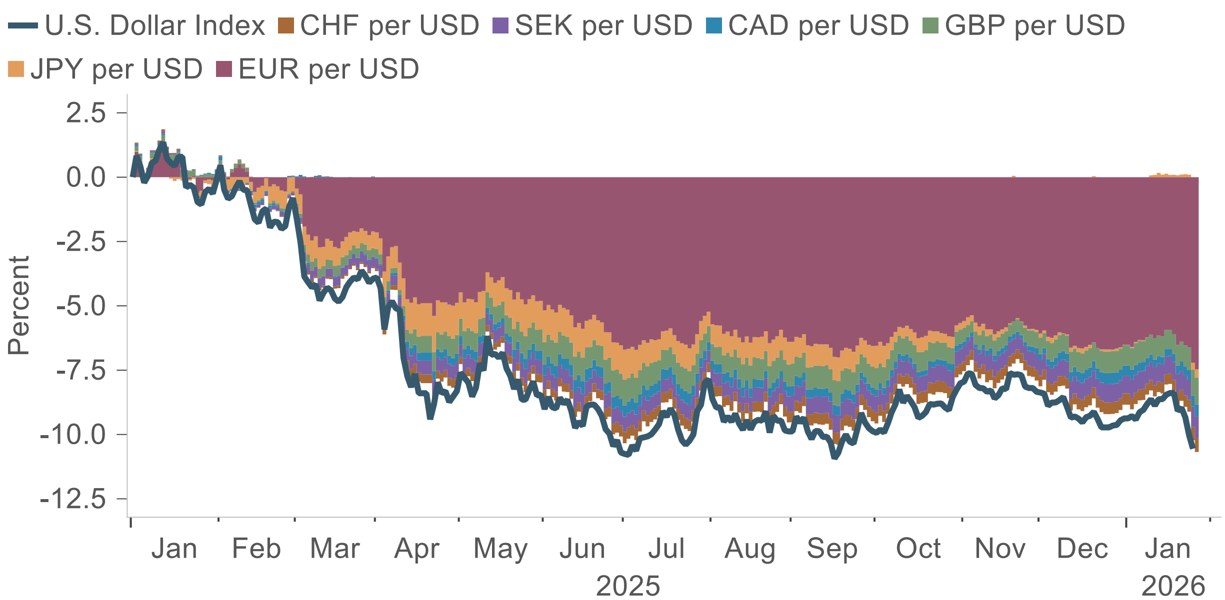
Second: the dollar debasement trade. The flow of geopolitical risk headlines so far in 2026 has contributed to the dollar's selloff against the yen becoming more broad-based, including against emerging markets currencies. U.S. President Trump has expressed for many months, and in the last few days, that he is comfortable with a weaker dollar, accelerating the downward pressure.

Is this the start of another sustained leg down for the dollar?

Not necessarily. Our base case economic outlook calls for continued U.S. economic outperformance – that's dollar bullish. Offsetting this, global investors remain focused on U.S. policy change, rising debt levels, and elevated U.S. dollar liquidity: all of which are dollar bearish. As a result, we hold a low-conviction view that the U.S. dollar will remain rangebound and volatile in 2026, between 92 and 102 DXY levels.

The USD's 2025 weakness against major currencies is sharply accelerating

Contributions to the U.S. dollar index since Jan 2025



Sources: New York Life Investments Global Market Strategy, Intercontinental Exchange (ICE), Macrobond Financial AB, Macrobond, January 2026.

Is gold the clear winner?

Gold has hit another all-time high amid the geopolitical headlines and dollar selloff – but we are wary of investors piling further into gold because of its momentum, rather than its role as a diversifier. We wrote about gold extensively in December, highlighting the drivers of its nearly two-year bid: central bank demand, the dollar-debasement narrative, and – increasingly – investor flows related, at least in part, to a 'fear of missing out' or 'FOMO' trade.

Accordingly, we are very cautious of investors turning to gold as a source of outperformance. We believe that today's environment is prone to upside inflation surprise, which can pull stock-bond correlations together and make commodity exposure a more accretive portfolio diversifier. Even still, we'd advocate for a range of commodity exposure to, at minimum, include industrial and precious metals rather than exclusively gold. Such a commodity satellite could be sized at 5-15% of a portfolio depending on conviction in inflation surprises, as well as other alternatives exposure such as private assets and real estate. Investors who have benefited from the runup in gold may want to use this quarter as an opportunity to trim positions back toward strategic targets rather than add at elevated levels. For investors with no existing exposure, this is not an obvious entry point for a large allocation, but a small starter position can still improve diversification if stock-bond correlations remain positive.

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