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Using currencies to hedge recession risk

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Teresa Alves: Investors are becoming more concerned about a US recession.

We've recently saw the unemployment rate rise by about half a percent over the past year- which, according to an indicator called the Sahm rule, would suggest the US is already in recession.

Now, our base case is that the US will actually avoid a recession in the next year. But rising recession fears are having a big impact on currency markets. In particular, a weak US jobs report, together with a Japanese rate hike, sent the yen sharply higher in early August.

Looking back, the yen has often served as a reliable safe haven currency. The yen typically strengthens versus the dollar in recessionary periods because it's very exposed to moves in US yields.

Another option for US investors looking to hedge recession risk would be shorting the Mexican peso. The peso has tended to fall sharply during recessions, which we saw during the financial crisis and also in 2020. The Mexican economy is closely tied to the US economy, but is it more

volatile- so it gets hit hard by US recessions. So, both shorting the peso and buying the yen could serve as effective hedges against US recession risk.

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