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CMA Update: The US Dollar's Value in World Markets....Does It Matter?

There is a lot of discussion in the financial press about the "Falling Dollar" and the potential consequences for: 1) US inflation, 2) a growing lack of international confidence in the Dollar and US economy, and 3) that Gold has rallied above $800. At first sight, this commentary suggests very negative consequences for the US.

I think investors would benefit though from a fuller understanding about the dollar's value in international markets, and how are current negative assessments about the dollar going to affect the US economy and the US stock market.

First, we need to understand that the US dollar has "Reserve Currency" status with most all of central banks of foreign countries. This means that over the past 40 years the US dollar has earned a high level of stature among foreign country central banks to hold our currency as their store of wealth accrued from trade and balance of payments surpluses. Today, unfortunately, the press does not go back enough years in its assessment of the dollar to describe the evolution of the dollar from 1970 onward to be the premier reserve currency of the world.

Prior to 1970, the British Pound Sterling was a Reserve Currency for foreign central banks, but the British fell on hard financial times and the Pound sunk in value from over $4.00 US to under $1.00 during the 1970s. Other hard currencies of Europe like the Swiss Franc and German Mark were candidates for reserve currency status to replace the Pound, but neither the Swiss nor Germans wanted that financial responsibility. Further, since the US was the most dominant military and political power in the Free World, the US dollar again had a lot going for it to be sought by central banks as their reserve currency. Today then, the US dollar is the main reserve currency, not by our choice, but de facto in that the market wanted it to be that way to secure a sound global financial system.

Today, the press has suggested that the dollar is collapsing all around and is becoming worthless. In response I say that the dollar is not collapsing, but rather other currencies like the Canadian Dollar, Euro and Pound Sterling as just trending higher in value to the US dollar. The Canadian dollar has gained about 24% over the past 12 months, yet it has only returned to its historical level during the early 1970s. From the 1970s onward the C$ sunk to near $.60US from potential separatism and poor fiscal management within Canada.

Regarding the Euro, in 2000 the Euro came into existence and there was much doubt if a collection of diverse European countries could ever create a common currency and make it work without a lot of squabbling among the countries in an attempt to have common social policies, tax policies, welfare policies, interest rates, inflation goals, money supply growth and so one. Prior to the creation of the Euro, most of the European currencies, except the Swiss Franc were in a financial mess having constant devaluations and revaluations between the currencies of Western European countries. So, perhaps one could say that today the Euro is a lot higher than it was in 2000 because the "common currency works", and the previous negative sentiment and suspicion have waned.

Another factor that has caused the US dollar to grow in abundance as foreign central bank reserves is from "Dirty Currency Floating". This means that foreign central banks manipulate their native currency to "stay relatively weak" versus the US dollar and hold off from selling their balance of payments surpluses in dollars for their native currency. As an example, Japan has massive US dollar central bank holdings, because for decades Japan has been reluctant to sell dollar holdings in the foreign exchange market for Yen. If they did, the Japanese yen would be a lot higher than 113 yen per dollar, and Japan's ability to run chronic trade surpluses with the US would end. If the Yen were at say 80 per dollar (without the dirty float) Japanese imports to the US would cost US consumers about 35% more and Japan Inc. could be "out of business" as a US consumer goods and capital goods supplier.

The same is occurring with China today. The Yuan is way too weak (under valued) to the US dollar so we import tons of stuff from them, because it is cheaper to make things there than in the US under the Yuan's current exchange rate. The Chinese central bank is accumulating billions of US dollars in reserves because they refuse to sell their import dollars received for Yuan that would cause the Yuan to appreciate against the dollar and end their massive trade surplus with America. This is why China is growing at 10% GNP each year. They are following the Japan mercantilist practice of maintaining an "under valued currency".

In summary, by my estimation in watching and participating in the global financial markets since 1970, I do not see the so called weakness of the US dollar as something very negative. Rather, it is a positive for the US economy and our stock market as long as nobody panics out of the dollar. And, there is no panic today....it is an orderly adjustment taking place. It is a good adjustment in that the currencies of our trading partners are rising against the US dollar making our exports much more attractive to foreign countries as compared to when the dollar was "over valued", which is the result of any currency having "reserve currency status".

I like the situation that the Euro is now at $1.50 to the dollar and not at $1.00 as in 2000. US exports to Europe will thrive at this lower cost to them, and they will be more happy and attracted now to come to the US for vacations, rather that stay in Europe where it is more expensive...this helps our tourist and hospitality industry, not Europe's. It is the same for Canadians....it is 25% cheaper for our northern neighbors to go to Florida, Arizona and southern California than it did last year. Skiing in Vail and Aspen is now 25% cheaper. Near 90% of Canadians live close to the boarder for weekend shopping excursions to the US.

The current "weak US dollar" situation is a very positive factor to lift US growth in our exports, in-bound foreign tourism, lower US imports that can add to US job growth, and have Americans decide to travel more within the US than to higher cost foreign destinations. On the stock market side, a lower US dollar causes the revenues and earnings of multinational US companies to benefit from higher translations of C$, Euros, Yen and other currencies into dollars.

The financial press is not talking much about the "silver lining" that the dollar is enjoying and will enjoy further in terms on new stimulus to the US economy to offset our housing market situation.

CMA has focused its equity and fixed income investment selections to benefit from the weak dollar going forward. Our client holdings that have a positive bias from a weak dollar include: Alcoa, Advanced Micro, Amgen, Ashford Hospitality, Avon Prod, Barclays Bank, Strategic Hotels, Broadcom, Citigroup, Coach, Disney, eBay, Estee Lauder, GE, Harley-Davidson, LaSalle Hotels, Starwood Hotels, International Game Tech, JP Morgan Chase, Marriott Intl, MMM, Motorola, Starbucks, Sunstone Hotels, Tiffany, Texas Instruments, Yahoo.

Please call Chuck Dushek or Greg Nickum (630-963-4235) at CMA to discuss any/all of the company-specific or macro factors CMA uses in its portfolio strategy process.

Sincerely,

Chuck Dushek