

Insights

Investment Alternatives in a Weak US Dollar Environment

While the US dollar has traditionally been considered a “safe-haven” currency for investors, we’ve now entered a period in which the dollar is weak. The dollar is expected to weaken further over the long run, although we do not expect a significant overall move in that direction. In this environment, there are a number of attractive investment opportunities to consider as part of a well-diversified asset allocation plan.

The Dollar: Where We Are Today

For years, the US dollar has been viewed as the currency to hold during turbulent times. However, a number of factors have contributed to the current weak dollar situation, including: 1) concern about more terrorism; 2) fears about a weak US economy; 3) US military troubles overseas; and 4) the growing US account deficit. Furthermore, low US interest rates have made it less attractive for investors to invest in the US and thus buy fewer dollars. Keep in mind that while the dollar is currently weak, a change in US monetary policy, or events such as a US economic surprise on the upside or a successful resolution in Iraqi tensions could lead to a reversal in direction.

Investment Alternatives

Six possible investment choices for your portfolio that may provide attractive investment opportunities are described below.

- US multinational stocks
- Mutual funds that invest outside of the US
- Bonds from highly-rated foreign issuers
- Gold
- Shares of companies that only do business abroad
- Foreign currencies

US Multinational Stocks

Large, US-based companies earn much of their profits overseas. Since these companies are constantly converting those profits back to dollars, they naturally earn more as the dollar weakens. They should benefit from a profit margin expansion because of the dollar decline. Three risks are inherent to this strategy: 1) fundamental business trends take precedence over dollar weakness gains (troubled multinationals will cause client revenue losses despite dollar weakness levels; 2) companies with many overseas expenses will benefit less (revenues and costs will rise when translated back into dollars); 3) some multinationals may use financial instruments to hedge against dollar declines, which would mean the loss of any benefit from a weaker dollar.

Mutual Funds that Invest Outside the US

A simpler move is to put more money in mutual funds that invest outside of the US, since most do not hedge against dollar declines. Added benefits generally also include more attractive equity valuations abroad, as well as access to industry leaders not prevalent in the US.

Bonds from Highly-Rated Foreign Issuers

You may want to place some of your assets in highly-rated foreign issuers as a solid fixed-income investment. In many parts of the world, such as New Zealand, Norway and Australia, yields on highly-rated debts are considerably higher than in the US. Unhedged foreign bonds could be an ideal way of gaining FX exposure while capturing the interest rate spread. The yield curves in some of these countries are much flatter, allowing investors to capture the maximum return with relatively short maturities.

Gold

There are three reasons that this strategy makes sense in a dollar-declining environment: 1) since gold is priced in dollars, as the dollar falls gold becomes cheaper; 2) global concerns that weigh on the US dollar, such as terrorism and economic weakness, do not have the same impact on gold; therefore, gold is viewed as a safe harbor while increasing in value; and 3) prolonged dollar weakness may add to inflation, whereas gold is regarded by many as an inflation hedge.

Shares of Companies that Only Do Business Abroad

This is a tricky strategy that requires extensive research prior to investing in individual foreign stocks. The local banking, healthcare and retail sectors abroad that do not do business with US firms are among the suggested areas to investigate.



Foreign Currencies

Purchasing foreign currencies is a traditional strategy during periods of dollar weakness. As the dollar declines, foreign currency values rise, encouraging additional purchases of the dollar. Another investment is F/X forwards, which can be used to protect investors against further dollar weakness. Some financial tools, such as options and futures, are commonly used to invest in currencies and are usually used by sophisticated investors.

We recommend that you review the above suggestions with your Private Banker to determine if any are appropriate within the context of your individual risk appetite and investment goals. One, or several, strategies may represent a viable way to take advantage of dollar weakness as a component within a diversified investment portfolio.

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