

Dollar Doldrums

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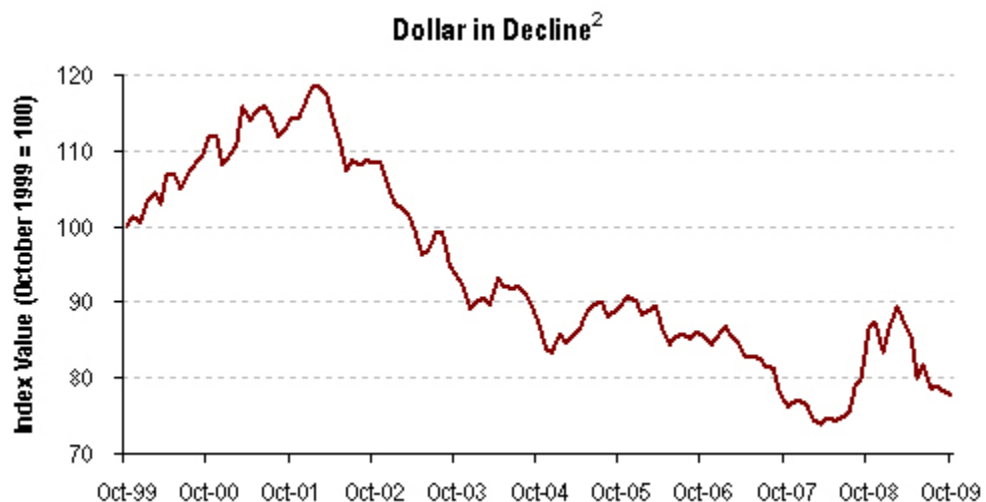
A variety of factors is driving down an already diminished U.S. dollar, posing challenges and opportunities for businesses and investors alike.

After rallying briefly in 2008 when investors sought a relatively "safe haven" following the collapse of Lehman Brothers and AIG, the U.S. dollar has resumed a seven-year downward trend. Most recently, it has declined 6.8% on a trade-weighted basis for the six-month period ending October 30, 2009.¹

Forces Weighing on the Dollar

Many observers believe that the U.S. dollar's decline is likely to continue, at least for the short term, reflecting several factors working against the greenback.

- The U.S. budget deficit is at its highest point relative to the overall economy since 1945 and is expected to remain high for years to come.
- U.S. interest rates are likely to remain low, as inflation remains negligible and policymakers focus more on stimulating the economy.
- The U.S. trade deficit remains high by historical standards.
- Expectations of modest economic growth have prompted investors to search for assets denominated in currencies where growth may be more robust. Standard & Poor's anticipates U.S. economic growth of 1.8% next year.



Source: Federal Reserve. For the period October 31, 1999, to October 31, 2009. Based on the value of the U.S. dollar as measured against major U.S. trading partners whose currencies circulate widely outside the country of issue. The countries are weighted by import and export shares. The value of the index is set at 100 as of October 31, 1999.

Portfolio Strategies

Investors looking to capitalize on the erosion in the value of the U.S. dollar might want to consider the following strategies.

- Allocate a portion of your portfolio to international investments. U.S. investors experience gains when the dollar falls against the currency in which a foreign security (which they hold) is denominated. As a result, depreciation of the U.S. dollar can make overseas investing more attractive to U.S. investors. For instance, the dollar depreciated 36% from the end of 2001 to the end of 2008 against the euro, making an investment denominated in that currency 56% more valuable once it was converted back to dollars, and that's before counting any appreciation of the underlying investment.²
- Consider U.S.-based multinationals. Companies that are based domestically but earn a considerable portion of their profits abroad may benefit from a declining dollar, which makes goods produced domestically more competitive with those manufactured abroad. Multinationals may also have opportunities to sell into markets that are growing faster than those in the United States.
- Examine sectors linked to commodities.³ A weaker dollar enhances the value of commodities, such as oil, that are produced abroad but sold domestically in U.S. dollars. Sectors such as Energy and Materials, which together account for 16% of the value of the S&P 500, are examples of this trend.

The relative value of the U.S. dollar in the months and years ahead is likely to depend on a number of factors, including the U.S. deficit, domestic economic performance, and comparative trends in other parts of the world. In the meantime, U.S. investors may capitalize on these strategies that potentially enhance returns when the U.S. dollar is in decline.

¹Source: Federal Reserve.

²Source: Standard & Poor's. Foreign investments involve greater risks than U.S. investments, including political and economic risks and risk of currency fluctuations, and may not be suitable for all investors.

³Sector funds may be more volatile than funds that diversify across many sectors or industries.