

FINANCIAL OUTLOOK

April, 2008

Should You Be Concerned About Weakened U.S. Dollar?

The subprime crisis is widely blamed for the recent plunge in the U.S. Dollar. In reality, the downward trend of our currency has been in motion for some time; the dollar dropped below the euro in 2002 and hasn't looked back since.

Warren Buffet summarized the cause of the declining dollar in layman's terms in his annual Letter to Shareholders in February: "Americans like buying products made elsewhere more than the rest of the world likes buying products made in the U.S. Inevitably, that causes America to ship about \$2 billion of IOUs and assets *daily* to the rest of the world. And over time, that puts pressure on the dollar." Typically, a falling dollar translates into more competitive pricing for U.S. products offered to foreigners, helping to bring trade deficits back into balance. Alas so far, the evidence contradicts the maxim this time around.

According to the December 2007 issue of *The Economist*, the dollar's place as a reserve currency always seems to be questioned when it falls. Weakness in 1977-79, 1985-88 and 1993-95 was met with predictions that global governments would switch their reserves into another currency. The dollar has weathered these previous storms, and still remains the world's choice currency peg. Despite this, mainstream media continues to push predictions that foreign governments will break its currency peg to the U.S. dollar, with foreign central banks dumping U.S. dollars.

These scenarios do not square with the facts. Witness the flood of sovereign capital flowing into U.S. financial companies from the Middle East and Asia (you may recall last November the Abu Dhabi Investment Authority paid \$7.5 billion for a 4.9% stake in CitiGroup) – while U.S. investors fled this sector. The question we must ask ourselves is "What do they see that we don't?" It is clear that sovereign investors have deeper pockets and longer horizons than most of us.

And let's be clear on this point: Foreign investment in the U.S. is invited and welcomed. Quoting Warren Buffett again "This is *our* doing, not some nefarious plot by foreign governments. Our trade equation guarantees massive foreign investment in the U.S. When we force-feed \$2 billion daily to the rest of the world, they must invest in *something* here. Why should we complain when they choose stocks over bonds?"

That said, how do you position yourself financially during this currency slump?

As always, promoters working the capital markets are ready to sell you structured products aimed at protecting your portfolio against changes in domestic or global economic dynamics.

Traditional hedges against falling currencies include foreign CDs, single-currency exchange-traded funds, commodities, gold and precious metals, and direct investments in foreign markets. All investments carry risks for the unwary. Foreign bank accounts and CDs are not FDIC insured, and average investors may not receive competitive prices enjoyed by locally

connected investors. Gold prices recently soared to an all time high of \$1,000 / oz (gold is a neutral currency that is not backed by a government, and tends to be inversely correlated to the dollar). Finally, be forewarned that many foreign countries do not recognize or implement the same accounting procedures and reporting regulations as those required of U.S. companies. Consequently, direct investments overseas are much more complex if you lack firsthand knowledge of a foreign company and industry, and ability to analyze financial data which is presented without apples-to-apples comparables to U.S. benchmarks.

So, should you be concerned about the value of the U.S. Dollar – or something more closely tied to your financial situation?

My Advice is to Look Beyond Fear and Greed.

Remain cognizant and focused on your long term financial goals. Maintain a well diversified portfolio containing negatively correlated asset classes, sectors, and international exposures.

In fact, you may already participate in foreign currency hedges, since roughly 25-50% of sales and earnings of U.S. companies come from abroad.

Great companies like General Electric (founded in 1890) received 50% of its revenue from foreign markets in 2007, while it increased its total earnings by 137% and its dividend by 174% over the last ten years. What wonderful inflation protection you gain from this dividend! (You need not be hypercritical of relatively flat stock prices if you are living off dividends which outpace inflation).

Procter & Gamble (founded in 1837) selling its major brands overseas (Tide laundry detergent, Charmin toilet paper, Cover Girl cosmetics, Folgers coffee, Iams pet food, and Gillette), doubled their sales derived from developing countries since 2001. Over the last ten years, P&G's total earnings have increased by 159% and its dividend has increased by 167%, while its stock price doubled over that time.

I affirm that the current position of the U.S. dollar makes little difference to your portfolio in the long term, as long as your underlying securities represent profitable companies doing business around the world. Let us get back to the basics of reviewing your goals, determining how much money you'll need in your personal time horizon, maintain investments in high quality assets. Good, old-fashioned dollar cost averaging will cover market and currency fluctuations over the mid- to long-term.

Sources: Wall Street Journal – April 4 2008; The Economist – Dec 1-7 2007; Berkshire Hathaway Annual Letter to Shareholders – Feb 2008; Business Times – Nov 14 2007; Financial Planning Magazine – Nov 1 2007; Financial Advisor Magazine – Feb 2008; company websites: www.ge.com and www.pg.com



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