

# ENVISION

## MARKET REPORT

May, 2008

### American Greenback

2008 is already shaping up to be a year of surprises, both inside the market and out. Honestly, if someone were to suggest back on January 1<sup>st</sup> that Building & Real Estate stocks would be among the best performing sectors by May, that both the New England Patriots & Tiger Woods would finish second in their respective "Super Bowls", and that the Democrats wouldn't have a Presidential candidate by Cinco De Mayo; you would probably think they were crazy. Yet here we are in May 2008 having grown accustomed to all of these circumstances. Since we have adapted to all of these, surely a bottom in the U.S. Dollar should be palatable as well, right?

For the past few years the dollar has continually become weaker and weaker compared to foreign currencies. The dollar is down about 8 percent against the 15-nation Euro, and has touched lows against the Yen and Great British Pound. One reason for the slide is that the Federal Reserve continues to lower interest rates – and that makes the dollar less valuable.

Given the substantial losses in the dollar we have not seen US jobs and exports increase as much as we would hope. This means that the U.S. should have been able to increase its exports. In other words, imports become more expensive while exports become cheaper. However, large US companies with strong overseas markets are beating earnings forecasts, and the US is becoming a cheaper and more attractive place to do business. This economic stimulus should begin creating new jobs and also increase foreign monies coming into the U.S., benefiting the economy and the dollar.

On Friday May 2<sup>nd</sup>, the U.S. Dollar Index produced its first Point & Figure buy signal since November 2005, ending a series of 10 consecutive sell signals that spanned 2 1/2 years. While it is admittedly still a bit early to call a long-term bottom in the Dollar, this breakout does at least lay the foundation for such a development.

With the month of April behind us we now see that in addition to the positive breakout on the trend chart of the US Dollar Index we have also seen a positive development on the Monthly Momentum front for the index. Having been negative for 14 of the last 15 months, and 23 out of the last 28 months, this change in long-term momentum is another

encouraging sign for the US Dollar. While changes in monthly momentum in recent years have been useful indications, they have more foreshadowed a pause within the long-term downtrend rather than a spectacular change in direction for the Dollar (Dorsey Wright & Associates).

Still it is understandable why a growing number of experts are betting on a dollar rebound. Foreign investors, for example, are buying more U.S. securities than they are selling. This increased inflow of foreign monies shows others are investing in the U.S for the future.

Fundamentally the main cause of the dollar's recent strength is the same reason for its rapid collapse over the past year: the U.S. Federal



Reserve. The dollar's value suffered when the Fed cut interest rates to try and stop the financial crisis and prevent a U.S. recession. The turning point may have been on Apr. 30, when the Fed last lowered the fed funds rate target by a quarter-point, signaling that their rate-cutting campaign may be drawing to a close. This has given much needed support to a dollar trying to work its way higher. The futures markets suggest that if the Fed takes any action in the next few months, it will be a rate hike to keep inflation in check, which would also boost the dollar.

But with the U.S. economy under strain, resistance by foreign central banks to cut interest rates and a massive U.S. trade deficit, a number of currency experts are betting the dollar will stay under pressure at least through the remainder of the year.

The government is attempting to break the economic slump by pro-actively taking actions to stimulate the economy. The Fed has already slashed interest rates, such that people en masse have the option of creating new money for themselves (loans). At the same time the Fed is hopeful that the government's \$168 billion stimulus package of tax rebates for people and tax breaks for businesses will lift the country out of its

slump. While these steps are being implemented to help the economy they are concurrently pointing the U.S towards an inflationary path and hurting the dollar.

Is this truly a bottom for the dollar? Will we see a full reversal for the greenback in the near future? While the dollar continues to show strength inflation fears still linger. Mohamed El-Erian, co-head of the world's largest bond fund company, PIMCO, does not see the dollar rebounding. He believes the Federal Reserve's monetary policy may not help the economy escape recession. He also adds that the Fed is "particularly challenged" because of its dual mandate that calls for maintaining solid employment and low inflation. Unfortunately for the Fed, keeping the unemployment rate low creates higher wages and a tighter labor market which is good, but it is also inflationary.

There are a lot of indicators and analysts on both sides of the economic issues of inflation and the dollar. There is also a lot of news out there that seems to strive more for a dramatic effect than solid, unbiased reporting. Statistics are the result or explanation, and not the cause, of the dollar rising or falling in value. Hence the adage, sell on good news and buy on bad news.

At this point you are probably wondering why a declining dollar matters. The truth is, its impact is felt in many areas of our lives. Specifically, as far as the stock market goes, the market has historically performed better when the dollar's value is increasing, thus making a stronger dollar better for your portfolio. According to *Bespoke Investment Group*:

"Since 1967, the dollar has had four up cycles and five down cycles. The average return of the S&P 500 during the four up cycles is a gain of 86.6%, which is over five times the average return of 16.4% during dollar declines."

Since the dollar is still weak, money market position yields have been reduced dramatically. Some of our clients have turned to specific investments we have that yield 7% annualized plus appreciation; trumping low yielding money market and bond funds.

There are powerful arguments for each side. Some are convinced of pending inflation due to the recent Fed rate cuts, the US trade deficit, foreign banks not cutting their rate, a continually weakening dollar, and just an overall down trending economy. Still others

are looking towards a strengthening dollar, an increase in foreign investment in the U.S., an end to rate cutting, and an improving U.S. economy. Our research still shows the U.S. Dollar stuck within a bearish trend and a little more than a point away from hitting a new low. It appears that as for now, supply remains in control of the dollar from our perspective so we will remain bearish until our indicators show the dollar has made a full reversal. What we are doing is preparing ourselves for both ways the market could go, such that we are ready to capitalize on economic improvement or an economic downturn. The key here is to remain level headed and stick to the game plan already in place.



Thank you for your business and support,

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