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Is the dollar at risk?

A brief history of the strong dollar and implications for investors

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The dollar has been a bull market currency

Since the mid -1990s the dollar has increased in value against other currencies. This strength in the dollar coincided with the bull market in U.S. stocks and bonds.

The following chart illustrates the dollar's strength against a basket of major currencies through early 2002.

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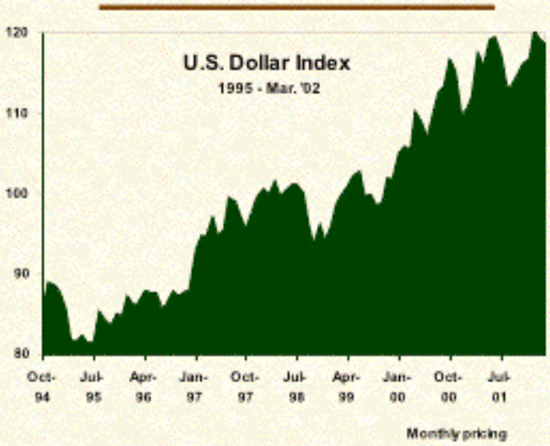
A long bull run for the dollar …

The Dollar Index reflects exchange rates with six major currencies



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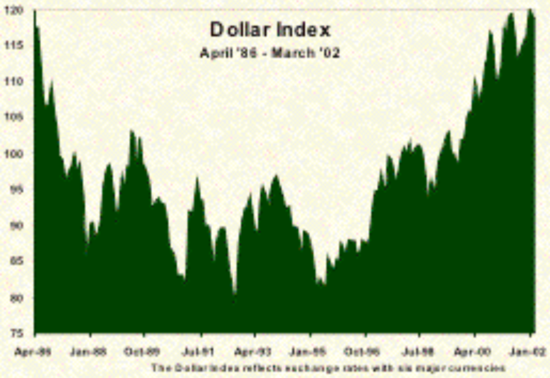
But the dollar doesn't always appreciate against other currencies …

The dollar has experienced bull and bear markets.



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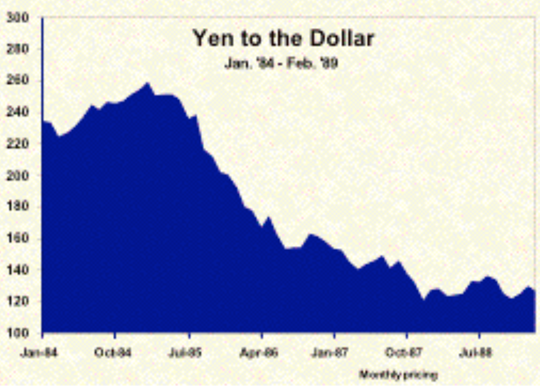
Here's an example of the dollar sinking against a specific currency …

From Oct. '84 to Nov. '89, the U.S. Dollar lost half of its value against the Yen



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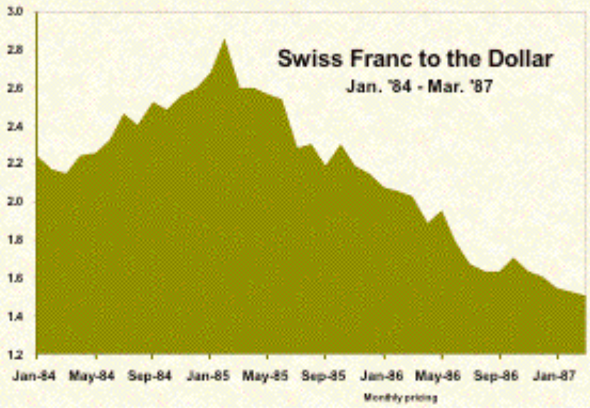
Here's another example

From Feb. '85 to Dec. '87, the U.S. Dollar lost more than half of its value against the Swiss Franc



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And now it appears that the dollar peaked in 2002

The Dollar index reflects exchange rates with six major currencies

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In our view, there is a risk of an extended period of dollar weakness. After all, the U.S. has imported far more than it has exported in recent years...

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But those exporting countries have been content to "recycle" our dollars into U.S. securities including Treasuries...

Purchases of Treasuries by foreigners have been *far above average* in recent quarters

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As a result, foreign investors & central banks now hold 40% of all outstanding Treasuries ...

Would interest rates be higher and the dollar be weaker without foreign enthusiasm for US securities?

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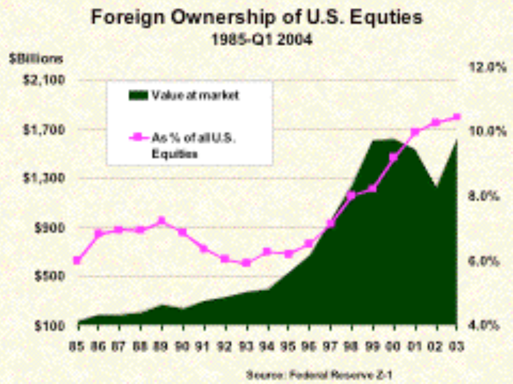
... and foreign ownership of equities is approaching the bubble peak.



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In our view, there is a risk that foreigners will reduce holdings of dollar -based assets.

Reasons could include:

- **Perception that returns on U.S. assets will be less attractive in the future**
- **Increased preference for other currencies (e.g. euro), or desire to diversify away from the dollar**
- **Increased preference for hard assets (gold)**

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If foreign investors and foreign central banks demand fewer U.S. assets, the dollar could weaken.

A weakening dollar could affect investors in the following ways:

- **Selling pressure on U.S. securities could depress securities prices**
- **Interest rates could rise as foreign demand for bonds weakens**
- **Import prices could rise in dollar terms, increasing the rate of inflation**

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More on dollar vulnerability in today's environment is available in the articles below.

The foreign fools who are buying American bonds, Gross, Slate (6/15/04)

Clock ticking on dollar as reserve currency?, Ferguson, Prospect (6/10/2004)

Building a Record Trade Deficit Isn't Easy, Benson, Guest Column (11/28/03)

The Dollar Crisis: An interview with Richard Duncan, Guest Column (11/8/2003)

Why I'm not buying the U.S. dollar, Buffett, Fortune (10/26/03)