

The Week

Tom McManus, Chief Investment Officer

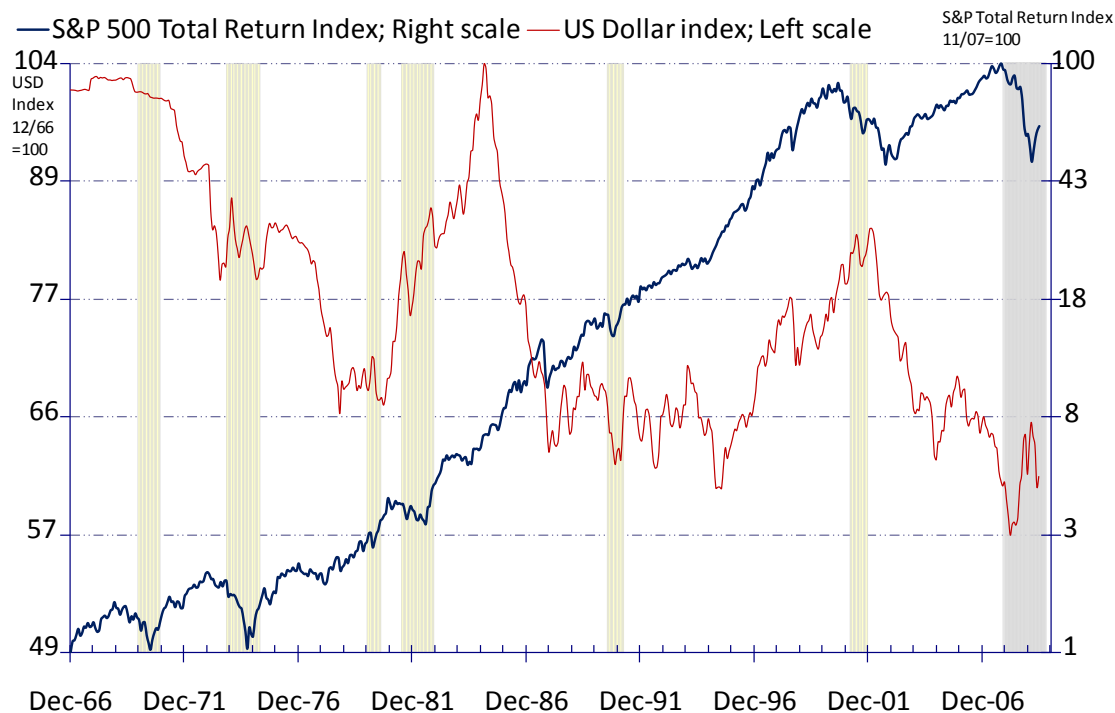
US Investors Should Consider Reducing Their Exposure to the US Dollar

- As markets for “risk assets” like stocks and low quality bonds have enjoyed a nice rebound since March, “safe-haven assets” such as Treasuries, other high quality bonds and even the US dollar (USD) itself have suffered from weaker demand. Investors are now clinging less fervently to securities that offer more certainty, in favor of those they hope will offer more growth in a hoped-for recovery.
- The dollar has relinquished about one-half of its sharp four-month rally seen in the latter half of 2008 (see chart overleaf), undermined partly by increasing concern about its future as the world’s dominant reserve currency. Except for a brief recent period (late 2007- early 2008), the dollar today buys fewer units of most important foreign currencies than it has at any time in the past half-century.
- In New Zealand, the Kiwi dollar is rising so quickly against the US dollar that exporters are worried about demand for their products. Similar concerns have beset Canada and Australia, two other commodity-rich economies. All three countries’ dollars are close to posting their strongest quarters against the greenback since at least 1971. Strong currencies in a robust economy may be acceptable, but populist pressure in a weak economy may force policymakers to look for ways to weaken their own currencies.
- Together with Japan, China and Russia now control nearly 50% of the world’s reserve assets, and these two have been suggesting the eventual development of an alternative to the dollar’s current prominence as the basis for world trade.
- In a recent survey, nearly two-thirds of economists polled believe that the dollar will continue to fall — relative to a basket of foreign currencies — over the next five years. How quickly is the dollar expected to lose value? The ten most bearish respondents believe the loss will average nearly -4% /year over five years, while the ten least worried believe the loss will be about -1% /year over the same period. By comparison, the decline has averaged -1.2% /year since the mid 1960’s, with substantial variability (see chart).
- What is an investor to do — if concerned about an accelerating decline of the dollar? There are a number of opportunities, depending on whether the weakness is concentrated in our own currency, or whether there is a widespread decline in the purchasing power of most currencies, i.e. a global inflationary episode. **Consider these with your financial advisor:**
- **Real Estate:** Recent declines in residential and commercial property values make real estate a controversial choice as an inflation hedge, but we figure that values are more reasonable at today’s prices, considering income levels and financing costs. Real Estate Investment Trusts (REITs) offer enhanced liquidity, diversification and professional management, at a price.
- **Commodities:** Commodity prices have recovered a substantial portion of their recent losses and strength may continue in the longer run, according to experts like Mohammed El-Erian and James Rogers. Energy, industrial materials, agricultural commodities — and precious metals, too — are now more liquid and investable, because of financial innovation.
- **Collectibles:** Art, wine, and other collectibles such as coins and stamps — and even more arcane items such as rare cars and boats — are popular inflation hedges for good reason. Be wary of the transaction costs, and recognize the importance of expertise in these areas.

There are special risks associated with an investment in real estate, including credit risk, interest-rate fluctuations and the impact of varied economic conditions. Distributions from REIT investments are taxed at the owner’s tax bracket.

Buying commodities may provide diversification for those sophisticated persons who wish to add commodities to their portfolios and who are prepared to assume the risks inherent in the commodities market. Any purchase represents a transaction in a non-income-producing commodity and is highly speculative. Therefore, commodities should not represent a significant portion of an individual’s portfolio.

Dollar Weakness Is a Long-Term Trend; Has Tended to Benefit International Investments & US Multinationals



Past performance is no guarantee of future results. An index is not managed and is unavailable for direct investment. Figures do not include fees, commissions or taxes which would have a negative impact on investment results. The US Dollar index shown is a weighted index of 7 currencies: Euro (30%); Japanese Yen (20%); British Pound, Swiss Franc, Chinese Yuan, Canadian Dollar and Taiwan Dollar (all 10%). The S&P 500 total return index assumes all dividends and distributions are reinvested in the index. Dividends can be increased, decreased or totally eliminated at any point without notice. US recession periods are shaded. Sources: Bloomberg, Federal Reserve, Standard & Poor's.

Businesses: Owning a business that has pricing power and defensible margins may be a good inflation hedge. Many businesses face little backlash when raising prices during an inflationary period, and then some are able to defend their pricing when the economy and prices weaken.

Securities: History shows that stocks typically perform better than bonds in an inflationary period, however, they are not immune from a significant compression of valuations. Active portfolio managers may outperform by owning shares of commodity producers and other companies seen as benefiting from dollar weakness. Even large capitalization multinational companies are likely to be beneficiaries of a weak dollar, given their exposure to growth in emerging and developed international economies. Conservative investors should consider owning Treasury Inflation Protected Securities (TIPS) instead of traditional Treasury notes. Ironically, bonds of highly-indebted enterprises may fare better than you might expect, especially if the underlying business has an international revenue base and domestic costs.

Investment and Insurance Products: ►NOT FDIC Insured ►NO Bank Guarantee ►MAY Lose Value

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