LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

We've heard much about the strength of the U.S. dollar over the last few months. For the first time in twenty-five years the dollar gained against all thirty-one of its major counterparts. It is now at its highest level against those major currencies since September of 2003. But as U.S. consumers, we've felt very little direct impact to date. So what does a strong dollar really mean and what are its possible impacts, positive and negative?

When we speak of a strong dollar, we are referring to its relative value compared to foreign currencies—such as the Euro, Yen, or Pound Sterling. As the dollar gets stronger it buys more of these foreign currencies. When it weakens, it buys less.

Relative currency values can tell us quite a bit about a country's economy. When a country's currency is strong it could mean that interest rates are higher in that particular country (which may attract international capital), or that country may be viewed as a safe haven compared to other economies, or it could indicate that a particular country's Gross Domestic Product (GDP) is growing faster than other countries—which could also draw additional investment. On the other hand, a country with a relatively weak currency likely has low interest rates and no need of additional foreign capital. Or the economy might be perceived to be in trouble—perhaps with such slow growth that it may fall into recession.

A strong dollar makes imported goods cheaper. Companies that import goods (from soft goods such as apparel to durable goods such as appliances) and sell them in the U.S. will pay less, hence lowering their costs and increasing profits. Assuming some of this acquisition cost is passed on, consumers will also pay less. This is good for the consumer—but as these products are not produced here—it has a negative impact on the U.S. GDP. Another positive of a strong dollar for the American consumer is that it is cheaper to travel abroad as a dollar buys more of a foreign currency.

In the short run, a strong dollar will fuel U.S. stock and bond markets by boosting returns for global investors who measure their performance in other currencies. An interesting side is that a strong dollar seems to limit any upside potential in the oil market. Since oil is priced in dollars, a stronger dollar typically makes the dollar-denominated commodity more expensive in other currencies.

Some of the negatives of a stronger dollar include foreign buyers having to pay more for U.S. products, which gives foreign competitors a price advantage. In other words, a strong dollar makes U.S. exports more expensive to foreigners. Thus, U.S. companies that rely on exports will likely see the dollar's strength eating into earnings. U.S. exports have grown steadily as a share of U.S. GDP from just over 4% in 1980 to nearly 15% in 2013. In spite of this growth, this is still a relatively small share of the U.S. economy. With a stronger dollar, meeting U.S. export sales goals in 2015 could be tougher than expected. In addition to exporters, companies who have large foreign sales such as food and beverage companies will show lower earnings on their foreign sales as those are translated into fewer dollars. This is largely a bookkeeping item, as the earnings are seldom actually converted to dollars and brought back here.

Foreign tourists spend approximately $200 billion a year in the U.S., according to the World Bank. A stronger dollar makes everything from hotel accommodations to restaurant meals more expensive for foreign visitors.

Perhaps the greatest threat to global stability relates to the increased use of dollars by borrowers and lenders outside the U.S. Many emerging market companies have borrowed in dollars because they sell a lot of goods in dollars and believe borrowing dollars to be a hedge. When the emerging market currency is strong and the dollar weak, the company's balance sheet looks strong making it easy for the company to borrow more. When the dollar is strong, this effect is reversed. The emerging market currency falls and the company has trouble making payments on its dollar denominated loans. Banks become less likely to lend, the emerging market economy weakens, and capital leaves the country.

In terms of worldwide economic growth, what remains to be seen is whether the positive domestic effect of a stronger U.S. dollar will offset its negative effect on foreign economies. While we are not in the business of forecasting the future strength (or weakness) of the dollar, it is prudent to prepare and understand both the positive and negative impacts change may bring.

Year End 2014

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