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Investor Info

Investment Commentary

Goodbye USD?

This Investment Commentary takes a look at the current discussion regarding the USD and the conclusions that may be drawn.

In the last Investment Commentary, I discussed the USD and mentioned its declining importance as a global currency. However, despite the gloomiest predictions, the USD remains highly intertwined in many aspects of the world economy and is immensely important in terms of global asset diversification. Even if your own portfolio has no direct investments in the USD, you shouldn't be under the illusion that the USD plays no role in its performance. Take raw materials, for example. In short: no matter how you turn it around, you simply can't get away from USD exposure, be it direct or indirect. That's reason enough to take another look at this currency.

The collapse of the USD

The mainstream media seem worryingly unanimous in their belief that the USD will continue to weaken. The country's rising debt is continuously cited as the most important reason behind this pessimism. The level of debt, they say, is now so high that the US has no other option but to print more money (i.e., create inflation) to pay it down. The process, more elegantly termed "quantitative easing" in the industry lingo, has led to serious misgivings, so much that we've begun numbering the various "rounds" of easing activities.

The ARVEST Investment Committee is not suggesting that fears regarding the USD are being pulled out of thin air. Quite the contrary: in the long term we share the concerns of the market. Based on our rather pessimistic assessment, the ARVEST Global Starts Fund has been less heavily invested in US stocks (and thus the USD) versus the S&P 1200 benchmark index for many years now – not just since "yesterday." While more than 50% of the S&P 1200, like all other global stock indices, is made up of North American stocks, by the end of 2006 the ARVEST Global Stars Fund was only 15% invested in the region. Thus, our past pessimism was not based on financial crises or quantitative easing. In retrospect, our cautious positioning toward North America, which was in sharp contrast to market sentiment at the time, has helped the fund to significantly outperform the market.

A world full of USD pessimists

Today, on the other hand, we are faced with a different situation. Besides US politicians, one would be hard-pressed to find a qualified person with a positive view of the USD. Criticism of the US currency has progressed to the point that it has been universally adopted by the mainstream media. Recently, even the free Swiss daily [1] "20 Minutes" ran a headline announcing the continued decline of the dollar, going on to describe it as a "free fall" in the associated article. However, the dollar's free fall is not a recent phenomenon. The following chart shows its decline over at least the past ten years, during which it lost more than half its value against the CHF.

Admittedly, however, virtually every currency has depreciated against the CHF. However, even from a trade-weighted perspective[2], the USD has declined by a good 38%. Those who are just now looking to position themselves defensively against the USD are probably a bit late to the game.

Contrarian strategy

The past has repeatedly shown that investors who align themselves with the mainstream sentiment often end up buying at the wrong time (i.e., at top prices) and selling at bottom prices. Contrarian investors, on the other hand, are able to use the asymmetry between their views and those of the market to their advantage.

In the opinion of the ARVEST Investment Committee, there is the distinct possibility that the prevailing sentiment in the market may have led to a larger-than-justified devaluation of the USD. Especially compared to other freely tradable currencies of open-market economies[3] , the adjustment in the USD seems to have exceeded purchasing power parity. If, however, investors continue to count on a USD collapse, they would need to position theirselves much more defensively than merely reducing the USD exposure.

A collapse of the USD would have no less of an impact on the financial markets than the Lehman crash.

May 3, 2011
ARVEST Funds AG,
Beyzade Han, Fund Manager

[1] I have purposely avoided the term "newspaper" here.
[2] Currently: EUR 38%, JPY 18%, GBP 9%, CAD 31%, CHF 3%

[3] This certainly does not include the renminbi.