

THE DOLLAR

The dollar has been sinking since January 2002. Corporations that do not have a competitive advantage want an even weaker dollar. Those, like Microsoft, with an above average competitive advantage hardly care about the dollar. Why?

The dollar, like any currency, reflects:

1. The **inflation differential** between two countries. The country with higher inflation will experience a weaker currency.
2. The **productivity differential** between two countries. The country with higher productivity growth will experience lower inflation and a stronger currency.
3. The **real interest rates differential** between two countries. The country with higher real interest rates is likely to experience higher productivity growth, lower inflation and a stronger currency.
4. **Government policies** (fiscal, monetary, and foreign).

The weakness of the dollar has deep roots that can be traced to one or all of the above factors.

The weak economic outlook for the US accompanied by an aggressive monetary policy is a major reason for concern. Higher inflationary expectations caused by the aggressive printing press of the Fed and uncertain economic times scare off foreign capital.

I believe, however, that the real uncertainty overhanging the dollar is caused by a confusing, unreliable, and ever-changing **foreign policy**. These issues were discussed in great detail and depth in the November-December issue of *Foreign Affairs*.

The world is concerned about the objectives and actions of the current administration. All my overseas friends are concerned that we have decided to become the policeman of the world. We are seeking a *Pax Americana*.

Our desire to bring peace is accompanied by a tremendous show of power, force, and technology, which **scares and intimidates the rest of the world community**. The idea of "preemptive action" to insure peace has been unanimously, including Mr. Carter, singled out as a very dangerous doctrine.

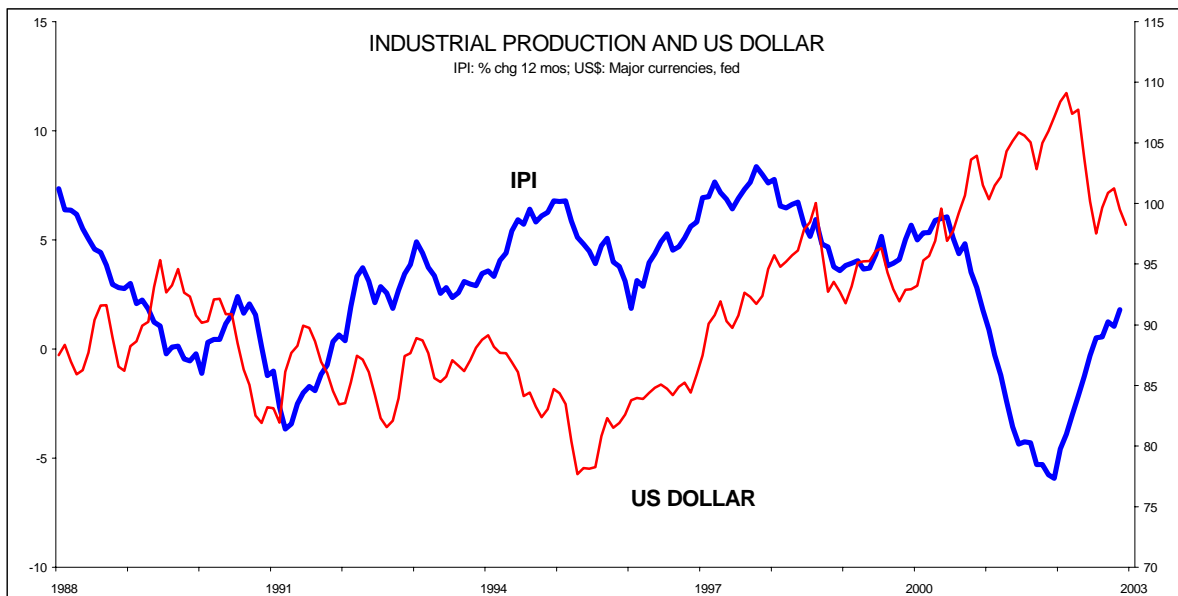
Even in the US, we are not sure about what to believe. As Americans we have to be united. As rational thinkers we are concerned about the reasons for attacking Iraq. Pressure has now been placed on North Korea. Who is next? When are we going to stop? Why?

These concerns are deep in the minds of foreign investors. The uncertainties created by this Administration are frustrating our global friends.

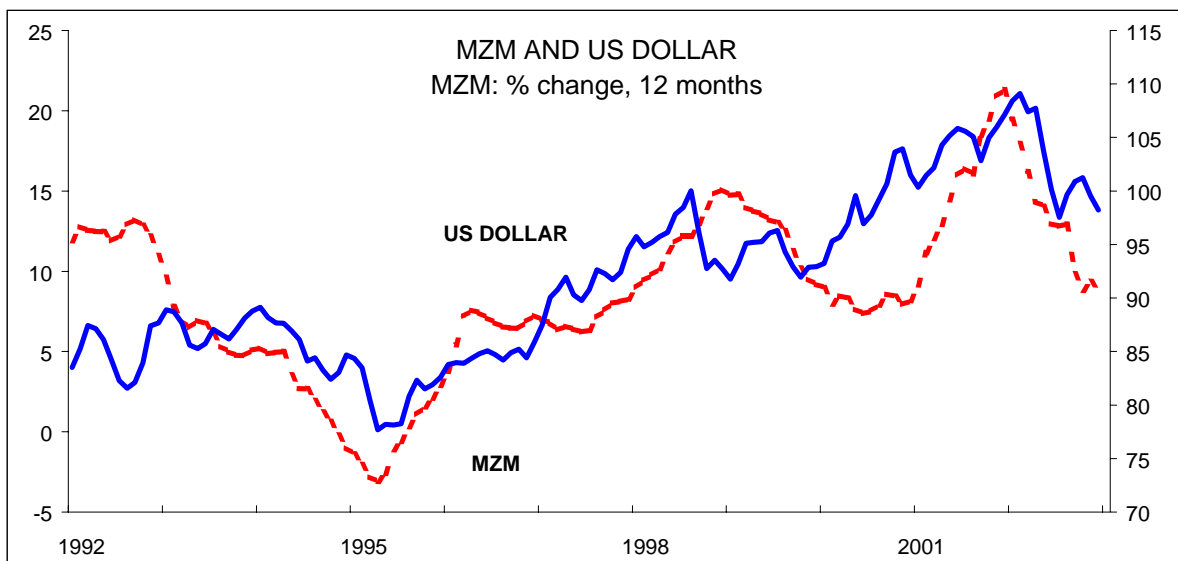
The international community is voting its **disagreement** with what is happening in the US by **selling dollars** and moving them in a more predictable economic environment.

This process has been taking place **since January 2002** and has **negative implications for our economy and financial markets**.

You can read more on these issues in my book *Profiting in Bull or Bear Markets*.



The weakness of the dollar has always been associated with periods of sluggish economic growth. A strong dollar, however, has anticipated economic strength by 12-24 months. The weakness of the dollar in 2002 is predicting a sluggish economy in 2003. Trends in the dollar are also closely related to those of the stock market.



The cyclical turning points in the dollar coincide with the turning points in the growth of the money supply. The dollar and the growth of the money supply are two of our most important leading indicators of economic activity. See more details on this website and in my book *Profiting in Bull or Bear Markets.*

George Dagnino, PhD

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