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## Hedging against a further drop in the dollar

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As most of you know, I've been hedging client portfolios against a fall in the dollar for over four years now. I've done so by using two foreign bond funds, and it's been highly successful so far. It's time now to reassess the hedge and shift it away from the yen, the euro and other European currencies

I'm recommending this shift because the dollar has dropped more against those currencies than it has some other currencies. Specifically, I believe we'll be seeing more appreciation in the currencies of emerging markets countries such as China, India, Turkey, Russia, Singapore, Malaysia, Thailand, Hong Kong and Peru. All of those countries have higher growth than average annual GDP growth around the world over the last 5 years. As such, they have the potential for attractive investment opportunities.

What this means for client portfolios is that I'm recommending that we move from the current even split between American Century International Bond fund and Pimco Developing Local Markets fund to a heavier weighting of the latter. The former invests in government bonds in Europe and Japan and has given us great returns over 4 years. The latter invests in very short-term bonds and money market funds in emerging markets countries such as the ones mentioned above.

As I write this, the dollar has dropped to the point that a euro costs \$1.52. As the Wall Street Journal indicated just today, many Asian currencies have been bid up by currency traders, inspired by the dollar's drop to a new record low against the euro. Asian central banks are

intervening, trying to curb their respective currency's rise versus the dollar; however, they're approaching this in a much less aggressive way than they have in the past.

Why? Asian central banks have been showing a growing willingness to let their currencies rise in order to curb inflation. As we've been hearing recently regarding China, inflation is picking up not only there but also throughout Asia. There seems to be a general policy consensus in Asia to fight inflation with stronger currencies. It makes sense, too, since stronger currencies buy more goods abroad. In fact, the U.S. is suffering from just the opposite of that phenomenon; with the weak dollar, it's taking more dollars to buy foreign goods or travel abroad. That's considered inflationary.

So my recommendation is that we move from the current 4.5% (which is what most of you hold) in each of the two foreign bond funds to 3% of your portfolio in American Century and 6% in Pimco Developing. Further, I'm recommending that should the euro rise to \$1.55, we liquidate the remaining 3% in American Century and redeploy it to the Pimco Total Return Bond fund (or an identical fund also managed by Bill Gross called the Harbor Bond fund) These funds opportunistically and expertly seeks out inefficiencies in the U.S. mortgage market and elsewhere and have stellar long-term records. Even those battered markets are selectively starting to recover, and I believe there is relatively safe value to be had there.

So be sure to let me know if you do not agree with this strategy; I'll be starting to implement it across all clients within the next week.

