FPA FINANCIAL PLANNING PERSPECTIVES

HOW THE FALLING DOLLAR MAY FALL ON YOUR FINANCES

You may have recently read or heard numerous references about the “falling dollar,” but not paid them much attention. Perhaps you should. If you travel overseas, invest domestically or internationally, or buy any imported products, the falling U.S. dollar will have an impact on your personal finances.

The falling dollar refers to the fact that the exchange value of the American dollar has been declining sharply against several major world currencies over the last couple of years. The American dollar, for example, lost 20 percent in buying power in 2003 against the euro, 10 percent against the yen and 34 percent against the Australian dollar, according to numbers from the *Wall Street Journal*, and it hit an 11-year low against the British pound and a 6-year low against the Canadian dollar. In short, the buck buys less abroad than it once did.
The impact of this decline produces both good and bad trade-offs for American consumers, depending on their investing and spending habits. Here are the major impacts, and what changes you might make in your finances to minimize or take advantage of the impacts.

More expensive consumer goods. Many consumer goods Americans buy, from cars to electronics to apparel, are imported. The prices of those products inevitably rise as the value of the U.S. dollar declines. But fear of losing market share in the United States has compelled many foreign companies to absorb some of the currency increases by reducing their profit margins. And some “foreign” products, such as many Asian cars, are actually manufactured in the United States. Still, numerous imported products have risen in price. The obvious counter strategy, of course, is to buy American.

Travel costs more. It's a cold fact that hotels, meals and tourist sights are going to cost more for American travelers to Europe, Japan Canada and Australia, among other nations, because their dollars won't buy as much of the local currency as they did before.

You can either delay travel until the dollar strengthens, or "buy American" by traveling in the United States. Or, as should be noted when discussing the impact of the falling dollar, it isn't falling everywhere. The dollar, for example, has risen against the currencies of Mexico and several Latin American nations, making them cheaper travel destinations.

Investing. While you may not want to travel overseas soon because of the cost, you may want to send your money there. Many foreign stocks and bonds have performed well for U.S. investors, and no small part of those good returns has been due to the dropping dollar.

Most who invest internationally do so through U.S.-based mutual funds, and they should pay special attention to what nations or regions a fund invests in, and how the fund handles currency fluctuations. Some funds fully or partially hedge against currency swings, up and down. This reduces fund volatility for investors. But hedging also costs, reducing the return for fund investors. Furthermore, some experts point out that hedged funds correlate more closely to U.S.-dollar investments than unhedged funds, thus undercutting some of the benefit of diversifying internationally.

On the domestic investment side, a weak American dollar is good for those American companies—small as well as the huge multinational corporations—that sell a lot of their product abroad. Exported American products are cheaper, and thus more competitive, and when those increased international sales revenues are converted to U.S. dollars, they can take advantage of the favorable exchange rates, further boosting profits.

Still, caution financial planners, as with any investment decision, you should be wary of "chasing performance." Many experts predict that the U.S. dollar will remain weak much if not most of 2004. But the risk here, naturally, is that they could be wrong and the dollar unexpectedly begins to rebound against foreign currencies. That would hurt international investment returns and returns of American companies that do a lot of business abroad.

Ultimately, most investors should look long term. For one thing, currency fluctuations generally even out over time. Second, the primary benefits of devoting a portion of your portfolio to overseas investments (perhaps 10 to 20 percent) is not to ride the winds of currency fluctuations but to diversify and actually reduce overall investment risk, and to buy into good companies abroad.

-30-

February 2004— This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Marnie Aznar, MBA, CFP•, a local member of the FPA.