LMCG INVESTMENTS®

UNFILTERED

EDITION 8 | MAY 2017

MONTHLY INVESTMENT COMMENTARY FROM LMCG

Foreign Currency Tailwinds Are A-Blowin'

Since Donald Trump's election in November, the future course of the US dollar has been hotly debated, backed by some science and plenty of bluster, like weather newscasters tracking the latest named storm. By Inauguration Day in January, the "long dollar" bet was where the smart money advocates were positioned, and a stronger dollar seemed as certain as … higher interest rates.

Well, neither of these outcomes has materialized in 2017 so far. Investors are complacent, however, still reasonably confident that the promise of tax and banking reforms will be delivered and rising rates and a stronger dollar will naturally follow. In this edition of Unfiltered, we want to remind investors that a weakening US dollar may actually be a part of the growth plan, and that taking on foreign currency "risk" may actually be the opposite.

Yes, You Are Exposed to Currency Risk, but Not Where You Think

Read just about any mutual fund prospectus today and you will likely find a disclosure pertaining to "foreign currency risk". I don't think you will find many paragraphs pertaining to "home currency risk". The simple reason is that most people look at their bills in dollars, and if their investments fall relative to those, that's real risk.

Spend time with someone from Great Britain today and you might hear what a decline in home currency can do. The British pound fell sharply against the US dollar and euro following the Brexit vote last year, and pain has been felt by businesses and consumers alike. More expensive import prices hit certain sectors of the British economy hard, and the relatively worldly British citizen was poorer in the global shopping mall. UK exports have benefited, however, and business on the whole has picked up as a result. Pro-Brexit forces led by Theresa May have that case to boost them in June elections, which is beginning to become the next financial market narrative.

> "I think our dollar is getting too strong, and partially that's my fault because people have confidence in me. But that's hurting – that will hurt ultimately," Trump said on Wednesday. "It's very, very hard to compete when you have a strong dollar and other countries are devaluing their currency," Trump told the *Journal*.
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> *Wall Street Journal* Interview, April 12, 2017

It has been a very, very long time since the US dollar has been decidedly weak against foreign currencies – and we are not there – yet. This helps make the threat of real US dollar decline seem so … foreign. You have to reach back into the 1980s when a steep decline in the dollar after Reagan left office followed the surge in the dollar during Reagan's first term.

The Reagan dollar experience is very relevant today. The dramatic dollar surge in the early 1980s accelerated the devastation of a wide range of US-based manufacturing industries. Decades later, that set the stage for Trump's populist support among the regions that have yet to recover from the exodus to low labor cost destinations.

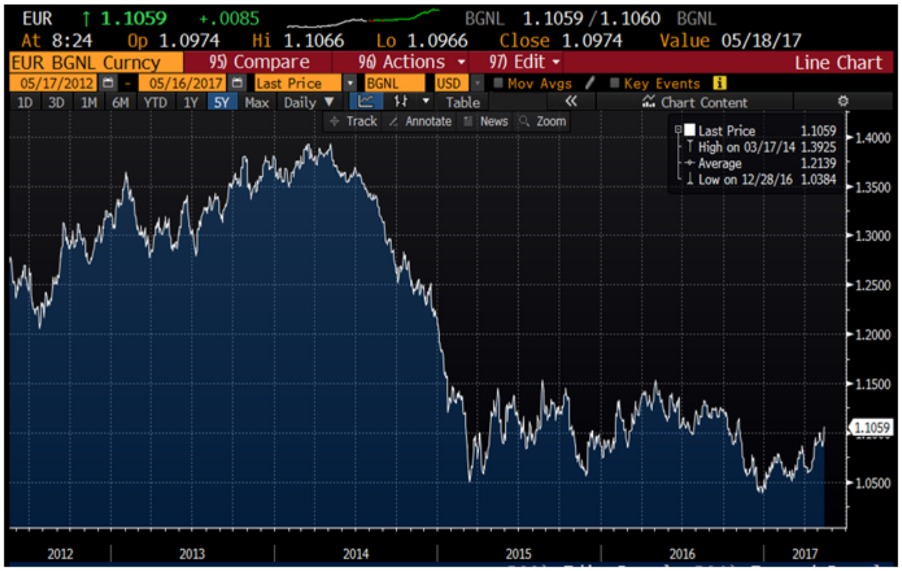
Donald Trump has already indicated awareness of the dangers of a strong dollar in his campaign goals of returning manufacturing and industrial jobs to the United States. However, there is no explicit policy to devalue the dollar – Treasury Secretary Mnuchin has been adamant that the administration is not trying to talk the dollar to lower levels. But, there is precedent among major trading partners in explicit currency management. Prime Minister Abe has not been shy in working to devalue the Japanese Yen as part of his "Abenomics" program, which has been the source of friction among its Asian trading partners over the past three years. And, in spite of several sharp reversals, the yen has declined from its peaks in August, 2016.

In summary, political will has shown some success in devaluing currency elsewhere, and a weaker dollar is consistent with achieving the political goals of the Trump administration. On top of the will, the latest data from the US, Europe and Asia may help push the dollar down further.

How Much Foreign Currency Tailwind So Far? More in the Future?

Through the Memorial Day weekend, the weaker $US has given about a 5% boost to foreign investment returns in developed and emerging international equity markets.[1] It's important to point out, however, that these non-US markets are also strong in local currency terms. The MSCI EAFE Index is up 8.7% YTD in local terms and the MSCI Emerging markets are even stronger – advancing 14.1%[2] without the currency translation effect. Clearly if these markets continue to perform well, this should provide additional strength for these non-US currencies – providing a tailwind for our non-US assets in the LMCG Global MultiCap strategy. If the currency move seems like a lot of tailwind to strong foreign investment returns, it pales in comparison to the headwinds investors felt as the dollar surged in 2014.

[1] Source: FactSet.
[2] Returns are through 5/26/17. Source: FactSet.



Much is being made about the falling dollar in the midst of uncertainty in Washington, but the truth is that the Euro and other major currencies have only slightly retraced their fall in 2014.

We believe currency diversification is an essential part of managing a core portfolio today.

Source: Bloomberg

We are not believers that the dollar will climb back to the top of this steep mountain, but we think further retracement is likely. As we enter the summer of 2017, European and emerging market economic indicators are moving higher as US indicators are stalling (but not falling). More than political jawboning, the underlying cycles of global economies could well provide what President Trump is looking for in a weaker (better yet, competitively priced) US dollar.

In terms of what this means for US based investors – we think it points to a strong argument not to hedge currency exposures.

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