TWEETING THE DOLLAR DOWN

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As an accounting principle "last in, first out" (LIFO) serves an important purpose. As a management tactic it leaves something to be desired - particularly when we are referring to dollar policy and the president-elect of the United States.

Yesterday, President-elect Donald Trump expressed his view (in an interview with *The Wall Street Journal)* that the dollar was "too strong." He further explained the border adjustment tax proposed by Congress "was too complicated." He may be right on both counts—a debate for another time—but there is a more important issue for investors to consider: the impact of executive jaw-tweeting on the markets. This constant stream of consciousness discourse gives the impression that the President-elect is spouting the views of the last expert he consulted or the most recent article he read—last in, first out.

As soon as Mr. Trump's comments were published, the dollar tumbled to its lowest level in a month. This trend manifests each time Mr. Trump opens his Twitter account. Auto, defense, and pharmaceutical companies - to name a few - have been in the PEOTUS' cross-hairs with short-term negative impacts on their respective stock prices. However, the phenomenon appears to be short-lived.

Pharmaceutical stocks in our portfolios, for example, are amongst the strongest performers year-to-date. This despite a shout out from the President-elect at his first press conference stating his desire to curb pharmaceutical price hikes since, as he so ironically stated, the pharmaceutical companies "have been getting away with murder" for years.

What does all this have to do with the U.S. dollar? One of the potential headwinds for investors in light of President-elect Trump's proposed economic policies is the potentially negative effect of a too strong dollar on U.S. multi-national earnings and added pressure on already anemic global economic growth. These proposed policies that investors have celebrated as being good for U.S. stocks (corporate tax-reform, lower individual taxes and a potential tax holiday for corporate cash stashed overseas) will also put upward pressure on the dollar. In other words, Trump's growth-oriented policies that have spurred stock prices will de facto lead to a strong dollar. The question is how strong. Squaring the policy circle on this dollar policy disconnect will be critical. And rhetoric is not policy.

Keep in mind that talking up the value of the dollar and positioning official policy to favor a strong dollar has been part and parcel of U.S. official dollar policy for decades. Ever since the "shock" when President Nixon took the dollar off the gold standard in the 1970s and the subsequent sharp decline in its value, it has been U.S. policy to favor a stable to strong currency. The "stagflation" experience of the 1970s was in part a direct result of the weak dollar and related loose monetary policy.

According to a recent editorial in *The Wall Street Journal,* tight Fed policy and tax cuts during the Reagan Administration (which Trump's election is frequently compared) caused the dollar to "rise dramatically relative to other major currencies, appreciating more than 50% from 1980-1985." That strong dollar did the trick in boosting GDP growth (up 7.3% in 1984), but wreaked havoc on U.S. multinational earnings, reduced competitiveness for domestic manufacturers, and put downward pressure on commodity prices. Enter Jim Baker, Reagan's Treasury Secretary, who negotiated the Plaza Accord in cooperation with other major economic powers to stabilize and lower the dollar exchange rate. The result was as desired—protectionist fears subsided and trade expanded as the dollar stabilized in an acceptable but strong dollar trading range.

The historical strong dollar policy encouraged the use of the dollar as the preeminent global reserve currency. It led to trade and commodities to be priced in dollars and has

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resulted in enhancing the apparent worth and stability of investment in U.S. assets: everything from real estate to equities to U.S. Treasury bonds, which are the primary global source of official savings. The strong dollar supports lower and more predictable inflation, encourages foreign investment, and bolsters its use at the center of the workings of the global financial system.

Walking back the official commitment to a strong dollar sends a very discouraging message to foreign holders of U.S. assets. It also makes U.S. pronouncements start to ring hollow of how other countries unfairly use their foreign exchange rates to manipulate trade. Presidential musing, out loud, in the global public square, sow the seeds of mistrust and imply that the U.S. would be willing to do the same with our own currency if it served US interest. With trillions of dollars invested in U.S. Treasury Securities as international reserves, raising questions about the U.S. position on the dollar invites selling, at least on the margin, and potentially higher interest rates for everyone.

The irony is that between the relative performance of the U.S. economy and the Federal Reserve being in a tightening mode, one would expect the dollar to be strengthening. Talking (or 'tweeting') the dollar down threatens to undo this process and potentially weakens the Fed's efforts to ward off inflation. Just today the CPI figure for December came in at 2.1% year over year with the core CPI at 2.2% year over year -- right in line with the Fed's target.

It is unclear how much stronger the U.S. dollar would have become without the President-elect's pronouncement. But the immediate impact was volatility, short-term weakness, and questions raised about the U.S. government's official stance after years of stable policy. Uncertainty on this front is to no one's benefit. Time to dial down the 'art of the deal' rhetoric and get to work on policies that will generate growth.

U.S. Real Effective Exchange Rate