WHAT A RISING DOLLAR MEANS FOR YOUR STOCK PORTFOLIO

Jeremy Schwartz – Global Chief Investment Officer
11/05/2014

The Mauldin Economics team released a headline-grabbing report in late October called "The Ticking Time Bomb of the Strong US Dollar." Its author warns readers, "You're going to hear hundreds of US multinational companies blame their profit shortfalls on the strong dollar."[1] Typically, if a company's home currency is weakening compared to the currency where the company's sales are generated, this will have a positive effect on sales and profitability, and if the home currency is strengthening, it could negatively impact sales and profitability. This is the dilemma Japanese companies faced for many years as they fought the uphill battle of a strengthening yen. The Mauldin team put it quite nicely in reference to the latest U.S. dollar surge: • **"Top Line Pain:** A strong dollar raises prices for foreign customers and those higher prices can negatively affect demand. • **Bottom Line Pain:** The value of overseas sales declines when translated back into US dollars."[2] The recent U.S. dollar strength is certainly being felt at some multinationals, but the moves may be just the beginning. See the latest warnings: **The Coca-Cola Company** "Although the currency headwind on operating income was in line with the outlook provided last quarter, foreign currency unfavorably impacted earnings per share (EPS) by 6 points due to additional currency headwind related to remeasurement gains/losses recorded in the line item Other income (loss) – net." **Philip Morris International** In the most recent earnings release, CEO Andre Calantzopoulos stated that "currency headwinds have stiffened." Later in the report, the company quantified the impact of currency by forecasting "an unfavorable currency impact, at prevailing exchange rates, of approximately $0.72 per share for the full-year 2014 compared to unfavorable currency of approximately $0.61 per share in the prior guidance."[4] **The Procter & Gamble Company** "P&G reiterated its organic sales growth and core earnings per share growth guidance ranges for fiscal year 2015. P&G added that the quarterly profile of earnings will be heavily influenced by the variation of foreign exchange impacts from period-to-period. The Company expects significant negative sales and earnings impacts from foreign exchange in the October-December 2014 quarter."[5] **Strengthening Dollar Can Negatively Impact Revenue of U.S. Multinationals** We are working to quantify the impact on S&P 500 Index earnings from a move in the U.S. dollar, but market data is quite clear: the S&P 500 has traded quite inversely to the currency moves over recent years, and it has become increasingly negatively correlated. Recall, this is very much like the situation in Japan, where the market and currency tended to move in the opposite direction. The reasons here in the United States also may be similar in nature to those in Japan. A growing share of revenue and profits for U.S. corporations comes from overseas—and that share seems only likely to increase with globalization of the economy. Of course, there is also a safe-haven association with the U.S. dollar, and moves out of equities during periods of risk aversion have benefited the U.S. dollar. But on a company fundamental and earnings basis, there is some connection, as the company reports above illustrate. **Three-Year Correlation of U.S. Dollar to S&P 500 Index**

Sources: WisdomTree, MSCI, 12/31/73–9/30/14. Past performance is not indicative of future results. You cannot invest directly in an index.

Who Benefits from a Strengthening Dollar? • **International Equities:** Foreign multinational companies have the potential to benefit from a strengthening dollar because their products become less expensive to U.S. consumers, possibly increasing sales. These companies also benefit as their foreign sales are translated back to their home currency through a more favorable exchange rate, resulting in higher earnings. We think this is why developed international equities have historically performed better in periods when their currencies were weakening, compared to periods when they were strengthening.[6] Even though a stronger U.S. dollar and weaker euro or yen might help the profits of European or Japanese companies, the dollar strength can drag down the total returns of U.S. investors who do not hedge their international equity exposure. For this, we encourage investors to consider Japanese and European multinational companies, where we see some of the strongest examples of U.S. dollar strength relative to these currencies. • **Domestic Small Caps:** Typically, small-cap companies generate a majority of their sales domestically and are not as sensitive to movements in exchange rates as large caps. Also, domestic small caps are typically not impacted by foreign economic growth, which has been tepid compared to U.S. growth.

[1]Tony Sagami, "The Ticking Time Bomb of the Strong US Dollar," Mauldin Economics, 10/28/14. [2]Ibid. [3]The Coca-Cola Company, Third Quarter and Year-to-Date 2014 Results, 10/21/14. [4]Philip Morris International Inc., 2014 Third-Quarter Results, 10/16/14. [5]The Procter & Gamble Company, Q1 2015 Earnings Release, 10/24/14. [6]Sources: WisdomTree, Bloomberg, 12/31/69–09/30/14. Refers to the currencies and equities in the MSCI EAFE Index.

Important Risks Related to this Article

Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. Investments focusing on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development. Investments focused in Japan are increasing the impact of events and developments associated with the region, which can adversely affect performance.

For standardized performance and the most recent month-end performance click here NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

For more investing insights, check out our Economic & Market Outlook

View the online version of this article here.

IMPORTANT INFORMATION

U.S. investors only: Click here to obtain a WisdomTree ETF prospectus which contains investment objectives, risks, charges, expenses, and other information; read and consider carefully before investing.

There are risks involved with investing, including possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country, sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Investments in emerging markets, currency, fixed income and alternative investments include additional risks. Please see prospectus for discussion of risks.

Past performance is not indicative of future results. This material contains the opinions of the author, which are subject to change, and should not to be considered or interpreted as a recommendation to participate in any particular trading strategy, or deemed to be an offer or sale of any investment product and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein. Neither WisdomTree nor its affiliates, nor Foreside Fund Services, LLC, or its affiliates provide tax or legal advice. Investors seeking tax or legal advice should consult their tax or legal advisor. Unless expressly stated otherwise the opinions, interpretations or findings expressed herein do not necessarily represent the views of WisdomTree or any of its affiliates.

The MSCI information may only be used for your internal use, may not be reproduced or re-disseminated in any form and may not be used as a basis for or component of any financial instruments or products or indexes. None of the MSCI information is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. Historical data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The MSCI information is provided on an "as is" basis and the user of this information assumes the entire risk of any use made of this information. MSCI, each of its affiliates and each entity involved in compiling, computing or creating any MSCI information (collectively, the "MSCI Parties") expressly disclaims all warranties. With respect to this information, in no event shall any MSCI Party have any liability for any direct, indirect, special, incidental, punitive, consequential (including loss profits) or any other damages (www.msci.com)

Jonathan Steinberg, Jeremy Schwartz, Rick Harper, Christopher Gannatti, Bradley Krom, Tripp Zimmerman, Michael Barrer, Anita Rausch, Kevin Flanagan, Brendan Loftus, Joseph Tenaglia, Jeff Weniger, Matt Wagner, Alejandro Saltiel, Ryan Krystopowicz, Jianing Wu, and Brian Manby are registered representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC, in the U.S. only.

You cannot invest directly in an index.

DEFINITIONS

Currency : Currency in which the underlying index returns are calculated. Euros: The returns are calculated, and there is no currency conversion; resulting statistics result purely from the returns of the equities. U.S. dollars: The returns are calculated and then converted into U.S. dollars; resulting statistics are the result of a combination of the euro's performance against the U.S. dollar and the returns of the underlying equities.

Earnings per share : Total earnings divided by the number of shares outstanding. Measured as a percentage change as of the annual Index screening date compared to the prior 12 months. Higher values indicate greater growth orientation.

Headwind : challenges to performance or expectations of performance.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

Correlation : Statistical measure of how two sets of returns move in relation to each other. Correlation coefficients range from -1 to 1. A correlation of 1 means the two subjects of analysis move in lockstep with each other. A correlation of -1 means the two subjects of analysis have moved in exactly the opposite direction.

Fundamentals : Attributes related to a company's actual operations and production as opposed to changes in share price.

Exchange rate : The exchange of one currency for another, or the conversion of one currency into another currency.

Small caps : new or relatively young companies that typically have a market capitalization between $200 million to $2 billion.