

WHAT IS THE U.S. DOLLAR ACTUALLY WORTH?

Ambar Bajaj – Senior Solutions Specialist – ETF Model Portfolios
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As we highlighted in a [previous blog post](#), answering the question of what the U.S. dollar is actually worth depends on the reason for asking the question in the first place. For importers and exporters, it is likely the value of the dollar compared to the currencies of its principal trading partners. For currency traders, it is likely the value compared to the most frequently traded currencies. With foreign exchange [volatility](#) starting to rise, many investors are increasingly cognizant of the impact foreign currencies have on the returns of their stock and bond portfolios. For these investors, the value of the dollar is simply relative to the currencies of their investment exposures. In measuring the dollar against its largest trading partners and most frequently traded currencies, we sought to create an intuitive approach to tracking its value over time. The [Bloomberg Dollar Spot Index \(BBDXY\)](#) tracks the value of a basket of 10 currencies against the U.S. dollar. Through [our approach](#), we believe that the Index takes into account three primary roles the dollar plays in the global economy: its role in global trade, its impact on the relative attractiveness of foreign assets and the impact owning foreign assets has on the value of U.S. investors' portfolios. As of last year, the economies of constituent currencies in the Index represented 80% of overall trade with the U.S. and nearly 94% of the overall trading volume in the foreign exchange market. In our view, the [ICE U.S. Dollar Index's \(DXY\)](#) static approach to assessing the dollar's value does not accurately reflect the role the dollar plays in the global economy, nor does it properly consider the impact it has on investors' returns. In 1982, the economies of DXY's constituent currencies represented 80% of trade with the United States; that proportion is now only 42%. While international fixed income investing is only beginning to catch on in the U.S., investors have for decades allocated a portion of their portfolios to international equities. As shown in the table below, BBDXY has a remarkably similar weighting scheme to the currency exposures of two of the most popular international equity benchmarks, the [MSCI EAFE Index](#) and the [MSCI ACWI ex-US Index](#). Bloomberg Dollar Spot Index vs. MSCI EAFE & ACWI ex-US

Country	Currency	Weights				
		Bloomberg Dollar Spot Index	MSCI EAFE	MSCI EAFE Difference	MSCI ACWI ex-US	MSCI ACWI ex-US Difference
Eurozone	European euro (EUR)	31.4%	33.7%	-2.3%	23.8%	7.6%
Japan	Japanese yen (JPY)	19.1%	21.0%	-1.8%	14.9%	4.2%
Canada	Canadian dollar (CAD)	11.5%		11.5%	7.2%	4.2%
Great Britain	British pound (GBP)	9.5%	18.5%	-9.0%	13.1%	-3.6%
Mexico	Mexican peso (MXN)	9.6%		9.6%	1.2%	8.3%
Australia	Australian dollar (AUD)	6.2%	7.8%	-1.6%	5.5%	0.7%
Switzerland	Swiss franc (CHF)	4.2%	9.9%	-5.6%	7.0%	-2.8%
S. Korea	Korean won (KRW)	3.3%		3.3%	3.3%	0.0%
China	Chinese yuan (CNY)	3.0%		3.0%	3.1%	-0.1%
Brazil	Brazilian real (BRL)	2.2%		2.2%	2.3%	-0.1%
Sweden	Swedish krona (SEK)		3.0%	-3.0%	2.2%	-2.2%
Other	-		6.1%	-6.1%	16.5%	-16.5%

Spot Index vs. MSCI EAFE & ACWI ex-US

Country	Currency	Weights				
		ICE U.S. Dollar Index	MSCI EAFE	MSCI EAFE Difference	MSCI ACWI ex-US	MSCI ACWI ex-US Difference
Eurozone	European euro (EUR)	57.6%	33.7%	23.9%	23.8%	33.8%
Japan	Japanese yen (JPY)	13.6%	21.0%	-7.4%	14.9%	-1.3%
Canada	Canadian dollar (CAD)	9.1%		9.1%	7.2%	1.9%
Great Britain	British pound (GBP)	11.9%	18.5%	-6.6%	13.1%	-1.2%
Mexico	Mexican peso (MXN)			0.0%	1.2%	-1.2%
Australia	Australian dollar (AUD)		7.8%	-7.8%	5.5%	-5.5%
Switzerland	Swiss franc (CHF)	3.6%	9.9%	-6.3%	7.0%	-3.4%
S. Korea	Korean won (KRW)			0.0%	3.3%	-3.3%
China	Chinese yuan (CNY)			0.0%	3.1%	-3.1%
Brazil	Brazilian real (BRL)			0.0%	2.3%	-2.3%
Sweden	Swedish krona (SEK)	4.2%	3.0%	1.2%	2.2%	2.0%
Other	-		6.1%	-6.1%	16.5%	-16.5%

Sources: Bloomberg, MSCI, WisdomTree, as of 9/30/14. Past performance is not indicative of future results. You cannot invest directly in an index. Weights are subject to change. Values may not sum exactly due to rounding.

while we chose to establish our weighting scheme through global trade and [liquidity](#) measures, it is interesting to have our analysis in some ways validated by the comparative size of each country’s equity markets and, by extension, their weight in these popular equity indexes. Additionally, BBDXY avoids the large concentration risk to the euro found in DXY, while providing a broader approach (ten currencies compared to six) that also includes exposure to emerging markets. **Real-world Applications** while this coincidence helps to potentially validate our thinking about the dollar, a more interesting application for investor portfolios would be to use the [WisdomTree Bloomberg U.S. Dollar Bullish Fund \(USDU\)](#) as a way to opportunistically mitigate exposure to foreign currencies as part of an overall portfolio allocation. As we have seen in recent history, the U.S. dollar tends to benefit during times of market stress. For investors with [unhedged](#) international equity exposure, taking [short positions](#) in foreign currencies against the dollar could potentially offset a portion of the losses embedded in their [long](#) equity positions. For broader-based portfolios, USDU could also provide a way to tactically express a view on the value of the dollar.

Important Risks Related to this Article

The USDU Fund is new and has a limited operating history. There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. The Fund focuses its investments in specific regions or countries, thereby increasing the impact of events and developments associated with the region or country, which can adversely affect performance. Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations. Derivative investments can be volatile, and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions. While the Fund attempts to limit credit and counterparty exposure, the value of an investment in the Fund may change quickly and without warning in response to issuer or counterparty defaults and changes in the credit ratings of the Fund’s portfolio investments. The Fund’s investment in repurchase agreements may be subject to market and credit risk with respect to the collateral securing the repurchase agreements and may decline prior to the expiration of the repurchase agreement term. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting those issuers. Unlike typical exchange-traded funds, there are no indexes that the Fund attempts to track or replicate. Thus, the ability of the Fund to achieve its objectives will depend on the effectiveness of the portfolio manager. Due to the investment strategy of the Fund, it may make higher capital gain distributions than other ETFs.

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DEFINITIONS

Volatility: A measure of the dispersion of actual returns around a particular average level.

Bloomberg Dollar Spot Index (BBDXY): Tracks the performance of a basket of ten leading global currencies versus the U.S. dollar. Each currency in the basket and their weight is determined annually based on their share of international trade and FX liquidity.

ICE U.S. Dollar Index (DXY): a geometrically- averaged calculation of six currencies weighted against the U.S. dollar. Current exposures include the euro, Japanese yen, British pound, Canadian dollar, Swedish krona and, & Swiss franc.

MSCI EAFE Index: is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.

MSCI ACWI ex-U.S. Index: A free-float adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets excluding companies based in the United States.

Liquidity: The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

Hedge: Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security, such as a futures contract.

Short (or Short Position): The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).

Long (or Long Position): The buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value, the opposite of Short (or Short Position).