



Weekly Market Commentary



April 25, 2011

Mirror Images: Dollar Down, Stocks Up

The US dollar fell nearly 1% last week, taking out its 2009 low and sliding to its lowest point since the 2008 financial crisis. The dollar now stands less than 5% above its all-time low, hit in March 2008.

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Highlights

The ongoing decline in the US dollar is reinforced by several pressures including the unsustainable budget deficit, slackening foreign demand, and the easy monetary policy of the Federal Reserve (Fed).

The dollar may get a respite this Wednesday, April 27, when Fed Chairman Ben Bernanke may signal a pending transition in Fed policy.

However, any near-term dollar strength is likely to be short-lived and we expect the orderly decline in the dollar to continue and maintain the favorable, mirror-image-like relationship with the stock market.

Why is the Dollar Falling?

A weaker dollar has been a dominant investment theme we have focused on this year. The ongoing decline in the dollar is reinforced by several pressures. These potent forces have combined to sink the dollar even when compared to the euro and its member country's debt problems.

- **The Unsustainable Budget Deficit** - Last week renewed worries about the U.S. budget deficit weighed on the dollar. On Monday, April 18, debt-rating agency Standard & Poor's announced a negative outlook on the United States' AAA credit rating indicating a downgrade was possible if the massive U.S. budget deficit cannot be brought under control within two years. This heightens the focus on the deficit and debt ceiling deliberations in Washington.
- **Slackening Foreign Demand** - China has been allowing greater appreciation of its currency lately as part of its efforts to manage inflation pressures. This results in less demand for dollars by China and other Asian countries that link their currency policy to China's actions.
- **The Easy Monetary Policy of the Fed** - It may seem a wonder that the dollar could be falling against the euro considering the ongoing sovereign bailouts, as a number of European nations are unable to repay their maturing debts as their bond yields continue to soar. But, in fact, the euro hit a 16-month high versus the dollar last week. Tighter monetary policy, in the form of higher interest rates and a recent rate hike by the European Central Bank—in contrast to the easy money policy of the U.S. Federal Reserve—is the key to strength in the euro.

This last driver of dollar weakness may get a respite this Wednesday when Fed Chairman Ben Bernanke is scheduled to give the central bank's first-ever press conference following a policy-setting meeting. The added ability to explain the statement provided by this press conference allows the Fed to deliver a more complex message than can be conveyed in a mere statement. This potentially offers the opportunity to signal a pending transition. It is possible that the Fed in the week ahead may take this



opportunity to signal the pending end of their most aggressive monetary easing program, termed QE2 (Quantitative Easing), towards tighter monetary policy in the quarters to come. Our view is that the Fed may wait until the June FOMC meeting to signal such a shift.

However, any near-term dollar strength is likely to be short-lived. Even a deal by lawmakers on the debt ceiling and cutting the deficit might not reverse dollar weakness since the U.S. economic recovery could be weakened if the plan contains significant spending cuts or tax hikes. The Fed would be forced to balance this contractionary fiscal policy with monetary stimulus by holding interest rates at record lows well into next year even as other central banks around the world raise rates. The much lower short-term interest rates in the United States would likely make holding dollar deposits less attractive, thereby further weakening the dollar.

Stocks and the Dollar

While the dollar has fallen, this year, stocks have risen. In fact, the S&P 500 and the dollar have been mirror images of each other over the past year. As of the end of last week, the S&P 500 is up about 6% in 2011 while over the same period the dollar has fallen about 6%. [Chart 1]

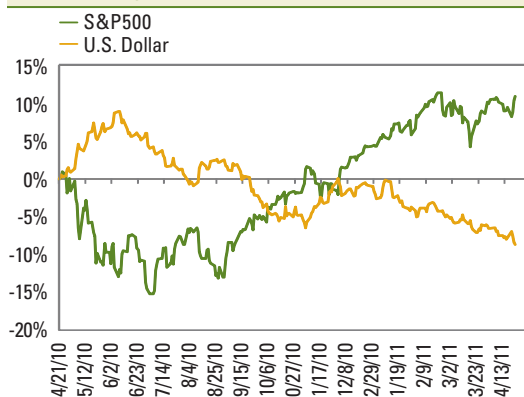
It may seem strange that the weaker dollar has been anything but negative for stocks, especially since it has helped to boost prices at the pump and the grocery store, raised consumer worries about inflation in the coming year, fueled concerns about a decline in global standing for the U.S., and appears to have negatively impacted the President's polling numbers. However, the weaker dollar is a plus for U.S. exporters by making their goods more competitively priced and boosting foreign sales growth. This has aided technology and industrial companies and contributed to the ongoing boom in U.S. manufacturing. The weaker dollar is also boosting the profits of commodity producers and profits repatriated from foreign operations. This has more than offset any shift by consumers as they are forced to spend more at the pump and the grocery store.

Orderly Decline

While the dollar may get a break this week, we expect a further orderly decline in the value of the dollar over the longer term. This is part of the reason we continue to favor commodities asset classes such as precious metals even as they continue to make all-time highs, as precious metals prices have continued to rise in terms of a weaker dollar.

We do not expect a sudden drop in the value of the dollar or intervention by the Treasury that might reverse the dollar's current relationship with the stock market.

1 Mirror Images: The Dollar and the Stock Market
Trade Weighted US Dollar and the S&P 500—One Year



Source: LPL Financial, Bloomberg data 04/22/11

The S&P 500 is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.



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The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

Quantitative Easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

Credit rating is an assessment of the credit worthiness of individuals and corporations. It is based upon the history of borrowing and repayment, as well as the availability of assets and extent of liabilities.

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Precious metal investing is subject to substantial fluctuation and potential for loss.

Stock investing may involve risk including loss of principal.

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