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The Dollar in Decline

The Currency Is Worth Less, but Investors Can Use That to Make a Buck

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Advertisement

Oh, the amazing shrinking dollar.

The U.S. currency tumbled last week to a record low after the Federal Reserve cut interest rates, continuing the dollar's six-year slide. Behind the latest drop is the expectation of weaker U.S. growth and stronger overseas economies. The slump took the dollar below $1.40 for each euro and put it at parity with the Canadian dollar for the first time in more than 30 years.

While U.S. tourists might think twice about a vacation abroad, investors are discovering a variety of ways to make a buck betting against the buck.

Wall Street is cranking out a multitude of new investment vehicles to make it easier for small investors to participate in global currency markets: a worldwide network of banks, hedge funds, speculators, governments and financial institutions that process about $1.8 trillion a day.

The investment products include certificates of deposit, mutual funds and exchange-traded funds packed with various currencies or linked to baskets of foreign exchange. More than $2.7 billion was invested in open-end currency funds by the end of July, up from $36 million at the end of July 2000, according to estimates by Lipper, a Reuters company.

"We're like Greyhound. Leave the driving to us. That's what a mutual fund does," said William E. Seale, chief investment officer of ProFund Advisors, which offers both a Falling U.S. Dollar and Rising U.S. Dollar fund, whose performances are linked to an index measuring the value of the dollar relative to a basket of six major foreign currencies.

So far, the falling dollar fund is the better bet: It is up 7.91 percent for the year, as of Thursday. The rising dollar fund is down 2.66 percent.

Some financial advisers say individual investors with an appetite for risk -- and who already have a portfolio of stocks, bonds and real estate -- may want to diversify further by putting a small portion of their savings into currencies, particularly those projected to continue appreciating relative to the dollar.

One traditional, relatively low-risk way to take advantage of a falling dollar is to simply buy the stocks of big, multinational U.S. companies that benefit from the weaker currency. A lower dollar helps boost U.S. exports by making them relatively cheap on world markets.

The Commerce Department reported recently that U.S. exports rose 2.7 percent in July, to a record high of $137.7 billion, reflecting stronger sales of U.S. farm goods, autos and auto parts and other manufactured goods. Beneficiaries include companies such as aircraft maker Boeing and construction and mining equipment maker Caterpillar.

A weaker dollar also benefits U.S. companies that have extensive service operations abroad, such as McDonald's and Coca-Cola, because the profit they earn overseas in foreign currencies is worth more when brought home and converted into dollars.

Another way for individual investors to profit from overseas economic growth is to buy foreign stocks and foreign-stock mutual funds. The U.S. investor converts dollars into the currency needed to buy the stocks, whether euros, pounds, yen or something else. Then, if the share price holds and the dollar falls, the investor gains when he sells the stock and converts the money back into dollars. If the share price has risen, the profit is even greater. Of course, if the dollar appreciates in the interim, the process works in reverse.

For risk-averse investors, this is safer than trying to play the currency markets, which can be volatile. Currency values can fluctuate with wars, trade deficits, inflation, interest rates and government whims.

Annette Simon, a financial adviser with the Garnet Group in Bethesda, said investing in currencies or currency funds "is not the kind of thing we would encourage for individuals."

"I think you can get the same kind of diversification by investing in international stock and bond funds, and letting the funds work out the currency fluctuations," Simon said. "Betting on the currency itself, to me, seems risky."

Many U.S. companies and foreign stock funds hedge their currency risk, diluting both the losses and gains from currency swings.

Investors willing to tiptoe on the wild side can trade currencies directly by getting a foreign exchange, or forex, account, either through a broker or online. The process is simple: If you use dollars to buy euros, and the euro rises relative to the dollar, the amount invested will be worth more dollars when converted back into dollars later.

Global Forex Trading, or GFTForex.com, is one online service that offers demo accounts to let small investors test-drive currency trading, and mini-accounts that can be opened with as little as $250. Other online providers include Capital Market Services and FX Solutions. All offer educational information about foreign exchange markets on their Web sites.

Another way to invest directly in currencies is through foreign certificates of deposit, or CDs. Everbank.com offers CDs denominated in a variety of foreign currencies or in baskets of currencies. You can invest in one foreign currency or groups of currencies focused on regions or geopolitical or economic developments.

For example, the Everbank Web site offers a "world energy CD" that combines the currencies of four countries rich in energy resources: Australia, Britain, Norway and Canada. It offers a "prudent central bank" CD with the currencies of Britain, New Zealand, Europe and Australia, whose central banks pursue strong anti-inflation policies.

An investor puts some money in the CD, which pays interest over time. Then, when the CD matures, the money is converted back into dollars. The amount is worth more dollars than at the start if the foreign currency has appreciated in the interim; it's worth fewer dollars if the foreign currency has depreciated.

But currency markets can shift suddenly. Remember the Asian financial crisis of 1997-98? That occurred after global investors decided suddenly, en masse, to yank their money out of several Asian currencies. The dollar surged during this period, in part because investors shifted their money into the safe haven of U.S. Treasury securities but also because of booming U.S. economic growth and rising technology stocks.

The dollar has been sliding for the past six years because conditions have reversed. The U.S. economy went into recession in 2001, and the recovery was initially weak. Today, economic growth is stronger in Europe, Asia and many parts of the developing world. And the dollar is under downward pressure from the United States' burdensome current account deficit -- the broadest measure of the trade gap and the result of borrowing billions of dollars worth of foreign money each day to finance spending and investment.

These trends show no sign of reversing soon, but the sharp turnaround in one decade underscores the volatility of currency markets.

"Currencies are a tricky animal, best left to professionals," said Alan Ruskin, chief international strategist at RBS Greenwich Capital. "And really staying on top of what's driving currencies is a bit of a full-time job."

Still, some individual investors may have a little more appetite for risk. For them, another option is a currency fund, similar to a mutual fund. Several are linked to the performance of the New York Board of Trade's U.S. Dollar Index, which tracks the value of the dollar relative to a basket of six other currencies: the euro, Japanese yen, British pound, Canadian dollar, Swedish krona and Swiss franc. The index has fallen by more than a third since peaking recently in July 2001 and is down 66 percent so far this year.

Franklin Templeton Investments offers the Templeton Hard Currency Fund, which invests primarily in money-market instruments denominated in the currencies of foreign countries and markets with low inflation.

The Merk Hard Currency Fund is a no-load fund that invests in eight foreign currency investments, such as money-market instruments, from countries with strong anti-inflation policies. The fund also invests in gold, which is often seen as a hedge against inflation.

Another alternative is a currency exchange-traded fund, or ETF. They are traded on exchanges and therefore are priced throughout the day like a stock, rather than at the end of the day like a mutual fund.

For example, Rydex Investments of Rockville offers eight currency ETFs, called CurrencyShares trusts. Each holds one currency: the euro, Japanese yen, British pound, Australian dollar, Canadian dollar, Mexican peso, Swedish krona or Swiss franc. An investor buys shares in a trust; the value of the shares rises or falls with the value of the currency relative to the U.S. dollar. If the dollar falls, the shares gain.

Such vehicles can yield rewards, said David Petersen, president of Financial Services Advisory. But, he added, "as with every investment, somebody needs to watch it to say when you should exit."

Staff researcher Richard Drezen contributed to this report.

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