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## StocksView: Slumping dollar, rising stocks: What gives?

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By Dick Satran

NEW YORK, Dec 12 (Reuters) - Each fresh fall in the dollar this year has given rise to a new chorus of warnings that an exodus of foreign investors, and a new stock market decline, can't be far away.

But in a year during which the dollar has fallen more than 15 percent against the euro and 10 percent against the yen, the Dow Jones industrial average has risen 20 percent, topping 10,000 this week for the first time in 18 months.

Now, the currency is widely expected to drop by another 5 to 10 percent in the months ahead, and some analysts still worry that it might become a negative factor -- fanning inflation and scaring away overseas buyers of U.S. securities.

Charles Schwab chief investment strategist Liz Ann Sonders, in a research note Friday, said there is a risk that foreigners will flee from the U.S. market because of its decline.

"Support for our market needs to come from sources other than domestic investors," said Sonders.

Past history doesn't clearly demonstrate that a falling currency will hurt Wall Street, however, say a number of market historians.

"Everybody's convinced that the dollar decline hurts U.S. securities," said James Bianco of Bianco Research LLC, an investment advisory firm. "But I put it in the 'Repeat-a-lie-often-enough-and-it-becomes-fact' category."

### DOLLAR'S SLIDE

Gibbons Burke of Markethistory.com, who tracks correlations between markets, agrees that the falling dollar hasn't usually derailed stock market rallies. Indeed, he says, the evidence appears to go the other way -- the stock market tends to lead the dollar: Rising equity prices tend to boost the currency.

"If that relationship holds true," he said, "then the bullishness in stocks eventually would put the brakes on the dollar's slide."

Still, most economists agree, a severe drop in the dollar would set off alarm bells. Such a precipitous drop preceded the October 1987 stock market crash.

But Markethistory.com's Burke says that market crash was the result of a surprise interest rate rise, aimed at breaking the dollar's fall. Stocks had risen sharply all year while the dollar was weakening. The rate hike, Burke says, was "a first, early mistake that new Fed chairman Alan Greenspan quickly corrected."

The Federal Reserve this week committed to hold steady with low interest rates. "The Fed welcomes the decline of the dollar" as a way to boost U.S. exports, says Josh Feinman, chief economist for Deutsche Asset Management.

#### BENEFICIAL FOR STOCKS

"As long as the dollar's decline is slow and gradual it's OK," said Richard Yamarone, director of economic research at Argus Research.

"It hasn't gotten to the disorderly stage, it's not a crisis -- and in fact, on the margin, it's probably beneficial for stocks, " said Feinman.

On Friday Treasury Secretary John Snow called the dollar's fall "orderly," which currency traders took as a green light to sell, pushing the greenback to a lifetime low of \$1.23 (EUR=: [Quote](#), [Profile](#), [Research](#)) per euro and down to 107 yen .

The gradual depreciation of the currency this year has added hundreds of millions of dollars to U.S. company's bottom lines since multinationals get higher earnings translations from abroad when the local currency gains on the U.S. unit. It also makes U.S. exports less expensive on global markets.

Chuck Hill, director of research at Thomson First Call, figures the dollar decline has added about two percentage points to corporate profit growth this year. That might not sound like much, but in the early stages of the profit recovery this provided more than 20 percent of profit growth and gave a spark for the market's upturn.

Foreign investors have continued to participate in the stock market despite that decline, holding about 10 percent of the total of U.S. shares, said Bianco. The share of offshore money has remained at about that level for the past decade, even as the dollar fell nearly 40 percent against the euro over the past two years.

The flow of investment money from abroad "tends to follow the performance of the stock market," said Bianco. That means that whenever U.S. stocks have risen, foreign cash has flooded in, regardless of the dollar's level. Indeed, the impact of the currency has been "little or none."

#### PRESSURE FROM DEFICIT

There are signs, though, that foreign investors are losing their enthusiasm for U.S. securities, said Schwab's Sonders. The rising federal budget deficit is adding to the pressure to bring in foreign investment capital.

Whenever the dollar drops, the yield declines for foreign holders of U.S. debt. That could force them to demand higher interest rates to keep financing the U.S. deficit. Sonders says "the plunge in the dollar represents a graying cloud" for the market.

Markethistory.com's Burke, however, argues that the dollar decline has made U.S. assets a bargain. "They're counting on it to come back, which it has in the past and surely will again."

But that brings up a fresh concern: The boomerang effect on earnings. "If the dollar swings the other way, it can have a pretty strong effect. The pendulum effect then can turn strong earnings into weak," said First Call's Hill. But like most other analysts, Hill doesn't see that happening any time soon.

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