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Written by Philip C Benedict, CFP®

BENEDICT *FROM THE 5TH FLOOR*

6000 Lake Forrest Drive NW, Suite 550, Atlanta, GA 30328-5901 • 770 671 8228 • 770 671 0232 *fax* • 800 678 8227

By: Philip C. Benedict, CFP®
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First, a little background. A few years ago we moved the office. I am sitting among the boxes and the phone rings with the question, "Do you see better from there?" I respond that looking at the treetops of Atlanta is a rather nice view. "No, he said, can you see the future better?" I babbled something about how nobody knows what the future will bring. "I know that, but we hear so much and I would like to hear your comments, your perspective on the economy and the stock market once in a while," he commented, "I don't believe a lot of what those television guys say, but I hear them all the time and I want to get your views." Thus, we created From the Fifth Floor towards a more focused audience.

I WANT EUROS…!

I have no idea who this self-proclaimed *supermodel* is, but Gisele Bundshen made the news a few months ago demanding she be paid in Euros instead of US Dollars. Whether the story was true or not, the media picked up on it as a very embarrassing slap-in-the-face for our country, our economy and our pride. (I know what you are thinking, but who says a pretty model can't be fluent in international currency trading…or has a marketing company that knows how to get her name plastered all over the media.) Later, a headline in the Financial Times read, *America Must Live with Being a Bargain Basement.* (December 2, 2007 by John Gapper) The article told how European shoppers were flying to New York to do their Holiday shopping and how they were buying up properties in New York and Florida for their second homes. American goods are so cheap…indicating having very little value.

The article went on to compare this to the late 1980's when Japanese investors were buying up trophy properties in this country. (He didn't mention how many Japanese lost-their-shirts on the investments because they grossly overpaid for the properties.) Mr. Gapper then goes on to explain how this decline in the US Dollar's value, especially compared to the Euro, is a result of our imports being far greater than our exports for the last several years, resulting in a *savings glut* in Asia and the Mid-East. These funds are flowing back in the form of investments…US Treasuries and, recently, some equity investments. Then he added, "It is a natural financial rebalancing act, but it unnerves politicians and commentators." I found the article quite contradictory bouncing between…it is natural…to America should get its financial house in order.

Now, if you live in Tennessee, Oklahoma or Virginia or most any other part of this country and you perform work, you probably receive US Dollars as your compensation. If the things you buy are priced in US Dollars, you probably don't much care if Brazilian supermodels or Arab sheiks or Hip-Hop stars are upset with the *weak* US Dollar.

But, you may hear an *expert* on television explain with knowledge and passion how this *weak* dollar will eventually destroy our economy and greatly lower our standard of living.

What's my take on this?

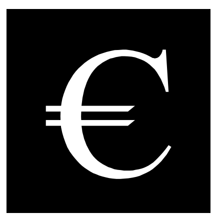
Right up front, I want all readers to know that none of us here at the office professes any particular knowledge nor have I had meaningful experience when it comes to foreign currency issues. All I have done is to make an effort to read more than normal on this topic over the last few months in an attempt to come to my own conclusion. This is just a summary of my readings and thoughts. (I did read part of Dr. N. Gregory Mankiw's book "Principles of Economics" which is the college textbook at Harvard where he teaches. I figured many of those smart economists seem to come from Harvard, so this would be the last word. It was actually rather interesting and informative. I got a lot of information, but, unfortunately, minimal insight.)

I believe the first problem to rational understanding are the terms ***weak*** and ***strong*** when it comes to describing the US Dollar. For example, since 2000, the US Dollar has ***lost*** over 29% of its purchasing power compared to the Euro, thus it is very ***weak***.

None of us wants to be weak, nor does our patriotic pride want us to live in a weak country. But, it doesn't seem as though it is that simple. If I am a large beverage company with most of my expenses based in US Dollars, the ***weak*** currency, and most of my sales are in countries that use other currencies that are ***strong***, I am actually very happy. This is a real boom for my business. If I am a giant hamburger chain with stores all over the world, the weak US Dollar increased my sales dramatically.

However, if I am a German auto manufacturer that has to pay my workers in Euros and most of my sales are in US Dollars, this is a real problem for me.

So, the US Dollar is ***weak,*** at least compared to the Euro. Is that very bad or very good? I believe we are dealing with three different ways to make this judgment.


Euro symbol

- First, you have the argument that the *weakness* is due to our budget deficit, our unfunded liabilities for future social programs and our lack of good fiscal stewardship. These arguments certainly have merit, but emotion is also added many times if the person making judgment dislikes the current political leaders or is adamant about returning to a gold backed currency, or whatever. I am not happy at all with our deficit spending, etc; however, I see a big problem with this argument. The Euro is the currency of the European Union, and the largest countries of the EU have larger budget deficits, far bigger social pension liabilities facing them in the future, along with a declining population and a host of social issues. They don't sound so perfect either. Plus, don't the world financial leaders wonder what will happen to the European Union if that part of the world heads into a financial crisis…might some countries simply leave? This is a relatively new grouping.

- Second is the interest rate differential. This can be complicated, but let's grossly simplify it. If interest rates in the US are 4% and in Germany they are 5%, a skilled trader can "short" the US currency and "buy" the Euro and pocket the 1% differential. Who would do this? A lot of big people apparently. Daily trading in the international currency markets is more than 50 times that of all the world stock markets. This is big, folks! If you are an international corporation, these traders have a big impact on your operations. Thus, we are seeing more and more manufacturing corporations move their operations (expenses) to the country that produces the most revenues, thus, eliminating or minimizing the exchange-rate risk. Currently, this is helping the country with the *weak* currency…the US.

- Thirdly, we have the issue of China, which has forced its currency to remain low, allowing it to produce cheap goods to export, especially to the US. Japan followed this strategy for years, forcing their currency down, until it eventually crashed creating a fifteen year recession. It wouldn't surprise me to see a similar event in China's future, but who knows. It appears the *weak* US Dollar will only accelerate this event.

It also seems to depend on your perspective regarding the *strength* or *weakness* of the US Dollar. For example, if you are a giant Wall Street brokerage/ bank firm, you want a very *strong* US Dollar. This makes imports cheap and helps keep inflation down, thus your bonds and such are repaid with non-deflated dollars and you can borrow very cheaply.

However, if you are a manufacturing company, then you want a *weak* US Dollar so you can export your products all over the world; however, far more of our financial experts come out of Wall Street than the manufacturing sector, thus we hear more of that side of the story.

Look at the chart [Page 3] of The Historical US Dollar Valuation vs. G10 Currencies…from 1960 to the present. Do you see any pattern here? It looks to me as though the US Dollar was way too ***strong*** a few years ago, which made it very difficult for our exporting companies. And, maybe, it is too ***weak*** today, but my guess is that it is more likely to ***strengthen*** over the next few years than ***weaken***. I do not view this as predicting our society will end much like the Roman Empire or whatever other scare stories I read. The ***weak*** dollar is really helping our exporting companies and commodities, ask a farmer. In fact, there are some ***experts*** who will argue that the US Dollar is now about where it should be. I don't know whether that is correct or not, but my guess is that the pretty Brazilian lady may be reacting to yesterday's news and not tomorrow's.

[continued on Page 3]

Sources: Articles in Financial Times, Atlanta Business Chronicle, Navellier's Weekly Marketmail, Van Eck on Money and Investing. Barron's The Economist, Economic Report of the President, The Weber Global Opportunities Report, Douglas Casey's International Speculator and chart from Financial Advisor, December 2007 issue

MORE ON THE *WEAK* US Dollar...

In the previous article, we spoke briefly about how manufacturing companies have learned they need to balance their revenues and expenses in the same currency or face serious risk of loss due to changing exchange rates or incur large expenses for currency hedging. Let's see how this is working in the real world.

During the last fiscal year, foreign and domestic companies invested $878 million in Georgia manufacturing and distribution facilities. Some of the domestic money included the new plant to produce ethanol from pine trees in Soperton, GA and the Cessna plant in Columbus that will manufacture aircraft parts.

But, this article is on the *weak* US Dollar and how it has encouraged foreign companies to move their manufacturing to this country so their expenses will be in US Dollars as are their revenues. Some examples of foreign investment include:

- Korean company, Sewon Precision opened a new chassis plant in LaGrange.
- Korean company, Hyundai Mobis opened an auto parts plant in West Point.
- Japanese Nichiha USA opened a fiber-cement siding factory in Macon.
- Chinese company, Sany Heavy Industry opened a construction machinery plant in Peachtree City.
- Indian company, Wipro Technology opened a software development company in Atlanta.

It seems unlikely that most of these firms would have located to this country if we had a *strong* US dollar because, if that were the case, it would be cheaper for these companies to manufacture in their country and export the products to the US.

So that obviously means a *weak* US Dollar is better than a *strong* US Dollar, doesn't it? Or, does it mean we are selling out America to foreign interests?

I still don't know the answer...*weak* or *strong;* however, it may be like the seasons. We will have both forever, or at least until some group convinces the government to interfere even more.

(Information came mainly from Dan Chapman's article in the December 26, 2007 issue of The Atlanta Journal-Constitution and other AJC articles plus the Atlanta Business Chronicle and the Georgia Department of Economic Development.)

THE EURO

The euro is the single currency shared by 15 of the European Member States (Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovenia, and Spain), which together make up the euro area (the Eurozone).

It was introduced in 2002, which meant that traditional European Union currencies like the French franc disappeared.

The euro is not the currency of all European Member States. Two Countries (Denmark and the United Kingdom) agreed an 'opt-out' clause in the Treaty exempting them from participation, while the remainder (many of the newest European Members plus Sweden) have yet to meet the conditions for adopting the single currency. Once they do so, they will replace their national currency with the Euro.

What do International Currency Exchange Rates Mean to Me?

So, we have talked about the *weak* US Dollar and some of the ramifications in general, but what about all of us Tom, Dick and Harry's around the country? What does the *weak* US Dollar mean to us?

- Imports should cost more, but a lot of consumer imports haven't gone up that much in cost due to competitive price pressures and the fact that China is still "playing games" with its currency exchange rates. Thus, I don't think Tom and the boys have been impacted much at the local Wal-Mart store.

- The area most Tom's and his friends would see the impact is in the price of gasoline, which is directly dependent on the price of crude oil. Crude oil got as low as twelve dollars a barrel in 1999 and a good part of this was the *strong* US Dollar at that time. Now, oil prices have risen due to much increased world demand AND the weak dollar, resulting in soaring gasoline prices.

- People living near the Canadian border are probably most sensitive to the exchange rate changes. For the first Holiday season since Wal-Mart was a baby, residents of Windsor, Canada could drive across the bridge and buy their goodies in suburban Detroit for about ten percent less than in Canada. In the past, it has been just opposite this for many, many years.

- The small mutual fund investor has always been somewhat of a joke in the investment world because, as a group, this investor has an uncanny way of chasing yesterday's glory. It appears to be happening again as one of the hottest areas for new money are the mutual funds that own foreign stocks. I doubt that many of these new investors have any idea how much the recent exaggerated returns are due to currency exchange differences and how they have impacted their mutual fund.
- And, what about the stock market? How does currency change affect stock prices? I see no direct impact from currency changes on US share prices. Most of the *noise* about the *weak* US Dollar is coming from foreigners who should be investing less in US Dollar denominated investments. However, I'm not sure this is the case. In fact, there seems to be a trend for foreign investments to flow into US equity investments since our interest rates are so low.

The summary…other than the price of gasoline and European vacations, I don't think many Tom, Dick or Harry's give a flip about the *weak* or *strong* US Dollar. The noise we hear is coming from the areas with *strong* currencies and, probably, exaggerated by commentators who have no more than surface knowledge themselves.

How Are You Handling the US Dollar Crisis?

I wrote this *Report* on December 23rd which was a slow day around the office. Near the middle of January, I'm sitting in an aisle seat getting ready for the plane to take off from the Detroit airport. A young gentleman, probably in his early thirties, suddenly leans across the lady who is across the aisle from me as though she wasn't there. "Where did you get that book? Are you a client of theirs?"

I responded that I had just ordered their new book and, since it is an extension of this book, I wanted to refresh my understanding. He said their books are not available to the public. I told him I didn't know about that, but I just ordered their new book…from their offices in Hong Kong. "I'm quite familiar with the group; in fact, my very best friend is married to Mr. Gave's daughter (or something like that). I've been to his home many times. You must manage investment accounts; how have you been handling the US Dollar crisis?"

Feeling quite sorry for the lady caught in the middle of our conversation, I tried to be very brief and explained that the US Dollar crisis hasn't had much impact on Americans unlike the pain it has caused for people using other currencies. "I didn't think about that," he commented, and then the captain took over.

(The book referred to is: "Our Brave New World" by Charles Gave, Anatole Kaletsky and Louis-Vincent Gave. And, if you are interested, you can get it at www.gavekal.com)

Who is Happy with the Exchange Rates?

"American politicians bash China for its policy of keeping the Yuan weak. France blames a strong Euro for its sluggish economy. The Swiss are worried about a falling Franc. New Zealanders fret that their currency has risen too far." (The Economist, August 22, 2007)

The Economist's Big Mac Index is published every summer using the pedestrian hamburger as a guide to what international currencies are over/under valued. Let's see what the current index is telling us as of July 2007.

Country	Cost of a Big Mac in US Dollars	Under(-) or Over(+) Against the US Dollar
United States	$3.41	-
Australia	$2.95	-14%
Canada	$3.68	+ 8%
Euro area	$4.17	+22%
Sweden	$4.86	+42%

Given these alternatives, if you are a fast-food junkie, where should you live? Looks like Australia to me! But, if you are a real bargain hunter and are willing to be adventurous, you can get your Big Mac for $1.89 in Sri Lanka or enjoy the beautiful sun rises of Iceland while paying $7.61 for the tasty burger.

The February 1, 2008 issue of the *Atlanta Business Chronicle* had this cover story: "...US must fix Information Technology Worker Shortage."

Basically, the story was an interview with Azim Premji, the CEO of Wipro, Ltd, the Indian global information technology powerhouse that is opening its first US office in the Buckhead Community of Atlanta. Mr. Premji indicated that United States business leadership needs to "take the problem by the horns" and address the country's growing shortage of high-tech professionals. America does not have the talent. There's a huge shortage of IT professionals here."

He went on to say the Buckhead office will eventually employ about 500 software development professionals. The article didn't focus much on the *weak* US Dollar, but it seems that something has inspired the firm to locate in an area with a rather severe shortage of qualified personnel.

The article indicated that engineering degrees awarded in the country are about twenty percent less than two decades ago. Mr. Premji said the problem is that too many Americans find high-tech and math courses boring and too difficult. Schools need to find a way to make these classes stimulating. "It is such an exciting area if it's well taught," he exclaimed.

OUR OFFICE

Philip C Benedict, CFP®
Travis M James
Mark A Beaver
Christopher P Hall, CFP®
Ashley A Thompson
Jean B Wilson
Kristen D McElwaney

The primary author of *From the Fifth Floor* is Philip C. Benedict, CFP®, an Investment Advisor Representative and Registered Principal with LPL Financial, a registered investment advisory firm and member of FINRA/SIPC. Travis James, Mark Beaver, Chris Hall, CFP® and Ashley Thompson provide technical assistance. Jean Wilson handles the layout and editing of the *From the Fifth Floor* and Kristen McElwaney assists with the mailing.

BENEDICT
FINANCIAL ADVISORS, INC

6000 Lake Forrest Drive, Suite 550
Atlanta, GA 30328-5901
770.671.8228

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