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One Way to Play a Falling Dollar

Looking abroad may provide a hedge

The U.S. dollar's decline so far in 2009 relative to most foreign currencies may have many investors looking for investment strategies that could provide some protection against the greenback's recent depreciation.[i]

Foreign Stocks Offer a Hedge

One effective way to hedge a decline in the dollar is to own foreign developed-country stocks. During the past decade, foreign stocks have outperformed U.S. stocks in all six years when the dollar weakened—see Exhibit.[ii] (In contrast, U.S. stocks have bested foreign stocks three out of four times during years when the dollar strengthened.) A falling dollar historically is a positive development for U.S. investors owning foreign developed-country stocks: As the dollar falls, the appreciation of foreign currencies provides an extra boost in return to U.S. investors because foreign securities are worth more when translated back to dollars.

For example, amid the dollar's year-to-date decline, foreign developed-country stocks rallied 30%, outperforming the 19% gain for U.S. stocks. Most of the relative outperformance by foreign stocks—a full eight percentage points—was due to the falling dollar (i.e. foreign stock returns were eight percentage points lower in local currency terms). In all six years when the dollar has fallen during the past decade, the magnitude of the outperformance by foreign stocks (relative to U.S. stocks) was primarily due to the boost in return investors received as a result of the falling dollar.

Unlike emerging-market stocks that historically have been significantly more volatile, foreign developed-country stocks have tended to provide a purer hedge against dollar weakness because they typically have risk/return characteristics that are similar to stocks of U.S. companies. Thus, a significant portion of the difference in return to U.S. investors is often due to currency movements. Emerging-market stock performance, in contrast, tends to fluctuate at greater magnitudes, of which currency tends to be a smaller factor, particularly because some emerging-market countries do not allow their currencies to float freely.

Investment Implications

In recent years, stock markets around the world have tended to move in the same direction. As a result, the main difference in performance between foreign developed-country stocks and U.S. stocks frequently has been due to currency movements. Thus, having some exposure to foreign currencies through the stocks issued in foreign developed countries can help U.S. investors diversify their portfolios, in addition to hedging any potential weakness in the dollar.

U.S. investors in foreign developed-country stocks typically see a boost in performance when the dollar falls, and vice-versa.

The Influence of Dollar Movements on Asset Returns

Foreign Developed-Country vs. U.S. Stock Returns
(2000-2009)

	Dollar Movement	Foreign Stock Returns	U.S. Stock Returns	Did Foreign Stocks Outperform U.S. Stocks	$ Impact on Foreign Stock Return (percentage pts)
2000	↑	-14%	-9%	No	-7%
2001	↑	-21%	-12%	No	-5%
2002	↓	-16%	-22%	Yes	10%
2003	↓	39%	29%	Yes	18%
2004	↓	21%	11%	Yes	8%
2005	↑	14%	5%	Yes	-16%
2006	↓	27%	16%	Yes	10%
2007	↓	12%	5%	Yes	8%
2008	↑	-43%	-37%	No	-3%
2009 (YTD)	↓	30%	19%	Yes	8%

Shaded regions = U.S. dollar weakened & foreign stocks outperformed

Asset classes represented by: U.S. stocks – S&P 500 Index; Foreign Developed-Country stocks – MSCI EAFE Index.
Source: FactSet, FMRCo (MARE) as of 9/30/09.

KEY TAKEAWAYS

- **During the past decade, foreign developed-country stocks outperformed U.S. stocks in all six years when the dollar declined, including so far in 2009.**
- **In the years when the dollar fell, the magnitude of the outperformance by foreign stocks (relative to U.S. stocks) was primarily due to the boost in return investors received as a result of the falling dollar.**

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Investment decisions should be based on an individual's own goals, time horizon, and tolerance for risk.
Past performance is no guarantee of future results.

Foreign investments involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations, all of which may be magnified in emerging markets.

Stock values fluctuate in response to the activities of individual companies and general market and economic conditions, domestically and abroad.

[i] YTD change in U.S. dollar through 9/30/09 was -6%. U.S. dollar value represented by Trade-Weighted Major Currencies Index. Source: Federal Reserve Board, Haver Analytics, FMRCo (MARE) as of 9/30/2009.
[ii] All references and performance statistics of U.S. stocks are represented by the S&P 500® Index; foreign stocks are represented by the MSCI EAFE® Index. Source: FactSet, FMRCo (MARE) as of 9/30/09.

You cannot invest directly in an index.

All indices are unmanaged and performance of the indices include reinvestment of dividends and interest income, unless otherwise noted, and are not illustrative of any particular investment.

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