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WILKINSON O'GRADY
Global Asset Management

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In 1932 a prominent English family established a Trust in Switzerland that began for reasons of diversification with its capital equally divided between portfolios in London, Geneva and New York – between British pounds, Swiss francs and U.S. dollars. Ultimately this Trust came under our management, and in 1982 when the Trust was liquidated, we were charged by the trustees with evaluating the results. How had the decision to diversify assets by currency fared after fifty years? Briefly, the assets in Swiss francs outperformed the assets denominated in dollars, despite the post-war boom in U.S. equities, and in turn, both of these portfolios outperformed the assets denominated in the weaker pounds sterling. While all stock markets did well after WWII, the key determinate to the final wealth tally was the long-term strength of the base currency. Because of its financial integrity, the strong Swiss franc overcame the ostensible higher growth of equities in dollars and pounds. Strong or weak currencies really matter to wealth in the long term.

This experience led our firm to adopt, as part of its investment strategy, an emphasis on the importance of maintaining "Global Purchasing Power" for clients and also to create the Swiss Helvetia Fund (NYSE). I mention this because the unfolding global problems of sovereign debt imply that we are in for a period in which the long-term strength of currencies may well override the strength or weakness of domestic stock markets in tabulating one's final portfolio return.

Already in the first decade of this century, an important element of return was shaped by initial dollar weakness. But since late 2008, we have been of a mind that the comparative economic advantages among countries were shifting and that the dollar could become strong. None of this means we are optimistic about the United States' balance sheet – nothing could be further from the truth; but to paraphrase Winston Churchill's statement about democracy: *the U.S. dollar is fundamentally a weak currency, except that it is better than all the others*.

Many dollar investors are unaware of how much their global purchasing power has risen in 2010, just as most were blind to their loss when the dollar was declining. The S&P 500 has dropped some 4% year-to-date through late June, while the Euro Stoxx 50 Index is down 24% in dollar terms (the Euro has declined by 13%). The fact is that the rise in the dollar has increased global purchasing power for dollar holders. We expect the dollar to consolidate against the euro, but our long view is that the dollar will appreciate to new highs versus the euro and versus most commodity currencies as a result of growing sovereign debt problems and general economic weakness.

For 2010 our portfolios have had modest exposure to non-dollar investments and this remains a sound strategy. Despite the enormous financial imbalances in the United States, it is in Europe that sovereign debt problems have first reached the critical stage. The budget and balance sheet problems of Greece are actually almost exactly the same as those faced by New Jersey and Illinois; however, in the United States, we have a unified political, financial system. The European Union is different and the financial imbalances there are difficult to reconcile, as reflected, say, in the differences in productivity between Spain and Germany. There is a real possibility that the euro could ultimately split into a Northern European currency and a Mediterranean European currency.

The rising dollar papers over the balance sheet weaknesses in the U.S. financial markets. Unless we as a nation change our debt-on-debt policies, it is inevitable in the future that after European imbalances are fully discounted, the dollar will turn once more into a weak currency. For now, we think that is over the horizon.

Our point is that real portfolio returns are greatly affected by the strength or weakness of key currencies over time. While you want to own dollar assets at present, keeping your non-dollar exposure at a minimum, that may change decisively sometime in the next few years. Whatever happens, a primary investment goal will be to preserve your "Global Purchasing Power."

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