

WHAT IS THE U.S. DOLLAR ACTUALLY WORTH? REDUX

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As we highlighted in a [previous blog post](#), answering the question of what the U.S. dollar is actually worth depends heavily on the reason one asks the question in the first place. With foreign exchange [volatility](#) garnering more financial press headlines recently, investors are increasingly cognizant of the impact foreign currencies have on the returns of their stock and bond portfolios. As we reasoned previously, by measuring the dollar against its largest trading partners and most frequently traded currencies, we have sought to create an intuitive approach to tracking the value of the dollar over time. The [Bloomberg Dollar Spot Index \(BBDXY\)](#) tracks the value of a basket of 10 currencies against the U.S. dollar. Through [our approach](#), we believe that the index takes into account three primary roles the dollar plays in the global economy: what role the dollar plays in global trade, how it impacts the relative attractiveness of foreign assets, and what impact owning foreign assets has on the value of investors' portfolios. In our view, the [ICE U.S. Dollar Index's \(DXY\)](#) static approach to answering the question of the dollar's value does not accurately reflect the role the dollar plays in the global economy, nor the impact it has on investors' returns. While international fixed income investing is only beginning to catch on in the U.S., investors have for decades allocated a portion of their portfolios to international equities. As shown in the table below, the two most popular approaches to broad-based international equity investing are represented by the [MSCI EAFE Index](#) and the [MSCI ACWI ex-US Index](#).

Country	Currency	Bloomberg Dollar Spot Index	MSCI EAFE	MSCI EAFE Difference	MSCI ACWI ex-US	MSCI ACWI ex-US Difference
Eurozone	EUR	31.4%	31.7%	-0.3%	23.0%	8.4%
Japan	JPY	19.1%	20.8%	-1.7%	15.1%	4.1%
Canada	CAD	11.4%		11.4%	7.1%	4.3%
Great Britain	GBP	9.5%	21.3%	-11.8%	15.5%	-6.0%
Mexico	MXN	9.6%		9.6%	1.2%	8.5%
Australia	AUD	6.2%	7.4%	-1.2%	5.4%	0.8%
Switzerland	CHF	4.2%	9.3%	-5.1%	6.7%	-2.5%
S. Korea	KRW	3.3%		3.3%	3.3%	0.0%
China	CNH	3.0%		3.0%	3.9%	-0.9%
Brazil	BRL	2.2%		2.2%	2.2%	0.0%
Sweden	SEK	0.0%	3.2%	-3.2%	2.4%	-2.4%
Other	-	0.0%	6.3%	-6.3%	14.4%	-14.4%

Country	Currency	ICE U.S. Dollar Index	MSCI EAFE	MSCI EAFE Difference	MSCI ACWI ex-US	MSCI ACWI ex-US Difference
Eurozone	EUR	57.6%	31.7%	26.0%	23.0%	34.6%
Japan	JPY	13.6%	20.8%	-7.2%	15.1%	-1.5%
Canada	CAD	9.1%		9.1%	7.1%	2.0%
Great Britain	GBP	11.9%	21.3%	-9.4%	15.5%	-3.6%
Mexico	MXN	0.0%		0.0%	1.2%	-1.2%
Australia	AUD	0.0%	7.4%	-7.4%	5.4%	-5.4%
Switzerland	CHF	3.6%	9.3%	-5.7%	6.7%	-3.1%
S. Korea	KRW	0.0%		0.0%	3.3%	-3.3%
China	CNH	0.0%		0.0%	3.9%	-3.9%
Brazil	BRL	0.0%		0.0%	2.2%	-2.2%
Sweden	SEK	4.2%	3.2%	1.0%	2.4%	1.8%
Other	-	0.0%	6.3%	-6.3%	14.4%	-14.4%

Sources: Bloomberg, MSCI, WisdomTree, as of 12/31/13. You cannot invest directly in an index. Subject to change.

Interestingly enough, [BBDXY](#) currently has a remarkably similar weighting scheme to the currency exposures of MSCI EAFE and MSCI ACWI ex-US indexes. While we chose to establish our weighting scheme through global trade and [liquidity](#) measures, it is interesting to have our analysis in some ways validated by the relative size of each country's equity markets and, by extension, their weight in these popular equity indexes. Additionally, BBDXY also avoids the large concentration risk to the euro found in DXY, while at the same time providing a broader approach (10 currencies compared to 6) that also includes exposure to emerging markets. **Real-World Applications** While this coincidence in some ways helps to potentially validate our thinking about the dollar, a perhaps more interesting application for investor portfolios would be to use the [WisdomTree Bloomberg U.S. Dollar Bullish Fund \(USDU\)](#) as a way to opportunistically mitigate exposure to foreign currencies as part of an overall portfolio allocation. As we have seen in recent history, the U.S. dollar tends to benefit during times of market stress. For investors with unhedged international equity exposure, taking [short positions](#) in foreign currencies against the U.S. dollar could potentially offset a portion of the losses embedded in their [long](#) equity positions. For broader-based portfolios, USDU could also provide a way to tactically express a view on the value of the U.S. dollar.

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DEFINITIONS

Volatility : A measure of the dispersion of actual returns around a particular average level.

Bloomberg Dollar Spot Index (BBDXY) : Tracks the performance of a basket of ten leading global currencies versus the U.S. dollar. Each currency in the basket and their weight is determined annually based on their share of international trade and FX liquidity.

DXY Index : Weighted geometric mean of the dollar's value compared only with basket of 6 other major currencies, Euro, Japanese Yen, Pound Sterling, Canadian Dollar, Swedish Krona, and Swiss Franc.

MSCI EAFE Index : is a market cap-weighted index composed of companies representative of the developed market structure of developed countries in Europe, Australasia and Japan.

MSCI ACWI ex-U.S. Index : A free-float adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed and emerging markets excluding companies based in the United States.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid asset.

Short (or Short Position) : The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).

Long (or Long Position) : The buying of a security such as a stock, commodity or currency, with the expectation that the asset will rise in value, the opposite of Short (or Short Position).