

# WHAT IS THE U.S. DOLLAR WORTH?

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As U.S. investors continue to diversify their equity and bond holdings into markets around the world, they are beginning to realize that the value of foreign currencies against the U.S. dollar can have a significant impact on the total return of their investments. As a result, the links between trade and currency values are becoming increasingly important in the global economy. For these reasons, tracking the value of the U.S. dollar can be of paramount concern for global money managers. However, on any given day, the value of the dollar may increase against some currencies but decline against others. So what is a dollar actually worth? In 1973, the [Federal Reserve \(Fed\)](#) sought to create an index that tracks the value of the U.S. dollar against a basket of foreign currencies, selected and weighted based on the United States' largest trading partners at the time. Before the advent of one-click access to international financial markets, the value of the currency was seen as a significant factor impacting the competitiveness of trade. Although the only change to the original U.S. Dollar Index occurred after a number of individual European currencies were combined to form the euro, the Federal Reserve created a series of indexes in the late 1990s that sought to create broader, trade-weighted measures of the dollar. In this regard, the Fed had evolved its thinking about how the value of the dollar should be tracked. Today, in our view, both trade and markets define the value and role of the dollar in the global economy. Its value continues to evolve with new economic relationships and changing market dynamics. Compared to the [U.S. Dollar Index \(DXY\)](#), capturing the value of the dollar against its primary trading partners alone diminishes the impact of capital flows in defining short-term foreign exchange (fx) movements. Balancing the relative impact of [trade flows](#) and [portfolio flows](#) may provide a truer sense of the value of the dollar in response to short-term movements and longer-term trends. **An Evolving Index for a Changing World** For many market participants and researchers, the U.S. Dollar Index was one of the most common metrics for assessing the value of the dollar against a basket of foreign currencies. But its inflexible methodology is hopelessly stuck in the 1970s. In many ways, this static methodology doesn't seem very reflective of the realities of the current global economy. In 1973, the currencies in the basket contributed over 40% of the global output; today, that number is only 27%. In fact, some of America's largest trading partners—such as China or Mexico—and some of the most [liquid](#) currencies in the world—such as the Australian dollar or the Korean won—do not appear in the Dollar Index at all.

**Bloomberg Dollar Spot Index (BBDXY) vs U.S. Dollar Index (DXY)**

As of 12/31/12	BBDXY	DXY	LIQUIDITY	TRADE
Euro (EUR)	34.30%	57.60%	1	2
Japanese yen (JPY)	16.20%	13.60%	2	5
Canadian dollar (CAD)	12.00%	9.10%	6	3
British pound (GBP)	9.90%	11.90%	3	7
Mexican peso (MXN)	8.50%	0.00%	12	4
Australian dollar (AUD)	5.50%	0.00%	4	14
Swiss franc (CHF)	4.90%	3.60%	5	12
Korean won (KRW)	3.60%	0.00%	10	6
Chinese yuan (CNY)	3.00%	0.00%	14	1
Singapore dollar (SGD)	2.20%	0.00%	11	10
Swedish krona (SEK)	0.00%	4.20%	8	22
<b>% of DXY Currencies Contained in BBDXY</b>	<b>77.30%</b>			

Source: Bloomberg, 10/31/13

Liquidity rank based on Bank for International Settlements (BIS) Triennial Survey. Every three years, the BIS survey serves as the most comprehensive source of information on the size and structure of the global foreign exchange market. Trade rank is based on annual trade data compiled by the Federal Reserve between the United States and its foreign trading partners.

In response to the evolution of the global market place, the [Bloomberg Dollar Spot Index \(BBDXY\)](#) attempts to proxy the value of the dollar against a broader basket of foreign

currencies. In addition to identifying the largest trading partners of the U.S., it also conducts a screen for currencies with the greatest level of fx turnover. Not only does this make BBDXY more diversified and dynamic, it also provides an intuitive measure of the dollar in the global marketplace. Given that the index conducts an annual screening process to determine the weights and constituent currencies, BBDXY is able to incorporate changes in the evolution of the global markets. With emerging markets now accounting for nearly 40% of global gross domestic product (GDP), it is imperative that the value of their currencies be tracked against the U.S. dollar. Ultimately, we believe that a dynamic approach should be taken to adequately assess the value of the U.S. dollar. By focusing not only on the most liquid global currencies but also on the largest trading partners of the U.S., the Bloomberg Dollar Spot Index provides a broad-based and intuitive approach to valuing the U.S. dollar against a basket of foreign currencies.

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## DEFINITIONS

**Federal Reserve** : The Federal Reserve System is the central banking system of the United States.

**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.

**Trade flows** : the movement or transfer of assets to facilitate the exchange of goods and services.

**Portfolio flows** : the movement or transfer of assets to facilitate security transactions.

**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.

**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.