

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.

Important Risks Related to this Article

The USDU Fund is new and has a limited operating history. There are risks associated with investing, including possible loss of principal. Foreign investing involves special risks, such as risk of loss from currency fluctuation or political or economic uncertainty. The Fund focuses its investments in specific regions or countries, thereby increasing the impact of events and developments associated with the region or country, which can adversely affect performance. Investments in emerging, offshore or frontier markets are generally less liquid and less efficient than investments in developed markets and are subject to additional risks, such as risks of adverse governmental regulation and intervention or political developments. Investments in currency involve additional special risks, such as credit risk and interest rate fluctuations. Derivative investments can be volatile, and these investments may be less liquid than other securities, and more sensitive to the effects of varied economic conditions. While the Fund attempts to limit credit and counterparty exposure, the value of an investment in the Fund may change quickly and without warning in response to issuer or counterparty defaults and changes in the credit ratings of the Fund's portfolio investments. The Fund's investment in repurchase agreements may be subject to market and credit risk with respect to the collateral securing the repurchase agreements and may decline prior to the expiration of the repurchase agreement term. As this Fund can have a high concentration in some issuers, the Fund can be adversely impacted by changes affecting such issuers. Unlike typical exchange-traded funds, there are no indexes that the Fund attempts to track or replicate. Thus, the ability of the Fund to achieve its objectives will depend on the effectiveness of the portfolio manager. Due to the investment strategy of the Fund, it may make higher capital gain distributions than other ETFs. Although the Fund invests in very short-term, investment-grade instruments, the Fund is not a "money market" Fund, and it is not the objective of the Fund to maintain a constant share price. Please read the Fund's prospectus for specific details regarding the Fund's risk profile. Asset allocation cannot assure a profit nor protect against a loss. ALPS Distributors, Inc., is not affiliated with Bloomberg or MSCI.