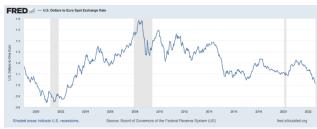


What Does a Strong Dollar Mean for the Markets and Global Economy?

For any readers considering a trip to Europe sometime in the future, now might be as good a time as any to make your plans. For the first time since 2002, the dollar has strengthened so much against the euro that the two currencies are at parity – meaning they are roughly equal in value. One dollar gets you one euro.¹

U.S. Dollar to Euro Exchange Rate

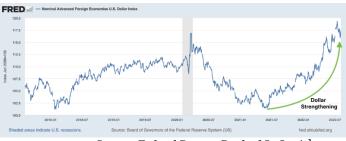


Source: Federal Reserve Bank of St. Louis²

This move to parity comes on the heels of the U.S. dollar strengthening by over 15% relative to the euro year-to-date, as seen in the sharp decline on the chart above. The dollar has also been strengthening against a basket of the broad developed market and emerging market currencies, which has come as the Federal Reserve embarks on a relatively aggressive

monetary policy tightening campaign. The U.S. economy is also largely seen as strong relative to Europe and the developing world, particularly as China's economy slows in response to restrictions tied to its zero-Covid policies. This relative strength encourages foreign investors to invest in U.S. assets and debt, which generally means using dollars and boosting the greenback in the process.

U.S. Dollar Index Against Developed Foreign Economies



Source: Federal Reserve Bank of St. Louis³

In terms of what the stronger dollar means for markets and the global economy, there is no singular answer. A stronger dollar creates winners and losers, and in that sense, a stronger or a weaker dollar is not inherently negative or positive. Among the winners are U.S. consumers, and also businesses that rely heavily on imports in order to drive domestic sales. Americans can stretch the value of the dollar when traveling overseas and/or buying goods and services from abroad, and businesses that rely on imports may see some input cost relief given the dollar goes further.

On the flip side, multinational corporations that generate considerable revenue from abroad can see foreign sales take a hit in a strengthening dollar environment. In combing through Q2 earnings reports, we saw quite a few mentions of the stronger dollar impacting foreign sales. Microsoft, for instance, generates most of its profits from overseas (\$36 billion abroad versus \$35 billion domestically last year), and so a stronger dollar can mean a higher cost for foreigners buying Microsoft products. The company reported a \$300 million impact from a stronger dollar in the last quarter. To be sure, however, many multinationals never convert foreign profits back to dollars (repatriation), instead using their earnings to pay for production, costs, and investments in the foreign country where the revenue is derived.

Foreign consumers, the U.S. tourism industry, and Emerging Markets countries can also be adversely impacted by a stronger dollar. Since a stronger dollar means foreigners have less spending power in the U.S., some may opt not to visit or may spend less when they're here. That can of course impact hospitality businesses in the US, like hotels, restaurants, and tourist-dependent businesses.

Emerging Markets can also be hindered by a stronger dollar, particularly those countries with high debt-to-GDP ratios and relatively low foreign currency reserves. Since some level of Emerging Market debt is financed in dollars, a stronger dollar means that interest payments are more expensive. That can hurt a country with high debt levels and a non-dynamic economy, particularly those that are commodity-intensive.

Bottom Line for Investors

The bottom line is what a stronger dollar means for equity markets. The answer, fortunately, is that there are too many other factors driving the equity markets for the dollar to have outsized influence.

To the extent a strong dollar affects earnings, individual stocks can feel an impact. But broadly speaking, the stock market has done very well when the dollar was strengthening and weakening, and vice versa. There is no significant correlation between the two. A strengthening dollar historically corresponded with one of the best periods for stocks, 1995 – 2000, but also one of the worst: the 2008 bear market. At the same time, the dollar's weakening period from 2003 – 2006 did not adversely impact the economic expansion and stock market recovery then, just like a strong dollar is not likely to shift the economy or market's direction now.

ABOUT MITCH ZACKS

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

¹ Wall Street Journal. July 22, 2022. https://www.wsj.com/articles/what-a-strong-dollar-means-for-the-rest-of-the-world-11658482200

² Fred Economic Data. August 5, 2022. https://fred.stlouisfed.org/series/DEXUSEU#

³ Fred Economic Data. August 5, 2022. https://fred.stlouisfed.org/series/DTWEXAFEGS#

Weekly Market Update

Important Market News We Think Worth Considering

IN FOCUS THIS WEEK

- Inflation falls to 8.5%
- Wage growth and the decline in productivity
- The global phenomenon of a "jobful recession"

Inflation Falls to 8.5% – Is It a Sign That Rising Prices Have Peaked?

The Labor Department reported on Wednesday that inflation – as measured by the consumer price index (CPI) – rose 8.5% year-over-year in July, which was a smaller increase than the 9.1% y-o-y rate posted in June. Importantly, the month-over-month inflation reading for July was flat from June, which is key in determining whether inflation has peaked or not. At this stage, it is too early to tell – several months of inflation data will be needed to confirm the peak. One of the main drivers of falling prices came from the energy sector, as gas prices fell 7.7% from June to July. Falling gas prices are good for consumers, but they are also very volatile – meaning we could just as easily see a spike later in the year due to supply disruptions or further complications tied to the war. Inflation pressures persisted in other areas of the economy as energy prices fell. Food prices were up 1.3% from June to July and 13.1% year-overyear, which marked the fastest annual rate of change since 1979. Equity markets shifted into rally mode with the relation of inflation figures, as easing price pressures may open the door for the Federal Reserve to slow the pace of rate increases in the months ahead. Market watchers are focused on the decision at the September 20-21 policy meeting, which at this stage amounts to a 50 or a 75-basis point increase.¹

Wage Growth and Productivity Declines Suggest Price Pressures May Stick Around

Wage pressures in a tight labor market may also act as a countervailing force to falling prices elsewhere in the economy, a factor that many Fed-watchers do not seem to be giving much weight to. The Labor Department this week also reported that average hourly wages rose by 5.2% year-over-year in July, which marks seven straight months of wage increases exceeding 5%. It is widely known that employers are having a challenging time finding enough workers, particularly in hospitality and service industries, and rising wages are one method being used to retain key workers. Wage growth is inflationary by itself, but there is also the downstream effect of businesses needing to pass along the higher costs of labor to consumers, in the form of higher prices. This phenomenon is often referred to as the wage-price spiral. While wages and price pressures rise, US labor productivity has been falling – another headwind to falling prices. If workers are being paid more while producing less, it sets up a negative outlook for inflation down the road.²

The "Jobful Recession" is a Global Phenomenon

Official figures from the Bureau of Economic Research show that the US economy contracted in the first two quarters of 2022. The jobs market suggests otherwise. In the US, 372,000 jobs were added in June and payrolls increased by over 500,000 in July, with the Labor Department reporting that there are still a seasonally adjusted 10+ million open jobs in the economy. Indeed, payroll growth in the US economy has continued to defy weakening output, with more jobs being secured in the first six months than any other post-WWII period

when the economy was technically contracting. This "jobful recession" scenario is a global phenomenon that exists in other developed economies like Germany, Japan, and New Zealand. In Germany, the unemployment rate is hovering at a 40-year low even as an energy crisis has curbed manufacturing output. In New Zealand, GDP also fell in Q1 of this year while the unemployment rate sits at 3.3%, a historically low figure. This disconnect between plentiful jobs and weakening output makes this 'global recession' – if it is one – different from any other in history.³

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¹ Wall Street Journal. August 10, 2022. https://www.wsj.com/articles/us-inflation-july-2022-consumer-price-index-11660077986?mod=hp_lead_pos1

² Wall Street Journal. August 9, 2022. https://www.wsj.com/articles/u-s-productivity-falls-for-second-straight-quarter-11660049393?mod=djemRTE_h

³ Wall Street Journal. August 7, 2022. https://www.wsj.com/articles/weak-growth-tight-job-markets-are-a-global-phenomenon-11659865504

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