



# Client Bulletin

William Baker  
& Associates, Inc.

400 Galleria Pkwy, Suite 1500 Atlanta, GA 30339 Phone: (770) 956-4073  
e-mail: [wmbaker@wilbankssecurities.com](mailto:wmbaker@wilbankssecurities.com) [www.wmbakerinvest.com](http://www.wmbakerinvest.com)

February 15, 2010

## PIIGS AND THE DOLLAR

January 2010 ended and February 2010 came in with negative year-to-date returns. It was not a great surprise and fortunately we had been raising cash in our portfolios before the global markets' downdraft of Thursday, February 4th. The January newsletter mentioned that the level of equity risk has been high. Since then the level of market and sector risk has risen higher and so has the cash being raised in our portfolios.

PIIGS is an acronym for Portugal, Ireland, Italy, Greece and Spain. You may have been hearing a lot of media talk about Greece and its debt problem. In addition to Greece however, there are concerns about debt problems with all of the aforementioned countries.

With the above concerns surrounding sovereign debt there appears to be a flight to the U.S. dollar as a safe haven currency. You may look at it as the U.S. dollar, for now at least, is taking on the role of the "least worst" alternative as far as currencies go.



As often mentioned in the past the strength or weakness and specifically the longer term trend of the dollar significantly impacts how we put money to work in the investment world. Let me try to explain this. First of all, many commodities such as oil, gold, basic metals, and agricultural goods are denominated in dollars. If you were a farmer in a foreign country and the U.S. Dollar were trending down in value, you would have to demand more dollars for your wheat or corn. Why? If you, the local farmer did not demand more dollars, you'd end up with less of your own local money to pay your expenses. The cheaper dollar would buy you less pesos, kronas, or whatever your currency might be. Therefore, in order to maintain your living standard you would demand more dollars for your produce.

Vice versa, when the value of the dollar begins to trend up as is happening now, the opposite will happen. You, the local farmer, would need less dollars for your produce since a stronger dollar will buy you more pesos, kronas, etc. In fact, you would be able to hold your own with less dollars in a strengthening dollar environment.

In terms of practical investment impact, that stronger dollar means that commodities and foreign equities are less attractive now in part because there is no boost in value from the exchange rate differential. A foreign company whose earnings are denominated in their own currency will buy fewer dollars if their currency is weakening relative to the dollar. In other words, you as an investor in that foreign company will get fewer dollars than you did when their currency was strong relative to the dollar. There's no longer any boost from the exchange rate in your favor as an American investor in that foreign company. *(continued on next page)*

(continued)

So, in just a matter of days and weeks the investment world has been hit with market storms. A change in the trend of the dollar and the uncertainty with regard to sovereign debt and its potential global-finance ripple effects have in part created those storms. Also, the major market run-up in 2009 probably got ahead of itself. As mentioned in earlier bulletins and newsletters there has not yet been a significant correction since the March 2009 lows. That correction would be normal and expected. *There are never any guarantees as to what markets will do or when they will do it.* What we can do is work to be the best at managing our portfolios given the reward - risk investment conditions that we're in.

On February 4, 2010 International Equities dropped out of one of our top two relative strength asset classes. International Equities have been beaten out by Cash. *The top two asset classes on a relative strength basis are now Domestic Equities and Cash.* These two asset classes are now beating out International Equities, Fixed Income, Commodities, and Foreign Currencies. What a difference a week or so can make! As market conditions and the reward and risk pictures change we will adapt our investment strategy and tactical allocation with the idea of adhering to our mantra *First Do No Harm and Make Money\** (please read footnote)

Being a top asset class on a relative strength basis does not mean the price will go up. What it means is that in a rising market environment the top-relative-strength asset class will most likely rise higher than other asset classes. On the other hand, in a dropping market, the top relative strength asset class will most likely drop less than other asset classes. In a transition period such as we've just seen regarding international equities being bested by Cash, we experience a loss. We deal with that, go on, and adjust to the changed market conditions with the goal of capitalizing on those changes as we go forward.

Market and sector risk is separate and distinct from relative strength. Over the past few months market risk has methodically and progressively risen. We have seen this as positions that we hold move down in price to their exit strategy price-points and cause us to sell. A wide array of indicators and tools that we use suggest that the markets are in for some rough sledding in the near to intermediate term. We can't guarantee that. All we can do is assess what is happening in the market and our assessment right now is that we are in for some rough sledding. As conditions change our assessment will change.

There is still much uncertainty with regard to the economic outlook and government policy and regulatory actions. That makes for a difficult investment backdrop. Given these conditions we are managing our portfolios, and at the same time evaluating areas of opportunity and actions that we will take as the reward-risk situation improves over time.

\*There is no risk-free investment! Investment portfolio values fluctuate and past performance is never a guarantee of future results. "Do no harm" translates into structuring and managing an investment portfolio to conform to a client's investment objectives, risk tolerance and time horizon. Proactive asset allocation, both diversification across and within asset classes, and continual monitoring and risk management of each position are methods we use in structuring and managing portfolios. Our tactical asset allocation approach includes corroborating fundamental research, with capital markets supply-and-demand research, also called technical research. At times we will use conservative hedging techniques to limit downside risk.