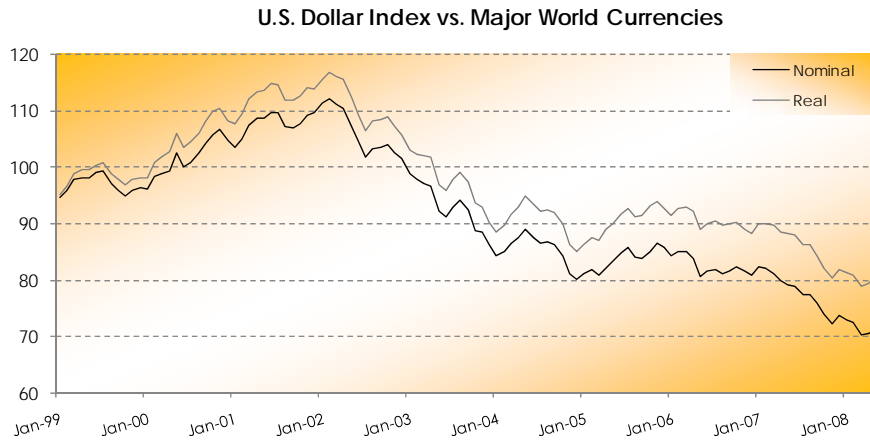


Since the euro was introduced as the hard currency of the European Union on January 1, 2002, the once-mighty dollar has fallen. In the time since, the U.S. dollar has depreciated 36% against a basket of major world currencies, with less than 6% of the



Source: Board of Governors of the Federal Reserve

The major currencies index is a weighted average of the foreign exchange values of the U.S. dollar against a set of currencies that circulate widely outside the country of issue. Index weights vary over time by U.S. export shares and U.S. foreign import shares.

fall attributable to inflation. Against the euro itself, the U.S. dollar has lost more than 70% of its value. Given the deep U.S. trade deficit and low real interest rates resulting from both Fed easing and accelerating inflation, we expect continued downward pressure on the dollar.

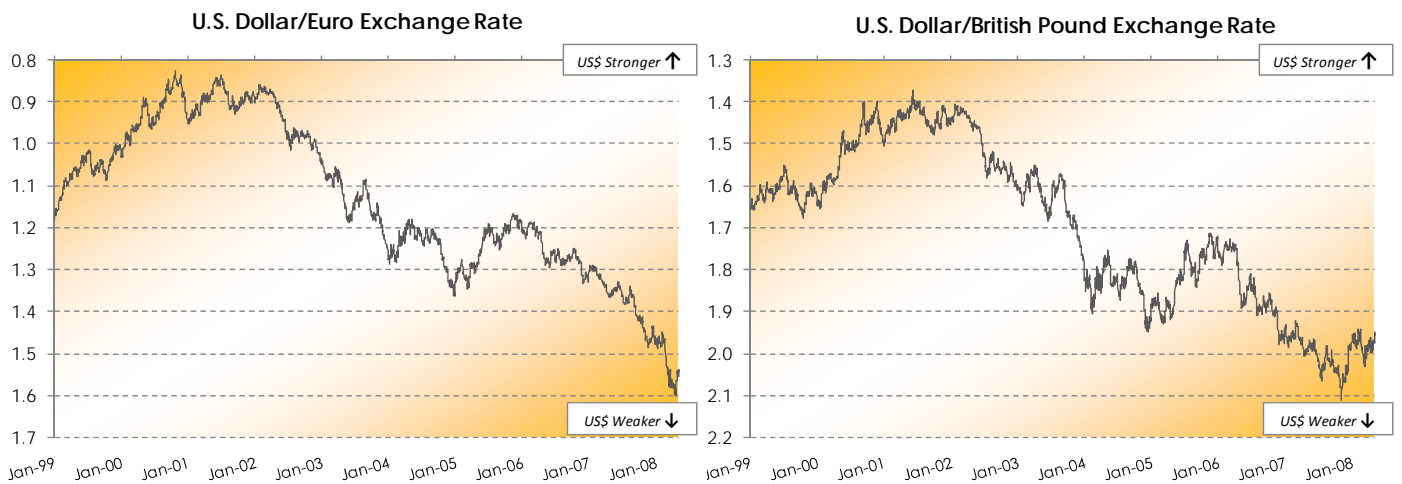
There are many complicated relationships at work behind the relative movements of world currencies, most of which are opaque for the average investor. While it may not be imperative for most people to understand the intricacies behind the movements, it is important that investors know how a depreciating currency impacts their portfolios. Below we shed some light on what the weak and falling dollar has meant, and will mean, for the U.S. and dollar-based investors.

■ **A depreciating home currency means greater returns on investments abroad.**

The dollar fell nearly 11% against the euro in 2007, which led to a markedly better return profile for dollar-based investors than euro-based investors. The table at right shows that for many major global indices the return in dollar terms was 9% to 18% greater than the return in euro terms. For example, a German investor who owned the MSCI Europe index would have gained only 2.7% in 2007, barely keeping up with inflation, while an American would have earned a 13.9% return.

2007 TOTAL RETURNS			
MSCI Indices:	In U.S. Dollar Terms	In Euro Terms	Return Difference (US\$ - Euro)
Japan	-4.2%	-13.6%	9.4%
USA	5.4%	-4.9%	10.3%
United Kingdom	8.4%	-2.3%	10.6%
EAFE	11.2%	0.3%	10.9%
Europe	13.9%	2.7%	11.2%
Russia	24.5%	12.3%	12.2%
Pacific ex-Japan	30.7%	17.9%	12.8%
Emg. Markets	39.4%	25.7%	13.7%
BRIC	58.9%	43.3%	15.6%
China	66.2%	49.9%	16.3%
India	73.1%	56.1%	17.0%
Brazil	79.6%	62.0%	17.6%

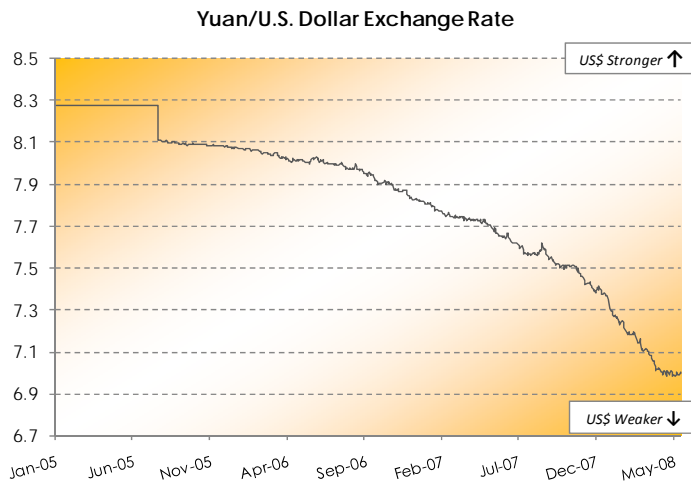
- **A weak dollar is associated with higher prices for commodities like oil, which are priced in U.S. dollars.** While we believe that there is a strong fundamental supply and demand case for rising commodity prices, there is also a currency component. Imagine that €1 (1 euro) is equivalent to \$1.35 (1.35 dollars), as was the case in May 2007. At that time, a barrel of oil cost about \$63 in U.S. dollar terms, which translated into about €47 per barrel in euros. While it is difficult to isolate a single factor, imagine that nothing changed since then except the dollar/euro exchange rate. During the past year, the dollar has depreciated from 1.35 dollars/euro to 1.55 dollars/euro today. In this scenario, the same barrel of oil that cost €47 (or \$63) last May would cost more than \$72 today due solely to the 15% depreciation in the currency. Since a barrel of oil is now running about \$50 more than that price, obviously there are other dynamics in play; however the falling dollar does play a role in the price increase. Additionally, consumers who earn a living in currencies strengthening against the dollar have less incentive to reduce oil consumption since their inflationary experience is not as drastic as a U.S. dollar earner.
- **Foreign travel is more expensive when the dollar is weak.** Anyone who has traveled to Europe in the past few years has experienced the dreaded post-vacation credit card bills. “That dinner cost *how much* in U.S. dollars?!” Using some personally accumulated data from October 2003, we looked at how much the falling dollar has increased the cost of a stay in Paris and London, beyond the drastic increase in prices. In October 2003, a particular 3 star hotel in the Latin Quarter of Paris cost €125 per night for a double room, or about \$145 in U.S. dollars. At today’s exchange rate, that would cost \$194. But in addition to the depreciating dollar, price inflation has taken its toll and that same hotel room now goes for €170 in euros, which translates into a dollar rate of \$263. A similar experience is found in London, where a hotel room near King’s Cross that cost £65 pounds (roughly \$110) in October 2003 today would run about \$127 in dollars. That room is now 40% more expensive in pounds (now £91), which translates into a total of \$177 in today’s dollars. Tack on the increases in air fares, fuel costs, food prices, etc., and for many Americans the Louvre will have to wait.



Source: Federal Reserve Bank of New York

Source: Federal Reserve Bank of New York

- **A weaker dollar makes imported goods more expensive for U.S. consumers.** Goods from emerging countries like China, which traditionally have been inexpensive sources for low-skill production items like clothes and toys, have



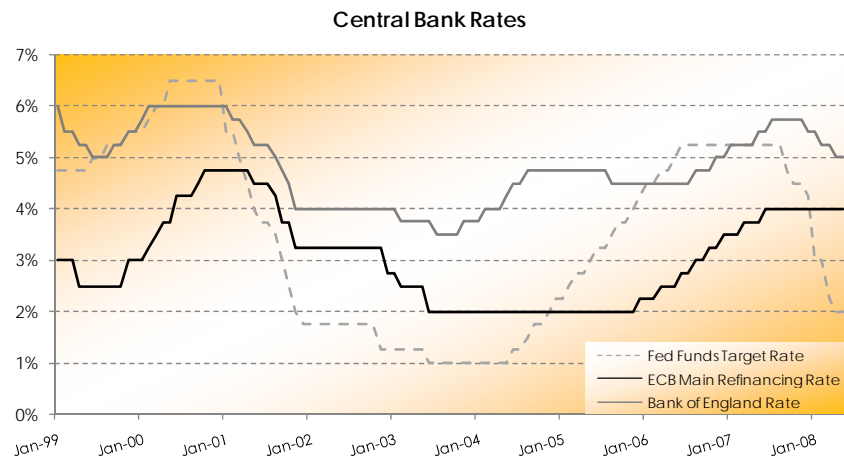
Source: Federal Reserve Bank of New York

been creeping up in cost. This is partially due to strong domestic growth and inflation in these developing regions, however, currency also plays a part. For example, in 2005 China abandoned its fixed peg to the U.S. dollar resulting in a steady appreciation of the Chinese Yuan. The result is that Chinese imports to the U.S. have grown more expensive.

The flip side of this scenario is that U.S. produced exports are *benefitting* from the weaker currency. The depreciating dollar makes U.S. goods sold abroad cheaper for other countries to purchase. We believe that U.S.-based multinational corporations, mostly mega-cap stocks in the U.S. market, should continue to benefit from this trend since large shares of their revenues are generated overseas. In fact, companies in the most internationally-oriented sectors of the S&P 500, such as Technology, Energy, Materials and Industrials, generate 35%-55% of their total revenues abroad.

- **Slower growth in the U.S. relative to Europe and Asia is encouraging dollar weakness.** With the domestic economy slowing, the U.S. market is less attractive to foreign investors.

Less investment in the U.S. means less demand for U.S. dollars which would be required to finance investment, further depressing demand for dollars. A Federal Reserve in easing mode also depresses the dollar, as low interest rates on



Source: U.S. Federal Reserve Bank, European Central Bank, Bank of England

Treasuries are not attractive to foreign investors. Money market investors in particular have shifted to the euro in search of higher rates.

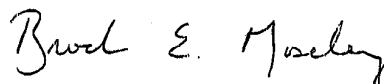
Our Two Cents

We believe that the dollar will remain depressed relative to other major currencies, with a persistence of the trends outlined above. We continue to favor non-U.S. equity markets for their growth potential, but also believe that currency trends will remain favorable for dollar-based investors. Within the U.S. equity market, we believe that mega-cap, multinational companies which earn a large share of their revenues internationally will tend to perform better than their more domestically-oriented counterparts. Continued dollar weakness could imply imported price inflation going forward, and in combination with the accommodative monetary policy stance currently in place we maintain our view that inflation will emerge as a major concern by the end of the year. We continue to stress the importance of inflation hedges such as gold and inflation protected fixed income securities in a well-diversified portfolio.

May 16, 2008



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