In the Markets Now

Dollar and Reserve Currency Status

We believe in the old saying: a picture is worth a thousand words. Here, we aim to recap recent market action and provide some perspective to investors.

PWM Equity & Fixed Income Research
Ross Mayfield, CFA
Investment Strategy Analyst

April 2023

THE U.S. DOLLAR'S RESERVE STATUS ISN'T GOING ANYWHERE SOON

One of the big themes in markets, economics, and policy lately is that of de-globalization; the idea that the post-WWII, post-Berlin Wall, post-China Shock boom in global trade (and quasi-friendliness) is slowing or even reversing. Amid rising geopolitical tensions and recent supply chain turmoil, it's hard to disagree that for the first time in ages, we're facing a more insular and multipolar world. **Along with this trend has come an uptick in anxiety over the status of the U.S. dollar (USD) as the global reserve currency.** Jason Trennert, Chairman of Strategas, a Baird Company, did a masterful job breaking this issue down in a recent article for Baird clients. And while I agree with his assessment, I wanted to add a few additional thoughts.

This story will persist into perpetuity. At countless different moments over the last fifty years, the USD's status has been called into question, and the news cycle has rarely failed to enthusiastically engage in the debate. There's nothing more powerful than a good story, and the narrative of foreign actors conspiring to unseat American power is the perfect lever to generate engagement. Scary headlines get the reactions and sell the ads. That is not to say there aren't kernels of truth in most versions of this story (including today). But as long as the USD remains entrenched as the reserve currency, the stories about its imminent demise will persist. Buckle up.

Source: Epsilon Theory, the Economist

Reserve currency status puts upward pressure on the dollar. This is not a unilateral positive. For one, it makes U.S. exports more expensive, thereby reducing competitiveness of U.S. exporters: in 2010, McKinsey concluded that, "Manufacturers that compete with imports lose out by up to $100B because of the strength of the dollar, reducing employment in these sectors by between 400K and 900K." A strong dollar also makes it harder for U.S. multinationals to operate abroad, as foreign sales convert back into fewer dollars. Near-term, the pressures against the dollar may lead to a cyclically weaker period after a long decade of strength. A weaker dollar has historically benefited U.S. multinationals, foreign assets, and Gold.

Reserve status is not a prerequisite for equity strength. Plenty of other country's stock markets have performed well over the last century while not possessing the world's reserve currency. U.S. equity performance is not dependent on this one factor (and, as noted above, is occasionally inhibited by it). The formation and ascendence of Apple was not based on the dollar being the global reserve currency, nor was the rise of Samsung inhibited because its home currency is the Korean won. A shift in the dollar's status would alter many things, *but it would not change the profit motive of U.S. companies.*

Network effects are powerful. As Jason notes, the dollar is well entrenched thanks to its transparency and liquidity combined with America's rule of law, economic might, strong property rights, and lack of major capital controls (a la China), among other things. He also notes that the USD is the first reserve currency in an era of true economic globalization. This is significant. There are few phenomena more powerful than strong network effects, especially in today's deeply interconnected world. As summed up here, "The dollar is accepted everywhere because the dollar is accepted everywhere." Global financial infrastructure has been designed explicitly for dollar usage, and its widespread acceptance reduces uncertainty and cost across all layers of global finance. This is not written in law, but in such a connected world, it is perhaps even more difficult to upend.

Disclosures

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

This report does not provide recipients with information or advice that is sufficient on which to base an investment decision. This report does not take into account the specific investment objectives, financial situation, or need of any particular client and may not be suitable for all types of investors. Recipients should not consider the contents of this report as a single factor in making an investment decision. Additional fundamental and other analyses would be required to make an investment decision about any individual security identified in this report.

For investment advice specific to your situation, or for additional information, please contact your Baird Financial Advisor and/or your tax or legal advisor.

Fixed income yield and equity multiples do not correlate and while they can be used as a general comparison, the investments carry material differences in how they are structured and how they are valued. Both carry unique risks that the other may not.

Past performance is not indicative of future results and diversification does not ensure a profit or protect against loss. All investments carry some level of risk, including loss of principal. An investment cannot be made directly in an index.

Other Disclosures

UK disclosure requirements for the purpose of distributing this research into the UK and other countries for which Robert W. Baird Limited holds an ISD passport.

This report is for distribution into the United Kingdom only to persons who fall within Article 19 or Article 49(2) of the Financial Services and Markets Act 2000 (financial promotion) order 2001 being persons who are investment professionals and may not be distributed to private clients. Issued in the United Kingdom by Robert W. Baird Limited, which has an office at Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB, and is a company authorized and regulated by the Financial Conduct Authority. For the purposes of the Financial Conduct Authority requirements, this investment research report is classified as objective.

Robert W. Baird Limited ("RWBL") is exempt from the requirement to hold an Australian financial services license. RWBL is regulated by the Financial Conduct Authority ("FCA") under UK laws and those laws may differ from Australian laws. This document has been prepared in accordance with FCA requirements and not Australian laws.