First Trust
Monday Morning OUTLOOK
February 23rd, 2015
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Strong Dollar: Good, Not Bad

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – Dep. Chief *Economist*
Strider Elass – *Economist*

In fifteen short days, the bull market will be six years old. And, we've never seen such a steep wall of worry. Nouriel Roubini called it a "dead cat bounce." Many said the recession wouldn't end until 2010, maybe 2011. Supply-siders said the "Fiscal Cliff" would do us in. Keynesians said "The Spending Sequester" would end the boom.

Don't forget Dubai, commercial real estate loans, Obamacare, or the implosion of the Eurozone. It's been a long six years, but the stock market keeps rising and the economy keeps growing.

So, the $64,000 question; why? We think this answer is simple – it's profits from entrepreneurial activity driving stocks higher, not QE or government spending. We use 60-years of historical interest rates and profits data, and with the 10-year Treasury yield below 4%, the current level of corporate profits means equites are undervalued when compared to historical norms. That's why equities keep rising. The market has been, and still is, undervalued. This will be true until corporate profits fall sharply, interest rates soar, or the stock market rises to a point that exceeds the current value of discounted earnings.

This is why we remained bullish through all the fears of the past six years and why we don't think the latest fear, a rising dollar, is something that should cause investors to climb into a foxhole.

As the theory goes, a stronger US dollar (up almost 20% versus major world currencies since mid-2014) will hurt US equities by either reducing profits directly or hurting the US economy first and then profits down the road.

In theory, a stronger dollar translates into lower profits for US-based and listed multinational companies. But that's only true if the dollar keeps rising. Otherwise, it's a one-time hit that will end as soon as the dollar stops strengthening. But, we don't think that will happen. Everyone knows the Fed is about to tighten policy and we expect any tightening to go very slowly. In other words, a key reason for a strong dollar is already priced in, maybe more than priced in.

And the theory also downplays other forces at work. The historical record shows little relationship between the strength of the dollar and corporate profits. Corporate profits grew rapidly in the first half of the 1980s and for much of the 1990s, even as the dollar soared.

One reason is something called the "J-Curve," which says that it takes a while for a stronger currency to change a country's appetite away from goods produced domestically and toward foreign goods. So, in the meantime, it takes fewer dollars to buy the foreign goods we were going to buy anyhow. As a result, the trade deficit shrinks even as the dollar is stronger, boosting US GDP.

Another idea to keep in mind is that a stronger US dollar can reflect weaker foreign currencies due to actions taken by those countries, like looser monetary policy designed to prevent deflation. If so, those policies may generate more real economic growth abroad, which helps everyone.

But the ultimate reason a stronger US dollar should not be seen as a negative for US equities is that the stronger dollar is itself a vote of confidence in the future of the US economy. It signals that the collective wisdom of currency traders is giving America a big thumbs up.

The US bull market will come to an end someday. But that day is still a long way away and a stronger US dollar won't be the culprit.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-23 / 9:00 am	Existing Home Sales – Jan	4.950 Mil	**4.890 Mil**	4.820 Mil	5.040 Mil
2-24 / 9:00 am	Consumer Confidence – Feb	99.5	**98.8**		102.9
2-25 / 9:00 am	New Home Sales – Jan	0.470 Mil	**0.465 Mil**		0.481 Mil
2-26 / 7:30 am	Initial Claims – Feb 22	290K	**283K**		283K
7:30 am	CPI – Jan	-0.6%	**-0.7%**		-0.4%
7:30 am	"Core" CPI – Jan	+0.1%	**+0.1%**		0.0%
7:30 am	Durable Goods – Jan	+1.6%	**+2.1%**		-3.3%
7:30 am	Durable Goods (Ex-Trans) – Jan	+0.5%	**+0.3%**		-0.8%
2-27 / 7:30 am	Q4 GDP Second Report	2.0%	**2.1%**		2.6%
7:30 am	Q4 GDP Chain Price Index	0.0%	**0.0%**		0.0%
8:45 am	Chicago PMI – Feb	58.0	**57.4**		59.4
9:00 am	U. Mich Consumer Sentiment- Feb	94.0	**94.0**		93.6