



January 1, 2015

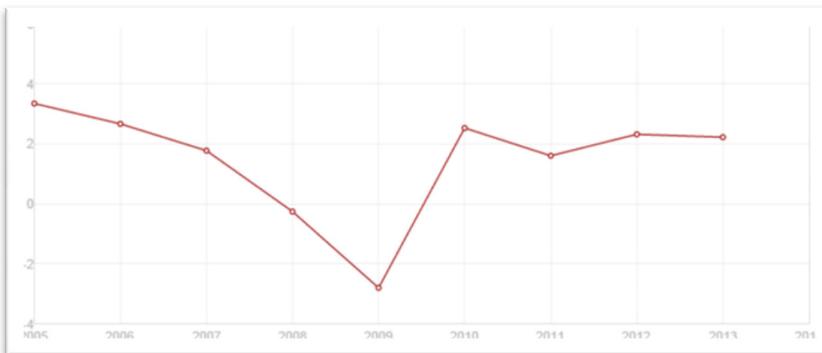
## The Herculean U.S. Dollar

The U.S. dollar (USD) has been strong during the second half of 2014, rising from 80 to over 92 (Chart 1). What events caused this remarkable strength in the dollar and what might the economic consequences be?



**Chart 1. US dollar index (DXY)**  
 Source: [barchart.com](http://barchart.com)

First, the **bold and decisive actions** of the U.S. Federal Reserve Chairman and the U.S. Secretary of the Treasury during the 2008-09 “Great Recession” provided a positive basis for the U.S. economic recovery. The U.S. has consistently achieved GDP growth in the 2-3% range 2009 (Chart 2). The Fed’s fiscal policy of maintaining low interest rates and massive quantitative easing allowed for economic stability, permitting many marginal businesses to survive and regain fiscal strength.



**Chart 2. US GDP growth.**  
 Source: [The World Bank](http://TheWorldBank.com)

Second, U.S. business leaders and workers maintained **fiscal discipline** and **strong productivity** throughout the crisis. Corporate balance sheets, in the aggregate, have strengthened. Record amounts of cash (\$1.64 trillion) have



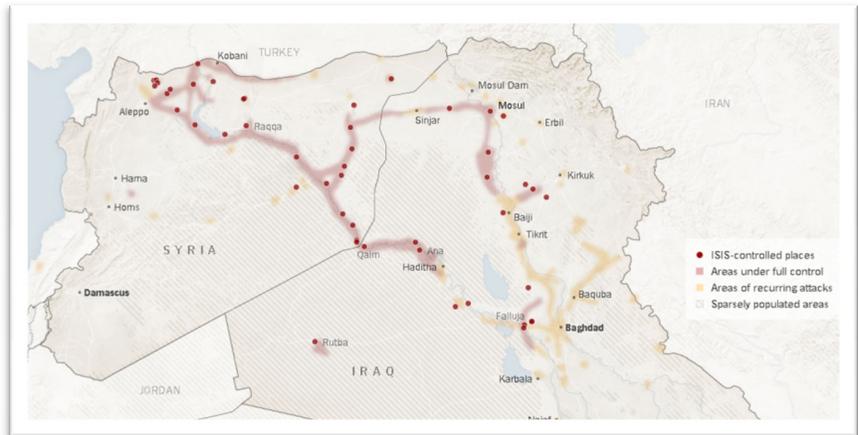
been reserved by corporate America,<sup>1</sup> and productivity has reached new levels in recent years.<sup>2</sup>

A third factor in the ascent of the dollar is the **economic fear** developing in Europe and Asia. In the autumn of 2009, acclaimed hedge fund manager, Kyle Bass, warned, "...the global debt drama would end with an epic U.S. dollar rally, a dramatic reversal in capital flows, and an absolute bloodbath for emerging markets."<sup>3</sup> It remains to be seen if Bass' predictions will be correct, but the dramatic rise in the dollar and higher capital flows into Treasury bonds suggest these events may be starting to unfold. German, Japanese and U.S. bond prices have rallied, as cautious money flows into the larger, more stable economies. Meanwhile, yields on German, Finnish and Swiss debt turned negative on January 14, 2015, according to the Wall Street Journal.<sup>4</sup> Another article stated that economists and investors are increasingly concerned that the stagnant economies of the euro zone may be headed for a prolonged bout of deflation—"a damaging spiral of falling prices and reduced spending and investment."<sup>5</sup>

Due to the increased tension with other nations, the strength of the dollar will evoke political and fiscal concerns. Earlier this month, former Soviet leader Mikhail Gorbachev warned that the Ukraine crisis could make a war unavoidable,<sup>6</sup> and additionally, that Vladimir Putin may launch a nuclear war.<sup>7</sup> These words are not to be taken lightly because Gorbachev is not considered to be an alarmist.

The declining price of oil and the drastic fall in the Russian ruble from economic sanctions imposed over the invasions of Crimea and Ukraine will cause a severe recession in Russia in 2015. Backed into a political corner, Putin may lash out military advances. Recent aggressive Russian military flyovers, increased Russian submarine patrols, and bellicose rhetoric from Putin are causing great anxiety in Europe and elsewhere. Not only do Putin's military actions cause political turmoil, but economic distress as well.

In addition to political concern with regard to Russia, investors should also be aware of the potential economic ramifications of the radical Islamic movement. ISIS continues to be a significant regional military threat and is now impacting the economic vitality of the oil exporting nations in the Middle East (Figure 1). The West cannot



**Figure 1. Areas controlled by ISIS**

**Source: The Wall Street Journal**

allow ISIS to gain control of significant oil production. Should the ISIS military advances become a crisis, another costly military incursion into the region will be required. Such actions are incredibly expensive, and will put additional strain on the exiting massive debt burden of the Western economies.<sup>8</sup>

<sup>1</sup> <http://bloom.bg/1fGwTXU>

<sup>2</sup> <http://usat.ly/1qrl2mg>

<sup>3</sup> <http://onforb.es/10v5MOY>

<sup>4</sup> <http://on.wsj.com/1DZEfmK>

<sup>5</sup> <http://on.wsj.com/1AAeJ7R>

<sup>6</sup> <http://fw.to/yNMWe8F>

<sup>7</sup> <http://bit.ly/1unKeMe>

<sup>8</sup> <http://on.wsj.com/1C2b4zT>



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*Investing in a changing world*

The Herculean U.S. Dollar  
Roger Johnson, 1/1/2015

As global economic and political events unfold in 2015, markets will be climbing the proverbial “wall of worry.” American industrial might, consisting of our outstanding business workers and leaders, continue to be the backbone of the global economy. The global economy will likely face greater challenges with respect to currency wars, commodity volatility, radicalism, and actions of leading central banks’ interest rate policies. Bond and equity prices will likely be volatile.

Tighten your seat belt. As the U.S. dollar heads for the stratosphere, investors may be in for an exciting year!

*- Roger L. Johnson*

