Dollar

The Reserve Currency is Here to Stay

ECONOMY & MARKETS DAILY

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Best Stock Play to Profit from the Bullish Dollar

By: Rodney Johnson, Senior Editor, *Economy & Markets*

People always ask me when (not if) the Fed will succeed in driving the U.S. dollar into the ground, thus forcing us to lose our status as the reserve currency of the world. The majority of those who ask want to know, because they suspect the resulting inflation will boost the price of gold and other hard assets. This is the point where I really make people mad.

I have no choice but to give it to them straight: the Fed will not be punished for the greatest theft the world has ever known. I say this because the U.S. dollar will not lose its reserve currency status, despite all the calls to the contrary.

To think that investors, nations and large corporations will suddenly abandon the U.S. dollar implies that they will immediately embrace some other currency. This line of thinking misses the colossal change in the way currencies work since Nixon took the U.S. dollar off the gold standard in 1971.

We now operate in financial ether, where no currency is backed by a precious metal. Instead, currencies are valued against each other, and this value is now based on production and trade. Because of this, the greenback is far and away the most widely-used currency on the planet, and it shows no signs of losing its place.

So anyone holding out for the Fed to be punished for its larcenous, money-printing actions will be sorely disappointed. More importantly, anyone basing their financial future on a falling dollar will be not just disappointed but left behind financially.

It's All About Trade

The important thing to remember is that traditional definitions are no longer valid. In today's world, where no currency is pegged to a precious metal, a reserve currency is not a storehouse of value. Instead, it's all about trade.

It is easy to say that most trade is conducted in U.S. dollars, but the reasons for this, as well as just how deeply the greenback is embedded in international trade, can't be overstated.

The dollar's ascendancy in terms of international trade began when other countries started breaking their ties to the greenback. That left the dollar as the only currency that was still tied to a hard value. This made it the preferred choice for international trade, and put the U.S. in a dominant position where it could demand trade on its terms.

In today's world, the international obligations referred to earlier typically take the form of exchanging currency with domestic traders who buy and sell in other countries. To conduct international trade, companies have to agree on the method of payment. This involves settling not only on the terms, but also on the currency to be used.

For example, when exporting to the U.S., a company will typically price its goods in U.S. dollars. This allows the price to the U.S. consumer to remain the same, even though the selling company is taking a risk on currency volatility. It works the same in other countries. When selling in large quantities, it makes sense to price goods in the currency of the final buyers, because it allows them the luxury of stable pricing over time. This means the countries with the largest imports will drive international trade in their home currency.

Starting in 1971, the U.S. began importing more than it exported, leading to a negative balance of payments almost every year since. This left excess dollars outside the U.S. that could be used to meet obligations among foreign parties or invest back in the U.S.

In addition to money outstanding, the U.S. also maintains a sizeable debt. While having debt is not seen as a good thing, it actually facilitates a reserve currency, because it provides foreign holders of the currency with a place to store their funds. Instead of simply holding cash balances, international investors can purchase U.S. debt in order to invest the funds they hold in something considered safe and liquid.

All of this implies a free flow of capital across international lines. Holders of U.S. dollars or even U.S. debt are free to exchange or sell their holdings as they see fit. This free flow of capital is one of the main tenets of any currency that is to be used for international trade settlement and global payments.

Another factor that has caused dollar supremacy is that, over time, goods that can be substituted for each other tend to be priced in the same currency. This allows for easy comparison among providers and is called "coalescing."

Given that the U.S. was and remains a very large buyer of goods, and that many markets around the world used greenbacks in order to eliminate local currency fluctuation, many raw goods came to be priced in U.S. dollars. The most obvious example of this is oil.

No matter how hard the Iranians and others try, most oil transactions are still priced in dollars. This makes sense when you consider what would happen otherwise. If any exchange priced oil in something other than dollars, then an arbitrage opportunity would potentially exist, allowing participants to pit sellers against each other. Every time the exchange rate of a currency pair changed, so would the price of oil in one currency or both. If the value of the dollar falls against the euro by $.01, does oil become more expensive in dollars on an exchange based on euros? To avoid such confusion, sellers of such commodities tend to follow each other and simply use one currency to price their goods.

The Dollar is Here to Stay

Looking at reserve currency through the lens of trade brings a lot of clarity to our current situation. It is obvious that the dollar enjoys a unique position in terms of international trade settlement, but this position is not due to any love affair that other countries have for our currency. It is simply a matter of efficiency and size.

Yes, the Chinese renminbi is coming on fast, but there still exists a vast gulf between the dollar and everyone else. Recently, the Society for Worldwide Interbank Financial Telecommunication (SWIFT) announced that the renminbi had surpassed the euro to become the second most widely used currency for settling international trade.

This would appear to support the argument that the Chinese are gaining ground… which they are. The question is: "How much ground?" The Chinese moved into second place after capturing 8.66% of trade, while the euro slipped to third with 6.64% of trade. These two currencies trail the dollar dramatically, which was used for a whopping 81.1% of trade finance.

The Bank of International Settlements (BIS) compiles a report on foreign exchange transactions (forex) every three years. In 2013, the dollar was party to 87% of all such transactions, which is up from 84.9% in 2010. By comparison, the renminbi was party to just 2.2% of all transactions. The stark difference, even in the face of rising use of the renminbi for trade finance, reflects the complexities of international finance and illustrates why the renminbi will not seriously challenge the U.S. dollar as the world's reserve currency.

In terms of global payments — not trade finance — the world breaks out a little differently. SWIFT reports the top five currencies used for global payments as:

Currency	$ of Global Payments
U.S. Dollar	38%
Euro	35%
Great Britain Pound	10%
Japanese Yen	3%
Australian Dollar	2%

These numbers are clearly concentrated in U.S. dollars and euros, with British pounds a distant third. Notice the absence of the renminbi. When it comes to global payments, the Chinese currency is ranked 12th — right behind the Thai baht — with a whopping share of 0.84%. This is a huge jump from last year, when the renminbi's share of global payments was 0.25%, but still infinitesimal when compared with the world's most popular currencies.

The difference between the amount of renminbi used for trade finance and the amount used for global payments points out a distinction that illustrates why the renminbi should grow dramatically in terms of international use without ever seriously challenging the U.S. dollar. It's the difference between trade and capital.

What I mean by that is China is a big international trade partner. In fact, it just overtook the U.S. as the world's largest trading nation. So it makes sense that parties trading with China would use more renminbi one-on-one with it, either financing their trading or making a payment to the Chinese.

However, for third-party transactions (i.e., ones that don't involve China) no one is using renminbi. This is where the dollar still reigns supreme. That's why I fully expect use of the renminbi to grow, but only as it relates to financing and paying for direct trade with China. I don't expect it to become a currency used in third party transactions.

The countries that use the renminbi for trade finance (where the renminbi just displaced the euro) are as follows:

Country	% of Renminbi Usage
China	59%
Hong Kong	31%
Singapore	12%
Germany	2%
Australia	2%
Others	4%

China (including Hong Kong, which it owns) accounts for 80% all by itself. Singapore is a major financier of Chinese-related business and import/export, while Germany and Australia are both major exporters to China. It makes sense that these three would use renminbi when possible to smooth out pricing to their clients.

What is missing from this list is a host of foreign countries that are using renminbi to settle trade with each other, away from China. The countries above use renminbi when dealing with China, and this should continue to grow as China exercises more of its power to demand that trade be denominated in its own currency.

But this only goes so far. Those demands stop at China's borders. When looking at international dealings that do not involve a currency's home country, the dollar is still king.

Even more importantly, the Chinese simply have no interest in making the renminbi into a reserve currency. They would have to give up control… not something they're keen on doing.

For the renminbi to gain significantly wider use as an international currency, there would have to be a huge supply of renminbi on the international markets. People in countries around the world would have to have access to the currency through some- thing as simple as a forex counter at their local bank. This is something that is possible with the dollar, euro and even yen today.

In short, before payments can be made in renminbi, people have to have renminbi. Remember from above that one of the main ways that people get greenbacks is through our negative balance of payments. The U.S. imports more than it exports, sending hundreds of billions of dollars abroad every year. These funds are available on the international market for trade. The Chinese do not run a negative balance of payments and have shown no interest in doing so anytime soon.

Then there is the matter of what a country or institution would do with their excess renminbi as they held it. The Chinese government does not issue many bonds. There is no readily available market for investing renminbi that is considered both safe and liquid. The only thing a country or company can do easily is buy more stuff from China, which puts people right back in the game of direct trade with the country that issued the currency in the first place. This would suit the Chinese just fine, but would not help countries that might want to use their reserves for something other than more trinkets from the Middle Kingdom.

A more esoteric point is the question of hedging. For companies and countries to build and use large currency positions for international trade, they must be able to hedge their holdings whenever they see risk. This would imply a well-developed, functioning capital market that includes futures trading. This does not exist for the renminbi today, although it would be the least difficult piece of the puzzle to address.

A final thought on the U.S. losing its status as the reserve currency is to ask: "Why would anyone else want that burden?" In the world today, every country is busy trying to export its way out of a financial mess. The U.S. wants to send more stuff abroad, the Europeans are counting on the steady flow of BMWs and Audis off the continent, and China continues selling all it can to other nations. Everyone wants to be a net exporter.

But when a currency gains favor — and everyone rushes to buy it — the currency goes up in value. This means that country's exports become more expensive. Why would China — or the euro bloc or Japan for that matter — want to encourage international players to buy more of their currencies simply to use them as reserves? They'd completely undermine their efforts to boost exports and alleviate their economic weaknesses.

Putting this all together, it is clear that the U.S. does not enjoy its position as the reserve currency due to any goodwill, or because the U.S. has been so financially responsible. It is simply a matter of currently accepted practices (coalescing), the availability of dollars, the well-developed status of capital markets, the size of U.S. trade, and the fact that becoming the reserve currency would not be to anyone's benefit.

Unless something dramatic occurs, the Chinese renminbi will grow in use to match a substantial portion of the trade of the country but likely no more than that. Meanwhile, the euro bloc and Japan continue their efforts to devalue their own currencies, not make them more expensive.

For those of us in the U.S., it means that Fed- printing will not lead automatically to a decline in the use of the dollar abroad and, therefore, will not cause a drop in the value of the greenback. Anyone pinning their hopes on a cheaper dollar — by pur- chasing inflation-protected assets like TIPS or gold — will be disappointed. In fact, the opposite is likely to occur. When the U.S. and the world hit the next rough spot, the U.S. dollar is likely to spike in value, not fall.

The Dollar is the Ultimate Safe Haven

As the biggest, strongest, richest kid on the block, the U.S. dollar has a great many detractors. But despite the copious gripes of those critics, the dollar remains the ultimate safe haven in a financial crisis.

As the next round of deflation takes hold, a strong dollar will mean that anyone who has a claim on streams of income can purchase more assets, more services and a higher quality of life down the road.

As for future growth, our economy appears to be in a "muddle-through" mode, while consumers continue to shed debt (excluding student loans and car loans) despite ongoing income stagnation. All of this puts us on the path of deflation, which is quite normal after such an incredible boom in debt as we had in the 1990s and 2000s.

Debt deleveraging, deflation and a strong currency all work to drive interest rates down, or simply hold them at low levels, and to boost the value of cash, not inflation-protected assets. This means that people who are busy buying assets could be in for a rough ride, while those who are amassing streams of income are buying protection.

How to Profit From Dollar Dominance

U.S. dollar has proven itself as the undisputed champion in the currency arena. It's the reserve currency to the world's $70 trillion economy. It's the most ubiquitous method of payment. And it's the best currency investment in times of global financial turmoil.

Yet, investing in the U.S. dollar alone is not enough.

We have a stock play that provides direct exposure to the profit potential of a strengthening U.S. dollar.

Our position in the **ProShares UltraShort Yen ETF (NYSE: YCS)** has already handed us an open profit of 66%. But there are more gains to come. Shares of this ETF fell back a bit in price after hitting a prior high of $71.

Once this level is broken to the upside, watch for YCS to trade as high as $79. This puts another 14% of profit potential overhead.

Action to Take: Buy the ProShares UltraShort Yen ETF (NYSE: YCS) up to $68.

Editor's Note: For a more in-depth look at our work. Dent Research has just completed a new video with our current forecast on gold, oil, the Dow and much more. Simply click here to watch it now.

About *Economy & Markets*

In 1989, Harry S. Dent wrote the book *Our Power to Predict*. In it, he revealed how an investor could use demographic trends to accurately predict the direction of the markets, sometimes decades in advance.

Since then, Harry and his business partner Rodney Johnson have been using this New Science of finance to accurately identify booms and busts well ahead of the mainstream.

They gained national attention for their work in warning investors of the 2008 credit crisis and subsequent stock market collapse, many months before it happened.

But this was not the first time they were "on the money" with their big picture forecasts.

For example, in 1989 Harry accurately forecast the Japanese economic collapse and the multi-decade depression in Japan that would follow.

He also called a Dow of 10,000 by the early 2000s at a time when most economists, politicians, businessmen, analysts and investors were expecting the exact opposite. The Dow broke the 10,000 barrier for the first time on April 5, 1999.

In other words, they accurately predicted most of the major economic and stock market events that could have made you substantially richer over the past 20 years.

How do they do it? Well, while most economists focus on short-term trends… policy changes… technical indicators… elections — things that are volatile, unstable and can change from day-to-day — Harry and Rodney focus on long-term trends. Demographics. Business cycles. Human behavior patterns. Things that have demonstrated themselves over hundreds (even thousands) of years to be consistent, predictable and measurable.

They study the past to predict the future… an approach that enables them to forecast years into the future with an incredible degree of accuracy. Then they make minor tweaks and adjustments in response to short-term events that occur along the way.

And that's what they bring to you in *Economy & Markets*, so you'll know what's coming next… where the immediate opportunities are… and where to park your money for the longer term.

As a *Economy & Markets* subscriber, you will know, for example, when it's time to start profiting from the rise of specific emerging market economies (it's not now, despite all the hype about these markets). And exactly what industries and investments will hand you the fastest profits, first.

You'll learn when commodities will likely reach their peak in their cycle and how to ride the gains. You'll also learn when they'll turn down and what investments to make to profit from any moves down.

And you'll learn when the property market will turn up again… you'll learn when, money markets and bonds would be a better investment than stock allocations… and when not.

You'll be ahead of the markets on every boom and bust… access the tools you can use to prepare yourself to survive and prosper.

Meet the Experts

Harry S. Dent Jr.
Editor

Harry studied economics in college in the '70s, but found it vague and inconclusive. He became so disillusioned by the state of his chosen profession that he turned his back on it. Instead, he threw himself into the burgeoning New Science of Finance where identifying and studying demographic, technological, consumer and many, many other trends empowered him to forecast economic changes.

Since then, he's spoken to executives, financial advisors and investors around the world. He's appeared on "Good Morning America," PBS, CNBC and CNN/FN. He's been featured in *Barron's, Investor's Business Daily, Entrepreneur, Fortune, Success, U.S. News and World Report, Business Week, The Wall Street Journal, American Demographics* and *Omni*. He is a regular guest on Fox Business's "America's Nightly Scorecard."

Harry has written numerous books over the years. In his book *The Great Boom Ahead*, published in 1992, he stood virtually alone in accurately forecasting the unanticipated boom of the 1990s. That same year he authored two consecutive best sellers: *The Roaring 2000s* and *The Roaring 2000s Investor* (Simon and Schuster). In *The Next Great Bubble Boom*, he offered a comprehensive forecast for the following two decades.

In *The Great Depression Ahead*, he outlined how the next great downturn is likely to unfold in three stages, with an interim boom stage between 2012 and 2017 before the long-term slowdown finally turns into the next global boom in the early 2020s.

In *The Great Crash Ahead*, he outlines how this next great crash is likely to unfold in the coming months. He explains why there is nothing the government can do to protect us as deflation takes hold of the economy.

Harry's latest book, *The Demographic Cliff, How to Survive and Prosper Dueing the Great Deflation of 2014–2019*, shows why we're facing a "great deflation" after five years of stumilus — and what to do about it now.

Today, he uses the research he developed from years of hands-on business experience to offer readers a positive, easy-to-understand view of the economic future.

Harry got his MBA from Harvard Business School, where he was a Baker Scholar and was elected to the Century Club for leadership excellence.

Rodney Johnson
Editor

Rodney works closely with Harry to study how people spend money as they go through predictable stages of life, how that spending drives our economy and how readers can use this information to invest successfully in any market.

Rodney began his career in financial services on Wall Street in the 1980s with Thomson McKinnon and then Prudential Securities. He started working on projects with Harry in the mid-1990s.

He's a regular guest on several radio programs and is featured on television where he discusses economic trends ranging from the price of oil to the direction of the U.S. economy. He too is a regular guest on fox Business's "America's Nightly Scorecard." He holds degrees from Georgetown University and Southern Methodist University.

Adam O'Dell
Investment Analyst

Adam has one purpose in mind: to find and bring to subscribers investment opportunities that return maximum profit with the minimum risk. He achieves this with his perfect blend of technical and fundamental analysis.

Tactically, he does exhaustive back-testing and probability-based research. It's the ultimate partner to the exhaustive research that Harry and Rodney do in the exciting realm of the New Science of investing.

Adam has worked as a Prop Trader for a spot Forex firm. While there, he learned the fundamentals of trading in the world's largest market. He excelled at trading the volatile currency markets by seeking out low-risk entry points for trades with high profit potential.

Aiming to find the best opportunities across all asset classes, Adam expanded into the commodities, equities and futures markets.

An MBA graduate and Affiliate Member of the Market Technicians Association, Adam is a lifelong student of the markets.

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