Ropes Wealth Reviews Blessings and Burdens of a Strong Dollar

Stocks stumbled as the inflation news went from bad to worse this week and earnings season kicked off with a thud. In a sign that price pressures remain entrenched, the Consumer Price Index (CPI) reported a 9.1% year-over-year increase, while the Producer Price Index (PPI) increased 11.3% from a year ago. In both surveys, nearly every category of cost was higher, which confirmed the Fed's course to raise interest rates later this month by an additional three-quarters of one percent as they try to get prices in hand. The start of earnings season yielded poor reports from the financial services sector headlined by J.P. Morgan and Morgan Stanley. Both companies reported earnings that missed forecasts by 30%, as trading and investment banking revenue were down amidst this year's market turmoil. J.P. Morgan and Wells Fargo were also noted to be setting aside reserves for credits losses on bad loans, in a sign Wall Street is preparing for the downturn to intensify in the months ahead. As Morgan Stanley Chief Executive James Gorman noted, "If I had to use one word to describe it, it would be 'complicated. I think it's important to say, though, it is not 2008 complicated. We're in specifically much better shape."

Another development worth noting from this week's ongoing volatility in stock prices and challenging economic news was a historic move in currencies. For the first time in 20 years, the euro and the U.S. dollar hit parity. While parity was brief, the dollar's strength against the euro and other foreign currencies is likely to prevail as the recession outlook for Europe grows even more worrisome, the Russian-Ukraine war drags on, and the region faces a winter in a severe energy crisis.

It is worth noting the dollar has been hitting 20-year highs against the currencies of all major trading partners, not just the euro. Despite many predictions for years to the contrary, the U.S. dollar is still the world's dominant currency for trade and central bank reserves. Its strength today reflects its status as a safe haven for investors in times of uncertainty, and relative optimism over the American economy during what is likely to be a protracted period of global weakness.

A strong U.S. dollar brings both blessings and burdens, though, and it is worth noting the impacts of those dynamics as we consider the future outlook. For example, the strong dollar's ability to provide a cushion against inflation, in the form of cheaper imports, can make it more challenging for the Fed to cool demand. This could put pressure on the Fed to raise rates even higher to tame inflation, and push the boundaries of our hopes for a short and shallow downturn.

There is also the flip side of cheaper imports. The dollar's strength hurts U.S. exports and currency-translated overseas profits of U.S. companies. In fact, it has been historically true that every percentage point gain in the dollar results in about a half point hit to earnings on the S&P 500. This is because our leading companies are multinational companies, who are already warning about currency headwinds in earnings reports. Slowing overseas profits and sales is yet another hit for companies already struggling with margin pressure from cost inflation, higher/unwanted inventories, and slower demand. In fact, analysts estimate that at today's 16% year-on-year increase in the dollar level, we can expect an 8% headwind for S&P 500 earnings growth. On top of everything else, it would seem downward pressure on earnings will continue, and stock prices may not have yet reached bottom to reflect these risks.

Our counsel in this period of market upheaval and uncertainty is to recall the flexibility, diversification, and liquidity built into your investment plans. These shifts in dynamics are putting pressure across all equity investments indiscriminately at this moment, but as time marches on and more clarity flows through on the impacts to the bottom line, there will be more discernment and differentiation of return by company. We are making careful shifts to prepare for that moment, emphasizing quality, resiliency and the potential opportunity that this global reset may create in the holdings we select on your behalf.

Thank you for your interest in our investment commentary. If you would like to speak personally with a member of our team at any time, please click **here**.

Ropes Wealth Advisors LLC
800 Boylston Street Boston, MA 02199-3600