BEEFY BUCK

How to Invest for a Strong Dollar

U.S. stocks are a good bet—but you have to choose carefully.

BY ANDREW TANZER

Among the many challenges confronting investors in 2022 is the dizzying rise of the U.S. dollar. From the start of the year through September 9, the Dollar Index (DXY) surged 14%, reaching its highest level in 20 years. The three largest components in the index's basket of currencies—the euro, Japanese yen and British pound—have all slumped 15% to 25% against king dollar over the past 12 months.

Exchange-rate movements are driven by an amalgam of factors including interest rates and monetary policy, inflation and economic growth, trade balances and perceived geopolitical risk. For example, higher U.S. interest rates and aggressive Fed monetary tightening help to strengthen the value of the dollar. So does the relative strength of the U.S. economy compared with Britain, the eurozone and Japan.

And the tragic war in Ukraine only raises the risk profile in Europe. "When things go bad, generally the dollar trades as a safe haven, and today there is a shortage of safe havens," says Brent Donnelly, president of Spectra Markets, a macroeconomic and currency-trading adviser.

Perhaps the greatest source of downward pressure on the euro and pound this year is the Russian invasion of Ukraine, which has severely disrupted the supply of oil and natural gas to Europe. European countries now face a nasty energy crisis and a cold, dark winter ahead. The eurozone's ill-considered dependence on the kindness of Vladimir Putin for the supply of natural gas through an extensive pipeline network emanating from Russian gas fields has backfired. The price of gas and electricity in Europe (including in Britain) has skyrocketed to stratospheric levels, with the price of imports of energy and other raw materials escalating far faster than the export price of, say, a BMW. The U.S., a net exporter of energy and agricultural goods, is in a much stronger terms-of-trade position.

What does this mean for U.S.-based investors in stocks? There are multiple implications, many of which defy easy solution. "The trouble of a strong currency in the U.S. is that it creates more losers than winners," says Andy Kapyrin, co-chief investment officer at RegentAtlantic. About 30% of revenues of companies in the S&P 500 index are generated overseas. Profits on those sales decline when they're repatriated to the U.S. from weak-currency markets and translated into strong dollars.

The equation for international stocks is mixed. In theory, the earnings of a foreign multinational such as Toyota Motor, with costs in weak-currency Japan and revenues in the strong-currency U.S. market, should benefit when those

dollars are exchanged for yen. But not every foreign company shares those favorable economics, and the thought of exchanging dollars today for the stock of an overseas company denominated in a shrinking foreign currency is a bit intimidating. Says Simon Lack, co-manager of Catalyst Energy Infrastructure Fund, "If you think the dollar is going up, you want to minimize international exposure."

Currency volatility is a complicated issue for investors—and keep in mind that there are many other confluent factors influencing stock prices, including valu-

COURTESY LOCKHEED MARTIN

LOCKHEED MARTIN, WHICH MAKES F-35 FIGHTER JETS, LOGS SALES MOSTLY IN THE U.S.

ation, product pricing power and competitiveness. In fact, some professional investors simply refuse to play the game of trying to time movements and cycles of currencies. "Obviously there are no easy answers, so we simply try to invest in good companies trading for reasonable valuations to be held through several business cycles rather than thinking that we can figure out the gyrations of fickle currency traders," says John Buckingham, editor of *The Prudent Speculator*.

Considering this confusing brew, we have provided some suggestions for investors to think about and invest in today's strong-dollar environment. All investment returns are through September 9 unless otherwise indicated.

STAYING AT HOME

You can loosely divide U.S. companies into three groups: those negatively affected by dollar appreciation, those helped by a strong greenback, and domestically oriented outfits that are not directly impacted by currency movements. Large multinational corporations, such as Microsoft and Apple, that book most of their revenues abroad are hurt when foreign profits in weak currencies such as the euro and pound are translated back into U.S. dollars.

Importers are one type of business that, in theory, could benefit, because the cost of shopping abroad for parts and finished goods declines with currency weakness—as it does for American tourists shopping in Italy or Britain. (For more on navigating a strong dollar, see "Ahead," on page 9.) Joe Duffy, director and investment specialist at Harbor Capital Advisors, cites **TJX COMPANIES**, a large off-price retailer of clothing and home fashions, as an example of a firm that buys abroad but sells predominantly in the U.S.

In the same vein, Kapyrin likes **HOME DEPOT**, which imports much of its home-improvement merchandise from factories in weaker-currency locales, including China and Mexico, and registers about 90% of sales in domestic stores. The stock yields 2.5%, and the company has jacked up the dividend 16% annualized over the past five years. The stock is a member of the Kiplinger Dividend 15, the list of our favorite dividend stocks.

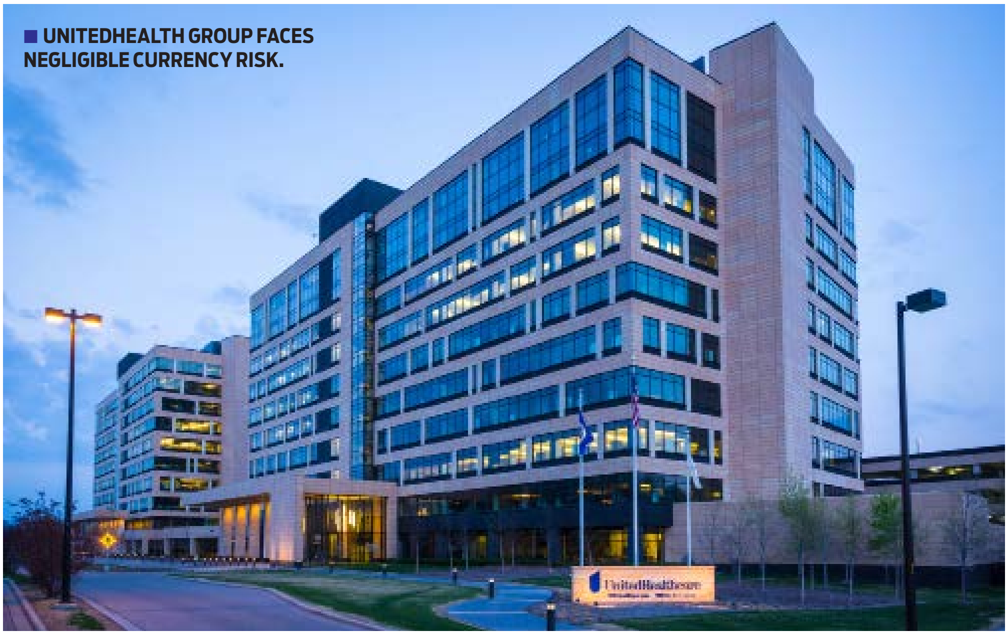
You could call the third

category stay-at-home companies, whose costs and (more importantly) revenues are principally here in the U.S., so they earn money in super-strong dollars. These tend to cluster in certain domestic industries. One is real estate, which Kapyrin calls "agnostic to the value of the dollar." Lisa McIntire Shaw, managing partner of Charlotte, N.C.–based Cygnus Asset Management, is particularly attracted to warehouse, storage, cell tower and 5G infrastructure real estate investment trusts, which are well represented in exchange-traded fund **VANGUARD REAL ESTATE**.

Another expanding sector dominated by domestic revenues is defense contracting. Alex Seleznev, director of wealth management and financial planning services at Councilor, Buchanan & Mitchell, likes **LOCKHEED MARTIN**. The company's sales are predominantly in the U.S., and it is exposed to long-term growth businesses including the F-35 fighter, hypersonic missiles and space militarization. Lockheed, another Dividend 15 stock, yields 2.7% and has raised its dividend for 19 consecutive years. Rising geopolitical tensions with countries such as Russia, China and Iran should provide a nice budgetary tailwind for defense contractors. If you'd rather spread your defense bets, consider **ISHARES AEROSPACE & DEFENSE**.

In health care, as with Lockheed Martin, Seleznev likes **UNITEDHEALTH GROUP** for the long run. By far the largest health insurer, domestically focused UnitedHealth has negligible currency-exchange risk and will continue to benefit from the inexorable growth in the number of Medicare patients (it's the leading provider of both Medicare supplemental insurance and Medicare Advantage insurance) and demand for medical care from an aging population.

Several energy companies, with revenues mostly in greenbacks, also look attractive. Stewart Glickman, energy analyst at investment research firm CFRA, is drawn to domestically focused exploration and production companies, including **EOG RESOURCES**, which has low debt and a clean balance sheet. EOG



■ **UNITEDHEALTH GROUP FACES NEGLIGIBLE CURRENCY RISK.**

COURTESY UNITEDHEALTHCARE

STRATEGY

TO HEDGE OR NOT TO HEDGE?

One tactic to address the issue of a strong dollar and weak foreign currencies for U.S.-based investors is to hedge currencies. Because this involves buying and managing portfolios of currency contracts such as futures or options, realistically this is a game best left to professional investors, and not all agree it's necessary. Fidelity International Growth does not hedge currencies, for one.

Many pros also seem to be shying away from currency hedging these days. Peter Essele, head of portfolio management for Commonwealth Financial Network, calls currency hedging "an exercise in futility and frustration" since there's a mismatch between the short-term, risky challenge of predicting currency movements and long-term investing in foreign companies. Brent Donnelly, president of Spectra Markets, a macroeconomic and currency-trading adviser, has been engaged in foreign currency markets for nearly three decades. "Hedging has a little bit of a bad name since it has a cost and the benefit isn't always clear," he says. "The risk-averse approach is to never hedge."

If you feel vulnerable to currency volatility, there is a way to play it both ways: **IQ FTSE INTERNATIONAL EQUITY CURRENCY NEUTRAL**. This exchange-traded fund, aimed largely at investment advisers, maintains a 50%, or neutral, currency hedge on its portfolio of international stocks by using derivatives contracts on each of the underlying currencies and resetting the balance monthly. "We think of it as the hedge of least regret," says Sal Bruno, chief investment officer of IndexIQ, the fund's parent. So far this year through September 9, the semi-hedged fund's loss of 14.1% was roughly six percentage points less than that of the fund's underlying unhedged international index.

recently announced a large find of natural gas in South Texas, which is conveniently located close to Gulf Coast facilities at which natural gas is converted into liquefied natural gas (LNG) through a cooling process that shrinks the volume of gas 600 times, enabling it to be exported to the world.

Indeed, Lack, of the Energy Infrastructure fund, is particularly enamored with natural gas plays in the midstream energy sector, which includes oil and gas pipelines and storage and processing facilities. The price of natural gas in Europe is now seven to 10 times higher than in the U.S. due to the continent's dependence on imported Russian gas. The U.S. can export all the LNG (in U.S. dollars) that it can process from natural gas.

At last report, the top two holdings in the fund that Lack comanages were **CHENIERE ENERGY**, which accounts for more than half of all U.S. exports of LNG and is expanding its LNG processing facilities, and **THE WILLIAMS COMPANIES**, which offers a nice 5.2% yield and, like most midstream companies, is generating abundant free cash flow. The two companies are in fact physically linked, as Williams pipes natural gas to Cheniere facilities in Louisiana and Texas, where Cheniere converts the gas to LNG and loads it on tankers for export.

INVESTING ABROAD

Even before the dollar went on a tear, international stocks were trailing badly behind U.S. markets in performance. That has made individual investors and financial advisers unusually wary of holding foreign stocks. "Domestic U.S. investors in equities second-guess *any* foreign exposure whatsoever," says Peter Essele, head of portfolio management at Commonwealth Financial Network.

Jed Weiss, manager of **FIDELITY INTERNATIONAL GROWTH**, a member of the Kiplinger 25 list of our favorite no-load funds, sees international investing's prolonged stretch of underperformance as an opportunity because the asset class is now inexpensive relative to U.S. stocks. (For instance, the price-to-book-value ratio of the S&P 500 index is more than double that of the MSCI EAFE index of international stocks, which offers an average yield of 3.3%, or nearly double that of U.S. stocks.)

As for currency impact, Weiss cites LVMH, the French maker of luxury goods such as Louis Vuitton bags. LVMH, which was a top-five fund holding at last report, produces mainly in Europe (with a weak currency) and books a large chunk of sales in U.S. dollars (a strong currency), which should bolster profits. Airbus, another large fund holding, becomes more competitive against Boeing because the former's plants are in the eurozone and Boeing's are in the U.S.

The trouble is that the energy crisis in Europe will likely sink the continent into a recession and potentially even spark political and social instability. Given energy shortages, Mike Green, portfolio manager and chief strategist with Simplify ETFs, anticipates a "wartime" economy in Europe this winter, with governments forced to make invidious decisions about rationing and allocating scarce energy resources among households and businesses—and about how much to subsidize electricity for end users. That just doesn't sound like a good recipe for visibility of corporate profits. ■

FOR QUESTIONS OR COMMENTS, E-MAIL FEEDBACK@KIPLINGER.COM.

CURRENCY CONTENDERS

OUR PICKS FOR A RISING GREENBACK

The stocks and funds below should be able to do well when the dollar is strong.

Company	Symbol	Price	Price-earnings ratio	Yield	Annualized total return 1-yr.	3-yrs.
Cheniere Energy	LNG	$161	10	0.8%	85.7%	37.6%
EOG Resources	EOG	123	8	2.4	94.2	19.0
Home Depot	HD	300	18	2.5	–7.4	11.1
Lockheed Martin	LMT	422	15	2.7	24.0	6.0
TJX Companies	TJX	67	21	1.8	–2.5	6.7
UnitedHealth Group	UNH	524	21	1.3	28.3	32.9
The Williams Companies	WMB	33	19	5.2	42.7	15.5

Mutual fund/ETF	Symbol	Price	Expense ratio	Yield	Annualized total return 1-yr.	3-yrs.
Fidelity Intl Growth	FIGFX		0.99%	0.6%	–25.6%	3.7%
IQ FTSE Intl Eq Curcy Neut	HFXI	$20	0.20	3.5	–13.9	4.4
iShares Aerospace & Defense	ITA	103	0.39	0.8	0.0	–1.2
Vanguard Real Estate	VNQ	96	0.12	3.1	–8.8	4.4
S&P 500 INDEX				**1.7%**	**–8.1%**	**12.8%**
MSCI EAFE INDEX				**3.3**	**–20.5**	**1.7**

As of September 9. Stock yields are based on the most recent payout, annualized. Fund yields are based on payouts for the past year.
SOURCES: Morningstar Direct, fund companies.