Philequity Corner (November 12, 2007)
By Valentino Sy

Hold US dollars = lose money

The most common question we receive from our readers now is: "What does one do with their US dollar position?" Since we first wrote about the dollar's decline and the peso's rise two years ago (see "*Peso, the strongest currency in Asia*" on Oct. 24, 2005 issue of *The Philippine Star*), the dollar has lost more than 20% of its value against the peso. In fact we have written several articles repeatedly predicting the appreciation of the peso. From way back, whenever we made a forecast on the peso, people deemed it farfetched at first, but eventually the peso moved right along.

Changing the mindset

Filipinos, by nature, are dollar keepers. Call it a form of colonial mentality. Perhaps we're so used of seeing the peso depreciate against the dollar (since time immemorial) that we buy the greenback whenever we have extra savings. However, things change. The US dollar is now on a seven-year low against the peso. Moreover, the US dollar is declining in value against most currencies and is on a verge of a freefall as the Fed prepares for more rate cuts.

So before we can address the question of what to do with the US dollar, Filipinos must first change their mindset and realize that holding US dollars now is not as safe as it used to be.

Diversification

Remember the old adage "Don't put all your eggs in one basket." The same strategy may also apply to your cash holdings. In financial parlance, it is called *diversification* or spreading your cash holdings into different currencies (e.g. Philippine peso, US dollar, Euro, etc.). In that way, your currency holdings that fall in value will be offset by other currencies that increase their worth.

When diversifying, it important to note that different currencies carry different rates of return. A peso deposit, for example, earns more than a US dollar deposit, which in turn, yields more than a yen deposit. Usually, the deposit rates on different currencies follow a benchmark set by their corresponding countries' central banks as can be seen below.

Overnight lending rates	
New Zealand	8.25%
Philippines	7.75%
Australia	6.50%
United Kingdom	5.75%
Canada	4.50%
United States	4.50%
Euro	4.00%
Switzerland	2.75%
Japan	0.50%

Source: Wealth Securities Research

In the current context, holding most of your cash savings in US dollars may not be the best idea as looming Fed cuts may add more impetus to its decline. We are not saying, though, that you should abandon the US dollar completely. However, you should diversify into other currencies such as the Euro, Canadian dollar, etc.

Asset Allocation

Asset allocation takes the concept of diversification a step further. By dividing your savings into different asset classes (such as stocks, bonds and cash), you are able to take advantage of a wide variety of investments and help spread the risks. At the same time, asset allocation provides numerous ways of achieving currency diversification. This includes investments in:

- International bond funds and equity mutual funds
- Exchange Traded Funds (ETFs) that put your money in foreign currency deposits: in the euro, Japanese yen, Australian dollar, Canadian dollar and more.
- Exchange Traded Funds that represent foreign stock indices: Brazil, South Korea, Singapore, etc.
- Currency options for greater leverage

Each of these alternatives has advantages and varying degrees of risk (with options having the most risk) depending on your individual investment objectives and all require thoughtful consideration.

But perhaps the simplest way to diversify out of the US dollar is to invest in peso instruments such as Philippine stocks, bonds and mutual funds. For new investors, mutual funds such as Philequity Fund can substitute for stocks until they become more familiar with stock investing.

Note that Philequity Fund has already returned 23.7 percent in peso terms from the start of the year. But in US dollar terms, the fund has already gained 39.3 percent because of the peso's 12.7 percent appreciation over the same period.

Hedging

For business owners, especially the exporters and importers, using forward contracts can help deal with foreign currency issues. Forward contracts let you buy and sell one currency against another for a fixed price at a future date, thereby reducing foreign currency risk.

The Bangko Sentral ng Pilipinas currently provides a non-deliverable forward foreign exchange facility (NDF facility). Authorized commercial banks may then tap this facility for the purpose of hedging the forex obligations of their borrowers.

It's never too late

Now that the US dollar has declined to multi-year lows against most currencies, you may be contemplating if it is already too late to diversify your dollar holdings. In fact, the European Central Bank (ECB) may intervene soon because of the recent strength of the Euro.

However, it is worth noting that currency moves are usually multi-year moves (sometimes even lasting for decades). Long-term currency movements are usually triggered by structural shifts in the economy. In the U.S. case, because of the sub-prime problems and their huge current account deficit, even an ECB intervention may not be enough to turn the tide. Therefore, it is never too late and it is always prudent to diversify.

Also note that even sovereign countries like China, Qatar, Sweden, Russia, UAE and others are diversifying their currency reserves. Some have set up investment funds, like Singapore's

Temasek Holdings, the Government of Singapore Investment Corp. (GIC). Just recently, China Investment Corp. was set up to manage China's $200 billion sovereign wealth fund.

Our very own GSIS is also on the right track as they announced that they will be investing abroad as part of their diversification strategy (and in spite of the strength of the peso). As more and more countries announce that they will be diversifying their currency reserves, we can only expect one thing: that the US dollar may further lose its value.

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