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VICTORIA Capital Management, Inc.

Market Musings

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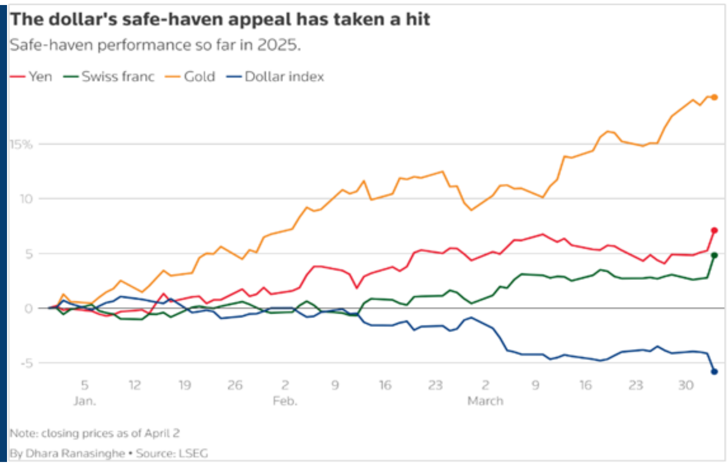
The recent decline in the dollar's value pales compared to its increase during the 2000s, when the increase translated into lower prices for imported goods and services. This year, the dollar's safe-haven status has come into question, making its value an essential indicator of the U.S.'s stature in the world economy.



Financial Markets and the International Value of the Dollar

The "tariff wars" are having an impact on the value of the dollar. As the world's reserve currency, virtually all global transactions are conducted in dollars, making the U.S. a powerful global economic force. Since our trading partners announced and implemented tariffs and reciprocal actions, the dollar has come under pressure. If tariffs cause a global economic slowdown, there is less need for dollars. Second, the uncertainty surrounding the actual level of tariffs is causing international investors to diversify their portfolios away from the dollar and into other currencies or tangible assets. And, as our trade deficit is likely to shrink in response to these restrictions on trade, i.e., rising prices and less supply, foreigners will be reducing their U.S. investments because of a shrinking trade surplus that will, in turn, weaken the dollar. An offset is that a weaker dollar makes U.S. goods more competitive in world markets and raises the price of imports. Again, even though exports might increase, that increase could be offset by a lower dollar value.

Historically, trade deficits have been viewed negatively, as President Trump refers to these shortfalls as foreigners ripping us off by selling Americans cheap goods. His first term tariffs on aluminum and steel imports protected those producers but harmed employment from competitive imports. The theory behind encouraging global free trade is to allow countries/companies to produce goods they know how to make at the lowest possible price, making everyone's standard of living higher. A country may favor one or more industries by imposing tariffs, but this will likely increase inflation in the total economy. The bottom line is that a shrinkage in world trade and lower U.S. trade deficits will produce a weaker economy and a falling dollar.

Even if the tariff wars end, the outcome should encourage world trade and focus on reducing prices. The combination of higher global growth and lower inflation will benefit the global economy and the dollar's value. The U.S. tariff policy must change to restore certainty in our economic outlook and openness to trading with other nations.

"The more people who own little businesses of their own, the safer our country will be, and the better off its cities and towns; for the people who have a stake in their country and their community are its best citizens."

- John Hancock

Market Commentary

April was not only a roller coaster ride in financial markets but also what seems like the longest month in history! From "Liberation Day" on April 2nd, stocks were whipsawed for the next 28 days by tariff-related trade concerns. Mid and small caps, given their more domestic focus, fared worse than their large-cap brethren, with the S&P MidCap 400 and S&P Small-Cap 600 falling by 2% and 4%, respectively. Conversely, large caps in Europe declined while mid and small caps demonstrated strong returns, highlighting a shift in market dynamics. Asian equities remained relatively resilient and advanced in April despite increased volatility on the back of strengthening local currencies against the U.S. dollar. Gold rallied to an all-time high during the month.

The Consumer Price Index (CPI) (-0.1%), Producer Price Index (PPI) (-0.4%), and Import Prices Index (-0.1%) all declined on a month-over-month basis in March for the first time since April 2020. Since the start of 2010, there have been only 14 other months in which all three inflation indicators have declined in the same month.
(Source: Bespoke)