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# Funds Learn to Gauge the Dollar

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FUND managers are often shy about discussing the role that foreign exchange movements or other macroeconomic factors play in their portfolios. Managers often portray themselves as stock pickers, viewing the market through a microscope, not a wide-angle lens. But the dollar's swoon is forcing them to adjust their focus.

"Most stock managers think of themselves more as long-term investors in business, and thus currency doesn't play a very big role in their portfolios," said Bridget Hughes, an analyst at Morningstar. She added, though, that "certainly some managers will consider currency effects as they pertain to individual companies' growth rates, revenues and profitability, but at a very micro level."

Especially now. As the dollar has fallen - it declined by 7.1 percent against the euro in 2004, for example - fund managers have seen fit to shift more of their assets abroad, Ms. Hughes said.

"We have been hearing of more managers buying more overseas stocks over the past year or so," she said, "but the argument has generally been valuations, not currency."

Whatever its logical underpinnings, the wanderlust has been rewarded. The average equity fund in Morningstar's database that mainly invested abroad climbed 18.3 percent last year, while the average domestic stock fund rose 12.7 percent.

Such numbers help to explain why fund managers have not been so reluctant lately to discuss how they incorporate currency movements into investment decisions. Holdings that have proved fruitful during the dollar's decline, they said, have included European and Japanese companies that sell into their domestic markets, generating revenue in the strongly appreciating currencies.

Those that have done still better are ones able to produce goods in the United States or dollar-based emerging markets, before turning around and selling them for euros or yen.

"Our shareholders have benefited massively from the trade," said Francis Claro, manager of the Evergreen Global Opportunities fund, referring to the sale of dollars for other currencies, especially the euro.

The dollar is likely to experience a reversal, he said, though he doesn't see a turnaround in the short term and did not give an estimate of when the rebound would occur. His fund is 70 percent invested overseas, a huge bet in a world where the United States accounts for roughly half of the total market value.

Mr. Claro has been concentrating on European companies with strong domestic sales. An example is Trisa, a

Spanish company that owns El País, the newspaper, and has interests in book publishing and radio.

"Trisa is benefiting from an upturn in the advertising market," he said. "If you have a Spanish newspaper that costs one euro, you've had the benefit of increased pricing power as a U.S. investor, without the company having to raise the price to its readers."

Another business that Mr. Claro likes for its strong euro sales base is Mobistar, a Belgian provider of mobile telephone services. "It's a local-currency play; all of its revenues are in euros," he said.

A further appeal is a relatively low valuation of 15 times earnings, he said, and the fact that the company "has been able to capture market share from some of its main competitors."

One reason the stock is so attractively valued, he said, is that it is no one's idea of the flavor of the month. "The Belgian market has not been a great focus of investors," Mr. Claro said, "and this company has been a small member within that space."

Ray Mills, manager of the T. Rowe Price International Growth and Income fund, has also been buying European companies with strong domestic businesses, particularly banks like Barclays in Britain, BNP Paribas in France and Nordea in Norway.

"European banks have been good investments lately," he said. Apart from the fact that their revenues are in euros or sterling, he said, "they have price-earnings ratios of 10 or 11 and yields near or over 4 percent. U.S. banks have multiples significantly higher than that and dividend yields that are half that."

A sinking dollar highlights candidates for managers to sell, not just buy, said Ron Holt, co-manager of the Vanguard International Value fund. "As the dollar weakens, companies that derive a lot of earnings in dollars are beginning to look less compelling to us," he said.

One company to avoid because of the weak dollar, he said, is Signet, a British jewelry retailer. "The majority of its profits are in the U.S., and they have been impacted by the weaker dollar," he said.

A better prospect in the present climate, Mr. Holt said, is Carrefour, a French owner of supermarkets and hypermarkets. "It's a global business, but a lot of it is based in France," he said. "We're starting to see a lot of pickup in consumption in Europe, particularly in France."

Mr. Holt said a falling dollar could give companies a boost on the other side of their balance sheets.

Companies that make products in countries whose currencies closely track the dollar, including many in Asia and Latin America, can cut costs without having to make changes in the way they manufacture or sell.

One company he favors is Johnson Electric, a Hong Kong concern that makes motors for devices like DVD players and car mirrors. Most of its manufacturing is done in China, where the currency, the yuan, is pegged to the dollar.

Mr. Claro, at the Evergreen fund, likes companies that benefit from a weak dollar when both buying and selling. Puma of Germany, for example, makes athletic shoes in emerging markets with weak currencies and sells two-thirds of the shoes to European consumers, he said.

Other strong beneficiaries of a weak dollar, said Mr. Mills of T. Rowe Price, include companies whose stocks "may have been pummeled unjustifiably."

Carmakers leap to mind. European and Japanese manufacturers depend on sales to Americans, so they seem to have the worst of all worlds: costs in euros or yen and revenues in dollars.

"But companies have shifted costs to the U.S.," most notably BMW and Toyota, Mr. Mills said. "If you just look at the surface, they're going to get hurt, but they may not get hurt as much as people think."

Similarly, Mr. Holt of Vanguard concluded that Japanese electronics companies like NEC and Canon were suffering less from currency movements than might be supposed.

"When you think about Japan, exporters are going to be hurt, but you do not have the same type of mismatch between costs and revenues as you would have had 10 to 15 years ago," he said. "There is less of that because most of these guys have moved their production to China."

Nigel Emmett, head of international investment management at J.P. Morgan Fleming, agreed. Japanese makers of consumer electronics would bear the brunt of a weaker dollar, but he likes Matsushita because "management has been able to manage its way through the difficult environment."

Mr. Mills stressed that the impact of foreign-exchange movements should be calculated one stock at a time.

"You don't want to bet the whole portfolio on currency movements," he advised. "You pick good companies with low valuations, investment by investment, and then monitor your risk factors and be aware of your dollar exposure."