



Outlook for the Dollar

Max Darnell

Chief Investment Officer

First Quadrant, L.P.

The Issues

- Trade Imbalance
- Budget Deficit/Debt
- Expensive Dollar
- Change in Foreigners' Appetite for US Assets

Faults in the Assumptions?

- Remember Crowding Out in the 1980's?
 - Large government borrowing would drive interest rates up and crowd out private investment
 - Foreigners have provided the needed capital, and private investment was not crowded out

Faults in the Assumptions?

- What Might Foreigners Do?
 - Sell US assets?
 - Cease to accumulate US assets?
 - Slow accumulation of US assets?

Faults in the Assumptions?

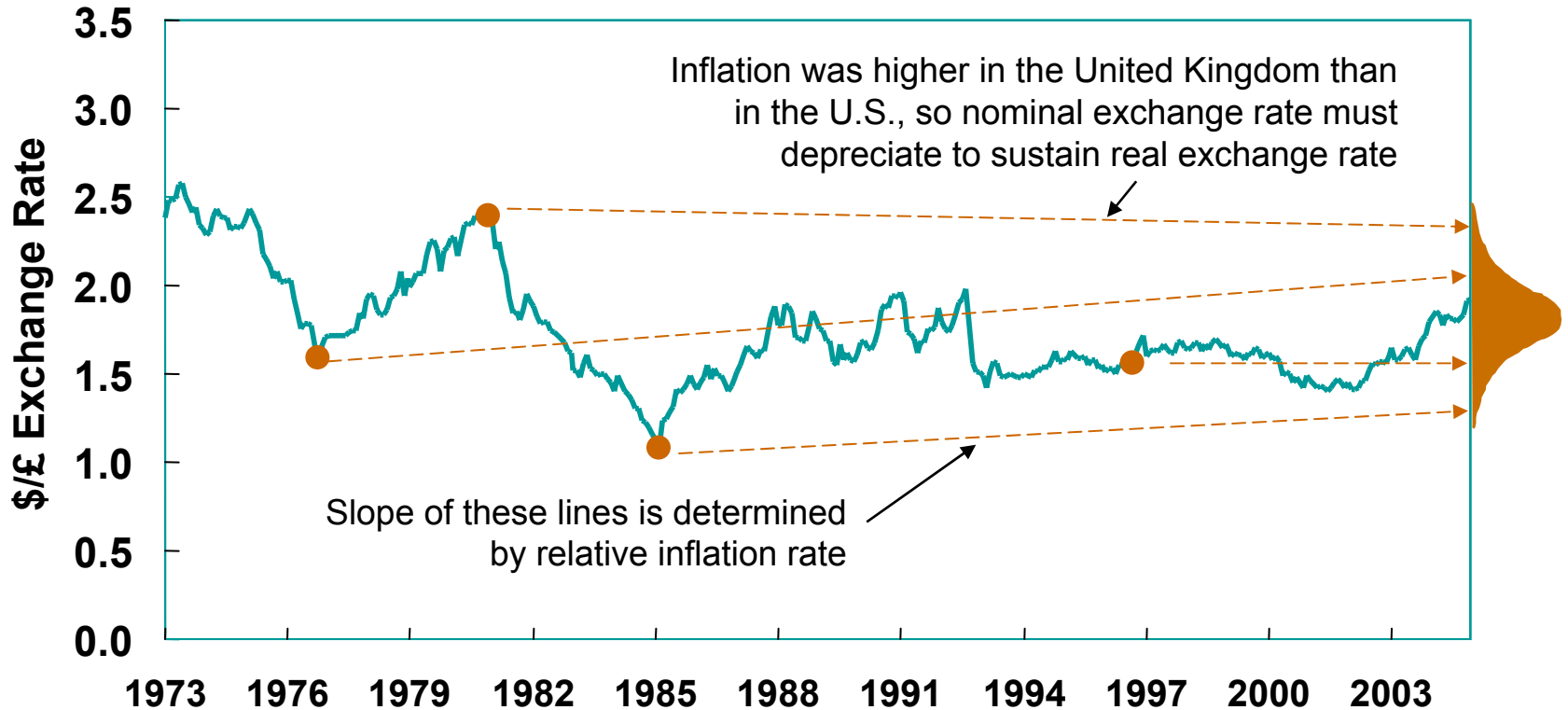
- Sell US Assets?
 - What would they buy instead?
 - Who would be the buyers?
 - Dollar impact
 - Whose portfolio changes?

Faults in the Assumptions?

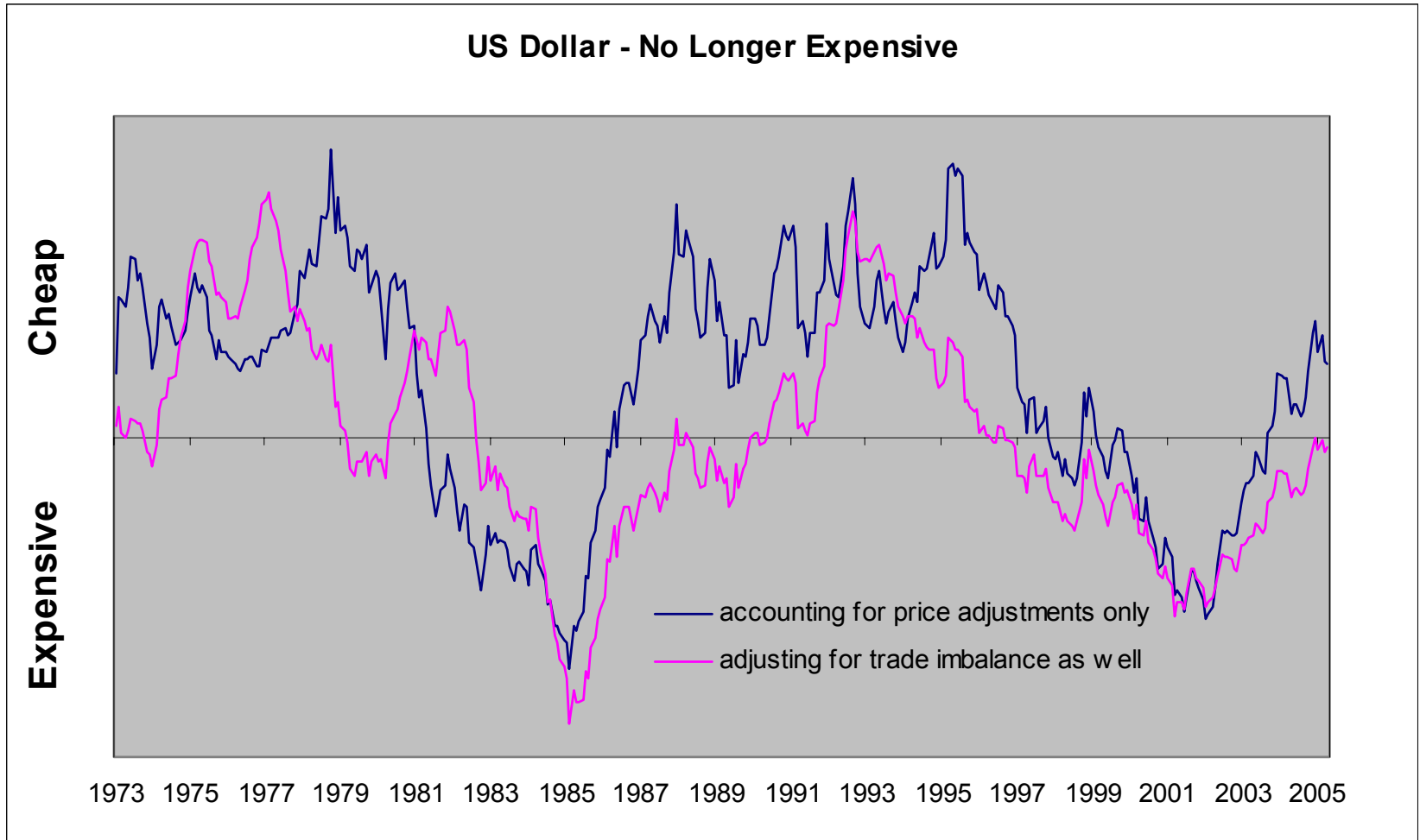
- Dollar still expensive?
 - Dollar has already fallen
 - What's fair value?

Calculating Fair-value

\$/£ Exchange Rate



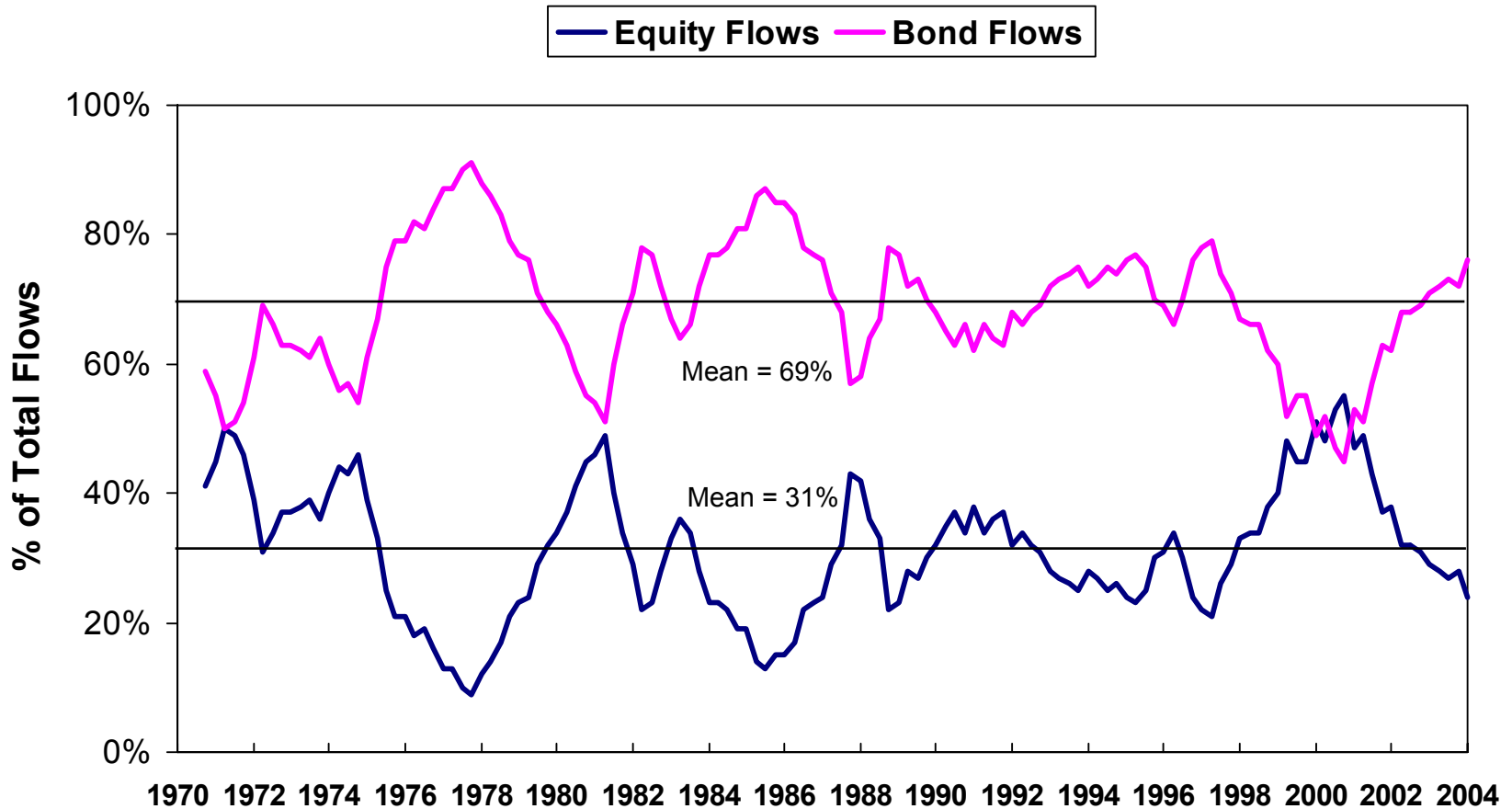
Is the Fall Finished?



Faults in the Assumptions?

- Dollar still expensive?
 - Dollar has already fallen
 - What's fair value?
 - Tendency for assets to overshoot

Equity Flows Dominate Flow of Investment Capital



Who REALLY trades in FX?

2004 Update

