



# The Crescent Group

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### The Crescent Group

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## May 2023 Crescent Commentary

Should investors have reservations about the U.S. dollar's (USD) reserve status? Following Russia's invasion of Ukraine last year, we've seen an increase in news headlines about the possibility of the USD losing its global reserve currency status. This chatter mostly stemmed from the thought that Russia needed to find a way to trade in international markets while limiting its use of the USD due to sanctions. These headlines expanded recently to include the idea that Russia, China, Brazil, Saudi Arabia and others might try to unify in the creation of a new reserve currency. Add to that worries about the U.S. defaulting on its debt and suffering a loss of global credit worthiness, and you have an excellent mix of events for the media to leverage in its pursuit of eyeballs and ad dollars.<sup>(1)</sup>

To delve deeper into this, let's start by asking what it means to be the world's reserve currency. A reserve currency is a currency globally held in large amounts by central banks and major financial institutions to use for international transactions. Why do countries use the USD as a trading currency, rather than their own currency? The U.S. enjoys an incredible amount of economic strength, stability, and transparency that we Americans typically take for granted. Other countries simply don't have this advantage. Because of that, their currency fluctuates widely and may be subject to extreme inflation. Holding the USD for international trade allows these countries to better manage their transactions with the help of a stable currency accepted all over the world.<sup>(2)</sup>

While media attention focuses on whether the USD will lose reserve currency status, the more important question for you as an investor is: does it matter? Well, it depends on how you're allocated. We'll get to that a bit later, but let's start with why it's highly unlikely the USD loses reserve currency status any time soon. We've had two reserve currencies in modern history: the British Pound and USD. The U.S. economy overtook the British economy in size in the 1870s, yet the USD didn't replace the Pound as the world's reserve currency until after World War II. So, reserve currency status is quite durable.<sup>(2)</sup>

Additionally, there currently are no realistic contenders to the USD as a reserve currency. The Euro tried beginning 24 years ago, and has failed to replace the USD. As we mentioned above, media outlets have discussed China, Russia, Brazil and

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Saudi Arabia uniting to challenge the USD, but there are many reasons why this won't work. To begin, a large block of transparent countries failed to replace the USD with the Euro. How can countries without a reputation for transparency do so? Russia tried to limit its USD reserves prior to invading Ukraine, but still maintained 20% in USD and 40% in Euros. The Chinese Yuan only represents 2.7% of global currency reserves, while the USD was on one side of 88% of all foreign currency trades last year. Considering the combination of all the above factors, the USD won't be replaced as the world's reserve currency any time soon.<sup>(3)</sup>

Can the USD lose its reserve currency status in the future? Of course. If that were to happen in your lifetime, would it matter for your investments? Let's consider the only other country in modern history that lost reserve currency status, Great Britain. The British economy has continued to thrive and grow over time despite the Pound losing reserve status. London continues to serve as a world financial center, and it was actually a British bank that bought U.S. investment bank Lehman Brothers out of bankruptcy during the Financial Crisis. Additionally, plenty of British companies are either the dominant firm or among the most dominant firms globally in their industries. In some cases, these companies have brands dating back to the 1700s that to this day remain highly valued and sought after all over the world.<sup>(4)(5)</sup>

We can point to many other countries where either their empire has dissolved and/or the country doesn't have much influence in the world, yet businesses domiciled in those countries remain dominant in their industries with brands dating back hundreds of years and highly valued and sought after throughout the world. As a result of these precedents, if the USD lost reserve currency status and / or the U.S. experienced a decline in global influence, we would expect globally dominant U.S. businesses with timeless global brands to continue to dominate their industries and thrive. Considering that Great Britain's economy has continued to thrive and grow over time despite its empire falling, we would expect the U.S. economy to continue to grow even if the U.S. declined in global influence. Continued growth in the U.S. would provide support for assets specifically tied to the U.S. economy – such as real estate – as well as products and services not sold globally.<sup>(5)</sup>

We see no current signs of the USD losing reserve currency status any time soon. And based on the evidence we just outlined, if it were to happen, it would not need to result in a negative experience for U.S. investors who maintain a globally diversified portfolio of timeless assets.

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### Sources:

- (1) First Trust
- (2) RBC
- (3) The Wall Street Journal
- (4) Company Reports
- (5) The World Bank

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