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The Pulse of New Jersey Business

Going Global: Pursuing Foreign Trade as a Growth Strategy

As the U.S. dollar continues to underperform against the world's benchmark currencies, the demand for American goods has increased. Combine this trend with the globalized economy, greater access to goods and services, and the availability of more effective currency risk management tools, and your organization is now better equipped than ever to explore opportunities in foreign trade.

Throughout New Jersey, more companies are expanding or considering foreign trade because 95 percent of the world's consumers and 70 percent of its purchasing power reside outside our borders. Plus, opening up new foreign markets can help offset any decline in domestic sales. According to the U.S. Department of Commerce, New Jersey exports in 2009 totaled $27.3 billion, ranking it 11th among the 50 states. Canada was the largest market receiving 20% of goods exported followed by Great Britain, Mexico, Japan and Germany.

It's important to note, however, that the fluctuation in value of the U.S. dollar (USD) has had, and is having, a profound impact on U.S. exporters and importers. When the dollar rallies or declines against the world's major currencies, your company's level of global competitiveness is affected. To succeed, it's become imperative to develop strategies that allow you to leverage these movements.

Issues Facing Exporters

If you're an exporter, a weak USD works to your advantage. Foreign buyers are able to obtain more for their money – making U.S. products more attractive.

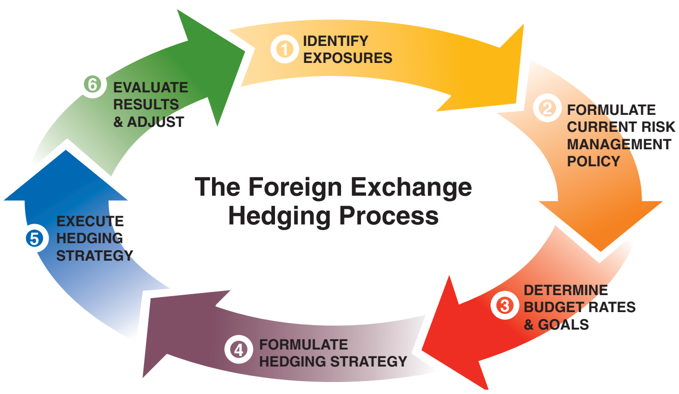
Case in point is Brazil – our 10th largest trading partner – and one of the world's most dynamic economies. As a result of an underperforming USD, American exports to Brazil have increased to the point where they have finally overtaken our total imports from Brazil for the first time.

To help reduce risk exposure to foreign currency fluctuations and protect the value of your international sales, *layered hedge protection* becomes a prudent strategy. Pursuing this approach provides a higher degree of certainty of foreign exchange market conditions in the near term than over time. Using a process similar to dollar cost averaging, you might hedge 80% of your sales in the first three months. Then apply additional layers of hedging as time elapses, i.e. hedge 60% of your sales in the next three months and continue this process at diminishing levels further out.

Issues Facing Importers

As the USD falls against foreign currencies, it spikes an increase in the overall cost of foreign products and requires more USD to purchase those goods. Concurrently, foreign suppliers receive less of their local currency when it is exchanged for USD. Increasing their prices is the only way for them to cover the difference.

While imports could represent viable sources of new business, the risk of foreign exchange rate volatility may adversely impact your projected cash flow and profitability. To protect against this exposure, hedging currency risk represents a proven strategy.



Sourced from: *Western Union Global Payment Systems, FX 101: About Foreign Exchange, What is Currency Hedging?*

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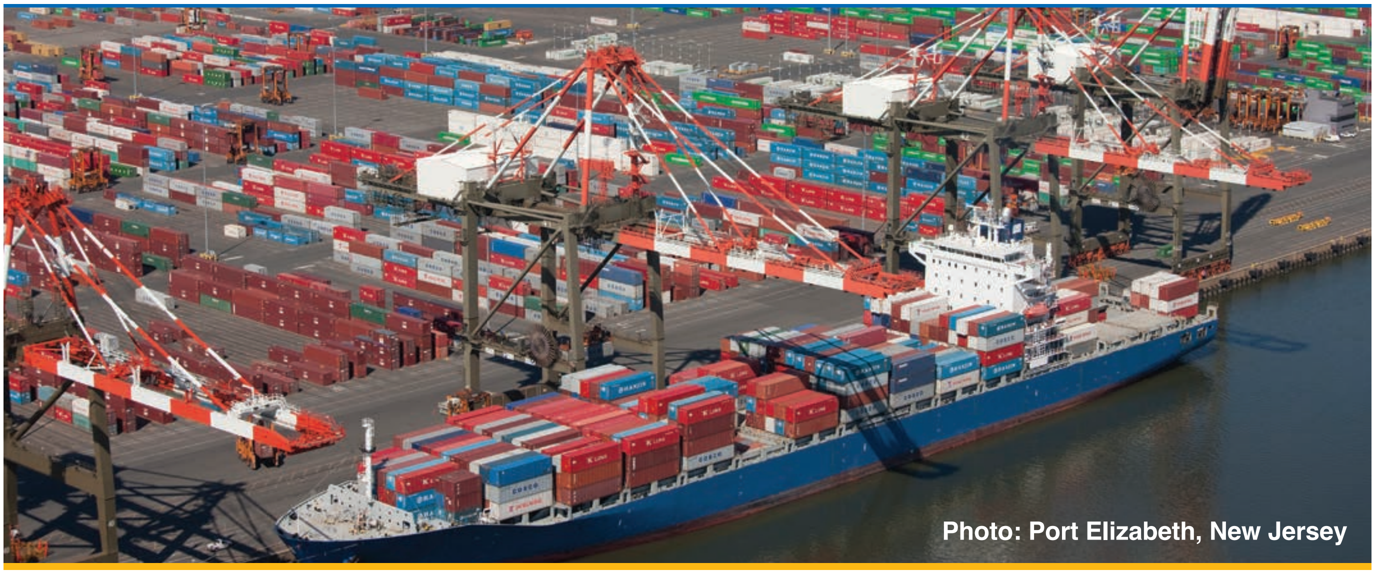

Photo: Port Elizabeth, New Jersey

Viewed through the lens of foreign exchange, U.S. importers should consider more efficient methodologies for managing and budgeting their cost in USD. U.S. export firms should set their sights on maximizing their revenue in the "home" currency when selling in overseas markets.

Hedging Strategies to Minimize Foreign Exchange Rate Volatility

Hedging is designed to reduce exposure to rapidly fluctuating currency markets and their inherent risk while concurrently allowing your business to profit. The hedging process is analogous to an insurance policy that limits the impact of foreign exchange risk. To remain competitive and protected, your organization needs to effectively manage and mitigate this risk.

If your company is involved in, or considering foreign trade, you might want to investigate the advantages of Forwards and/or Costless Option hedge products to give you an added layer of protection against downside risk. For example:

• Using **Forwards** guarantees an agreed-upon USD value against a unit of foreign currency. A Forward is an agreement between you and your bank for a future exchange of currency or USD that locks in the rate, notional amount, and the date of exchange. Effective use depends on the underlying spot, tenor of the trade, and interest rate differential between two currencies.

Importers who use Forwards as a hedge will be in a better position to budget more precisely as the USD value of payables is known on the front end. While there is no transaction fee associated with using the Forward, there is cash at risk on each settlement date.

• **Zero Cost Collars** provide worst-case rates and upside participation within a range.

A Zero Cost Collar gives you protection to buy or sell foreign currency on a specified date along with the:

- Ability to participate 100 percent in a favorable currency move upward to the participation cap while the floor is the worst-case rate.
- Flexibility to set the range according to your risk appetite around the forward rate.

The use of Collars does not require up front premiums, and the best-and worst-case scenarios are clear at the outset. You'll have the ability to execute more effectively than the current forward pending favorable market conditions.

Initiative is a series of executive reports prepared exclusively for New Jersey business leaders by Sun National Bank. Each issue is intended to share relevant news on timely business topics and trends. To learn more and to arrange an informal consultation, please speak with a Sun Relationship Manager at **1.800.SUN.9066** or visit any of our more than 60 locations throughout New Jersey.