**<u>COMMODITY CURRENCIES AND THE ECONOMIC RECOVERY STORY</u>**

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In "Good Times Roll", The Cars sing: "Let the good times roll Let them knock you around Let the good times roll Let them make you a clown Let them leave you up in the air Let them brush your rock and roll hair Let the good times roll".

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## OVERVIEW AND CONCLUSION

Australia, Brazil, Canada, Russia, and South Africa produce and export substantial amounts of crucial commodities. Think of the petroleum, base and precious metal, and agricultural sectors. Marketplace guides label the currencies of these five exporting countries "commodity currencies". The commodity shares within and the commodity export profile of these national economies varies.

In recent years, there has been a close linkage between trends in the S+P 500, commodities "in general" (use the broad Goldman Sachs Commodity Index as a weathervane), and the United States dollar. Remember the song guideline: "a strong dollar equals weak stocks (and feeble commodities), and a weak dollar equals strong stocks (and bullish commodities)".

The US dollar fell relative to commodity currencies from fourth quarter 2008/first quarter 2009 until spring/July 2011. The broad GSCI made tops in mid-2011. The S+P 500's May and July 2011 summits coincided with these. Stock marketplaces of the commodity currencies peaked a bit earlier than the S+P 500. These trends indicate that substantial progress toward solving the worldwide economic crisis that erupted in 2007 was made, or at least there was significant faith that this was the case.

The US dollar nevertheless then rallied against these currencies, with commodities and the S+P 500 falling alongside them. Fears regarding the sustainability of the global recovery grew.

Yet after around early October 2011, the dollar again fell against this currency group, while commodities and the S+P 500 climbed. Despite troubles in Europe, this reflects a relatively sunny viewpoint by many marketplace players regarding economic health.

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The S+P 500 inched above its 2011 top with its recent 1378 high on 2/29/12. However, neither commodity currencies nor the broad GSCI have exceeded their spring/July 2011 peaks. With the exception of South Africa's stock marketplaces, those of the other four commodity currencies remain quite a bit below their 2011 summits. In addition, the commodity currencies and the broad GSCI also attained their most recent elevations around the time of the S+P 500's end February 2012 one. So despite the S+P 500's new highs in 2012, and though the broad GSCI is not very far from its 762 springtime 2011 peak, suppose there is further weakness in commodity currencies versus the dollar. That probably will point to at least interim tops in commodities and the S+P 500.

**What's the bottom line prediction for the near term? The US dollar will strengthen against the commodity currencies (and the broad real trade-weighted dollar also will rally some). Commodities in general will decline (though the Iranian situation obviously is a notable risk). The S+P 500 (and equity marketplaces of commodity currency nations) will fall. As always, timing is everything. This trend probably will start around March/May 2012,**

**though it may be delayed until summer 2012. The various currency, commodity, and stock (and interest rate) marketplaces of course do not have to peak (or bottom) at the same time.** Thus the S+P 500 could peak after (or before) the broad GSCI.

## THE PAST: WORLDWIDE ECONOMIC SLUMP

Though the S+P 500 achieved its all-time high on 10/11/07 at 1576, it reached a crucial final top on 5/19/08 at 1440. The broad GSCI peaked not long after this, on 7/3/08 around 894. In April 2008- close in time to these 2008 summits in commodities and American (and many other) stocks- the broad real trade-weighted dollar ("TWD") made a key low around its major support floor of 84.0 (1973=100; monthly averages; October 1978 and July 1995 bottoms).

Important cross rate pinnacles in commodity currencies versus the US dollar occurred around the time of 2008's GSCI peak. Recall Australia's .985 on 7/15/08, Brazil's 1.55 on 8/1/08, Russia's 23.05 on 7/15/08, and South Africa's 7.18 on 8/4/08. Canada's top preceded these, on 11/7/07 at .906, but this stood close to the 10/11/07 US stock marketplace elevation. The Euro FX, though not a commodity currency, built ceilings against the dollar around the time of the equity and commodity plateaus, on 4/22/08 (at 1.602) and 7/15/08 (at 1.604).

As the economic crisis worsened, stocks crashed, tumbling especially sharply from late summer levels around 1313 (8/11/08) and 1265 (9/19/08). Commodities crumbled. The TWD climbed, attaining its final high in March 2009 at 96.9 around the time of the 3/6/09 low in the S+P 500 and the broad GSCI's 2/19/09 valley at 306. In a desperate flight to quality (safety), US government interest rates cratered. The UST 10 year note bottom at 2.04 percent preceded the stock marketplace trough, on 12/08/08. However, the UST made another important low shortly after that in stocks, on 3/18/09 at 2.46pc.

## UP TO THE PRESENT: ECONOMIC RECOVERY AND COMMODITY CURRENCIES

Scarlett O'Hara declares in "Gone with the Wind": "After all, tomorrow is another day." (Victor Fleming, director)

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Marketplace generals can analyze a commodity currency via various cross rates or by estimates of its real effective exchange rate. Since a commodity currency's level and trend against the United States dollar is a widely monitored signpost, initially focus on that measure in regard to these five nations.

**In the worldwide economic recovery as in the preceding downturn, the price and time trends of the five commodity currencies from the US dollar cross rate perspective intertwine closely with key moves in stock and commodity benchmarks.**

Viewing them as a group, these currencies soared higher against the US dollar from late 2008/early 2009 for over two years, until spring 2011/July 2011. Commodities in general and the S+P 500 made key bottoms in winter 2009 around the time of those in commodity currencies. The S+P 500 and the broad S+P Goldman Sachs Commodity Index (GSCI) then advanced dramatically for over two years.

In 2011, double tops in the commodity currencies (late April/early May; late July) link closely with the equity and commodity summits. The drops from late July 2011 are noteworthy because the S+P 500 subsequently fell decisively under the summer 2008 1265/1313 range (the financial crisis accelerated from around that 2008 time) and beneath the 4/26/10 top at 1220.

| | 2008/2009 Cross Rate Low v. US Dollar (date) | Spring and July 2011 Highs v Dollar (dates) | Autumn 2011 Low v $ (date) | 1Q2012 High v $ (date) |
|---|---|---|---|---|
| **Australia** | **.601 (10/27/08)**<br>**.625 (2/2/09)** | **1.098 (4/29/11)**<br>**1.108 (7/27/11)** | **.939 (10/4/11)** | **1.086 (2/29/12)** |
| **Brazil** | **2.620 (12/5/08)**<br>**2.450 (3/2/09)** | **1.557 (4/27)**<br>**1.529 (7/26)** | **1.955 (9/22)**<br>**1.919 (10/3)** | **1.689 (2/29)** |
| **Canada** | **1.302 (10/28/08)**<br>**1.307 (3/9/09)** | **.945 (4/29)**<br>**.941 (7/26)** | **1.066 (10/4)**<br>**1.052 (11/25)** | **.984 (3/1)** |
| **Russia** | **36.55 (2/18/09)** | **27.15 (5/4)**<br>**27.40 (7/27)** | **32.89 (10/4)**<br>**32.33 (12/30)** | **28.84 (2/28)** |
| **South Africa** | **11.87 (10/22/08)**<br>**10.73 (3/5/09)** | **6.54 (5/2)**<br>**6.62 (7/28)** | **8.49 (9/22)**<br>**8.61 (11/23)** | **7.40 (2/29)** |

For the five commodity currencies, note also that in addition to being beneath their spring/July 2011 pinnacles, their 1Q2012 highs are fairly near to retracement levels achieved not long after their early October 2011 lows. The Australian dollar high on 10/27/11 was 1.075, the Brazilian real's 10/28/11 at 1.672. The Canadian dollar's was .989 on 10/27/11; the Russian ruble's 29.67 interim high was on 10/28/11, with South Africa's 7.68 FX top 10/27/11.

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| **COMMODITIES: Broad GSCI** | | | | |
| | **306 (2/19/09)** | **762 (4/11 and 5/2)**<br>**712 (6/9) and 705 (7/26)** | **573 (10/4)** | **718 (3/1)** |
| **STOCKS: S+ P 500** | | | | |
| | **667 (3/6/09)** | **1371 (5/2/11)**<br>**1357 (7/7) and 1347 (7/21)** | **1075 (10/4)** | **1378 (2/29/12)** |

Alongside the late 2008/early 2009 lows in commodity currencies versus the dollar, compare the timing of their equity bottoms. Australia's low was 3/10/09 at 3091, Brazil's 10/27/08 at 29,435. Canada's bear low was 3/6/09 at 7480, Russia's 10/27/08 at 525, and South Africa's 11/20/08 at 17,771. Thus the bottoms in commodity currencies were made before or around the time of the S+P 500's. In regard to the October 2008 lows in commodity currency stocks, recall that China's stocks reached their trough 10/28/08 at 1665, with India's 10/27/08 at just under 7700.

**For the five commodity exporting nations, peaks in their equities occurred around the time of (or before) the 2011 highs in the broad GSCI.** Their equity tops "collectively" were not long before the S+P 500's May 2011 plateau. Australia's summit at 5070 was on 4/11/11; Brazil 11/4/10 high was just over 73,100 (end first quarter 2011 highs around 70,000). Canada topped on 3/7/11 at around 14,330; Russia's peak (depositary index) was 4/6/11 at 1863.

**However, unlike the S+P 500's recent situation, current stock marketplace levels for four of the five nations remain below their 2011 ceilings**. On 3/9/12, Australia's close was just over 4300, Brazil's around 66,700, Canada's about 12,500, and Russia's near 1625. Moreover, they have not inched over these 2011 (or slightly earlier, as for Brazil) peaks, with the exception of

South Africa. South Africa exceeded its 1Q11 high over 33,300 via its 2/2/12 elevation at 34,460 (though by less than five percent; its 3/9/12 close was about 33, 925).

A renewed noteworthy rally in commodity currencies relative to the US dollar would confirm (reflect) additional S+P 500 rallies. The stock marketplaces of those commodity exporting nations would accompany the S+P 500 to some extent. Yet the recent weakness of these commodity currencies versus the dollar, if it accelerates, will warn of an eventual decline in the S+P 500 (and the stock arenas of the commodity currency countries themselves) as well as in the broad GSCI.

## CURRENCY CONTEXTS, CONTINUED

How important are these five commodity currencies from the perspective of the broad real trade-weighted dollar? Only the Canadian Dollar is substantial. Canada's trade weight is 13.2 percent, Brazil's 2.1pc, Australia's 1.3pc, and Russia's 1.1pc. South Africa does not make this list. (Federal Reserve, H.10). Compare China's 19.8pc, the Euro FX's 16.4pc, Mexico's 11.5pc, and Japan's 7.8pc.

The TWD dollar trend fairly closely tracks the cross rates of these five commodity currencies "in general" against the dollar. The broad real TWD is a monthly average. However, nominal broad TWD data are daily. In spring 2011, on 5/2/11 (the same day as highs in the S+P 500 and commodities), the nominal TWD made a low at 93.9. In July 2011, it established a new low, at 93.7 on 7/26. It rallied to 101.3 on 10/4/11 (the same day as the S+P 500 low), and highs since then have not breached the 10/4/11 high by much (11/25/11 about 101.4; 12/14/11 101.5). The low since then is 2/7/12's 97.7, with 3/2/12 (the most recent data point) at 98.3.

What about during the 4Q08/1Q09 period? The nominal TWD's peak was 3/3/09's 115.0; compare the date of the S+P 500's bottom.

What are important broad real TWD levels to monitor? July 2011's very weak 80.6 represents a new record low (79.8 is five percent under the former major support at 84.0). Ten pc under 84.0 is 75.6. For resistance, watch 84.0. Keep in mind levels at the onset of the Fed's QE2 program- 87.6 August 2010/84.1 November 2010. December 2011's 85.1 is the recent monthly high, with February 2012 at 83.0.

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Many commodity traders closely watch the Euro FX versus the dollar cross rate. In broad brush terms, the Euro FX/USD trend resembles that of the commodity currencies against the dollar. Recall the Euro FX lows of 10/28/08 (1.233) and 3/4/09 (1.246). Don't forget its 2011 high around the time of the peak in the S+P 500, on 5/4/11 at 1.4940.

The broad GSCI made a noteworthy low on 5/25/10 at 459, with a higher one on 8/25/10 at 490. Compare the timing of lows in the commodity currencies. And what about Euro FX levels during the onset of QE2 (money printing, revisited) in late August 2010? The Australian Dollar established an initial bottom against the US dollar around .807 on 5/25/10, with a notable second one at .877 on 8/25/10. Compare Brazil's 5/25/10 at 1.915 and 1.782 on 8/24/10 as well as Canada's 5/25/10 bottom at 1.085, followed by one at 1.067 on 8/31/10. Russia's ruble made an initial trough at 28.92 on 4/14/10, with a later one at 29.6 on 10/7/10. South Africa's important low during this period was 5/20/10 at 8.08. The Euro FX made a very important low 6/7/10 at 1.1877, followed by one (near the advent of QE2) on 8/24/10 at 1.2588.

What about the Euro FX against the dollar recently (also watch the Euro FX's effective exchange rate)? Will a weaker Euro FX portend lower stocks, including the S+P 500? The Euro FX low versus the greenback was 1/13/12 at 1.2624, after those of the commodity currencies. Europe was busy battling its sovereign debt and banking crisis. The Euro FX's January 2012 effective exchange rate low around 90.0 bordered its June 2010 low at 92.2 (Bank of England data)

As financial rescue efforts made progress, the Euro FX rallied up to around 1.3500 at end February 2012. These late February 2012 Euro FX highs versus the dollar occurred around the time of the second LTRO round, and about the time of the five commodity currencies. Like the commodity currencies, the Euro FX has since sagged against the US dollar. **The Euro FX probably will decline further from current levels.**

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Even if numerous cross rates currently are moving more or less together in the same direction relative to the US dollar, obviously not all are (or must do so). The Chinese renminbi was 6.89 on 12/3/08, 6.85 on 3/3/09, and 6.82 on 9/2/10. Although the dollar has rallied against most currencies since late July 2011, China's renminbi continued to gain strength against it- until its 2/10/12 high against the dollar at 6.289. In early March 2012, China lowered its 2012 growth target to 7.5 percent. Though this GDP gain is substantial and enviable, if the target is hit, it will be the first time since 2004 that Chinese growth has fallen under 8.0pc.

So if China's currency weakens relative to the dollar (or at least does not strengthen any more), if the Euro FX slumps against the dollar, and if the various commodity currencies erode relative to the US dollar, what does that warn regarding the S+P 500 and commodities in general?

It indeed is possible for a strong US dollar to exist alongside a strong S+P 500 (and related equity playgrounds). However, that would break the pattern of the past several years.

Also, review the Japanese Yen against the greenback. The Yen's cross rate depth was Y75.4 on 10/31/11. It was around Y76.0 in early February 2012. However, it rose to near Y82.0. Japan ventured on further quantitative easing on 2/14/12 (Yen close 2/13 was 77.6; the 3/17/11 earthquake low for the dollar was Y76.2). Costly increased petroleum imports have helped to eliminate Japan's longstanding current account surplus. Its January 2012 deficit is the largest monthly shortfall since comparable records began in 1985.

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Gold's trend sometimes has moved alongside those of commodity currencies. For example, recall its 10/24/08 low at 681. Gold made a minor top on 5/2/11 at 1577, though it blasted up to a high of 1921 on 9/6/11. It has dipped since then, including from late February 2012.

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Since around March 2009, including after its QE2 money printing extravaganza, the United States has encouraged broad real trade-weighted dollar decay. However, many nations nowadays would love a relatively weak (or a less strong) currency. This bandwagon includes not just quite a few commodity currency realms, but also advanced nations (Japan, the Euro FX region in general, maybe even China). Since the US is not the only territory that craves a fairly feeble (or a not-too-powerful) currency, that tends to provide the dollar some support.

Moreover, suppose the worldwide economy becomes more fragile or even dangerous again. Not only are US financial marketplaces very large and generally liquid. Despite America's political feuds, it has great political stability. Therefore, even if America is not beautiful from every perspective, it may seem relatively attractive in some respects when compared with many other nations. In this context, again recall the US trade-weighted dollar's ascent from autumn 2008 up to its March 2009 high.

## EASING COME, EASING GO: SOME CONSIDERATIONS AND CONSEQUENCES

Although the Fed currently is not engaged in a third round of its massive quantitative easing program, other nations have continued their money printing or created a close relative to money printing. Japan enhanced its easing on 2/14/12. The Bank of England announced on 2/9/12 that it would embark on more money printing. The European Central Bank's long term refinancing operation ("LTRO"), revealed 12/8/11, resembles quantitative easing. It began on 12/22/12. The ECB had a big second round at end February 2012.

The broad real TWD continued its slide from September 2010's 86.6 (after the first hints of QE2 in late August) to November 2011's 84.1 (further money printing details) to its 80.6 July 2011 low (QE2 ended the prior month). Since various key advanced nations other than the Fed now are engaged in (initiating new stages of) money printing, that probably will help to rally the "dollar in general", including against the commodity currencies.

The Euro FX eventually rallied versus the dollar after the first LTRO. However, that arguably was because the LTRO helped to stop the Eurozone from falling to pieces due to its sovereign debt and banking crisis. Fear of that destructive outcome was a major reason weakening the Euro FX in general. Thus as these fears slowly subsided (to some extent), the Euro FX rallied against the US dollar on from its 1/13/12 low at 1.2624 to its end February high around 1.3500. Yet these late February 2012 Euro FX highs against the dollar occurred around the time of the second LTRO round, and about the time of those reached by the five commodity currencies. And like the commodity currencies, the Euro FX has since sagged against the US dollar in the past couple of weeks.

The Euro FX's second LTRO easing not only added more liquidity (making it a greater rival to the Fed's earlier money printing festival). Although the second LTRO helped to ensure that the Eurozone would not collapse, once that relief Euro FX relief rally occurred (up to Euro FX 1.3500), other money printing consequences analogous to the Fed's QE enterprises could occur for Europe. So all else equal, just as QE2 encouraged a weaker dollar, LTRO now (after two stages of it) encourages a weaker Euro FX. And the weaker Euro FX helps to undermine the commodity currencies relative to the US dollar.

There is always another side to a story, or other factors to consider. The carryover effects of money printing by these countries (and the consequences of the Fed's previous rounds) still could assist in boosting the S+P 500 and related marketplaces higher for a while longer. But remember that after the Fed's money printing ended in June 2011, equities (and commodities) fell.

On 2/25-26/12, G-20 finance ministers and central bank governors "agreed that a feasible way to increase IMF resources in the short-run is through bilateral borrowing and note purchase agreements with a broad range of IMF members". This may be an avenue for more money printing, which could help to rally various equity marketplaces. The IMF/World Bank Spring Meetings are 4/20-22/2012. Low nominal interest rates in key nations, such as the United States, Germany, and Japan, also help to encourage stock marketplace demand.

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It will be interesting to see if all the money printing finally helps to boost long term policy rates in key nations. Will yield lows precede major final highs in stock marketplaces such as the S+P 500? Note the similar timing of recent marketplace lows in the United States, Germany, and Japan. UST 10 year note yields lows at 1.67 percent on 9/23/11 (1.79pc 1/31/12). Compare the German 10 year government one at 1.64pc on 9/23/11 (1.74pc on 1/13/12 and 1.78pc 1/31/12), and the Japanese JGB's 1/16/12 low at .94 percent.

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Will there be end of first quarter 2012 buying in the US and other equity provinces, thus helping to propel stocks still higher? Also, US corporate earnings continue to be rather strong, and share buyback programs have not disappeared.

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In regard to the S+P 500's leap year high to date on 2/29/12 at 1378 and the potential for the beginning of a bear trend around calendar March, recall some historic important trend changes in calendar March. There is more than the 3/6/09 low at 667. For example, the S+P 500 reached a major high over a decade ago on 3/24/00 at 1553 (the Dow Jones Industrial Average one at 11910 was a bit earlier, on 1/14/00). The S+P 500 made a final low on 3/12/03 at 789. Also, a S+P 500 peak around March 2012 would be a three year diagonal calendar move relative to the March 2009 bottom.

Calendar timing is not destiny. S+P 500 calendar peaks have occurred at other times (as in the 10/10/07 pinnacle at 1576). Yet as the current global financial crisis has not been fully solved, also keep in mind the timing and 1440 level of the 5/19/08 final top. Recent highs are within five percent of that May 2008 elevation.