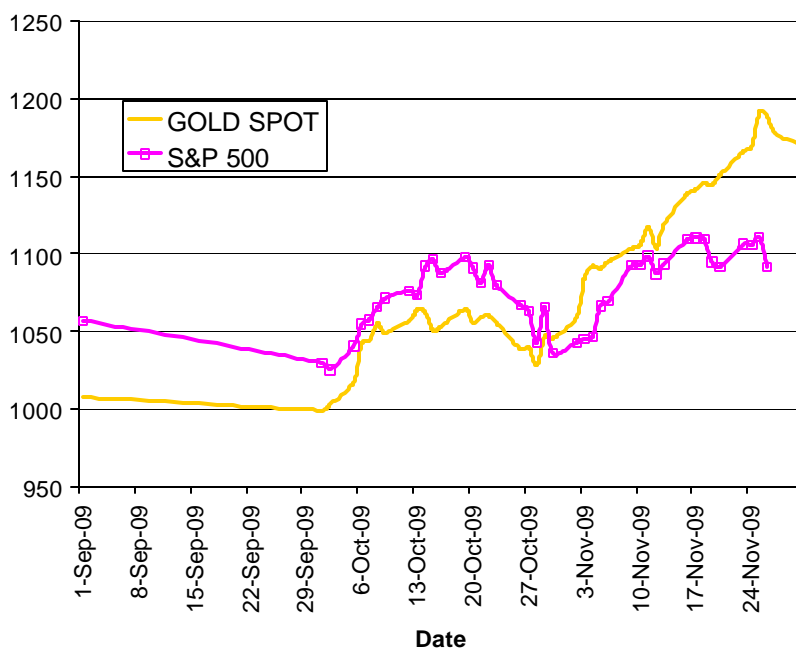




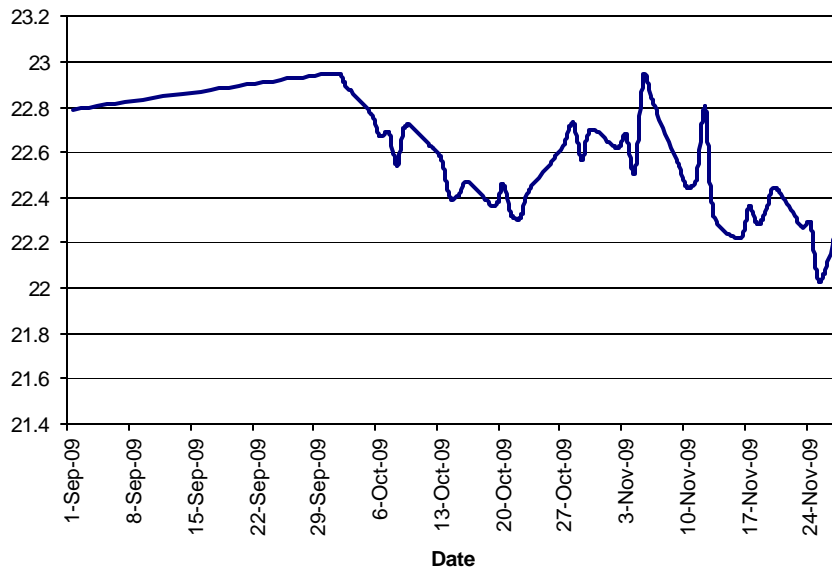
The Greenback's Fall From Grace

The impact of changes in the value of the US dollar on the value of commodities, gold spot prices as well as the direction of US stock markets has been growing in importance over the last few months. In fact many intra-day traders and technical chartists are also analyzing movements in the value of US dollars since it can act as a leading indicator for making trading decisions for the day ahead.

The graphs below show the changes in the value of the S&P 500 index, Gold Spot prices and the US dollar over the last two months. The Powershares DB US Dollar Index Bullish fund (TK: UUP) was chosen as the proxy for the value of the US dollar. This exchange traded fund (ETF) is designed to replicate being long the US Dollar against major currencies including Euro, British pound, Japanese yen, Swedish Krona and Swiss Franc.



Graph 1 – GOLD Spot & S&P 500 (Source: Bloomberg)



Graph 2 – DB US Dollar Index (Source: Bloomberg)

Graphs 1 and 2 clearly demonstrate the inverse relationships which exist between the value of the US Dollar and the price of Gold and the performance of US stock markets. UUP peaked around October 30th 2009 when it began a fairly sharp correction during the month of November. This has coincided with a run up in Gold prices and to a lesser extent a rally in US stocks. While speculative buying may have also contributed to the out-performance of Gold, the precious metal hit its 52-week high on the 25th November 2009 at USD1, 187 per ounce.

Why is the US Dollar falling?

Financial markets are a discounting mechanism of the future, thus the weakness of the US dollar is not so much a reflection of the current state of US monetary inflation as it is of anticipated continued weakness to come. The US Government has adopted a very loose stance on monetary policy and is continuing to print dollars at record levels as it needs to fund the monolithic stimulus packages required to keep the economy ticking along. In fact with a 10.2% unemployment rate, about \$12 trillion in fiscal and monetary stimulus, the world's lowest borrowing costs and a record \$4 trillion of government bond sales over 2009 – 2010, even the most optimistic of currency forecasters is bearish on the outlook for the US dollar.

Carry trade activity would have also contributed to perpetuate the dollar's weakness. A carry trade involves the buying (going long) of a high interest rate currency (for example the Australian dollar) by borrowing (selling or going short) in a low interest rate currency (in this instance the US Dollar). For each day that you hold that trade, your broker will pay you the interest difference between the two currencies, as long as you are trading in an interest-positive direction.

JP Morgan Chase and Company (JPM), the second largest US bank was quoted in a Bloomberg article as predicting that the dollar's fall to a record low next year due to the Federal Reserve's (the Fed) policy of keeping interest rates near zero until 2011 driving investors to higher yielding assets. JPM is projecting that the dollar will weaken to \$1.62 per euro by the second quarter of next year.

Historical analysis suggests that the dollar should not start appreciating against other major currencies, at least on a sustained basis, until at least 12 months after the Fed starts to raise rates since it will take some time to drain the oversupply

of dollars from the market. The dollar will probably remain weak until US interest rates rise over the levels of the other major currencies.

Impact of the Greenback's fall from grace

The political backlash, given the once mighty Greenback's fall from grace, has been one of the most publicized consequences. Earlier in the year, the Chinese central bank Governor was vociferous in his call for a new global currency saying that it was dangerous to rely on one nation's currency for making international payments. Market experts are also reporting that while Central Banks remain significant buyers of dollars there is evidence that they are hedging their bets.

The most recent and vivid example of a country trying to mitigate such losses is the actions of the Indian government. India, the world's largest gold consumer, bought 200 metric tons from the International Monetary Fund for \$6.7 billion in a bid to diversify their foreign reserves to protect against a slumping dollar.

On the other hand, the demand for higher yielding assets has led to a rapid appreciation of emerging market currencies as investors look to snap up local currency bonds that are paying relatively higher interest rates. This is also another consequence of carry trade activity by foreign exchange traders. Governments in these developing countries are quickly amassing record foreign exchange reserves to keep their currencies from appreciating too fast.

In particular, the Brazilian currency, the real, has appreciated 36% year-to-date while the Brazilian stock market, the Bovespa, is up 79% over the same period. Earlier this month, the Brazilian government imposed a 1.5 percent tax on certain trades involving American Depositary Receipts issued by Brazilian companies. In October, the government introduced a 2 percent tax on new foreign purchases of local equities and bonds. Finance Minister Guido Mantega acknowledged that the government is concerned about the impact of an appreciating real on the Brazilian economy and the measures taken were made with a view to stem this trend.

Trading the Dollar weakness

One of the more profitable ways of benefiting from the fall of the dollar would be to jump on the "Gold Bandwagon" while you still can. At the current overbought levels you can expect some short-term volatility but the longer term fundamental picture suggests that gold will continue to benefit from dollar weakness.

Another strategy would be to focus on US companies that derive a significant portion of their revenues from external markets. These companies stand to benefit from growth in nations like Brazil and China which will outpace growth in the more developed economies. Some good examples of such companies are Caterpillar Inc, Mc Donald's Corporation and Ford Motors.

Caterpillar, the biggest maker of bulldozers and excavators earns up to 66% of its sales outside of the US. Ford Motors, the only major US automaker to avoid bankruptcy also does up to 51% of its business abroad. A similar situation exists at Mc Donald's. Analysts estimate that converting currencies into dollars will add between 10 to 13 cents a share to Mc Donald's 2010 profit.

There is very little on the US economic landscape to suggest that the US dollar will strengthen in any substantial way next

year. Most experts agree that dollar weakness will persist even when the US begins to tighten monetary policy. More and more, the US dollar is losing favour as the world's preferred reserve currency. Global investors' preference for non-US equities, rising mergers and acquisition outflows from the US and central bank reserve diversification are all compounding the dollar's fall from grace.

DISCLAIMER

The information contained in this documentation is for your information only. All information contained in this documentation has been obtained from and is based on sources, including but not limited to, newspaper and magazine articles that CMMB believes to be accurate and reliable. However such information, facts, calculations, methodology, assumptions and estimates contained in this documentation have not been verified by us. All opinions and estimates constitute the Author's judgment as of the date of the documentation which are subject to change; however neither its accuracy and completeness nor the opinions based thereon are guaranteed. As such, no warranty, express or implied, as to the accuracy, timeliness or completeness of this documentation is given or made by CMMB in any form whatsoever. Consequently, CMMB assumes no liability for the accompanying information, which is being provided to you solely for general information.
