COMMODITY CURRENCIES AND ECONOMIC CRACKS

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CONCLUSION

Australia, Brazil, Canada, Russia, and South Africa are well-known as key producers and exporters of numerous important commodities. Many observers in currency arenas and other marketplace domains label the currencies of such exporting nations "commodity currencies". The share of commodities in their economies varies. These countries obviously do not have precisely the same commodity export profile. Anyway, think of petroleum, base and precious metals, and assorted agricultural commodities.

In recent years, there's been a close linkage between trends in the S+P 500, commodities "in general", and the United States dollar. Recent weakness in commodity currencies versus the US dollar coincides with and thus warns of continued declines in commodity benchmarks such as the broad Goldman Sachs Commodity Index and key stock indices such as the S+P 500. The worldwide economic crisis that erupted in 2007 has not been substantially solved.

2008, REVISITED

"I'm going to leave this brokedown palace,
On my hands and my knees, I will roll, roll, roll. " Grateful Dead, "Brokedown Palace"

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Marketplace history is not destiny. But that doesn't mean we should forget the past, either.

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 peaks in commodities and American (and many other) stocks- the broad real trade-weighted dollar ("TWD") made a key low around its major 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 it 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).

We all remember what happened next as the economic crisis worsened. Stocks crashed, falling especially sharply from the late summer levels around 1313 (8/11/08) and 1265 (9/19/08). Commodities collapsed. The TWD rallied, making a final high in March 2009 at 96.8, around the time of the 3/6/09 low in the S+P 500 and the broad GSCI's 2/19/09 bottom at 306. In a frantic flight to quality (safety), US government interest rates tumbled. The UST 10 year note trough at 2.04 percent came before the stock marketplace valley, on 12/08/08. However, the UST made another important low shortly after that in stocks, on 3/18/09 at 2.46pc.

COMMODITY CURRENCIES IN CONTEXT

"Where have all the flowers gone?
Long time passing…" From the Pete Seeger song

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One can analyze a commodity currency via various cross rates or by estimates of its real effective exchange rate. However, since a commodity currency's level and trend against the United States dollar is a widely monitored benchmark, let's concentrate on that.

The price and time trends of the commodity currencies from the US dollar cross rate perspective intertwine closely with key moves in stock and commodity benchmarks. Viewing them as a group, the five 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.

NATION	2008/2009 Cross Rate Low v. US Dollar (date)	Spring 2011: 1st High v Dollar (date)	July 2011: 2d High v $ (date)	August 2011 Low v $ (date)
Australia	**.601 (10/27/08) .625 (2/2/09)**	**1.098 (4/29/11)**	**1.108 (7/27/11)**	**.993 (8/9/11)**
Brazil	**2.620 (12/5/08) 2.450 (3/2/09)**	**1.557 (4/27)**	**1.529 (7/26)**	**1.659 (8/9)**
Canada	**1.302 (10/28/08) 1.307 (3/9/09)**	**.945 (4/29)**	**.941 (7/26)**	**1.001 (8/9)**
Russia	**36.55 (2/18/09)**	**27.15 (5/4)**	**27.40 (7/27)**	**30.19 (8/9)**
South Africa	**11.87 (10/22/08) 10.73 (3/5/09)**	**6.54 (5/2)**	**6.62 (7/28)**	**7.61 (8/9)**

Incidentally, note the interrelated movements of 8/9/11. That day saw an interim low in commodities and stocks intertwined with weak commodity currencies against the dollar. However, despite their bounces up from their 8/9/11 lows, all five commodity currencies remain beneath their summer 2011 peaks. The 9/9/11 closes: the Australian dollar was 1.047, Brazil 1.674 (beneath its 8/9/11 low, too), Canada .9967, Russia 30.05 (8/9/11 is being challenged now), and South Africa 7.29.

Keep in place these commodity currency timing columns for commodities and equities:

COMMODITIES: The Broad GSCI				
	306 (2/19/09)	**762 (4/11 and 5/2)**	**705 (7/26) (712 on 6/9)**	**598 (8/9)**
STOCKS: The S+ P 500				
	667 (3/6/09)	**1371 (5/2/11)**	**1357 (7/7); 1347 7/21)**	**1101 (8/9)**

On 9/9/11, the GSCI closed about 660, the S+P 500 at 1154.

CURRENCY CONTEXT, 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).

Yet how does the TWD dollar trend track those of the cross rates of these commodity currencies versus the dollar? Close enough to watch. 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 93.8 on 7/26. Its high since 7/26/11 is 8/9/11's 95.7 (statistics available through 9/2/11). What about during the 4Q08/1Q09 period? The nominal TWD's peak was 3/3/09's 115.0; compare the timing of the S+P 500's bottom.

What are key levels in the broad real TWD to watch? July 2011's very weak 80.5 is a new record low. This is fairly close to support at 79.8, five percent under the former major support at 84.0. Ten pc under 84.0 is 75.6. For resistance, watch 84.0, and keep in mind the levels at the onset of the Fed's QE2 program- 87.6 August 2010/84.1 November 2010.

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What about the Euro FX versus the US dollar? Many commodity traders closely watch that relationship. As of 9/9/11, the Euro FX was around 1.366. 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.

What about the Euro FX's levels during the onset of QE2 (money printing, revisited) in late August 2010? The Euro FX made a key low versus the dollar 8/24/10 near 1.259. The Australian Dollar established a notable low against the US dollar at .877 on 8/25/10. Compare Brazil's at 1.782 on 8/24/10, Canada's at 1.067 on 8/31/10, and Russia's 29.6 on 10/7/10.

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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 has continued to gain strength against it. The renminbi's 9/9/11 close of 6.39 is stronger than its 8/9/11 low at 6.43.

Keep an eye on the Japanese Yen against the greenback. Both China and Japan are creditor nations with substantial domestic savings and current account surpluses. The Yen's 9/9/11 close at Y77.6 versus the dollar remains fairly close to the important high on 8/19/11 at about Y76.0 (3/17/11 earthquake low Y76.2). Important resistance is the ancient former peak in 1995, Y79.8.

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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, although it since blasted through this.

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The economic crisis in general and the European and American fiscal disasters in particular grasped more and more headlines from mid-2010 onwards. The Swiss Franc made an important low against the Euro FX on 5/21/10 at SF1.458 and versus the dollar at SF1.173 on 6/1/10. The Swiss Franc then increasingly became viewed as a safe haven (flight to quality asset).

Fearful about the consequences of a very strong currency (especially against the Euro FX), Swiss policy makers became tired of such devotion and recently have battled to reduce it.

Recall the 8/9/11 date, one on which the US dollar was strong relative to commodity currencies. Yet on 8/9/11, and in contrast to the commodity currencies relative to the dollar, the Swiss Franc was powerful (about SF.707 versus the dollar). It also was at a record level against the Euro FX (SF1.007). Since then, the Swiss has plummeted against the dollar (9/9/11 close SF.884) and the Euro FX (SF1.207).

What does this Swiss Franc behavior since 8/9/11 indicate? First, it pushes the Swiss "into line with" the downtrends of the commodity currencies relative to the dollar that began in spring 2011 and July 2011.

But the Swiss is not a commodity currency. For many who worry about worldwide (especially European and American) economic stability and strength, the Swiss Franc is a solid store of value. Most would say it represents financial stability and so-called proper (prudent; good) economic policies.

Remember that nowadays many traders and analysts associate (see similar) trends in stocks (such as the S+P 500) and commodities ("in general"). In this context, commodity currencies tend to rally versus the dollar and alongside bull moves in commodities and equities. And all else equal, to the extent much of the world (economy) falls to pieces, stocks tend to head lower, and thus commodities and commodity currencies fall as well.

So on 8/9/11, there probably was a group of players that owned the Swiss Franc that also was short (or at least bearish in thought regarding) stocks and commodities. Consequently, a sharp fall in the Swiss Franc versus the Euro FX and the dollar (such as that beginning on 8/9/11) inspired some buying of equities and commodities. Hence the modest rallies in the S+P 500 and the GSCI and commodity currencies beginning 8/9/11.

However, renewed declines in the S+P 500 and commodities and strength in the US dollar against the commodity currencies (watch for breaches of 8/9/11 levels) and the Euro FX will underline the limited implications for the worldwide economy of recent Swiss policy actions.

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Switzerland's effort to weaken its currency also highlights the fractures in and substantial weakness of the worldwide economy. In this stressful situation, there's been murmuring for many months about competitive devaluations and currency wars. Admittedly, most nations do not want a badly debased currency.

Since around March 2009, and especially after its QE2 money printing festival beginning in 2010, the United States has encouraged broad real trade-weighted dollar erosion. However, these days, many countries would enjoy a relatively weak (or a less strong) currency. This clan includes not only quite a few commodity currency nations, but also advanced nations (Japan, the Euro FX region in general, Japan). Since the US is not the only one that wants a fairly feeble (or a not-too-powerful) currency, that tends to offer the dollar some support.

Moreover, suppose the worldwide economy is not merely in a rough spot, but is nearing (or actually in) a really dangerous landscape. America's financial marketplaces are very large and generally liquid. And despite America's political quarrels, it has great political stability. Therefore, even if the US is a mess from many perspectives, it may seem relatively attractive in some respects when compared with quite a few other nations. Again, recall the US dollar's rally after autumn 2008 up to its early 2009 high.

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The Conference Board's Consumer Confidence Index in May 2008 was fragile (a mere 58.1), despite the S+P 500's rather lofty mid-May height of 1440. The Confidence Index not only was well down from its July 2007 peak at 111.9. This measure also stood beneath its 61.4 March 2003 bottom, when the S+P 500 made its final trough at 789 (3/12/03). **As in May 2008, US consumer confidence in 2011 is cracked.** The Confidence Index ascended only to 72.0 in February 2011 from February 2009's dismal record depth of 25.3. At 44.5 in August 2011, it staggers below both the March 2003 and May 2008 levels.

FEDERAL RESERVE: UNEASE AND EASING

Many intertwined variables such as interest rates, stocks, and commodities influence TWD and dollar cross rate levels and trends. However, let's concentrate briefly on America's majestic quantitative easing program. The Fed has been trying to boost household net worth (and overall economic confidence), and thus wants a higher stock marketplace. The crack troops of the Federal Reserve unveiled a new round of money printing policy (QE2), in August/November 2010. This encouraged TWD weakness and dollar cross rate tumbles versus commodity (and many other) currencies. Quantitative easing ended at end June 2011.

Suppose the US dollar continues its rally relative to its spring/July 2011 highs over the near term and achieves new highs. Assume the S+P 500 not only falls back to its 8/9/11 low, but also attacks summer 2010's support level around 1000/1050 (1011 on 7/1 and 1040 on 8/27). Recall the Fed began its QE2 policy campaign around the time of the 8/27/10 low.

Such an equity price decline (especially if it is mirrored worldwide, and accompanied by even more troubling signs of economic weakness), could well inspire nervous Fed guardians to embark on yet another significant quantitative easing foray. All else equal (and assuming that most other key nations do not engage in a comparable money printing deluge), that will tend to weaken the dollar, as it did during past quantitative easing episodes.

Many observers have faith that a substantial QE3 action will rally the S+P 500 (and commodities). Won't history repeat itself? However, maybe history will refuse to do so, and stocks will climb very little before resuming their decline. **Money printing is not a genuine repair policy for real economic problems**. Despite the fearful Fed's determination to maintain an extremely low Federal Funds rate, a renewed money printing enterprise also eventually may inspire interest rate jumps in US debt playgrounds.

With or without QE3, will foreigners be forever happy about financing a gigantic US government debt if US Treasury rates remain very low alongside a depreciating dollar?