

MAAP August Review

September 2, 2009

MAAP experienced a small decline in August as declines in the long positions in energy and grains more than offset the gains in the long positions in metals, the three currencies in the portfolio, Australian dollar, Canadian dollar, and euro, and partial long position in the S&P 500

There are several questions, concerns on the minds of investors generally that deserve comment. Although in this monthly commentary we cannot comment in depth on each one, we can summarize our thoughts/ideas and their impact on investment strategy.

### **Commodities, Precious Metals and Certain Currencies Offer the Most Attractive Investments**

If one looks at the various components of production, labor, capital, and raw material inputs, in terms of both supply and valuation, raw materials (e.g. commodities) will be the first area of supply bottlenecks as economic growth resumes. Furthermore commodities remain undervalued, in real or inflation adjusted terms, relative to their price levels of the last 100 years. Although supplies have been in temporary surplus, as the recession temporarily depressed demand, any resumption of economic growth will quickly return the world economy to a tight supply situation. During the previous one hundred years, 15 percent of the world's population consumed roughly 95 percent of the world's resources. We are now in uncharted territory, where close to half of the world's population has entered various stages of a consumer and entrepreneurial driven economy. Closely tied to these trends is the limited supply growth of precious metals relative to the growth in financial assets and liabilities. Finally currencies of commodity producing nations, and currencies that will benefit from dollar diversification, should also appreciate.

### **The Uncertainty of Economic Growth**

Having just experienced one of the worst recessions and financial crises in modern times, it is difficult to imagine a return to normalcy. This uncertainty has been exaggerated by both a financial press and politicians who have added to a panic mindset, both due to their own human emotions and ulterior motives to serve their agendas. In the U.S. the current environment has been further unsettled by radical legislative proposals with regard to social/health issues, environmental/economic issues, and tax increases, and a banking system in disrepair. All of these factors can create a paralysis mindset that slows economic creativity.

Fortunately there are powerful, positive offsetting factors. First, recessions sow their own seeds of recovery. Inventories reach extremely low levels below even depressed sales levels forcing moderate production increases. Existing durables (e.g. appliances, autos) breakdown, forcing households into replacement purchases. Home construction falls below family formations, eventually forcing a stabilization and uptick in home construction. Superimposed on these factors has been the most massive financial/fiscal stimulation in history, not only in the U.S. but globally. While the fiscal stimulus is still 90 percent unspent, the massive Federal Reserve stimulus that commenced in mid-September 2008, after the Lehman bankruptcy, is impacting financial and real economic activity. Such stimulus has distorting, unintended negative consequences (e.g. distorted asset pricing, misallocation of resources, and potential inflation), but usually with a lag. The most immediate impact is improved money flows and price increases in financial assets and real estate, which in turn stimulates a wealth effect, improving confidence and spending.

Finally the U.S. economy is benefiting from Asian and developing country growth which is stimulating our exports. With the dollar weak against many foreign countries, U.S. exporters are in an advantageous position to gain global market share. Therefore growth in capital goods and agricultural exports may be a significant positive surprise in the next economic cycle. In summary, while the U.S. consumer will not be the engine of growth in this next cycle, there is a growth dynamic that has taken hold in the developing world, as their middle class emerges, that will provide the economic growth leadership in this next economic cycle.

### **The End of Dollar Hegemony?**

It has been our view that the dollar entered a long-term decline in 2001 that will eventually lead to major changes in the international monetary order. Experts differ on whether this will occur, and if it does, will it be slow (e.g. decades long as with the British pound in the 1900s) and at times disruptive, or more abrupt and therefore creating a more dysfunctional financial environment. Our view is the middle ground of slow dollar decline and at times disruptive because there are too many dual stakeholders in the dollar's current role. By dual stakeholders we mean countries with huge dollar reserve holdings, which are increasingly uncomfortable with those holdings, but are also dependent on the huge U.S. market for their exports or dependent on the U.S. militarily. Therefore they may attempt to restrict the accumulation of additional dollars but will find it difficult to sell their dollar holdings. What is more likely is diversification within their dollar holdings. Selling Treasury securities and investing the proceeds in dollar denominated equities and real estate, purchase of commodity reserves, and the purchase of precious metals. As in the 1970s, many foreign countries will find themselves increasing their money supply in order to intervene in currency markets to support a weak dollar. The net effect is higher inflation globally.

### **September-October Market Angst**

In past commentaries we have drawn parallels between the commodity price correction in the second half of 2008 with the stock market decline in the fall of 1987. Following October 1987 investors experienced a considerable level of angst with the price decline fresh in their minds. For the next couple of years this angst reasserted itself, especially as the September-October time period approached. This angst was egged on by the financial press looking for headline grabbing material. However other than minor short-term corrections during the next two years, the stock market was relatively calm as it continued its upward march. Because we believe that the long-term supply shortage of commodities will reassert itself as the global economy resumes its growth path, the bull market in commodity prices (similar to stock prices in the late 1980s) has much further to go both in price and time. At the same time we are confident that our new risk management process for managing leverage will serve us well in any unexpected severe corrections due to unforeseen events.

For the past twelve weeks commodity and currency markets have been in a trading range consolidation following the strong advances from their lows in late 2008 and early 2009. We believe this consolidation is preparation for the next phase of the unfolding bull market. As the global economy experiences renewed growth, commodities, precious metals, and foreign currencies should be the primary beneficiaries.

Past results are not necessarily indicative of future performance. Actual trading for 3X-6X commenced on 7/8/92 and 2X-4X commenced on 10/15/92. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. For a complete disclosure document of AIS Futures Management LLC's MAAP Program, contact AIS Futures Management LLC, 187 Danbury Rd. Wilton, CT 06897 (203) 563-1180.