

MAAP October Review

November 3, 2009

MAAP finished October with positive performance as four asset groups contributed to the gain. Long positions in the grains and energy provided the largest profit contribution, with smaller contributions from long positions in metals and foreign currencies. A very small loss occurred in the long position in the S&P 500 and short position in the U.S. Treasury bonds.

October was a pivotal month for the commodity sectors as the broad commodity indexes advanced above their early June highs after approximately 17 weeks of sideways consolidation. After early weakness at the beginning of the month, prices surged to new recovery highs, and then experienced a normal short-term setback in the last week of the month. The new recovery high adds further evidence that we are in an important long-term bull market in raw materials and precious metals. The world is in the midst of an unprecedented liquidity infusion from central banks and massive fiscal spending by world governments. **The amount of spending and liquidity necessary to prop up the weakest entities of the financial sector is excessive for the healthier sectors of the economy.** In addition, the size of world commodity and precious metals markets is miniscule compared to the size of world financial portfolios. Therefore as the world economy begins to grow, this excessive liquidity combined with the relative scarcity of new supplies of commodities and precious metals will have a dramatic upward impact on prices. Inflation, when it develops, will occur first in the crude materials component of the producer price index and only later in the consumer price index.

As mentioned last month, gold has provided important leadership in the bull market in commodities, for the past year, as well as for the past decade. It represents the quintessential embodiment of a safe harbor from all that ails the world financial system. Unlike financial liabilities which have been growing at rapid rates for decades, newly mined gold is only increasing at approximately 1.4 percent a year. Simple laws of supply and demand argue that over time a scarcer item should appreciate relative to its more abundant alternatives. Investment demand for gold was relatively muted during the financial bull market of the 1980s-90s. This muted demand for gold, combined with central bank net selling, kept prices subdued until the early part of this decade. The gold bull market commenced in 2001 after the U.K. liquidated half of their gold holdings. Now in addition to rising private investment demand, some central banks have once again begun acquiring gold as an alternative to holding U.S. dollars in their reserves. This trend is most apparent in the most economically dynamic developing countries such as China and India, who have both announced major gold acquisitions. Most recently India acquired 200 tons from the IMF. Given the expectation of continued aggressive monetary and fiscal stimulus policies for the foreseeable future, foreign central banks, sovereign wealth funds, and private investors are likely to gradually increase their use of gold as an alternative store of wealth. This could well lead to appreciably higher prices in the years ahead.

Although investors remain skittish, economic indicators continue to point to a new global cyclical recovery. The engine of this recovery will be the developing countries and their newly emerging middle class. The developed countries will lag but they will benefit from rising exports to the developing world. The U.S. will be a major beneficiary of export growth as the dollar remains weak. Many imbalances will remain but global growth is likely over the next couple of years. However as this growth occurs, tightness in commodity supplies will reemerge once again. Therefore we believe MAAP offers a unique portfolio combination that will benefit investors.