

MAAP September Review

October 5, 2011

September was a difficult month as all four asset classes in which MAAP had positions contributed to the negative returns. The largest loss came from the grain sector, followed by the metals, energy, and finally from the currency positions. In early October the leverage reduction system for the three commodity sectors was triggered and positions in those three sectors were reduced to 50 percent of maximum.

The leverage reduction system was last triggered in January 2010 in what proved to be an intermediated correction prior to a strong advance from August of 2010 through April of this year. Commodity markets have been in an irregular trading range correction since early May of this year. One of the reasons that the leverage reduction system was slow to be triggered was due to several markets (corn, the soybean complex and gold) making very recent new highs in either late August or early September. Markets then experienced a very violent selloff in the last eight days of September. In spite of the sharp decline in September, it is our view that the current environment is very different from the major correction in 2008. The irregular correction since early May, similar to 2010, is also of an intermediate type, and we believe will be followed by further new highs within a few months and during the years ahead.

The primary basis for our belief that the world is in a long-term primary bull market in commodities and precious metals is based on the growth momentum in the developing world. Even though the growth rates of countries such as China and India will moderate in the years ahead, from rates in the last decade, developing economies have reached a relative size where their growth rates will now overwhelm the slow growth of Europe and the U.S. Equally important, these developing economies have reached GDP per capita levels where a greater percentage of their populations are entering what economists define as middle class. History demonstrates that regardless of cultural background, once incomes reach these middle class levels, individuals want what we in the West have been accustomed to during our lifetimes. Thus the demand pressure on commodity resources will continue to strain economic growth in the years ahead and will continue to put upward pressure on prices of commodities.

The above bullish case is not meant to make light of the current financial issues currently facing the developed world. However, unlike 2008, the issues are more defined, therefore less likely to create unexpected surprises such as Lehman Bros. Participants such as banks, money market funds, investors, and central bankers have had months to prepare contingency plans for the “what ifs”. Therefore a discounting of these “knowns” has been taking place. The need for repair of the developed world’s banking system is still an issue so that normal lending activity can proceed. For this reason we think it is likely that another stage of quantitative easing is still a high probability. The combination of current low real interest rates and the possibility of further quantitative easing is very bullish for gold, as is the trend of developing country central bank buying. For these reasons, commodities and gold will continue to provide investment leadership in the years ahead.