25 April 2008

RIO Professional Investors Fund recent trade in Yen / Dollar position.

RIO Professional Investors Fund has a trade positioned to benefit from the recent Yen Dollar position. I posted the trade a few weeks ago at 103.60 sorted for a move 105 which we expect to see in the very near term which would result in further gains in this fund.

Of the G-10 countries, Japanese policymakers are the most likely to get their hands dirty and intervene in the currency markets when the Japanese Yen's price movements are too volatile and extreme for their liking. However, the Bank of Japan and Ministry of Finance have been a bit more lenient in recent years, as the last official intervention was conducted in March 2004. Nevertheless, policymakers have plenty of reason to be concerned about the Japanese Yen's most recent surge as the USDJPY pair has recently tumbled to an 8 year low of 101.40. The strength of the currency is hurting the profit margins of major Japanese corporations, as the most recent Tankan survey showed that most Japanese corporations forecast the value of USDJPY in 2008 to be around 113.00. With the pair now rapidly approaching the 100 level, those hedges are deep in the red. Furthermore, Japanese Economy Minister Hiroko Ota noted that the approximate break-even point for companies is at the 106.60 level, and firms like Toyota, Yamaha Motor Co., and Nippon Steel have all reported disappointing earnings as a result. Unsurprisingly, the shares of exporters have taken a hit and are a major reason why the Nikkei Stock Average has plummeted 6 percent over the past five days, the biggest loss since the week ended August 17. With over $1 trillion in official foreign reserves, the BOJ is by far the best equipped to attempt to put a cap on Japanese Yen gains as the appreciation seriously impairs the profit margins of Japanese firms.

RIO Professional Investors Fund -Commodities

Financial markets are not always rational, reasonable, merciful or fair, but they are always primal, and they always utilize the element of surprise to cull unsuspecting investors from the herd. During late March, the commodity markets mauled many, many investors the unsuspecting as well as the vigilant.

During the last four trading days leading up to the 21st March the commodity markets suffered their biggest one-week drop in half a century - despite the fact that the U.S. Federal Reserve introduced the most inflationary policies of its century-long history. After cutting through all the euphemisms and press releases, the Fed's newest lending facilities amount to an open cheque book for non-bank financial institutions. The Fed will readily accept the mortgage bonds that no one can value and no one can sell in exchange for the Treasury bonds that anyone could value or sell. Is it that all collateral is good collateral?

Soon, we can expect to see Goodyear Tire walk up to the Fed's lending window to exchange portions of its used tire inventory for Treasury bonds. And why not? Used tires probably possess a more reliable value than the collateral the Fed is actually accepting.

Who could have guessed that the announcement of the Fed’s new lending facility, along with the Fed’s meddling in the Bear Stearns takeover, would have produced a rout in the commodity sector? The folks at the Fed do not refer to their new “Primary Dealer Credit Facility as unlimited credit. (They’re too educated to make that blunder). But that’s the way the Fed cookies crumble it seems.

RIO’S research enabled me to be well prepared and positioned for this sharp sell off in the commodity sector; however I was not prepared for the last four trading days leading to 21st of March. Please bear in mind that short-term, sentiment-driven moves in any financial market have very little to do with underlying fundamentals. On the contrary, these dramatic, counter trend bursts have everything to do with the behavior of financial markets.

The soaring commodities market, we continued, are not immune to a sharp, sudden sell off. In fact, a sell off is exactly what the nearby charts seem to be anticipating.

In the gold pits, the Commercials have amassed their largest –ever net-short position. This large bearish bet by the smart money doest not guarantee a sell off in the gold market, but it does raise the possibility.

Okay, so what does all this mean?

We anticipate much higher gold prices and oil prices and grain price eventually. But we’d rather be a buyer on weakness than on strength.

We were right to expect a sell off and positioned the RIO Professional Investors Fund appropriately. But even so, we feel more wrong than right. The Fed’s tactics are inflationary and therefore, should have been very bullish for gold and most other commodities. Mr. Market had other ideas. He chose this moment to punish every investor who tried to guard against inflation.

William Gray
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The RIO Club