Commodity markets continue upward trend

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The strong increase in commodity prices has been driven by global economic growth propelled by emerging economies. In addition, further speculative investment has continued to move into commodity markets, amplifying the intensity of the price surge. The very dynamics of global commodity prices has also been changing, with a growing presence of financial investors in these markets.

It should be noted that the significant increase in new financial products and investors in the commodity markets has led to these markets becoming more sensitive to portfolio rebalancing by financial institutions and investors. This has resulted in commodity markets being more closely aligned to other asset markets, including major equity markets.

Finally globally accommodating monetary conditions have also played an important role in the surge in commodity prices, both by stimulating physical demand for commodities and driving further investment. **The above is likely to benefit RIO Professional Investors Fund**, which is frequently traded in both Oil and Gold. The Fund benefits from the fact that almost 30% of its holdings are in fixed interests (outside the US Dollar), reducing volatility and lowering the risk/reward ratio. The Fund has returned +22.76% to March and is positioned to benefit from any further bad news out of Japan or the Middle East. That said, I would be confident that this fund is likely to continue its outperformance.

The Fed is running out of options now!

The Fed can only choose one of two options now: either destroy the economy by allowing the Dollar to fall below support levels thus unleashing inflation, or abandon the "risk trade" stock market rally.

Because the overleveraged assets, from US real estate to stocks, collapsed during 2008 through to early 2009, the Federal Reserve took the desision to flood the global economy with zero-interest Dollars. This action resulted in the following;

1. It gave U.S. banks and other insolvent financial institutions an unlimited pool of money to borrow at zero interest and leave money on deposit at the Fed, where it earned risk-free interest.
2. It enabled a vast global "carry trade" in Dollars: speculators could borrow unlimited Dollars at no cost, and then deploy the cash around the world to chase higher yields in stocks, commodities, etc.

3. It allowed banks to lend profitably in the U.S., as their cost of money was reduced to essentially zero, and to pour fiat money into U.S. stocks, creating a virtuous cycle of ever-rising equity prices.

4. With the bulk of U.S. corporations growth and earnings coming from overseas sales, then a plummeting Dollar boosted their profits effortlessly, further affecting U.S. stocks.

5. When faced with the stark fact that savings earn nothing, U.S. investors were driven into the "risk trades" of the stock market and commodities, a flow of funds which reinflated asset bubbles. This reinflation was critical to foster the appearance of widespread recovery via the wealth effect of rising asset prices.

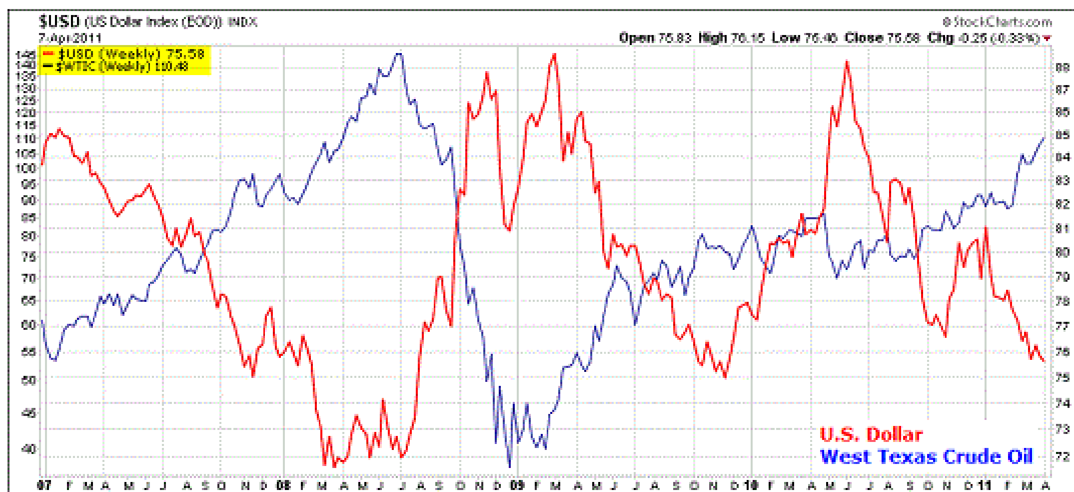
6. And finally a rising stock market not only offered an illusion of "growth" but it bailed out pension funds and set the stage for Wall Street to reap billions of Dollars from the resurgence of mergers and acquisitions, IPOs and derivatives.

I believe the basic idea was to extend the pretence which had worked previously in the last banking crisis in the early 1980s, a case of not forcing the banks to declare their losses, but simply extending and pretending while offering them risk-free ways to bank billions in profits. The goal was to enable the banks to recapitalize "painlessly" on the backs of consumers and taxpayers.

The other plan was to create some modest inflation by brute-force depreciation of the nation's currency. This inflation would be good because it would enable debtors to pay off debts with cheaper Dollars, and it would also serve to reestablish the sense of borrowing and spending that the Fed views as the bedrock of a "permanent growth" economy. If you are confident that your cash will be worth less next year, you are highly incentivized to spend it now rather than see its purchasing power decline.

In choosing to depreciate the Dollar, the Fed has engaged in a high-stakes play with potentially devastating consequences. I would site that by pushing the Dollar down the Fed now risks destabilizing the currency. My eighteen years of currency trading experience leads me to predict that; it’s very likely if the Dollar breaks key support levels, then traders and many others holding USD will be more than very concerned, which will encourage them to sell their Dollars immediately rather than witness significant loses.

As we can see in the chart below, the Dollar's decline has not occurred in a vacuum: when the Dollar declines, oil and gasoline prices shoot up. The Dollar and oil (and other essential commodities) are on a see-saw, for oil exporters simply raise prices to compensate for the loss of purchasing power as the Dollar declines.



The Fed is now trapped. If it devalues the Dollar and drives it lower, the price of oil will move toward highs of $140/barrel, a level witnessed in 2008 that then triggered a recession in the U.S. economy. I would comment that a recession now will seriously hamper the recovery and the rest of the Fed's plans.

The unintended consequences of the Fed's inflationary plan to depreciate the Dollar is evident everywhere in escalating food and energy costs. Devaluing the Dollar has triggered destabilization of global inflation which, if unchecked, threatens to simply run out of control.

But if the Dollar is allowed to rise, then their precious stock market rally will come to an abrupt halt. Below is a chart showing the long-term decline of the Dollar.

Dollar Index (DXY)

I will take this opportunity to say is it any wonder 97% of speculators are bearish?
I strongly feel that the "line in the sand" is not far below current levels. If the Fed pushes the Dollar below this level, technically there is no visible support, and oil will be on its way to $200/barrel, far past the point when its level would be pushing the economy into recession. **Again, good for those invested in RIO Professional Investors Fund (which trades oil).**

The Fed now has to choose between two bad options: either keep pushing down the Dollar and let oil's inevitable rise trigger a recession, or let the Dollar recover and watch stocks crater as the "risk trades" reverse. If the Dollar Bears have to cover their short bets, the ensuing rally in the Dollar might well be explosive and self-reinforcing.

If the Fed lets the Dollar depreciate in an uncontrolled fashion, then we may well end up with the hyper-inflation (loss of faith) that many expect. The question remains: Will a disorderly and disruptive collapse of the Dollar serve the Financial Power Elites' best interests? This is difficult to see since this would wreak great damage on their holdings.

Accordingly, it would not surprise me in the least were the Fed to shock the markets with a surprise rate increase within the next few weeks or months. Destroying the real economy to maintain the "risk trades" is a foolhardy way to close down a lose-lose position.

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