Sujet: Extrait du récent Basic Points / Abstract from recent Basic Points

Source: Basic Points

Date: 16.04.2010

DALPÉMILETTE CONSEILLERS EN PLACEMENT | Desjardins Valeurs mobilières Membre FCPE

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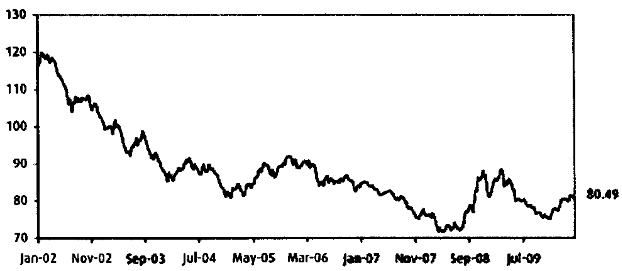
A Slow Boat to China

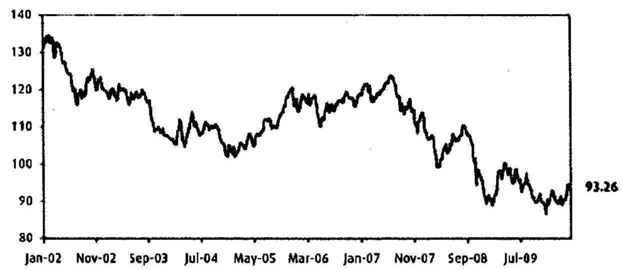
Greeks Bearing Gifts to Barack and Ben

Although the big mainstream media have been assuring us—day after day—that the best thing that has happened to his Presidency was getting the health care entitlement bill passed, we are inclined to the view that the best thing that has happened to his Administration—and to the Fed—is the sudden surge in support for the dollar.

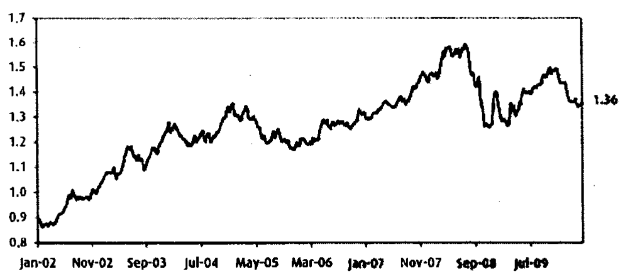
US Dollar Index (DXY)
January 1, 2002 to April 13, 2010



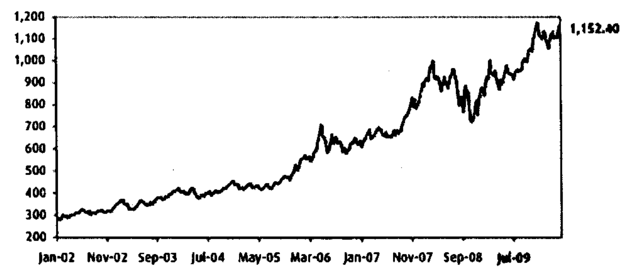
US Dollar – Yen
January 1, 2002 to April 13, 2010



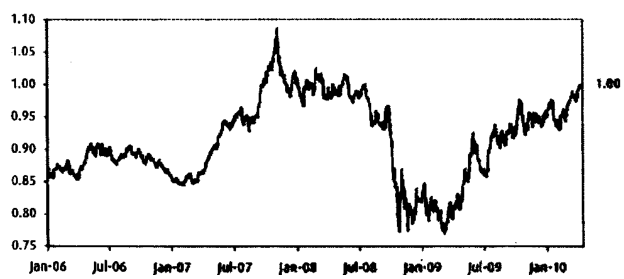
Euro – US Dollar
January 1, 2002 to April 13, 2010



Gold
January 1, 2002 to April 13, 2010



Canadian Dollar – US Dollar
January 1, 2002 to April 13, 2010



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MEMBRE FCPE

Since February 2002, when we announced at the BMO Resources Conference the dawn of the commodity era, we have been counseling clients to minimize their risks to the US dollar and to emphasize—in particular—Canadian dollar investments and gold.

In its time of need, the dollar is being rescued by the dramatic revisions of global investors' appraisals of Greeks and other PIIGS.

For most of the intervening period, the dollar has been weak against major tradable currencies. The exception came during the financial crisis, when overlevered players were forced to unwind exposure to American debt instruments. That process, plus a general tendency in panics to rush to the biggest of the alternatives, produced a powerful dollar rally.

However, as the financial markets stabilized, and as publicity about the drastic deterioration in US finances became a weekly event, the dollar resumed its bear market.

In recent weeks, the dollar has been rallying powerfully, despite continuing flows of negative reports about the Fed's balance sheet, Washington's deficits, Washington's spending, the likely cost of major new programs (such as health care and cap and trade), and that the Social Security Trust Fund cash flow has gone negative six years ahead of schedule.

In its time of need, the dollar is being rescued by the dramatic revisions of global investors' appraisals of Greeks and other PIIGS. That term covers members of the Eurozone whose finances are as bad—or worse than—the US, including Portugal, Italy, Ireland, Greece and Spain. But the greatest of these is Greece, where the weekly news ranges from union leaders bewailing a new kind of Greek tragedy or commentators across the world musing about a new kind of Greek comedy. Greece's fiscal deficit is listed at 12.5% of GDP, whereas eurozone members' deficit is supposedly capped at 3% of GDP and its national debt is said to be near 130% of GDP. Those numbers would not, in themselves, constitute disaster if there were any evidence that Greece could, with short-term aid, become credit-worthy without reliance on the productive eurozone members and the IMF.

But almost nobody believes that Greece can rein in its massive public sector with its massive benefits—including early retirement. Nor does almost anybody believe Greece can kickstart its economy by suddenly becoming strongly competitive. On the macro level, Greeks are better known for their charmingly casual approach to paying taxes and working efficiently. However, they share space in the world's largest free trade zone with such industrious and thrifty people as the Germans, Dutch, and Austrians.

A Slow Boat to China

The yen is the zero-yielding currency of a country whose demography is the worst in human history.

Greece has a storied past, as the founding culture of what would become the West. But its record since Alexander the Great's time is of 22 centuries in which most of the news was bad, and heroes were few—or nonexistent. The rest of Europe is willing to buy Greek art treasures and Aegean islands, but little else that is Greek. The Glory that was Greece lives on in our neighborhood: atop the former Board of Trade Building that now houses the CME is a splendid statue of Ceres, the Greek goddess of agriculture. (Thankfully, those atheist activists who rage against any public religious displays have tolerated Ceres.)

Greece's economy is tiny, so why is its seemingly hopeless and half-hearted attempt to escape from its self-spawned Laocoönesque coils good news for Washington?

Because, in foreign exchange markets, there are only three major trading zones—the dollar, the yen and the euro. Roughly 80% of all trades involve the dollar on one side. Until recently, investors wishing to escape from the dollar's highly-publicized problems could choose the yen or the euro.

Those escape routes are closing rapidly.

The yen is the zero-yielding currency of a country whose demography is the worst in human history. Its population is set to fall by 50% by 2050—the equivalent of two waves of Black Death in slow motion. By 2100, the whole nation will resemble its Cabinets—average age over 65. This could, in theory, be a time of bliss and harmony, because Japanese have traditionally venerated the aged, who are assumed to be wise. However, it will not be an economy that could service today's level of debts, let alone the stratospheric heights of the future. Soon the birth rate will be exceeded by the berth rate for desirable storage slots of ancestral ashes. Anyone with a yen for long-term Japanese bonds?

Eurobonds were obviously a better bet—no matter the name of the borrower.

Until Greece went from the obscurity which allowed it to peddle its bonds to investors abroad—and to the European Central bank—to Page One status as the Wastrel of the Western World, the euro was the currency of choice for currency traders and investors wishing to reduce their dollar risk.

Investors are now beginning to realize that Greece is just the first and most malodorous of the eurozone's PIIGS.

Result: more and more foreign exchange funds and institutional investors are almost compelled to buy US-denominated debt.

Looking Ahead

The sad reality is that the eurozone outside the traditionally Protestant (and therefore traditionally capitalist) northern industrial states and France is uncompetitive. Apart from tourism, much of Europe has bad demography, bad public finances, and few competitive advantages.

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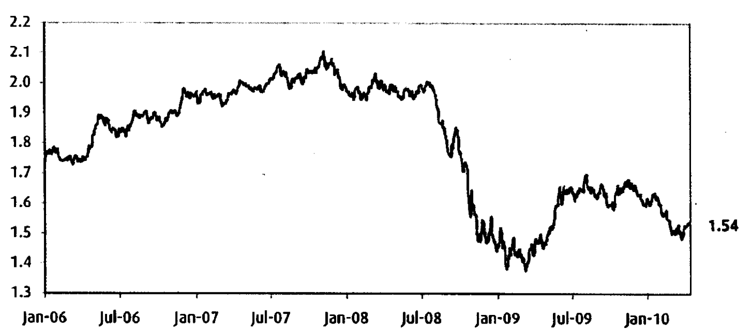
The US situation would surely be seen as grim by holders of Treasurys were it not being compared to the worsening situations in Japan and Europe.

Britain is not in the eurozone, but its demography and public finances are almost as pitiful as the average PIIG's, and the country is in an election campaign that matches a tired Labour government with whom the voters are fatigued, against a young Etonian whose resemblance to Thatcher is no greater mentally than it is physically. This callow candidate of great ancestry and even greater ambitions has been known to praise Saul Alinsky, the Marxist community organizer called "The Father of modern American radicalism" who inspired ACORN and the young Obama. The voters do not get to choose "None of the Above." Tony Blair, driven from office by his support of Bush in Iraq, looks better and better—but he is only slightly more available as a rescuer than Churchill.

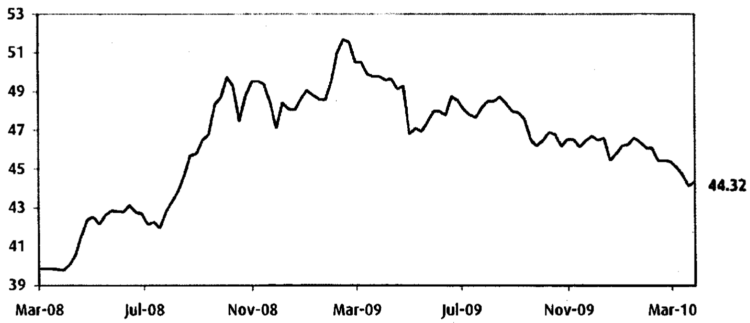
British Pound – US Dollar
January 1, 2006 to April 13, 2010



Switzerland is not part of the EU, but even the classic haven Swiss franc risks looking less and less Alpine and more and more like what Hannibal's elephants left behind. Its bailed-out banks are reporting robust trading profits redeploying their government-guaranteed deposits, but much of the economy is high-cost, and Swiss demography resembles the rest of aging Europe.

The only heavyweight among the tradable currencies is the Indian rupee:

US Dollar – Rupee
March 1, 2008 to April 13, 2010



...the US dollar is now first among the worst big alternatives to gold.

We have no chart on the untraded renminbi, which is likely going to be revalued upward modestly.

Conclusion: the US dollar is now first among the worst big alternatives to gold.

The turnaround in the dollar has already had its effect on some Asian central banks. They had begun unloading greenbacks in favor of euros—partly because they have more trade with Europe than the US, but mostly because the dollar's highly-publicized problems scared them at a time when total global forex reserves were roughly two-thirds in Treasurys. So we've seen greater central bank participation in some recent Treasury auctions.

This must please Barack and Ben. When you know that in the next year you're going to be rolling over more than a trillion in outstanding Treasury paper and adding another trillion to the supply, you'd like to think there are some buyers other than local banks who are buying your stuff because they are so financially emasculated they can't make new loans.