CLARIEN

U S Dollar and Strong Momentum

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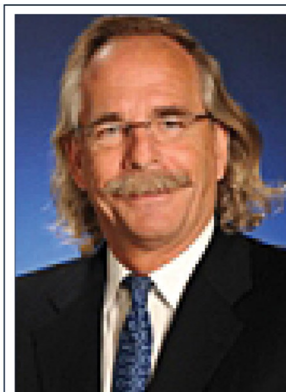
US Dollar in Cyclical Upswing



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The US financial assets may benefit from global asset allocation shifts that seem to favor US dollar positioning. Since the summer of 2011 until present, the US dollar has appreciated by a modest 9.5%. However, circumstances may be developing that could propel the greenback to a more substantial level of appreciation over the months and quarters ahead.

In the past, the US dollar has clearly benefited from severe risk aversion associated with the financial crisis of 2008 and the technology stock implosion of 2000. During these two periods the US economy was also in an economic recession which led global investors to seek the safety of the US dollar.

It is our contention that the current rally in the US dollar is the result of a broad-based global asset allocation shift away from yen and euro-based assets in favor of US dollar-based risk assets. Unlike previous cycles where the US dollar demand was accompanied with increased demand for US Treasuries, this cycle could see a significant increase in demand for US corporate assets. It should not be a great surprise that ALIBABA chose to list its IPO in the US where the US dollar is strong rather than in Europe or Asia where currencies are weak.

Europe's economy at best is only sputtering, Japan's economy is at risk of falling into another recession and China's economy is being challenged with maintaining real growth of 7.5% or higher. At the same time, the US economy is growing in real terms around 3.5%. The difference in the economic tone of the US versus Europe and Asia may be just enough to support the beginning of decoupling of Central bank monetary policy regimes.

Japan's Central bank has to continue to provide monetary stimulus to offset tax increases exercised earlier in the year. Moreover, Japan is clearly targeting a weaker yen to stimulate exports and to import inflation. The ECB is the only tool that Europe has to offset unwise austerity measures and address the growing concerns of deflationary pressures.

It is clear that market-based interest rates in Europe are still converging to 1% as measured by 10-year sovereign yields. At the same time, the US bond market is in the early stages of preparing for a possible rate hike by the Federal Reserve in either Q1 or Q2 of 2015. Regardless of the timing, the direction of interest rates in the US is most likely higher while the direction of interest rates in Europe is most likely lower.

Macro style hedge funds and other global asset allocators will have a much more interesting investment environment to make allocation decisions. Relative value and momentum investors should be able to focus on the European bond market for potential capital appreciation.

However, the most important decision will likely be whether to fade the recent strength of the US dollar or get on board for a much broader and longer ride. If the US dollar is gaining momentum based on fundamentals and not risk aversion (as in previous cycles), then a much further gain for the US dollar is possible.

The last time that the US dollar enjoyed a multi-year cycle of appreciation was between 1995 - 2001. During that period, the US dollar appreciated by approximately 45%. Using that cycle as a potential guide for the current cycle would suggest that the US dollar is only in the early stages of a multi-year cyclical rally. Commodities which are generally US dollar-based could come under further downward pressure helping to keep inflation a more distant risk.