

MARKET INSIGHT REPORT**Ben Bernanke: We Won't Do It Again**

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Speaking at Milton Friedman's 90th birthday party in 2002, Ben Bernanke thanked the great economist for educating the world on how to combat Depressions, assuring him that thanks to his work, "we won't do it again." Unfortunately for us mortals, great men and great economists are too sure of themselves – a bit of humility would help. Bernanke should have remembered Mark Twain's admonition that history does not repeat but only rhymes. Every situation that we face is colored by our history and what we remember from previous events, either experienced personally or learned from the memoirs of others. One other aphorism applies here, and then I promise I will revert to my own words: We can never step in the same river twice. The current dip into Depression is the first of its type. Although there are parallels we should examine and heed, the current events are very different than those during the Great Depression in the 1930's and in the more recent and continuing Japanese episode. In fact, the situation today is not the same as any of the hundreds of examples discussed in Carmen Reinhart and Kenneth Rogoff's 'must read' book *This Time Is Different*. Each time out we are faced with something we have never seen before, so our understanding of the situation has to be imperfect – in fact so far from perfect that the authorities are dreaming up their moves as they are making them.

Few seem to realize the gravity of the situation and the need to analyze all of the possible outcomes. Unfortunately, even if an individual like Ben Bernanke has many of the facts and possibilities in his mind and can lead his institution in the logical and perhaps correct direction, there are literally thousands of actors on the stage who have less understanding and, in some cases, systemically problematic goals. Richard Koo of Nomura Securities has been leading a one man crusade to educate Washington and the world on the intricacies of the Japanese experience. From his own historical role both in Japan and the US, Koo is an invaluable source of ideas. He might not be totally correct, but his belief that the government must supply the final demand that is missing in today's world and that this is the only way to avoid a spiral of decline into serious deflation and social collapse is important. Certainly the politicians in the Eurozone and the Tea Party loyalists are working in the other direction.

The world has enjoyed a very good recovery over the past fifteen months, but the government stimulus is running low and the interest rate levels are already as low as they can go. The theory was that final consumer demand would be kicking in around this time. As the signs are not good in that regard, we have to examine what the next year or two is likely to bring. With the Eurozone fiscal stringency taking place more and more aggressively as time goes on, we can not expect Europe to give us the demand we need. The US elections in November are likely to hand much power back to the Republicans and to the more conservative Democrats. The result will be a slowing of US stimulation – the American consumer of last resort is dead, at least for the next few years. Asia is the great hope and with more than two thirds of the world population, they will eventually become the driver of world growth. However, the Asian countries are still better exporters and they will not be changing their structure in the next few years. It will take a decade or so, and during the period between now and then the Western world is going to see a long and traumatic economic decline.



CURRENCY – Commodity Currencies Long-Term View

Sell Commodity Currencies

By Jonathan Clark

We are seeing disturbing similarities in the equity movements during the period between May and December of 2007 and the movements during the past seven months. This relationship is easy to observe in the Australian ASX 200 equity index. If Australian equities continue to track the historical movements this projects lows in mid-July and September of this year and this fits in well with our reading of the cycles. The longer-term cycles are calling for global equities to trend generally lower into second half of 2011. This argues that expectations for global growth will continue to be scaled back and market prices will adjust accordingly. Both equities and commodity prices will decline and this should be negative for the commodity currencies, but the Australian dollar reacted with a significant lag and it took until July of 2008 before it began a collapsing decline, but this later date is when commodities peaked too.



We are seeing some factors that suggest this time the Australian dollar will be quicker to react to equity movements and commodity prices are already declining. The correlation between the Aussie and the ASX 200 is far higher than it was in 2007. In 2007 the Canadian dollar peaked with equities and the New Zealand dollar five months later so it was only the Aussie that substantially lagged the others. This was due to the strength of the Australian economy as it managed to avoid a recession largely due to growing exports to China. Australia is largely dependent on exports to Asia and the Shanghai Composite index has declined by 25% during the past 2½ months and this argues the Chinese economy is slowing. The RBA tightening cycle is now likely to remain on hold for an extended period of time as the yield on 3-year Australian Bonds has fallen to its lowest level in nearly a year, and a rate cut is possible, and this will lessen the attractiveness of owning the currency.

AUD/USD should decline into the middle of next week and probably the week of July 12 before forming an intermediate low and should reach .8275 area. It should then recover for a few weeks before resuming its downtrend into September and our target for this downtrend is the .7825 area. The longer-term cycles call for this overall weakness to last into early next year and probably longer. **We recommending selling Aussie on bounces and the .8600 area should be a good place.**