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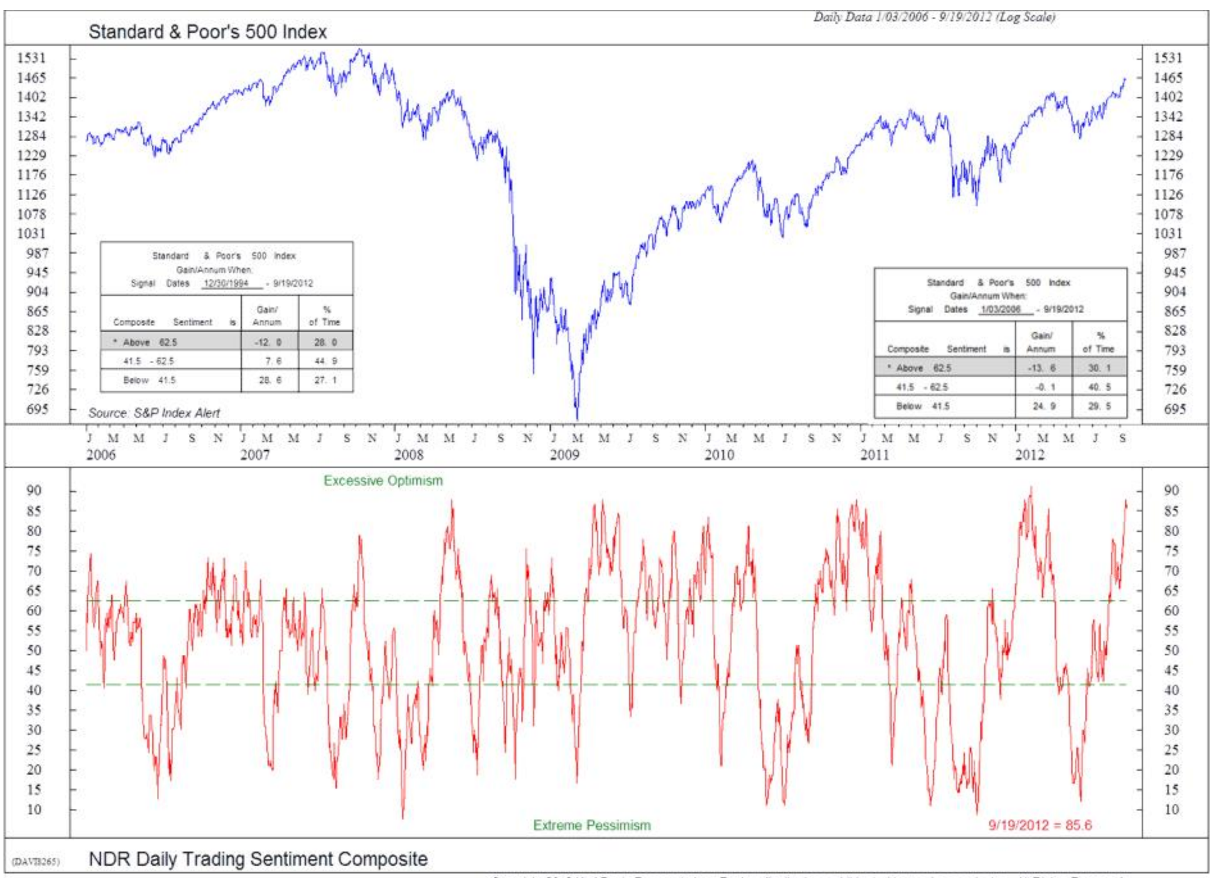
On My Radar

September 21, 2012
By Steve Blumenthal

QE is the big news. Below takes a look at the impact of QE on the dollar, Europe is in recession and Japan looks to be next. It's "game on" for currency wars. I include several interesting charts and the final bullet point below provides a link to one of the more thoughtful research reports I have read on QE. I hope you find the material helpful.

- **Investor Sentiment has spiked higher with QE3 - highest level since March 2012 and late 2010. This is short-term bearish for equities:** I continue to favor hedging the long-term equity portion of a portfolio with inexpensive put options or some form of volatility risk protection when sentiment reaches the Excessive Optimism zone. Note the performance for the S&P 500 Index (shaded gray areas) when sentiment is excessively optimistic. Source, NDR.



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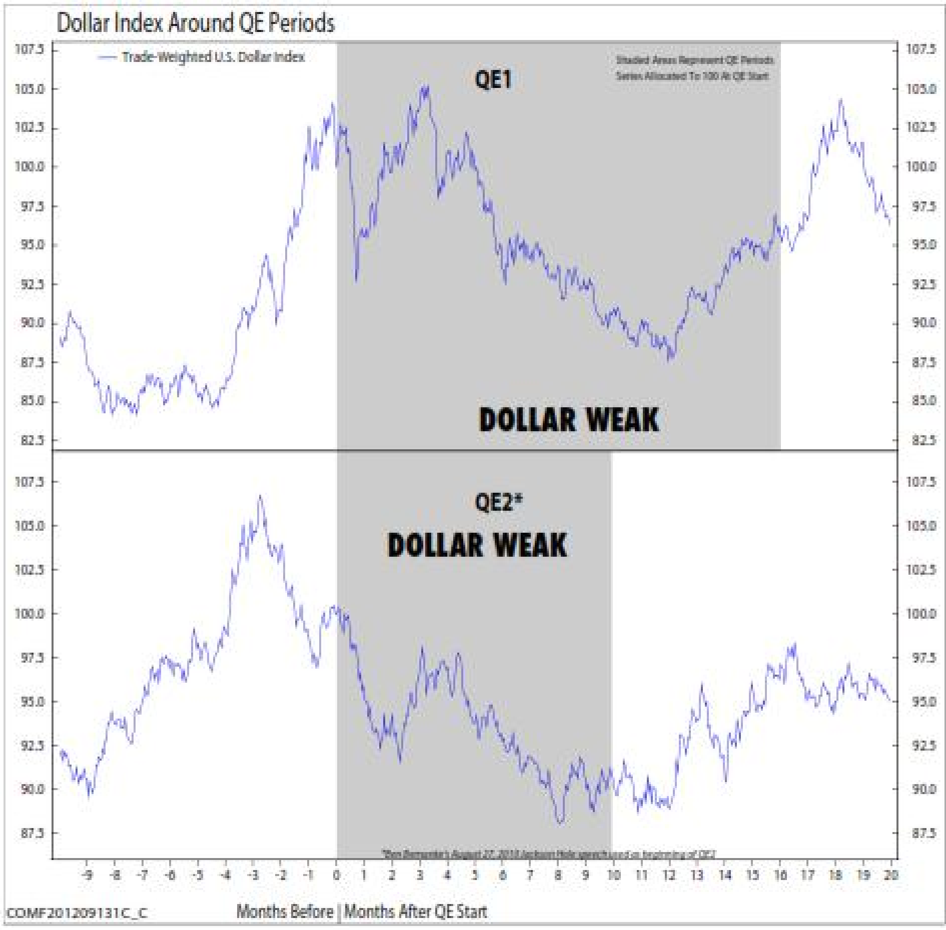
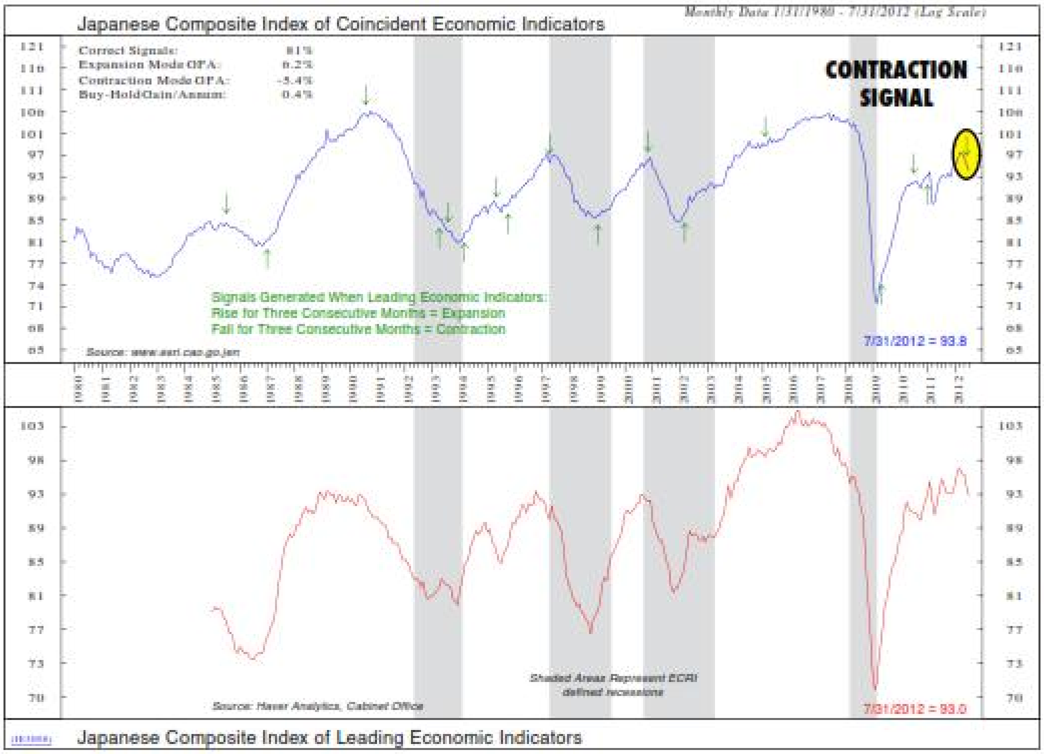
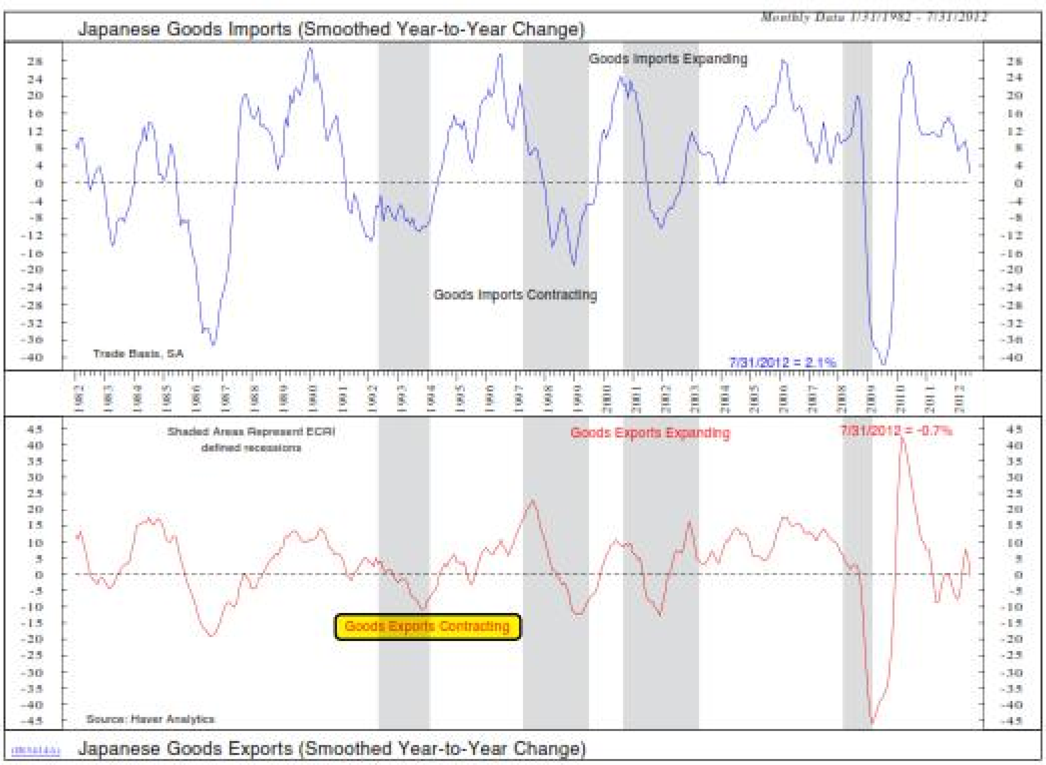
- **QE's Immediate Impact on the Dollar**



- **Japan appears to be heading into a recession.**
  Last week, the Japanese government downgraded its assessment of the economy for the second month in a row. This week, the Bank of Japan did the same. The top chart looks at economic indicators; the bottom chart looks at goods imports and exports. The majority of their exports go to China.





- **Currency Wars:**
  The U.S., E.U. and Japan are all printing at the same time. China is also printing as it fights to peg its currency to the dollar. Each of the major players have a goal to cheapen its currency in order to strengthen its trade advantage. The hope is to grow their way out of the debt crisis. The developed countries are in economic panic mode. In this they are exporting inflation to less developed parts of the world. This certainly favors gold and puts upward price pressure on food and other commodities.

  Watch for trade wars in the form of import tariffs to follow soon. The friction between neighbors will intensify. Quoting Bill Gross, "The age of credit expansion which leads to double-digit portfolio returns is over. The age of inflation is upon us, which typically provides a headwind, not a tailwind, to securities price - both stocks and bonds". I agree.

- **CME Group research piece: Quantifying QE: Fed's Medicine Did the Trick in 2009, New Measures Won't Work Long-Term**
  "Exit strategies from QE by central banks may be extremely challenging to implement and have the potential, if not the certainty, to delay the return to the normal conduct of monetary policy to the detriment of longer-term economic growth, currency values and inflation. That is, the long-term costs to economic activity and financial market stability of QE have the potential to be quite large."

  Jump to page 8 for the conclusions and read backwards from there.
  Click here to read.

With warm regards,

Steve

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