

# Is the Dollar Near Bottom?

(We think so)

December 6, 2004

If ever there was a universal position in the investment community, it's that the dollar is going lower . . . much lower. The Elliott Wave Financial Forecast reports an all-time low in the percentage of U.S. dollar bulls. At the same time, the bullish sentiment on gold, silver, and most all commodities are close to record highs. As we read somewhere in our daily search of economic and market data, the whole world seems to be "long on inflation and short the dollar."

As you know from our prior comments and market decisions, we are very contrary considering both of these positions. There is no question that the U.S., and for that matter the world, is flooded with dollars. The growth in money supply in this country has been greater than real GDP for most of the last ten years, but interestingly enough, the growth in other currencies in respect to their countries' real GDP has been even greater. This simply means that on a relative fundamental basis, the dollar is stronger than most other currencies, especially the Euro. Maybe a better way of saying it is that the dollar is less weak than other currencies, especially the Euro. Now a case can be made that foreign Central Banks may want to diversify their holdings, just as you and we believe it important to diversify our investment portfolios. But that doesn't mean that the world is about to dump the dollar. To do so would be catastrophic for world economic activity and is in absolutely no one's best interest.

On the commodity front, the recent decline in oil from \$55 per barrel to near \$42, we believe is the first step in an overall decline in the huge inflation trade made by Wall Street and especially the hedge funds. In that regard, we think it's entirely possible we will see another hedge fund blow-up such as 1996's Long Term Capital Management fiasco. Market theory has always been that hedge funds were contrarian investors, therefore supplying liquidity to the financial markets – but guess what? A recent study of their action indicates just the opposite. They are momentum investors just like those who brought us the tech bubble of 2000.

Deflation, not inflation, is in our future once this ill-conceived counter trend subsides. Be prepared.