

The Yuan And Commodity-Linked Equities

One of the stranger compulsions traders have is to use the butt-end of screwdriver to drive a nail even when a hammer is readily available. Two of my pet peeves in this regard are trading volatility in lieu of price when price is the actual motivation and trading commodity-linked equities instead of commodities. I suppose trading commodities to express an opinion on inflation or the dollar would qualify as a very large third sore point. My [September 2011](#) warning commodity-linked equities were destined to underperform proved prescient.

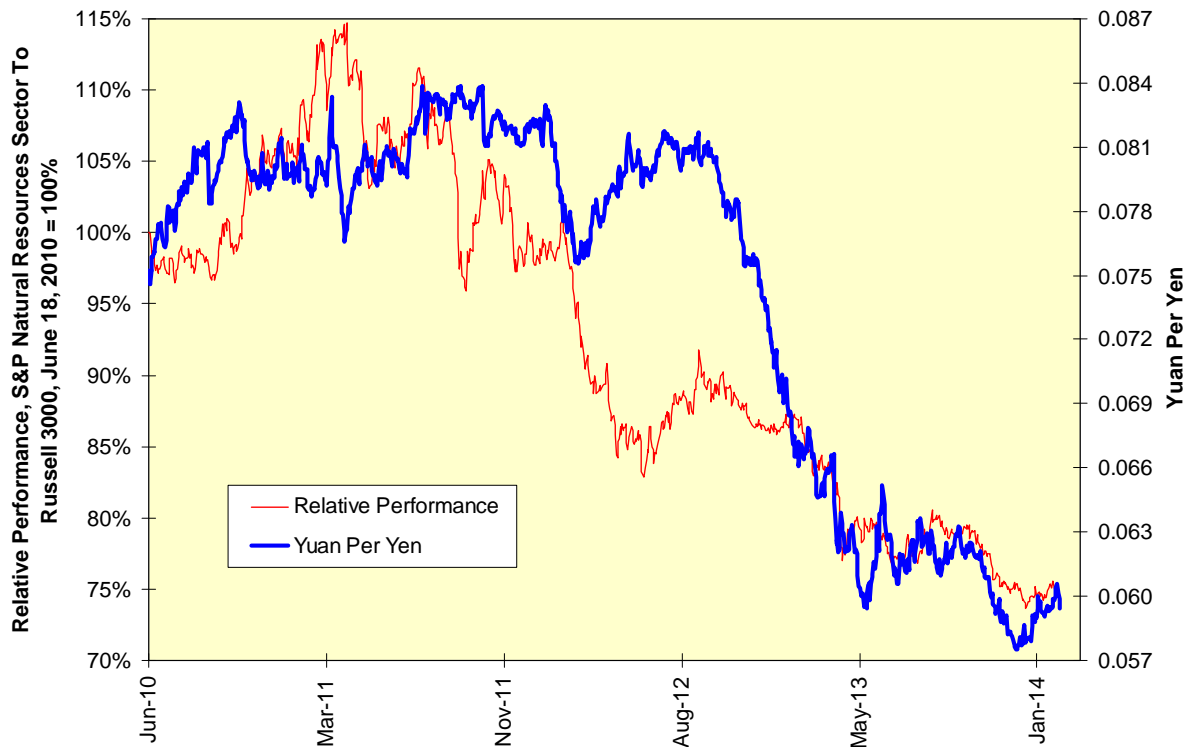
Misdirection From China

One of my conclusions from last week's discussion of the Chinese yuan (CNY) was the only way Beijing could weaken the currency for more than a few days would be to create more of it. Certainly there must be some how-to manuals on this floating around on central-banking Websites after the money-printing extravaganzas of the last five years. If China can agree with Japan on anything it is both want to keep their currencies suppressed on the theory this aids their export sector; I will let the dubious economics of this pass without further comment.

The cross-rate between the yen and the yuan reflects a combination of China's decision to let the CNY revalue for a second time in June 2010, Japan's assault on the yen beginning in November 2012 and ultimately the Chinese policy change from two weeks ago to inject a little two-way risk into the yuan.

The relative performance of commodity-linked equities as measured by the total return of the S&P North American Natural Resources Sector index (SPGSSINR) vis-à-vis the Russell 3000 index (RAY) kept falling as the CNY strengthened relative to the yen; this relationship started out tenuously and then became very direct by the end of January 2013. The r-squared, or percentage of variance explained, has been 0.80 since then.

CLE Relative Performance Bottomed Shortly After JPYCNY Peak



The relative performance of the resource sector bottomed on January 15, 2014; the JPYCNY peaked right at the beginning of the year and the CNY peaked against the dollar on January 14, 2014. While this may prove to be coincidental, previous periods of strong relative performance by commodity-linked equities have been associated with structural changes in monetary policies; the biggest one of these to-date was the May 2003 declaration of war on deflation by the Federal Reserve. The Basic Materials and Energy SPDR (XLB and XLE, respectively) returned 107.% and 203.15% between May 2003 and August 2007 as opposed to 64.15% for the S&P 500 as a whole.