



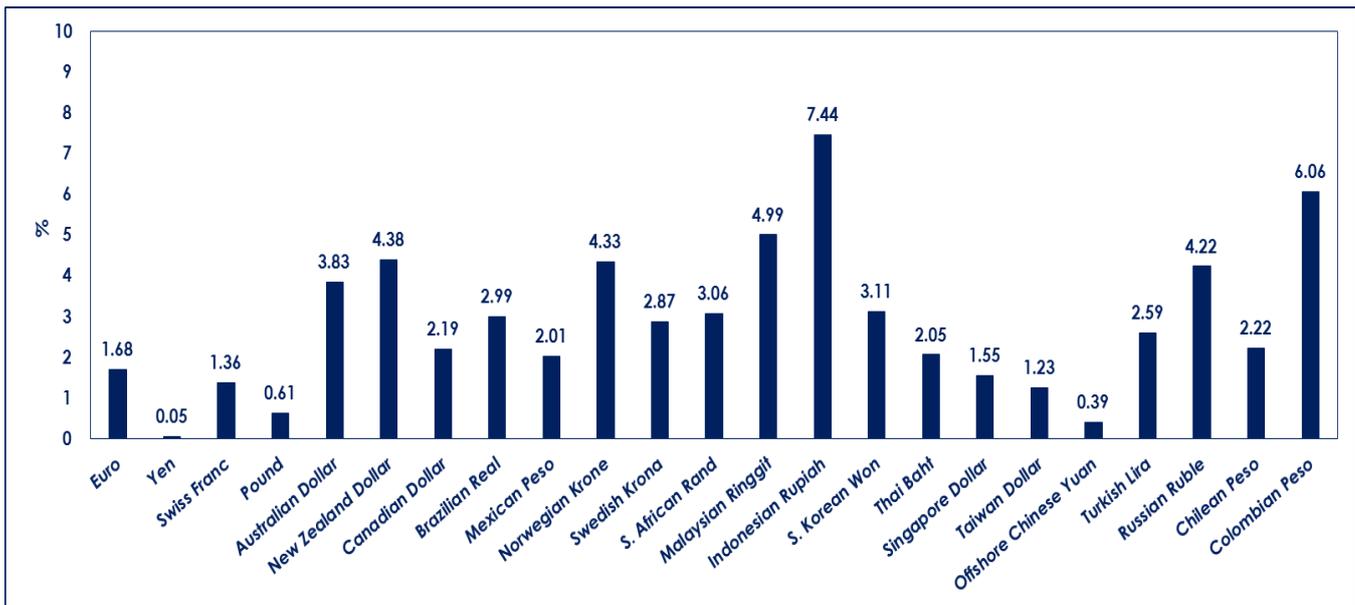
US Dollar - Commodity - EM Feedback Loop Has Reversed

The feedback loop that has operated in recent months between US Dollar (USD) strength, falling commodity prices and weak emerging market assets has reversed in October. The strength of the reversal leads us to believe that the USD has peaked, at least in the short to medium term. The corollary is that commodity prices and emerging market asset prices have bottomed for now.

The USD bull market of the last year has coincided with a slowdown in China's appetite for raw materials. Together these factors have combined with excess supply in many commodity markets to drive prices to multi-year lows. This has pressured the economies of commodity exporters and led to outflows from emerging market assets. This in turn has led to further USD strength.

USD strength, falling commodity prices and emerging market weakness have fed back into the United States through exports, import prices and financial market linkages to the point where the Federal Reserve held off from beginning policy normalisation in September, citing 'global economic and financial developments'. This decision was subsequently reinforced by the weak September employment report on October 2nd. The response to the employment report has been a sharp relief rally in commodities and emerging market currencies, bonds and equities as an imminent US interest rate rise appears increasingly hard to justify. The violence of the move has been fueled by the strength and duration of the prior trend.

Chart 1: Percentage Change versus USD in October to date



Source: Bloomberg, Three Rock Capital Management

For now we interpret this reversal as a short covering rally but a meaningful one which is likely to persist for several weeks at a minimum.

Conor O'Mara,
Chief Investment Officer,
October 13th, 2015

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