KAIZEN GLOBAL
Investments

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Could the Australian dollar fall to 50 cents against the US dollar again?

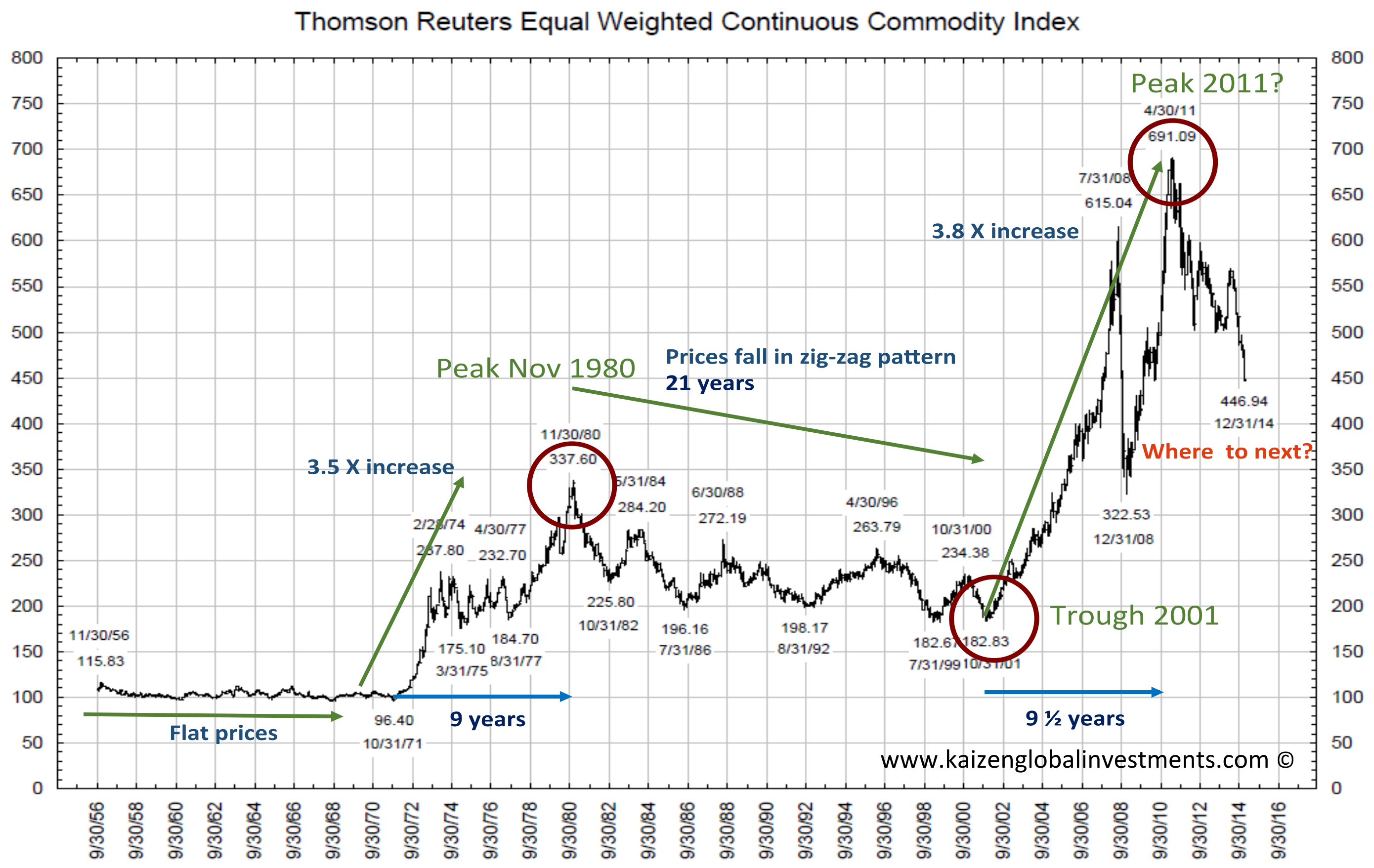
The Australian economy is linked to the fortunes of commodity prices, and this flows through directly to the currency.

When demand is greater than supply, commodity prices rise and this lifts the currency. When supply catches up and exceeds demand, prices fall – irrespective of export volumes – and the currency falls. We believe that history repeats and that this is happening again. We explain why below.

A look back at commodity cycles

The chart below is an index of commodity prices from 1956 to 2015. Typically commodity bull markets experience large (3-4x) increases, which last for a decade and are then are followed by periods where prices do nothing, or fall.

From 1956 to 1971 (15 years) prices remained largely range bound. But in the commodity boom of the 1970s, they rose sharply. The index rose by 3.5 times in value from October 1971 to November 1980 (over 9 years). It then fell for the next 21 years, in a zig-zag fashion, by almost 46% and bottomed in October 2001. In the next commodity boom, which started in October 2001, prices once again rose sharply and the index rose by 3.8 times in value (over 9 ½ years), peaking in April 2011.



Q: How did the Australian dollar behave over this period? **A:** **It fell 60% against the US dollar.**

The chart below shows the Australian dollar against the US dollar over a 30-year period. Notice how it peaked at $1.18 in January 1981 – 2 months after the commodity index peaked in November 1980. **Coincidence?** Notice then that the Australian dollar then **fell by 60%** in value over the next 20 years to trough in April 2001 and at its weakest, 1 Australian dollar only bought 48.3 US cents. The commodity index troughed in October 2001. **Coincidence?** We don't think so.

The Australian dollar then strengthened over the next ten years and **peaked in July 2011** when 1 Australian dollar bought 1.10 US dollars. The commodity index peaked two months prior, in April 2011. We find this pattern remarkable. The conclusion we draw from this data is that the Australian dollar could fall back to 50 cents (or lower) to the USD over a 10-15 year period and Australian investors should **buy international assets to protect themselves against the fall**.

Source: Bloomberg, Kaizen Global Investments

But, China is growing and needs our commodities

This is true, China will grow over the coming decades and it will consume our commodities, but **don't confuse increases in volume** (tonnes of coal and iron ore) with **increases in price** (per tonne). The high prices of the 2000 bull market, just like in the 1970s, spurred commodity producers to invest heavily and **increase supply**. When supply exceeds demand, prices fall. We believe that is exactly what is happening today. In addition, the World economy is much weaker than forecasters thought in 2007 (consider BHP, Rio's performance), so the expected **demand has not materialised** but the increase in supply has.

What if the Australian dollar does fall to 50 cents? What could investors in Australia do to benefit?

The average Australian Self-Managed Superannuation Fund (SMSFs) has less that 2% of its assets in international equities despite those markets making up 97% of the investable universe. A falling/weakening Australian dollar would benefit the Australian dollar value of the shares held internationally, but since this is such a small percentage in SMSFs, it really wouldn't help their overall assets much at all. In order to address this balance, superannuants could directly buy shares internationally, or buy into funds or listed investment companies that offer geographically well diversified global/international exposure.

Kaizen Global Investments offers both SMSFs and all investors the opportunity to diversify globally and hedge against a falling Australian dollar.

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