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DJIA	11,200.68		NASDAQ	2,497.07		S&P 500	1,189.95		10 yr Note	2.51%		Gold (Dec)	1,334.90		Oil (Dec)	82.25		FTSE 100	5,751.56
+68.12	+0.61%		+17.68	+0.71%		+6.87	+0.58%		-0.04	-1.57%		+9.80	+0.74%		+0.56	+0.69%		+10.19	+0.18%

How to Profit From a Weak Dollar: Bet on Commodities

By PETER COHAN Posted 6:00 AM 10/23/10 Investing, Investing Basics, Currency
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The dollar's value has dropped in recent years thanks to what investors believe is a vulnerable U.S. economy. Of course, the U.S. balance sheet has been under attack since 2001, when President Bush and congressional Republicans in Washington passed $2.5 trillion in tax cuts and nearly doubled the national debt from $5.6 trillion in 2000 to $10 trillion in 2008.

But lately, market watchers have been proclaiming the end of the dollar even more loudly -- thanks largely to U.S. dependence on China to finance our debt, and our clear future of annual deficits. For many investors, the question in this environment has been whether to bet on stocks, which have fallen 17% in the last decade, or to stay "safe" in money market funds yielding 0.4%. But there's a third way that could help the average investor: Placing bets on commodities through commodities mutual funds and ETFs.

And commodity prices have gone up quite dramatically -- particularly in recent weeks. As I wrote this week on *DailyFinance*, gasoline, oil, corn, cotton and wheat have all experienced price spikes, to name just a few that are likely to cut into consumers' budgets. Corn is up 25% in the last two weeks on strong demand and a smaller-than-expected harvest and it has spiked 54% in the last year. Cotton recently hit a 140-year record high and gasoline prices are up around 20 cents a gallon in the last few weeks as oil prices rise and traders expect new regulations that will boost the proportion of corn-based ethanol in gasoline from 10% to 15%.

Three Reasons For Rising Commodity Prices

To understand why commodity prices have gone up, you need to understand the supply and demand both for the underlying commodity and the currency in which it is traded -- and in many cases that currency is the dollar. As the dollar drops, the price of commodities traded in dollars goes up.

What is driving the dollar down? One factor could be China's currency policy. According to *The Washington Post*, China "pegs its renminbi to the dollar at a rate considered well below its true value, a policy that boosts its exports and arguably gives the country a global trade advantage." Another factor could be hedge funds shorting the dollar and buying dollar-denominated commodities, as *Fortune* reported in 2006. And a third could be the voices of doom seeking to create fear that they can translate into midterm election gains (such as Glen Beck and his sponsor, Goldline).

Those voices get intellectual ballast from Washington think tanks -- one of which argues that China's currency policy creates trade surpluses thanks to U.S. consumer purchases of its low-priced products which China invests in U.S. Treasury Securities. As Jim Dorn, a vice president at the Cato Institute, explained in an Oct. 20 interview, "China has $2.6 trillion in reserves mostly in U.S. Treasury securities. But the value of its holdings are dropping due to the weak dollar and it is worried that they could plunge if the Fed raises interest rates to fight inflation."

In fact, this catch-22 makes U.S. bonds a risky bet for China under almost any circumstance. If the dollar drops in value due to low interest rates and loose monetary policies, then when China gets its dollar-denominated interest payments, they are worth less when translated back into the higher-valued renminbi. But if the Fed raises interest rates, it would cause the value of those U.S. bonds to plunge, because bond prices move down when interest rates move up. A slightly offsetting factor is that if the Fed raised rates, it might strengthen the dollar, so as long as the Chinese held onto the bonds, the interest payments would be worth more. But the only scenario under which ownership of U.S. bonds would be good for China is if Dorn is wrong and deflation starts to take hold here. Then, the value of the bonds would rise. But deflation would be a real catastrophe for the U.S. economy.

For all of these reasons, China is taking steps to shift some of its holdings out of the dollar. According to Dorn, "China is responding by buying more Japanese bonds and finding other ways to diversify away from U.S. government securities."

Meanwhile, the Fed's moves to increase the money supply to boost the U.S. economy could cause inflation to exceed the Fed's target range. As Dorn argued, this could lead to much higher U.S. interest rates as the Fed switches gears to fight spiking prices, which would further drive down the value of Chinese holdings. The result would be much higher interest rates and a weaker dollar as the U.S. tries to sell $10 trillion worth of government bonds over the next decade to finance its budget deficits.

How Keep Ahead of a Falling Dollar

Investing in individual commodities is very risky. But there are diversified Commodity Exchange Traded Funds (ETFs) and mutual funds that might be worth considering. Here are four ETFs about which SeekingAlpha posted:

- iShares GSCI Commodity-Indexed Trust ETF (GSG). Expense ratio: 0.75%, 12 month return: -8.12%
- iPath Dow Jones-AIG Commodity Index Total Return ETN (DJP). Expense ratio: 0.75%, 12 month return: 4.05%
- iPath S&P GSCI Total Return Index ETN (GSP). Expense ratio: 0.75%, 12 month return: -6.44%
- PowerShares DB Commodity Index Tracking Fund ETF (DBC). Expense ratio: 0.85%, 12 month return: -0.32%

And diversified commodities mutual funds include:

- Fidelity Global Commodity Stock Fund (FFGCX). Expense ratio: 1.42%, 12 month return: 10.24%
- PIMCO Commodity Real Return Strategy (PCRAX). Expense ratio: 1.24%, 12 month return: 2.78%

If commodity prices keep rising, these funds might help you keep up or even profit. Of the ones mentioned, the Fidelity fund has done the best -- but it has a high expense ratio. Keep in mind though: At some point, the hedge funds are going to reverse their trading patterns to take their profits. If that happens, the dollar could rise and commodity prices would plunge.

As an investor, you have to decide whether the risk of missing out on profiting from a further decline in the dollar is greater than the chance that you might be getting in at the top.

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Peter Cohan is a columnist for DailyFinance. He is president of Peter S. Cohan & Associates, a management consulting and venture capital firm. His ninth book, co-authored with Professor U. Srinivasa Rangan, is *Capital Rising: How Global Capital Flows are Changing Business Systems All Over the World*. *The Achiever Newsletter* ranked his eighth book, *You Can't Order Change: Lessons from Jim McNerney's turnaround at Boeing*, as the #1 business book of 2009. He teaches business strategy to undergraduate and MBA students at Babson College and has also taught at Stanford, MIT, Columbia, and the University of Hong Kong. He has appeared on ABC's "Good Morning America," CNBC, CNN, Fox Business News and the Boston ABC and CBS affiliates. He has been quoted in *The New York Times*, *The Wall Street Journal*, *Bloomberg News*, *Time*, *Newsweek*, *Fortune*, and *Business Week*.

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