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Market Facts

Commodity-Currency Correlation Not Very High

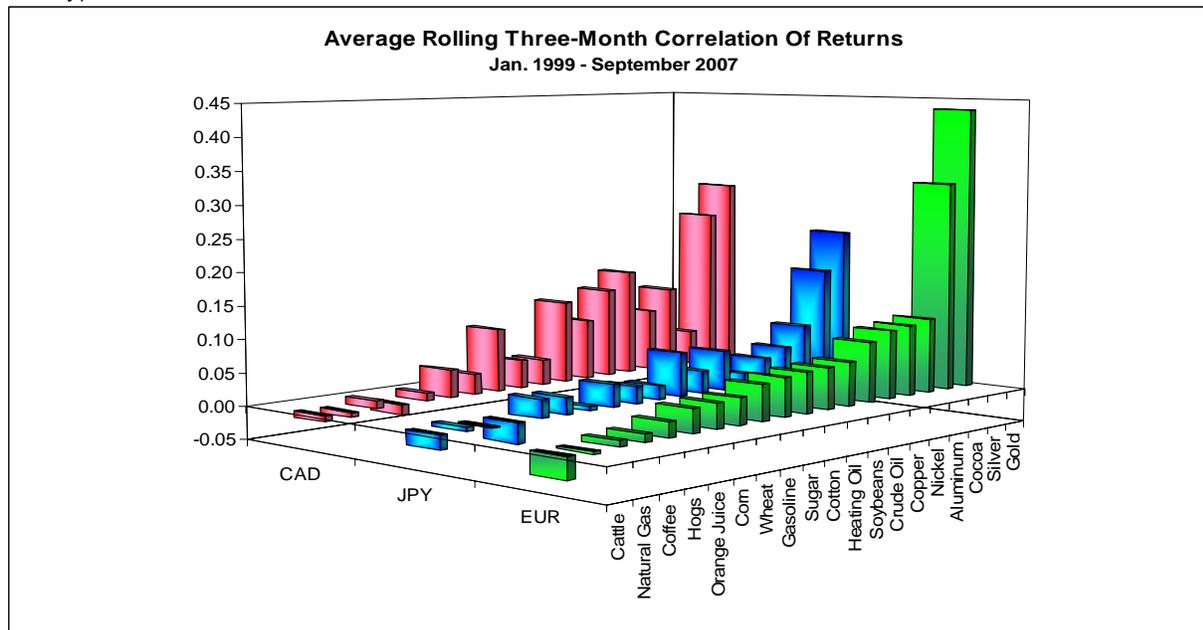
By Howard L. Simons (847) 304-1511

September 26, 2007

We expressed our displeasure with the inflationary implications of the Federal Reserve's rate cut last week in a recent [Commentary](#). However, we refuse to be drawn into the trap of equating moves in individual currencies such as the euro, Japanese yen or Canadian dollar (green, blue and red columns, respectively) with concomitant moves in various

individual commodities, such as the nineteen depicted below.

To acquiesce in such an unstudied response would repudiate the conclusion of an April 2005 [Market Facts](#) arguing against commodity indexation.



Discussion And Conclusion

The commodities depicted above are cash prices with the exception of orange juice; this allows us to sidestep the dislocations from contract rolls and the effects of forward curves on commodity index returns.

The rolling correlations of returns actually overstate the statistical quality of fit between the individual currencies and commodities; the variances of individual regression variances are highly non-stationary and exhibit trends in their means. This is glossed over in the averaging process.

With the exception of the two monetary metals, gold and silver, none of the correlations rise to the level of statistical significance. Moreover, many of the long-term average correlations for cattle, natural gas, coffee and hogs are near-zero or negative.

Wishing a relationship to be true does not make it true. Just because it seems logical for an increasingly debauched dollar to command fewer units of a physical commodity is insufficient; the assertion must be proven with the data so readily available. Failing that, the discussion should be restricted to the relationships between individual commodities and individual currencies and not brought up to the aggregated level of indices.

If we do step up to the index level and change the metric from currencies to inflation, we get a result similar in tone to the poor relationship above. If we rebase the Reuters/Jefferies CRB index deflated by the Producer Price index to September 1971 = 100%, it stood at 78.5% at the end of August 2007. Just because the paper is worth less does not mean the paper price of stuff will rise proportionately.

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