

Samson Multicurrency Plus Strategy

Executive Summary

In our last commentary we offered that the major free float currency markets would remain in a tug of war:

- The dollar would rally and the yen would outperform when stocks fell and the Eurozone debt crisis moved to the fore.
- The dollar would likely fall when stocks stabilized, the demand for safe haven assets diminished, and the market focused on a Federal Reserve on hold.

At the start of the 2nd quarter our position reflected a belief that monetary and fiscal stimulus will work over time (our overweight towards commodity currencies), that safe haven moves would nonetheless occur (a modest overweight to the yen as an insurance policy and stabilizer), and concerns about the euro would remain considerable (a large underweight to the euro).

For the first half of the year a rally in the dollar led to a -5.16% benchmark return. Though we have largely performed in-line with the benchmark throughout the year, our decision to reduce exposure to the yen in the last weeks of the quarter proved to be a drag on performance as one more equity market swoon propelled the yen to new highs in the last days of June. Our June decision to move to an underweight position in the yen, the first in a very long time, reflects our growing confidence in resolution of the Eurozone debt crisis (and so we increased euro exposure) and signs of economic slowdown in Japan (and so we decreased yen exposure).

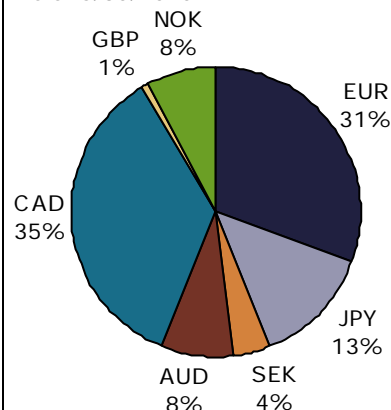
	SMP Target Exposure		Fed Majors
	3/31/10	6/30/10	Index
Euro	26%	30%	37%
Japanese Yen	23%	13%	17%

Strategy Discussion

The charts on the next page depict how the tug of war between risk taking and risk aversion themes influenced the currency markets. From the middle of April through late May, stocks fell and the dollar rallied. As stocks stabilized and rallied from late May through the third week of June, the dollar correspondingly fell. In our prior commentaries we have offered that a view on the direction of the dollar can be an important component to shaping an overall posture towards asset allocation and sector allocation and the 2nd quarter proved to be a microcosm of this concept.

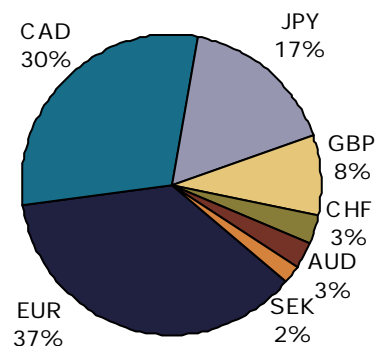
SMP Target Exposure

As of 6/30/2010

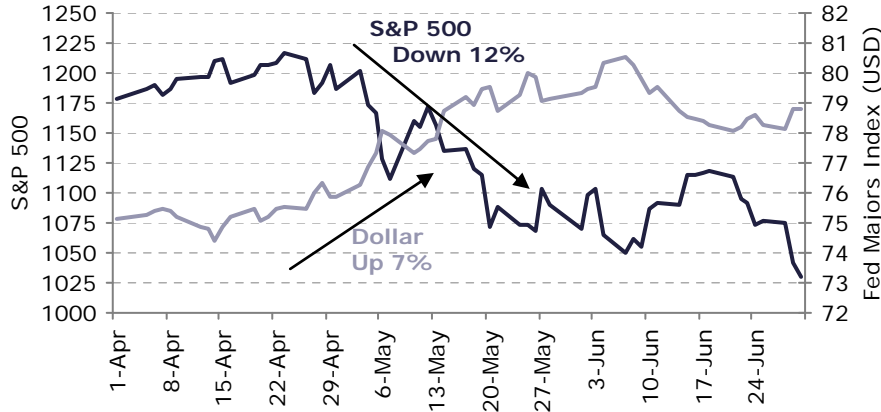


Federal Reserve Trade Weighted Majors Index Currency Exposure

As of 6/30/2010

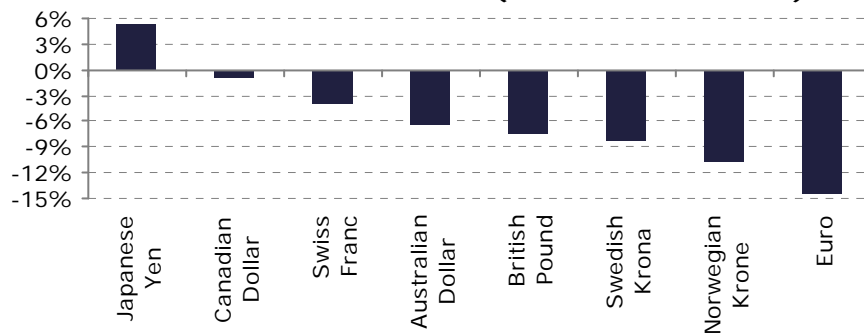


Relative Performance of Stocks and the U.S. Dollar



The Eurozone debt crisis had a major impact on the performance of the euro during the first half of the year. As the chart below on currency returns shows, the euro was the worst performing currency for the period.

Relative Performance of Currencies (12/31/09 – 6/30/10)



We entered the quarter with a significant underweight towards the euro relative to our benchmark. Our decision to maintain an underweight posture was based on our consideration of the Eurozone debt crisis, but also on the types of longer-term macro inputs that are part of our investment process: relative central bank policy analysis and relative growth rates. Yet, the underperformance of the euro relative to our solution set of investable currencies was influenced by factors well beyond the traditional inputs to a currency selection process. A considerable amount of the decline can be attributed not only to the loss of confidence in the ability of the governments of Europe to deal with the debt crisis (fundamental), but the hyperbole used by many market strategists and journalists about a possible collapse of the euro as a currency (speculative).

We have repeatedly argued that the collapse of the euro was unlikely and, in our last commentary, we noted that we were looking to bring our exposure to the euro closer toward neutral as our internal models were suggesting it had reached an oversold condition. Our statistical model evaluates each currency's movement against a the movement of a variety of other market priced indicators (for example, rates, stocks, and the relationship between puts and calls of a currency) and determines if the currency is overvalued or undervalued. Fundamental news is the trigger for acting on this evaluation. In the middle of May the European Union and the International Monetary Fund announced a nearly one trillion dollar bailout plan for EU member

The Federal Reserve Trade Weighted Major Currency Index is a weighted average of the foreign exchange values of the U.S. dollar against a subset of currencies in the broad index that circulate widely outside the country of issue. The weights are derived from those in the broad index. The broad index is a weighted average of the foreign exchange values of the U.S. dollar against the currencies of a large group of major U.S. trading partners. The index weights, which change over time, are derived from U.S. export shares and from U.S. and foreign import shares.

The U.S. Dollar Index® is composed of a basket of the world's major currencies. The currencies that make up the U.S. Dollar Index are representative of America's major trading partners and currently include euros, Japanese yen, British pound, Canadian dollars, Swedish kronas, and Swiss francs. The relative weighting of a particular currency in the index reflects the amount of trade the U.S. does with that country. U.S. Dollar Index® and USDIX® are trademarks and service marks of the New York Board of Trade®.

countries in danger of default. This was the fundamental confirmation we waited to see before reducing our underweight to the euro. By the end of June we had raised our exposure to the euro to a more modest underweight. We will look for signs of firming in the Eurozone economy before bringing our exposure to the euro above neutral.

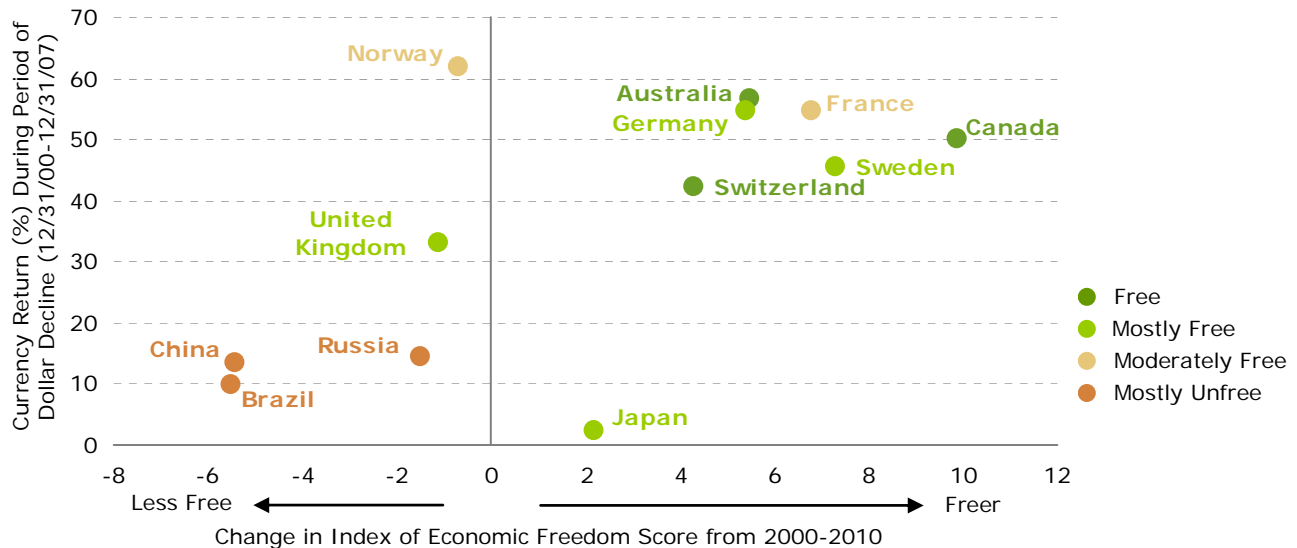
Focus on Free Float, Major Currencies

In our last commentary, we discussed our preference for investing in free float currencies. We reminded readers that although it is fashionable to discuss the inevitable appreciation of China’s currency, waiting for the currency to appreciate is not only frustrating, but, in our view, a speculation. After all, what investment process can be constructed to determine how the currency will go up, or down, when its value is determined in an opaque fashion by the unelected leaders of a one party state? The recent decision by China to revalue the currency at the time of the late June G-20 economic conference highlights the political character of how the currency is managed, and the meager return speculating on such an event offers. There has been considerable political pressure on China to allow its currency to strengthen against the dollar. President Obama and other world leaders have essentially demanded it. China’s response was telling: currency controls were relaxed, world leaders applauded, and China’s currency has now appreciated from 6.83 to the dollar as of the end of 2009, to 6.77 at the time of this writing. Currency controls have again tightened, and the yuan has crept into a new trading range approximately a thimble stronger than it was before the summit.

The small scale of China’s revaluation should not have made headlines, or surprised any investors. The past decade has shown China’s currency will change in value when its government decides the time is right (a political decision). Yet, this reality has not stopped investors from pouring their capital into ETFs and structured notes linked to the returns of China’s currency. This is the big story: despite the facts, investors still hope China’s leaders will make them rich by allowing the yuan to appreciate against the dollar. In the meantime, these investors have missed meaningful rallies over the past decade in the major currencies.

While the rationale for our skepticism towards a yuan rally should already be clear, we would like to offer another freedom. The Heritage Foundation maintains an Index of Economic Freedom and it provides a useful springboard for examining this issue. This foundation has done very interesting research on the correlation between economic freedom and income levels. Generally speaking, the freer the economy, the more affluent the society. For example, though income levels in China are rising, Heritage Foundation research suggests they would likely move even higher on a GDP per capita basis if the people enjoyed greater economic freedom. Stimulated by the research conducted by the Heritage Foundation, we have examined currency returns in the context of the Index of Economic Freedom. The chart below compares currency returns for a select group of currencies with changes in economic freedom over the 10-year period 2000 to 2010.

Currency Returns versus Change in Economic Freedom



Generally speaking, the more economically free a country became over the decade, the more likely its currency was to generate a positive return vs. the dollar during a period largely characterized by dollar decline. While there are many factors that go into making a currency investment, we should not lose sight that one consideration should be the freedom of its people.

Looking forward, we will continue to conduct research into the relationship between freedom, how freely a currency floats and currency returns.

Jonathan E. Lewis
Principal

July 23, 2010

For questions, please contact Radiance S. Chapman at 212-300-1600, or chapman@samsonca.com.

Data Sources: Bloomberg® Terry Miller and Kim R. Holmes, 2010 Index of Economic Freedom (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2010), at www.heritage.org/index

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