SAMSON
CAPITAL ADVISORS

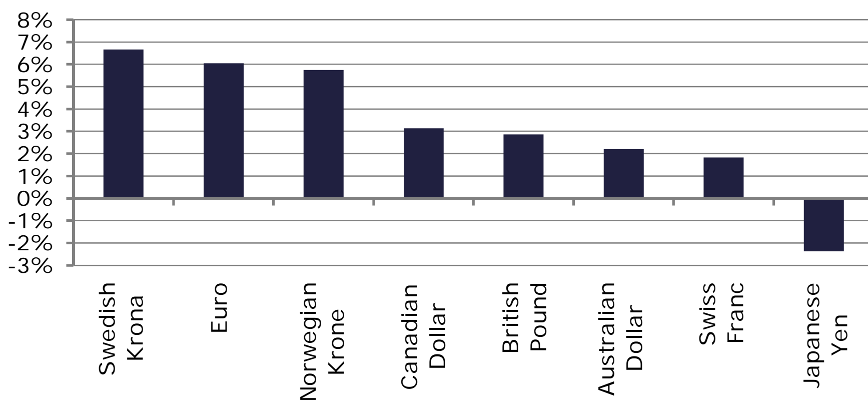
Samson Multicurrency Plus Strategy

Strategy and Performance Review

Our strategy was positioned at the start of the year for a continued recovery in the euro and underperformance by the Japanese yen. Indeed, the euro continued to strengthen as the market came to embrace our view that crisis in the peripheral nations would not destabilize the Eurozone, or lead to the end of the euro as a currency. The yen, despite a brief safe haven rally, fell by the end of the period.

Other aspects of the strategy did not fare as well in the first quarter. Our strategy also tilted towards global growth with an emphasis on the major commodity currencies in our benchmark. The Canadian dollar and Australian dollar, two of our larger overweight positions when we entered the quarter, rose in value for the period but underperformed the broader benchmark. Our overweight to the British pound, supported by our view that fiscal reform, economic recovery, and the inevitability of rate hikes would lead to outperformance, lagged the benchmark though it too generated a positive return. These overweight positions were the major contributors to our underperformance for the period.

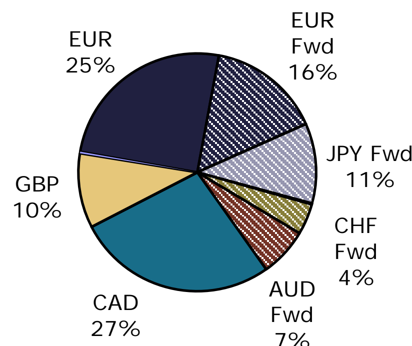
Relative Performance of Currencies (12/31/10 – 3/31/11)



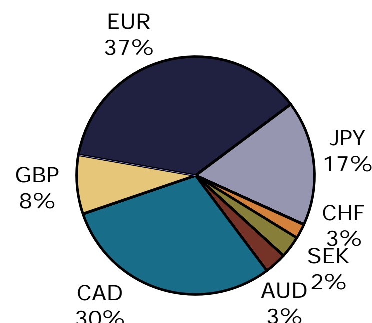
Our strategic positioning entering the second quarter reflects several main themes:

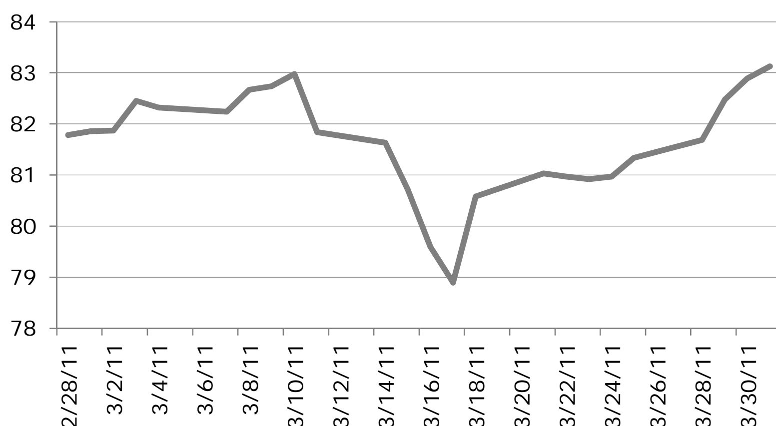
1. We believe the yen's role as a safe haven currency that rallies significantly during times of turmoil has essentially ended. Our thinking on this point, largely based on the G-7 currency intervention that ended the yen's rally after the earthquake and tsunami struck, is outlined in our recent research piece. "The Changing World of Fixed Income and Currency Safe Havens." The chart on the next page shows the decisive impact of the first G-7 intervention in over a decade. We feel it is clear, monetary authorities will not permit the yen to appreciate that sharply again.

SMP Currency Exposure
As of 3/31/11

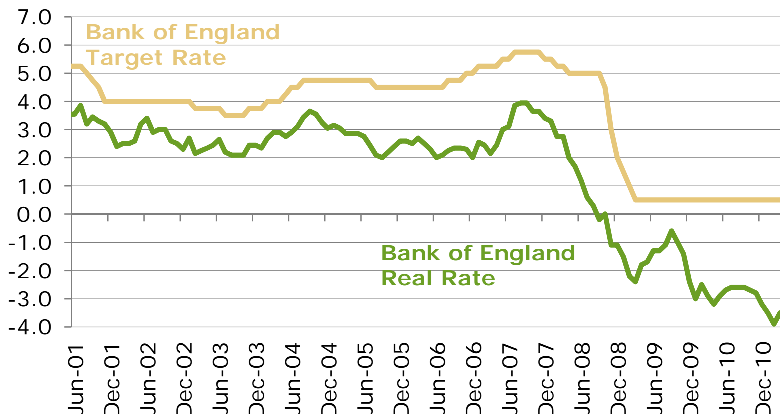


Federal Reserve Trade Weighted Majors Index Currency Exposure
As of 3/31/11





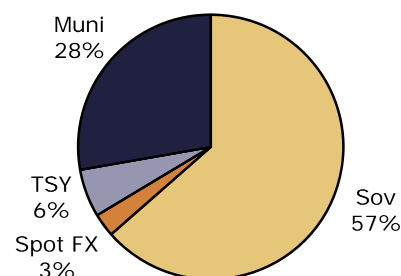
2. It is our position that the Bank of England will be forced to tighten as inflation remains above its official 2% policy target. The chart below shows the acceleration in UK inflation that has occurred and the growing gap between inflation and the Bank of England's monetary policy.



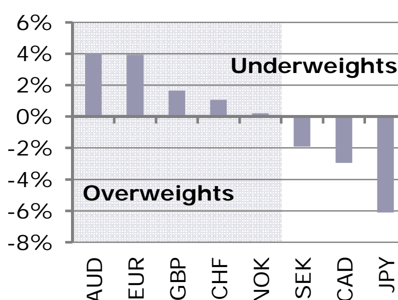
3. In our view, the Swiss franc is the only major currency left to step into the shoes of the yen as a safe haven in the short term. Though we have argued in the past that the strong financial systems of both Canada and Australia leave them positioned to assume such a role, their significant commodity links continue to overshadow the safe haven feature of the currencies. We will likely continue to build healthy Swiss franc exposure both to replace the role played by the yen, and due to the steady growth in Switzerland, a major beneficiary of recovery in Europe.

4. Central bank policy is again emerging as the major theme in currency investing rather than the kind of "risk-on"/"risk off" rotation that has dominated currency markets since the 2008 crisis. We believe this is positive as it suggests economics and market price action are embracing recovery. In this context we are likely to be adding to other currency positions tied to central banks that are raising rates.

SMP Sector Distribution
As of 3/31/11



SMP Current Weights
As of 3/31/11



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 USDX® are trademarks and service marks of the New York Board of Trade®.

Looking Forward

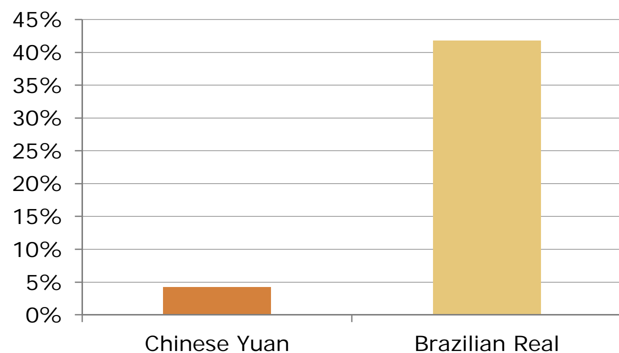
What does it mean when one of the world's most important voices for free market reform and freely convertible currencies changes its mind?

It's a trend change.

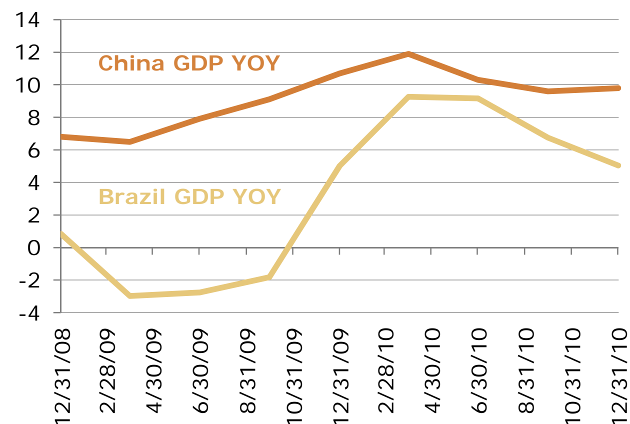
For decades, the International Monetary Fund has argued that the best way for developing and developed countries alike to support healthy growth was to allow their currencies to be freely convertible and to allow free market forces and free capital flows to drive local economies. This month the IMF has announced that it may be prudent for countries to use capital controls so that local economic growth is not distorted when waves of foreign capital flood an emerging economy seeking high rates of return. This new approach at the IMF, with detailed recommendations about ways to impose currency controls, is an understandable attempt to be a more relevant part of the policy dialogue in the emerging economies of the world.

Yet, if a trend change is upon us, what does it mean for currency investing? For those invested in currencies tied to emerging economies it will be a period of watchfulness. Countries want to control capital flows from distorting the value of their currency. If there is too much capital flooding into a country, the currency strengthens and exports become too expensive abroad. This would lead to a slowdown in an economy that is export oriented, not a good policy outcome. While this is a simplification of the reasoning behind currency controls, it highlights a key point: sometimes a nation with a freely convertible currency can lose control over its own policy agenda. This is why, of course, the People's Republic of China has not allowed its currency to be freely convertible, let alone to strengthen materially. The chart below compares the performance of the Brazilian real with the Chinese yuan since December 31, 2008. It also shows their comparative GDP growth rates.

Currency Return (12/31/08-3/31/11)



GDP Growth Rates (12/31/08-12/31/10)



Brazil has largely allowed its currency to float: the real has strengthened and growth has decelerated. China does not allow its currency to float: its growth rate far surpasses even Brazil. This has likely not been lost on Brazil, which is increasingly looking to use capital controls. Needless to say, it is unclear how far Brazil will move toward controlling capital flows, but if you were choosing between policy examples as the leader of an emerging economy, which example would you follow if all that concerned you was growth, Brazil or China?

It is too early to come to any hard conclusions about how this trend change may impact currency investing, but it does raise a series of related questions:

1. Currency investing provides diversification benefits only if currency values fluctuate. If emerging market currencies become less likely to move due to controls, what does this mean for the diversification benefits of those currencies?

2. If currency investors become concerned about capital controls in emerging market currencies, how will that impact emerging market bond and equity performance?
3. How will any such policy change actually impact the growth of emerging market nations? And, consequently, world capital flows?

Though it may be too early to offer answers to these questions, certainly the time to think about them has arrived.

Jonathan E. Lewis

Principal

April 20, 2011

Data Sources: Bloomberg®

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