Dear Clients and Friends,

Once again, the equity markets are experiencing a summer malaise of extreme volatility and little volume. While there are many headlines, both positive and negative, that are driving global markets in the short-term (e.g. lower unemployment, stronger housing, looming fed rate hike and lower oil) the most derisive issue is the recent devaluation of the Chinese yuan.

Due to the recent global market volatility and downright confusion resulting from China's currency policies, Locust Capital has decided to summarize the key issues surrounding this topic.

What Occurred

- On August 11th the People's Bank of China (PBOC) made a significant shift in how it manages their currency (the yuan). It now sets the yuan's daily fixing to the U.S. dollar based on the currency's closing level the previous day.

- However, the PBOC is not going to lose total control over their currency. The yuan can only trade two percent above or below the fixing level.

- The answer to why China's government devalued its currency is a source of continued debate among economists. China has a reputation of providing limited transparency on their policy decisions.

U.S. vs. China Currency Impact

- The move has been explained as a key reform that allows the market to steer their currency's value.

- China has been often accused of controlling its currency to help their exporters at the cost of other nations.

- China still manages the exchange rate within a range against the dollar and hence, the currencies are strongly tied.

- The U.S. dollar has risen rapidly against world currencies due to quantitative easing programs in the Eurozone and Japan.

- Devaluing the yuan most likely has more to do with the dynamics of global currency markets than a sudden urge to help Chinese exporters make their goods cheaper in the world market.

- Currency experts believe that China is attempting to manage the pace of trade-weighted yuan movement.

- If China had severely devalued the yuan, it would become clear that they are intentionally sabotaging their currency in order to bolster their exports. A two percent devaluation is vastly different: it keeps the yuan more in line with its trading partners' currencies, which have lost value relative to the U.S. dollar.

Political Impact

- By coincidence or not, the devaluation came days after data showing a big fall in exports. By weakening the currency, the thinking is that shipments will increase and jump start the economy.

- China wants to avoid a trade war with the U.S. Otherwise, it would have severely weakened the currency (see above comment). It also wants to boost the international use of the yuan for political purposes.

- Central to the devaluation is a bid to have the yuan accepted by the International Monetary Fund into its basket of reserve currencies. This would place the yuan on par with the dollar, euro, yen and British pound and also augment China's global stature.

In summary, we expect currency volatility and potential market volatility will prevail until China provides more substantive guidance. Unfortunately, the signs of a continued strengthening of our domestic economy have been temporarily washed out by this unforeseen and headline grabbing decision. Like many short term events, this too shall pass.

We hope you have a great end to the summer.

Best Regards,

Locust Capital Management, LLC