



Black Swan Capital

# Currency Currents

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Thursday 18 June 2009

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## Key News

- [World Bank Raises Forecast for China](#) (WSJ)
- [BRIC Dollar Bonds Beat Ruble, Real, Yuan Debt as Medvedev Blasts Currency](#) (Bloomberg)
- [Wall Street afternoon rally peters out](#) (Financial Times)
- [China bulls will be let down](#) (Financial Times)

Key Reports Due (WSJ):

**8:30 a.m. Initial Jobless Claims For June 13 Week:** Expected: +9K. Previous: -24K.

**10:00 a.m. June Philadelphia Fed Business Index:** Expected: -18. Previous: -22.6.

**10:00 a.m. May Conference Board Leading Indicators:** Expected: +1%. Previous: +1%.

**10:00 a.m. DJ-BTMU Business Barometer For June 6:** Previous: unch.

**10:30 a.m. June 5 EIA Natural Gas Inventories**

## Quotable

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“The narrow monetary aggregate, M1, is up 15.6% from a year ago, but the aggregate has fluctuated wildly in recent weeks as risk aversion has faded. Moreover, monetary easing has lifted the monetary base (bank reserves plus currency) relatively more, so the ‘money multiplier’ has edged lower after plunging late in 2008. So, tracking the effects of monetary easing on inflation potential through the monetary aggregates is tricky.”

Richard Berner

## FX Trading – Lose the Correlation

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The correlation between stocks and currencies is working; risk-appetite at its finest.

But say we didn’t have this connection ... say a 0.023% rise in the S&P 500 didn’t equate to the same 0.023% rise in the Australian dollar or euro or whatever. How would these currencies behave without this risk correlation?

Would it be an all-or-nothing proposition for the buck like it is now? I’d like to think not.

Think about it: why has the dollar benefited from risk-aversion? Why is it the safe haven currency during these very uncertain times?

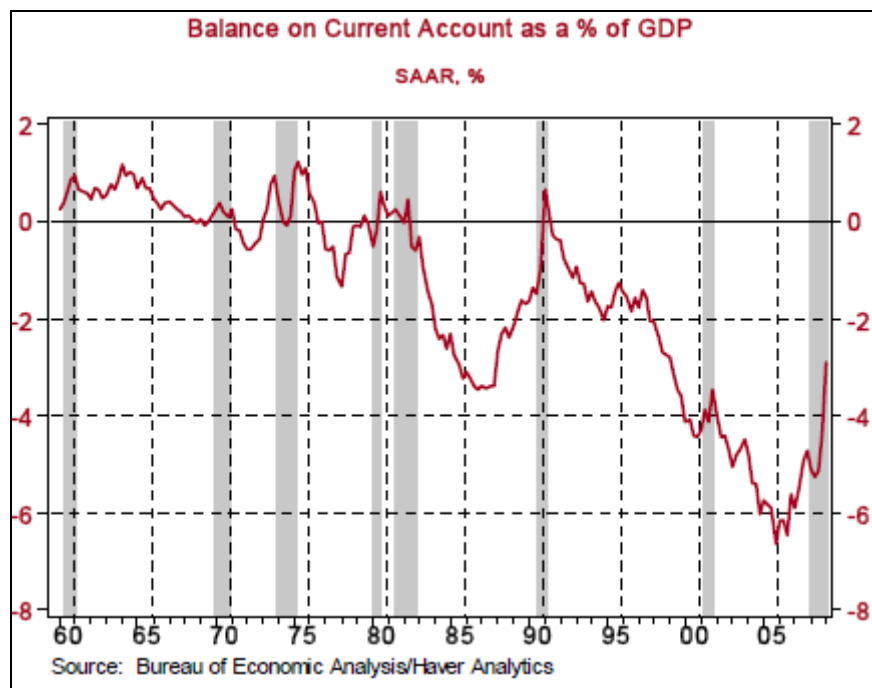
I think it's because investors understand the United States offers a financial environment that nearly no other single country can offer. Plus, the US dollar is deeply seeded in the global economy.

But as we often say: currency trading is a relative game. It's about the value of one currency appreciating or depreciating relative to the value of another currency. And from 2001 to 2008 there was a big bet placed against the fiat king.

The US dollar lost its appeal (and its value) not because any currency threatened to steal its throne, but rather because of the effects from a changed global financial landscape. Abundant dollar liquidity drove growth in countries epitomizing instability ... countries dependent upon outside forces ... countries once wallowing in economic stagnation ... et cetera.

The United States growth differential narrowed.

We all know what happened – we witnessed an overflow in the US current account deficit. Look no further, right now, to see that a major shift to this dollar-credit dynamic is shifting again. In the first quarter, the US deficit on goods shrunk by more than \$53 billion. That's good enough to be the largest quarterly reduction in the deficit on goods as far back as records show.



Source: Northern Trust Economic Research

It seems tough to argue the validity of this point, one that takes some pressure off of the dollar bear story. But it's easy to turn attention elsewhere.

Inflation expectations seem the biggest hindrance to a major dollar recovery. And right now it absolutely is 'expectations' because no signs of actual, significant price increases

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exist. The worry stems from the Federal Reserve's money pumping plus the federal deficit insofar as it could potentially instigate more Fed money pumping.

We understand the markets are forward looking, and we understand how inflation impacts currency expectations. But is the current mindset too forward-looking? Are we expecting recovery too soon? And are we then expecting the Federal Reserve to fail at tightening up the reins ... too soon?

Underestimation leading to overestimation is what we're currently witnessing.

So with no one set to annex the dollar's place as fiat king (except of course all those who think talking about dollar collapse will get them somewhere), we see little immediate reason why the relative position of the US dollar versus its counterparts should not improve.

Regards,

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