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## Key News

- [Confidence in European Economic Outlook Climbed More Than Forecast in July](#) (Bloomberg)
- [South African Producer Prices Drop by Record, Fueling Hopes of Rate Cuts](#) (Bloomberg)
- [China Central Bank Pledges to Control Lending Growth With 'Market Tools'](#) (Bloomberg)
- [Washington risks taking China too seriously](#) (Financial Times)

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## Quotable

“The mere attempt to examine my own confusion would consume volumes.”

James Agee

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## FX Trading – Down; Up; Now Which Way From Here?

This week in *Currency Currents* we've discussed some details surrounding China and their ultimate influence on the global economy and investor sentiment. For good reason, everyone seems to pay close attention to China – they're an economic leader. The goal, however, is to be right about to where China will be leading.

It has been our contention that China is set to majorly disappoint; that their recent “recovery” has been artificial rather than healthy. So far, we can slice away several items that prove our analysis accurate, but we have not been in sync with conventional analysis (at least in the last couple months). Big money flow, however, has been in sync with conventional analysis. That moves markets.

Below is a story taken from Bloomberg yesterday:

July 30 (Bloomberg) -- Chinese stocks will recover from their steepest drop since November and end the year higher as speculation that the government will limit bank loans is unfounded, billionaire investor Kenneth Fisher said.

The nation's economy is “gangbusters compared to the rest of the world, why would they try to kick that?” said Fisher, who has about \$900 million invested in Chinese shares among the \$28 billion he manages as chief executive officer of Fisher Investments Inc. in Woodside, California. “They have zero incentive” to curb lending, he said.

To us it seems Mr. Fisher here is ignoring the serious risks that could wreak havoc on the “gangbuster” economy. But when the gargantuan rally in Chinese shares is padding his managed accounts, affirming his view, then why fight it, right?

Big investment money has flown to China in the last couple months. But over that period of time it seems the outlook has not grown exceptionally clearer, nor become far more optimistic. But is there a potential for money flows to change direction?

Indeed, Jack mentioned yesterday a potential sentiment shift shaping up as far as China is concerned. Potential curbing of bank lending in China may have been the catalyst. Investors who were so giddy to jump on loan- and stimulus-based growth may start second-guessing their bets.

But that was yesterday; that was when Chinese shares finished the day down 5%; that was before the S&P 500 reversed nearly all its rather large intraday declines yesterday. Today China has tried to allay concerns over potential restrictions placed on bank lending. Not surprisingly, the market is clinging to this story because excessive loans have fueled the rise of China’s stock market.

To put it simply: yesterday offered great potential for an overall risk-averse mood to take grip of the markets. The news offered little optimism; negativity was starting to set in; the technical picture for so many asset classes looked ominous.

Today Chinese stocks have bounced back slightly; today US stocks are testing their highs; today the economic outlook in Europe is better; today everything all of a sudden appears rosy again ... when yesterday things did not.

I’d like to think the uncertainty stems from highly-sensitive, news-driven, short-term reaction by the markets; I’d like to think that’s the reason for so much back and forth price action. When you watch this stuff all day every day, this is the type of feeling you tend to get when markets have been somewhat range bound.

But honestly, despite the consistent shifts in sentiment and subsequent reaction in prices, the bias seems to be towards risk taking. Stocks continue to gain ground overall; the currencies continue to drift mostly higher versus the US dollar overall. Now, I’m not talking about big moves here, yet, but considering the welcomed reception towards optimism as compared to the somewhat confined reaction towards negativity, it seems clear what the market wants.

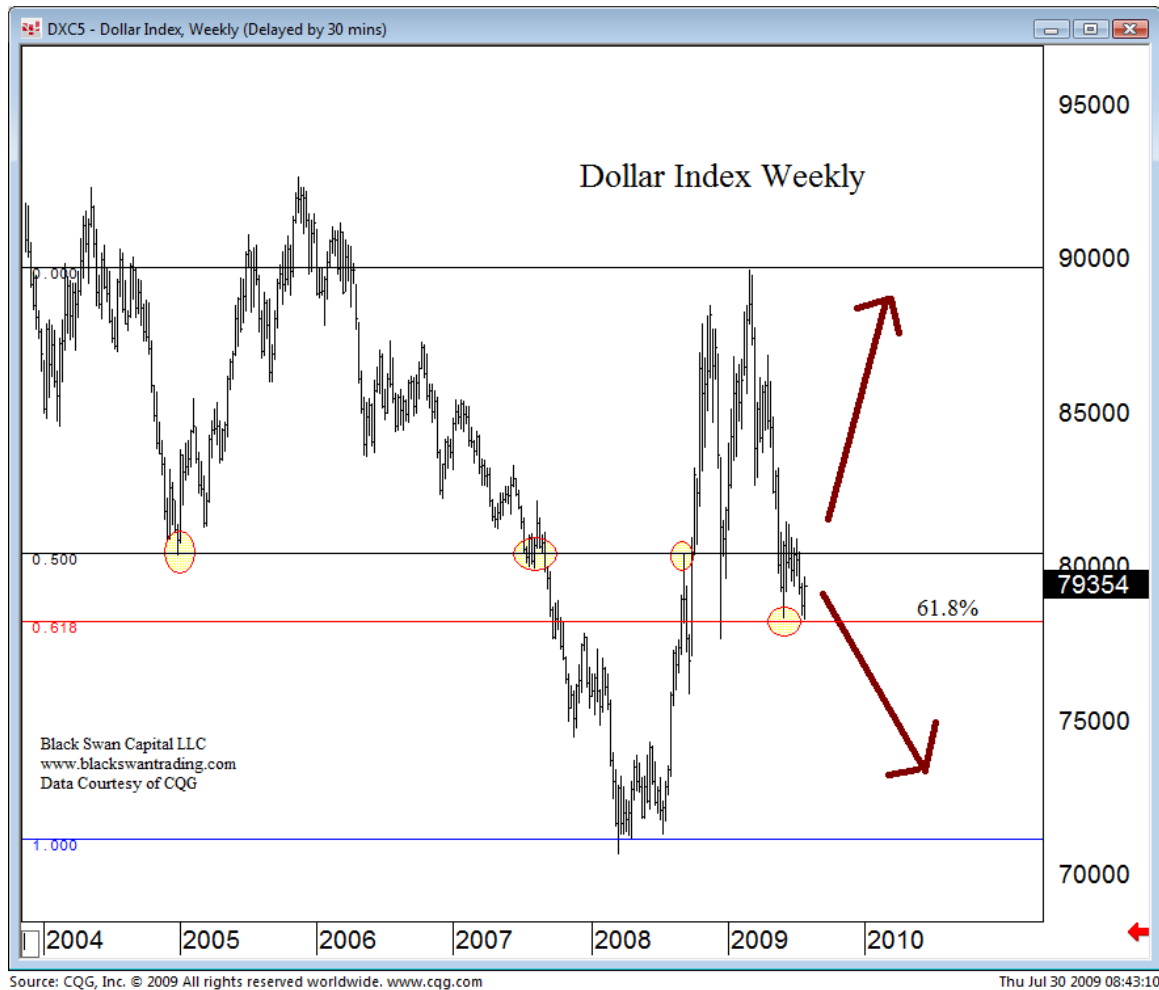
Either the market eventually gets what it wants, or it doesn’t. For the time being, it makes financial sense to play like the market will get what it wants; or don’t play at all. But it would be foolish to overlook the risk that the market comes up empty-handed.

Any move (soon) back in the direction of yesterday’s risk aversion could unleash heavy declines on stocks and currencies. But if the steady drift higher continues, that could be

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quite enough to keep risk appetite support and drive asset prices higher. So far it seems the latter will win out, again.

### US Dollar Index Weekly: Testing a key retracement level at 61.8% Fib.



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