



## Key News

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- [Australia Keeps Benchmark Interest Rate Unchanged at 3% for Fourth Month](#)  
(Bloomberg)
- [Calderon Peso Losing Confidence of Traders as Mexico Proves Worst Currency](#)  
(Bloomberg)

## Quotable

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“Chinese asset markets have become a giant Ponzi scheme. The prices are supported by appreciation expectation. As more people and liquidity are sucked in, the resulting surging prices validate the expectation, which prompts more people to join the party. This sort of bubble ends when there isn’t enough liquidity to feed the beast.

Andy Xie

## FX Trading – Tight Coupling, Decoupling and Risk – So What?

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In Richard Bookstaber’s *A Demon of Our Own Design* he starts things off with a brief analysis on economic and financial market risk. His conclusions are that we’ve made quite a bit of progress at removing much of the risk from economic cycles, i.e. the pain is much less severe with each new downturn.

On the contrary, he believes, all the steps taken to reduce the risk in financial markets actually serve to worsen the impact of each successive crisis. Later in his book he credits this phenomenon to something he calls ‘tight coupling’ or, more clearly, complexity and unintended consequences.

I’ll get back to Bookstaber in a minute. First, I wanted to bring your attention to an article I came across on [www.voxeu.org](http://www.voxeu.org) this morning:

### [Business cycles become less synchronised over time: Debunking “decoupling”](#)

I’m not going to attempt to explain the intricacies of the research discussed in that article as I’ll never do it justice; you can click on the link above and trudge through it at your own risk if you’d like. But I do want to discuss the findings of the research ...

Based on careful analysis of business cycles in industrial and developing economies, and the various correlations between them, it was found that there is little evidence that there has been any substantial decoupling from 1980-2007. It does seem, however, that business cycles across the world have become more tightly correlated since 2000.

As you might recall, the rest of the world's supposed decoupling from the US in late 2007 and early 2008 was getting quite a bit of press. Then, uh oh, the financial crisis sets in and no country, no economy, goes unscathed.

Now, back to the demon of our own design, what are the biggest risks as global investors and economist try to determine the path that lies ahead?

It's been our belief that significant economic and financial market risk remains. But perhaps we're underestimating Bookstaber's point that economic risks have been mitigated by the many new techniques, policies and procedures implemented over the last several decades. And maybe the global economy recovers ... together... and sooner than we expect.

In this case our current long-term expectations would be flat wrong. But ...

We're not yet ready to write-off the chances that Europe runs into more financial/banking trouble ... or that China bursts at the seams of excess liquidity ... or that US households have much more work to do in tidying up their balance sheets.

If our analysis proves correct and markets react to economic risk as they did when this crisis began, then we could very easily see another pull-back in the dollar-based credit that's beginning to flow more freely around the globe yet again. The result, demand for the safety of US Treasuries and demand for the US dollar.

And as it relates to financial market risk, there's no doubt about Bookstaber's belief that financial markets have become more complex and, thus, more risky. In fact, the abundance of risk in financial markets helped fuel the great collapse of 2008. Then again the tight lock between world economies is what really made the global recession, well, global.

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