



### Key News

- [Initial Jobless Claims in U.S. Unexpectedly Decreased to 545,000 Last Week](#) (Bloomberg)
- [Bank of Japan Sees 'Downside' Risks to Economy, Keeps Rate Target at 0.1%](#) (Bloomberg)

### Quotable

"Everything worthwhile is a good idea, but did you ever notice there is more bad ideas that will work than there is good ones?"

Will Rogers

### FX Trading – Recession Over? US Dollar Over?

It's turning out to be a long September down a one-way street for the buck.



The decisions of investors who've jumped in on stocks and risky assets are being validated by three things:

1. Improvement in economic data
2. Affirmation of recession's end

### 3. Continuation of risk taking

Each amounts to imminent recovery, in the eyes of so many. And who knows, they may be right. The worst may be in the rear-view mirror, a double-dip may not be in order, and corporations will be able to justify valuations brought on by this rally.

Forgive me, though, for not falling into the consensus camp just yet. It seems there is a long, slow uphill climb still ahead ... at best. Thus far, this rally has taken on a sort of self-reinforcing quality. Perhaps it's come unhinged from reality. A sobering up that seems inevitable at some point should at least throw a wrench into this mindset.

In many areas, the less-bad data has morphed into positive data. But let's remember what started the crisis in the first place: credit crunch. Sharply receding credit zapped economic growth.

But now that growth is back, it would only make sense that credit growth was back too.

Not so fast. This is one item that analysts mostly refuse to acknowledge but economists cannot ignore. An article in the [Financial Times](#) broaches this subject quite well. As we've noted several times throughout this rally in risk: banks are not yet lending, credit markets are not sufficiently functional.

From the FT article:

"In a normal economic cycle, a flood of capital market liquidity would fuel a recovery. However, there is nothing normal about this cycle as major channels of finance in the real economy remain blocked. Increased corporate issuance and rallying equities may raise the amplitude of the inventory cycle, stabilise consumer wealth and slow job losses.

"But without policy measures to restore normal credit creation the pressure of leverage on company and consumer balance sheets will keep spending below depressed income levels. As international markets price in the beginning of Fed, ECB and Bank of England exit strategies next year and China moves to restrict loan growth, this hardly bodes well for global growth."

And in similar comments from [The Institutional Risk Analyst](#):

Looking at the banking industry, it is really remarkable that Fed Chairman Ben Bernanke has decided that the recession is over - but not surprising. After the past decade or more of credit fueled exuberance, no surprise that the maddening crowd wants to go back to the way it was. Many of the bankers and Buy Side investors with whom we speak feel that the worst of the economic crisis is behind us. And we do see increase activity in the secondary markets for loans and failed properties, an encouraging sign that may - emphasis may - push down the ultimate cost of

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cleaning up the mess in the banking industry. There are many other indicators that suggest consumers and business are rebounding from the summer of dread.

But while we all do hope for better times ahead, the fact remains that the supply of credit available to the global economy continues to shrink with the balance sheets of banks around the world. Forbearance and flexibility are the order of the day for most lenders. The impact of this credit shrinkage on asset prices is decidedly negative, but in many cases, investments in residential and commercial real estate made over the past five years are so far under water that the owners are simply walking away. And when we say owners, we are not just talking about residential home owners, but some of the most respected institutional players in the worlds of Wall Street and commercial real estate as well.

So as long as this dynamic is overlooked, or viewed as unimportant by mainstream investors (or is slowly resolved), then the environment might not change for a while ... barring some sort of China disaster/disappointment.

For the buck, this means that momentum may not let up ... that the drive lower will continue. The current environment is flush with US dollar-based credit that's funding risky investment. And while a short breather may be in order for the near-term, sentiment is in a place where a major US dollar rally does not currently seem feasible.

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