Black Swan Capital
Currency Currents
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Quotable

In this age of electronic money, investors are no longer seduced by a financial 'dance of a thousand veils.' Only hard and accurate information on reserves, current accounts, and monetary and fiscal conditions will keep capital from fleeing precipitously at the first sign of trouble.

Larry Summers

It used to be said that when the U.S. sneezed, the world caught a cold. The opposite is equally true today. Our prosperity is linked inextricably to the maintenance of a strong world economy, an open international trading system, and stable global financial markets.

Larry Summers

Now is the time for us to strike. We must strengthen our foothold in Asia, to ensure no nation overtakes us.

Larry Summers

FX Trading – Go away you nasty deflation ... and take the dollar with you.

We'll make this short and to the point, since every analyst in the business has something to say on the Federal Reserve today:

1. The Fed is signaling their fear of deflation.
2. And gold is the go-to investment.

We weren't surprised by the Fed yesterday. And we weren't surprised by the market's reaction. But besides just saying risk is coming on strong today, here are a couple takeaways stemming from the two points above.

First, the attention the Federal Reserve paid to lower-than-normal inflation is a sign that they're concerned with how the US recovery is (or is not) developing. There are plenty of analysts out there who will tell you that the Fed would much prefer inflation than deflation; or more specifically: the Federal Reserve (indentured to the US government) will be happy to inflate away US debts and prop up "growth" via money creation. After yesterday, consensus seems to share that feeling.

This article from Bloomberg.com shows that players keyed off of the inflation rhetoric in yesterday's announcement:

The FOMC said in its statement that it's "prepared to provide additional accommodation if needed to support the economic recovery and to return inflation, over time, to levels consistent with its mandate."

That itchy feeling on the top of our collective head just won't go away. And every time we scratch it we can't help but think "JAPAN."

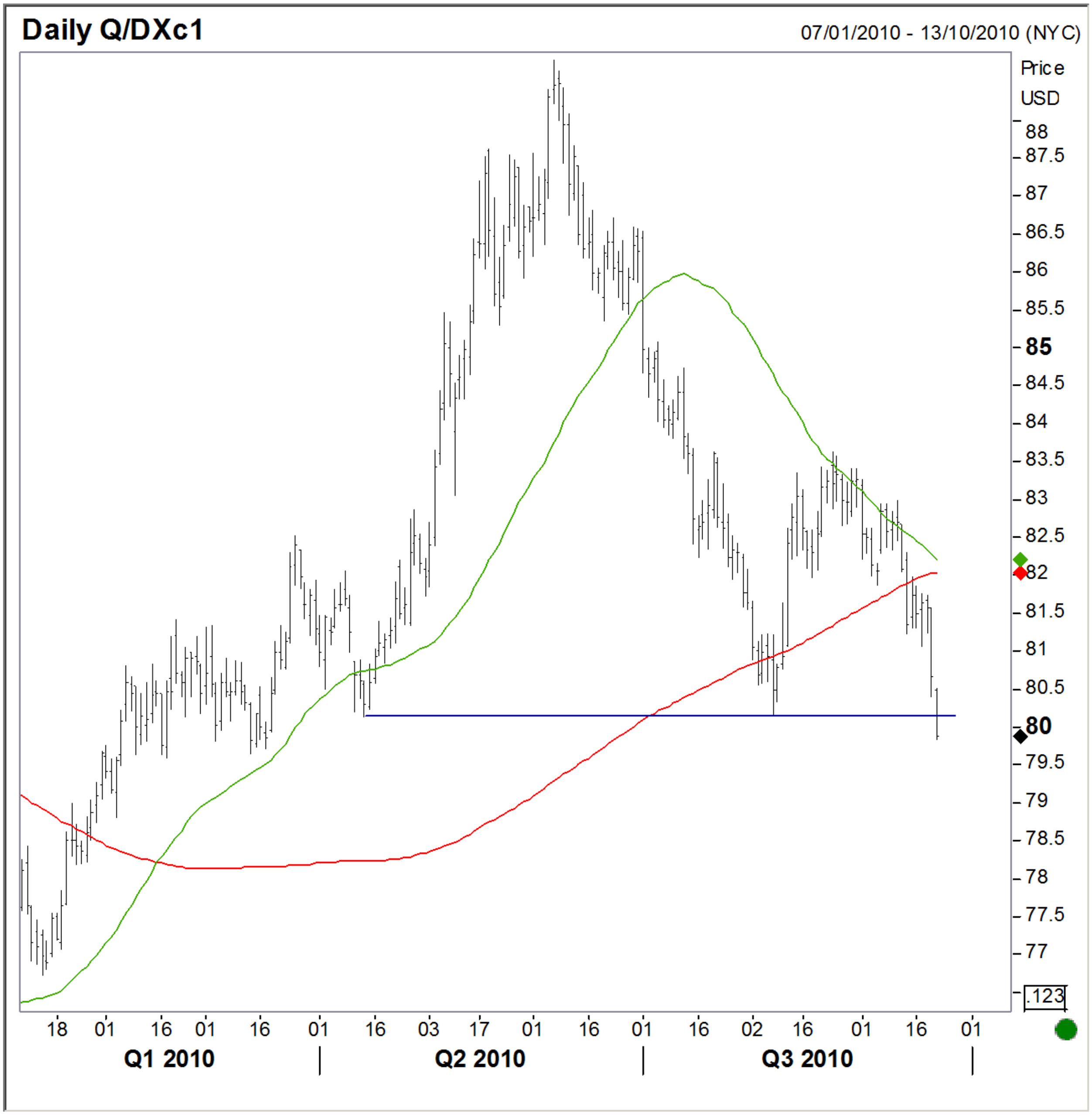
It was several weeks ago, if not months, when one of the Federal Reserve board members discussed the need to basically take the same steps that Japan did in order to ward of the same fate that Japan suffered and is still suffering.

Doesn't make any sense, does it? Oh well – maybe there are smarter people than us figuring this stuff out. Actually, there's a good chance there are a lot of people smarter than us working on this predicament; but the odds are growing increasingly likely that they have yet to figure it out.

Maybe we're a bit short-sighted and don't know it, but how much more could it hurt at this point to change tack? That does not necessarily mean get crazy tight with money and squeeze to death an economy that's already gasping for air. But it does mean sending a different message, one that may say "hold your breath for a bit" but also implies fresh air is on its way in.

Right now the air is very stale, perhaps even polluted ... and everyone knows it. The US dollar index has apparently decided to stop breathing it in ... or breathing at all. Key support has been broken. This is an ugly chart at the moment. A trap, or are we now very ensconced in the "US muddle through" area which means the dollar gradually works lower -- a lot lower -- on the increasing supply of dollars the Fed pumps out coupled with the below-trend US growth, i.e. the buck loses appeal on both growth and yield comparisons. The implicit policy is sacrificing the dollar to spur global liquidity -- we have seen it all before and it is not pretty for dollar bulls -- but quite nice for dollar bears. Instead of the Plunge Protection Team for stocks, we instead get the Dollar Destruction Team for the currency.

US Dollar Index Daily: Chart support broken! Green line is 50-day moving average; while the red is the 200-day moving average ...



Consensus seems to think November is when we could start to see some easier easing from the Fed. With that in mind, an assault on the US dollar through October may make sense. The view of the market goes a little something like this:

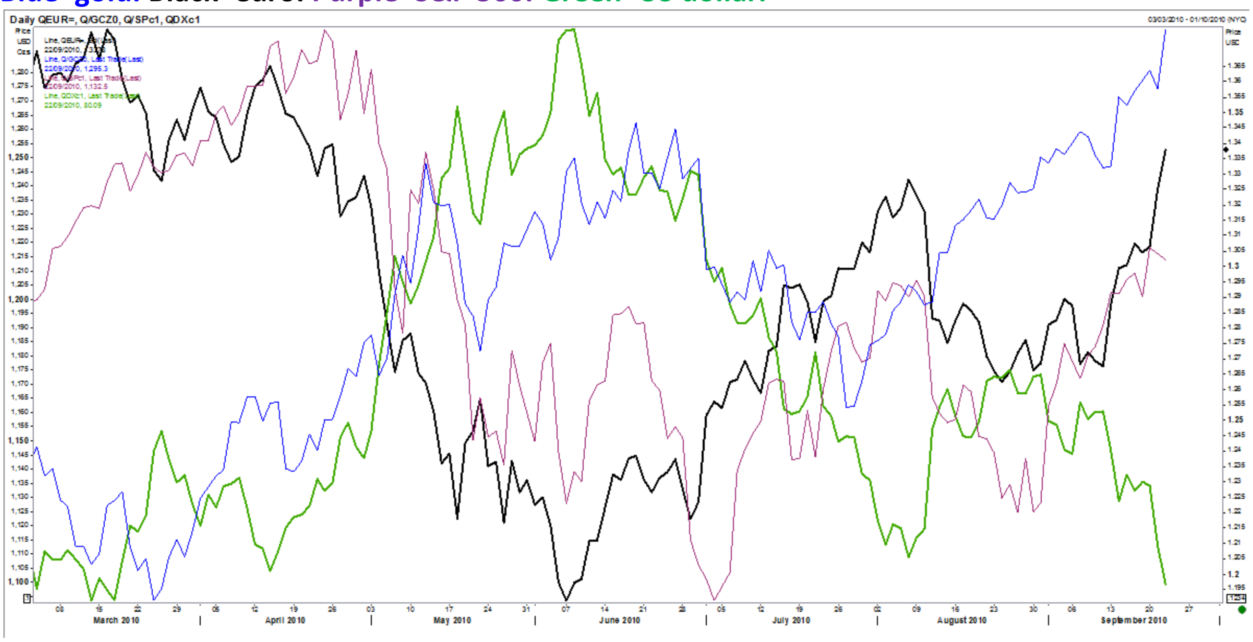
- The Fed is going to do something; but no one knows how much.
- No one wants to hold dollars if the Fed is going to do something.
- What the Fed does is anyone's guess, but after a dollar free-fall in October we could see a dollar recovery in the last few days leading up to the November FOMC meeting.
- And at that point it is open season as the market reevaluates its month worth of expectations and parses them with the Fed's actual activity.

Did you get that? The point is: the Fed's telegraphed position does not bode well for the US dollar.

There is the obvious poor performance of the US dollar telling the story; but there's a little more to watch ... like the performance of gold. A very broad, long-term theme we still hold to by a few threads is one where the US dollar rallies on major risk aversion. More than likely such an environment will again be sparked by trouble first out of the Eurozone and then less confidence in China.

Gold is taking a bite out of that theme, as the risk-averse dynamics seem to favor gold over the dollar lately.

Blue=gold. Black=euro. Purple=S&P 500. Green=US dollar.



Perhaps it's not even being debated, but gold's move is an absolute safe-haven play that's capitalizing on investors' distaste for, or rather their negative perception of, major fiat currencies; nothing more. And the fact that the S&P 500 price action in the wake of yesterday's Fed move is not sending its own signal of risk appetite (while risk currencies are stronger and US Treasuries are stronger) underscores investors' distaste for dollars. It may take a Halloween sugar-high to get the dollar moving up again. Unfortunately for the buck, that scary day is more than a month away.

Key Point that Could Change this Quickly: China. It seems US-Chinese relations are getting worse. The saving grace for the buck would be a risk bid. We can't guess or forecast that ... but we have to keep that in mind.

Parting note:

We would be remiss if we didn't comment on the exit of our illustrious economic czar; he never was a favorite of ours to say the least:

> Bye Bye Larry
>
> *Don't let the door hit you on the way out ...*
>
> Let's see if we have this straight -- you apply the best and brightest of the neo-Keynesian clap-trap economic ideas to an economy and drive it into the dirt in the process, yet you are hired to go back to Harvard to teach economics so you can fill the heads of the best and brightest minds in America full of economic mush that will only help them destroy economies? Do we have that about right? Hmmm ...
>
> We are sure the Harvard Economics Department is just thrilled to have Larry "I am somebody" Summers back in town. Just pondering the class syllabus at Harvard ... Larry's new class titled: Neo-Keynesian Clap-trap 401: An advanced policy view of how to destroy capitalism.

Jack and JR
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