FX Trading – Who cares? Who knows?

If you can believe it, the US dollar has gotten hammered in the last 12 hours -- the euro and pound up over a percent at their day's highs; the Australian dollar coming very close to US dollar parity.

The day's early moves have *hints* of capitulation as QE2 and currency war speculation saturate the headlines. In fact, we were easily stopped out of EURUSD and AUDUSD as the pairs blew through last week's highs and cleaned out whatever orders sat above those levels. The expectations for the US dollar to bottom are growing in *talk* but not in *walk*.

Indeed. Something was sent to us this morning which noted the US dollar's continued decline despite the fact that so many analysts were calling a bottom on the idea that price and the QE2 driver had become overdone. We can't argue with that – we've been trying to pinpoint that bottom for the last two weeks.

Of course that little bit of trading advice -- "markets can stay irrational longer than you can stay solvent" -- keeps nagging at us.

So in the "sounds like it matters but won't until it does" category is this reminder from Reuters:

> Over a quarter of all loans to Chinese local government financing vehicles are at serious risk of default, regulators concluded after a probe into what some analysts see as a liability for the economy ...
>
> According to the investigation, 24 percent of the debt incurred by the local financing vehicles is fully backed by revenues from the projects they have funded.

> A second batch of loans, about 50 percent of the total, will not be recoverable directly from the projects they have funded, but will be covered by secondary sources, such as government revenues.
>
> The third batch is the 26 percent that are in serious trouble.

That isn't really new news, as we covered it many weeks (perhaps months) ago when we thought the market might care that China's economy was not without meaningful risks of its own.

Our expectation then was that a handful of China-specific economic and financial items would pose a problem for Chinese growth and, more importantly, lead to a deterioration of market confidence in China and related investments. This deterioration would mean a risk-averse mood prevails to the benefit of the US dollar (safe haven).

Needless to say, that hasn't happened. But will it?

What this news from China says is this: it seems as though the market couldn't care less about it ... or any other country-specific issues that once held clout and spurred fear among investors. It's all about the US Federal Reserve reflation trade.

Accompanying the comments sent to us regarding the "US dollar's decline despite a growing number of analysts calling a bottom" was some analysis on the CRB. Price action here is very much indicative of the sentiment surrounding every spoken word regarding the Federal Reserve and its expected easing measures.

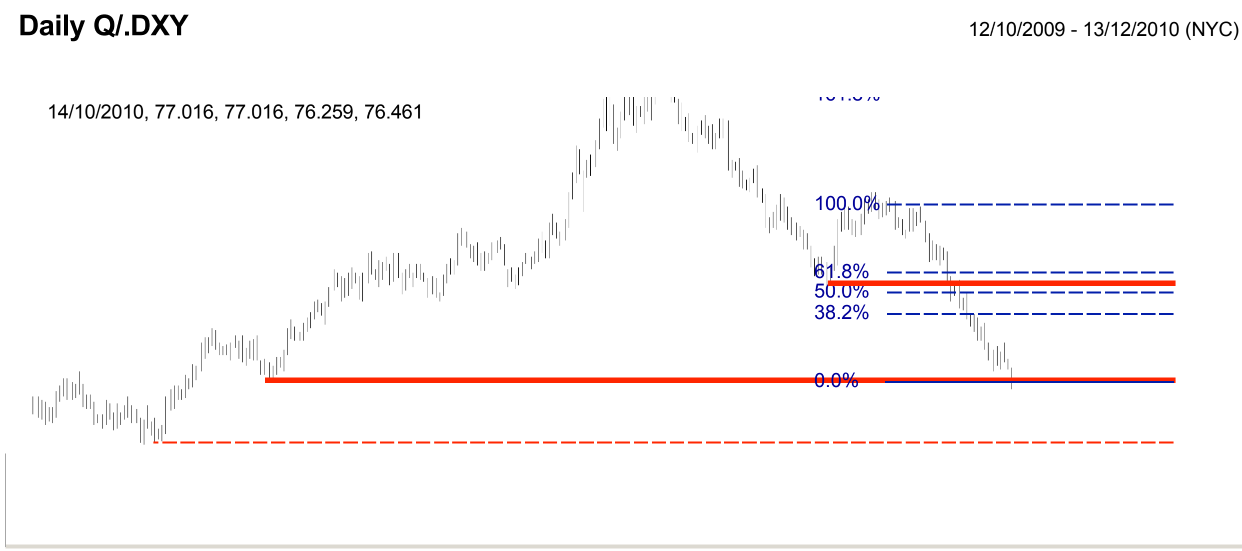
Reuters/Jefferies CRB Commodity Index Weekly: breakout?

Perhaps a technical US dollar-led correction slows down the CRB in the near-term; but barring a major change in risk appetite, it looks as though there's more room for this reflation trade to run. After all, that's what the Fed wants ... or it's least that's what recent currency-war prognosticators seem to think the Fed wants even though the Fed tells us benignly they just want to support the US economy. As it goes: the Federal Reserve will continue to "print" money and create inflation, driving asset prices higher and eventually causing countries (China) to overheat based upon the structure of their growth model.

And speaking of money printing, this link to a video recording with Jim Grant and Neal Soss discussing QE2 was sent to us yesterday; it's worth your time.

We showed the following chart of the US dollar index recently, indicating it could reach as low as 76.50 on the current move lower. From there a corrective rally to 79.00 or 80.00 is possible without throwing this downtrend into serious question. Note too that the 74.00 area is the next level of significant chart support.

US Dollar Index Daily:



The month of September and so far October can be characterized this way: investors only care about Fed reflation prospects. And depending on developments between nations regarding foreign exchange issues and November Federal Reserve action, there is the potential for this reflation idea to sustain itself.

That means we may eventually get the US dollar correction we've been looking. After that, though, there's currently nothing on the table that anyone cares about that doesn't amount to US dollar depreciation. And we know from earlier this decade, such a feeling can last a while ...

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What should you do to protect yourself from Bernanke's inflation?

Find out on October 18th.

Maybe Bernanke has promised it: The U.S. will create inflation come hell or high water. Maybe that's the most common perception of all this QE2 talk.

Ah, if manipulating the dollar were only that easy. Put bluntly, we think he has far less power than he thinks to create inflation. And we're among the few who believe (and putting our money where our mouth is) that inflation is the last of our worries at the moment.

Still ... it raises the question: how will you protect yourself against Bernanke? The Fed? The current U.S. monetary policy (we use that word loosely) ...

Our humble (and intelligently nuanced) answer is found every month in ***Currency Investor***. A quick read indeed, but packed full of the kind of information you need to armor yourself against the monetary tsunamis reaching our shores. Warning: ***Currency Investor*** is built for investors who want low leverage and longer timelines. [For the steady drum beat of daily and weekly trading, take a look at our all-in-one *Currency Currents Professional*.]

Currency Investor analyzes the macro situation as we see it ... then recommends exchange-traded fund (ETF) positions to take advantage of the trends we identify.

September's issue is no exception ... would you like to take a peek? Follow us in for a look ...

Or sign up now for only $49 per year. And be sure to sign up in time – Monday the 18th -- to receive **our October issue which will discuss the currency wars -- the ongoing FX battle to keep currencies suppressed and growth afloat -- and we'll go into detail on the Federal Reserve's not-so-covert reflation strategy that has the potential to keep pressure on the US dollar if things go according to plan.**