Black Swan Capital
Currency Currents

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FX Trading – Ganging Up Against the Euro Gang

The euro is getting pummeled again this morning, after a pitiful performance following the better than expected US Nonfarm Payrolls report on Friday. And while the QE2 implementation is only just beginning, the QE2 hoopla is waning. Coming into focus now – again – are the Sovereign debt issues of the eurozone.

We asked on Friday if something changed, warranting this renewed concern from the markets over whether or not the eurozone can keep it together. We didn't have an answer, and still don't – but we have some things worth considering that will eventually give us the answer:

The potential for an improving US growth differential, relative to Europe, may be the catalyst. No doubt the attention has been stuck on the US for most of the second half of this year. Unemployment in the US has been the thorn in the side of US economic recovery efforts. Friday's US Nonfarm Payrolls report puts the pressure on Europe – will the economic data (specifically unemployment numbers in eurozone countries) improve enough to keep the region and the euro in the market's favor?

That, of course, remains to be seen. But what can go back under the microscope is the progress (or lack thereof) being made on the Sovereign debt front. That's why the headlines and analysis this morning is so heavy on this story for an explanation of the euro's nosedive.

Discussion over amending treaties to shift risks away from taxpayers and onto bondholders is being debated; a permanent Crisis Resolution Mechanism is the thus-far-agreed-upon solution as well as discussions over reforming the Stability and Growth Pact, giving the central authority an easier path to confront countries who aren't in compliance with the Treaty requirements.

As has been the case since eurozone sentiment stabilized and the euro began its recovery earlier in the year, the market sees effort being made and action being taken by policy-makers to alleviate the current and any future Sovereign debt concerns. Thus far this has been sufficient in preventing a further deterioration in broad market expectations, with the exception of the run-up in credit spreads being the only real sign of investors acknowledging the risks of periphery economies.

So while all the talk about mitigating credit risk in the zone, and putting in place measures to prevent any future crises from rocking the euro members, likely will keep investors optimistic ... there are some concerns that could still throw a wrench into the plans.

One concern being: is this stuff palatable? Restructuring of debt is one potential piece of the proposed reform. While this piece should do something to cleanse the system, it has the potential to increase the pain within and across the eurozone financial system.

Another concern is whether the details make sense and can work. The European Central Bank has expressed some concern over whether the proposed measures are optimal in the current environment. Remember: we're talking about a union of countries here where decisions made on the national level can and will impact other members. This has been among the biggest reasons for this eurozone crisis from day one. Unintended consequences have swelled because policies have been built that, in hindsight, were implemented to the benefit of some countries and the detriment of others.

All this reform and restructuring stuff is just the half of it: what does the populace think of it all?

For starters, many European citizens aren't swallowing the austerity pill like it seems Americans have had no problem taking down. Riots and protests have been fairly common all year. In order for the imbalances among eurozone nations to be smoothed out, much needs to be done in restoring order to national budgets. If a shift in fiscal policy proves to be a burden on the economy and future unemployment, let's just say it's not going to sit well. Again, we are talking about a union that's economically interconnected but governed not from a central authority. Should the incumbent administration in France listen to its constituents or should it take cues from what the Greek administration feels is best?

Something like this, from Leto Research covering the results of regional elections in Greece, certainly shouldn't give the French or any other eurozone member a comforting feeling:

But this election did much more than repudiate the bailout agreement. The 40% abstention and plus the 9% protest/blank ballots are a repudiation of the existing political/party system and not merely a repudiation of the serving government. Greece has now entered a profound institutional and political breakdown crisis and has become ungovernable.

There will likely be early general elections next spring due to the inability of the present parliament to agree on a budget. That election, most likely will produce chaotic results and lead to a succession of general elections every few months producing short-lived and impotent governments.

Who is truly looking out for the common good of the eurozone? It seems everyone is bound to have a different answer. The process of reform, restructuring, bailouts, austerity and governing is all more complicated in a union in crisis.

The issue now is timing major changes in sentiment as the market digests all the bits and pieces.

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What You Don't Believe About Deflation Could Bankrupt You

Or: What you Believe about Inflation Could Bankrupt You

The braying herd of financial advisers and talking heads are all in agreement: hyperinflation is just around the corner! "Look at gold bumping up against $1300!" "Look at how fast the Fed is printing dollars!" "Listen to what Big Ben Bernanke says!"

We say… Not so fast.

In fact, we say "Inflation? Not Now. Not Soon. No Way." (This curmudgeonly bent does not make us popular with the "in" crowd. It has, however, made our subscribers a lot of money.)

While every scrying stone is an imperfect prognosticator of the future, our carefully polished lens reveals a world in which inflation is the very least of our problems.

Of course, this raises an interesting question close to the hearts of every investor (especially those, like us, who take to the floor to trade currencies)… how best to respond to nurture the nest egg rather than destroy it? Moreover, how to do so with some semblance of risk-management?

Our humble answer is found every month in our *Currency Investor* report. Built for the investor who wants low leverage and longer timelines (not the insanity of spot trading or even the steady drum beat of regular trading), *Currency Investor* analyzes the situation as we see it and then recommends funds to take advantage of the trends we identify.