



Quotable

“Rather than deal with these simple problems with simple, obvious solutions, the official reform plans are complicated, convoluted and designed to only have the veneer of reform while mostly serving the special interests. The complications serve to reduce transparency, preventing the public at large from really seeing the overwhelming influence of the banks in shaping the new regulation.

“In dealing with the continued weak economy, our leaders are so determined not to repeat the perceived mistakes of the 1930s that they are risking policies with possibly far worse consequences designed by the same people at the Fed who ran policy with the short-term view that asset bubbles don't matter because the fallout can be managed after they pop. That view created a disaster that required unprecedented intervention for which our leaders congratulated themselves for doing whatever it took to solve. With a sense of mission accomplished, the G-20 proclaimed "it worked." We are now being told that the most important thing is to not remove the fiscal and monetary support too soon. Christine Romer, a top advisor to the President, argues that we made a great mistake by withdrawing stimulus in 1937.

“Just to review, in 1934 GDP grew 17.0%, in 1935 it grew another 11.1%, and in 1936 it grew another 14.3%. Over the period unemployment fell by 30%. That is three years of progress. Apparently, even this would not have been enough to achieve what Larry Summers has called ‘exit velocity.’

“Imagine, in our modern market, where we now get economic data on practically a daily basis, living through three years of favorable economic reports and deciding that it would be ‘premature’ to withdraw the stimulus.”

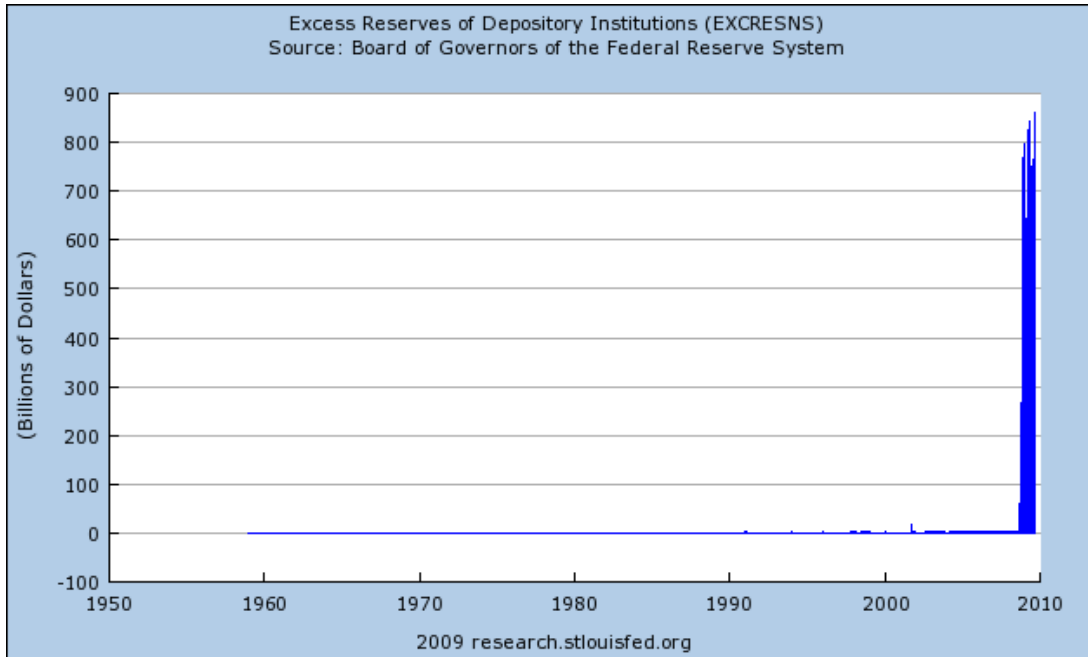
David Einhorn

FX Trading – A Potential Premise that Fools the Crowd Big Time!

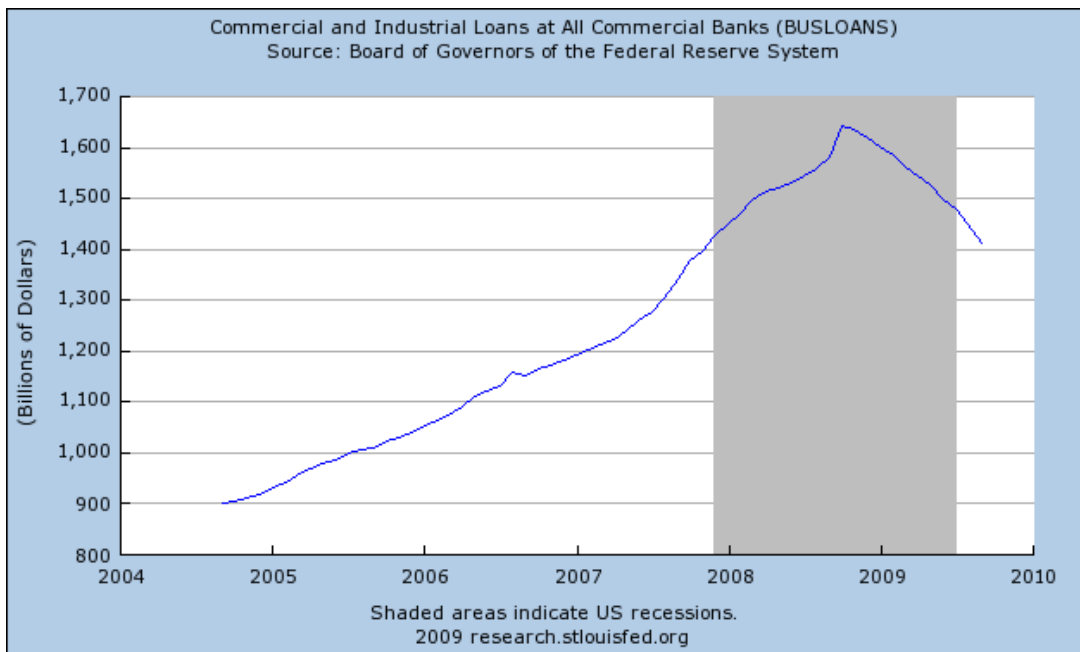
Nov. 1 (Bloomberg) -- [U.S. Treasury Secretary Timothy Geithner said](#) the country's economic recovery and job creation hinge on banks taking more risk and restoring the flow of credit to businesses.

“The big risk we face now is that banks are going to overcorrect and not take enough risk,” Geithner said in an interview today on NBC’s “Meet the Press” program. “We need them to take a chance again on the American economy. That’s going to be important to recovery.”

Excess Reserves on Bank Balance Sheets...this chart is almost comical in its appearance.



Thus, no surprise lending to the real economy has declined this year as financial markets soared...but still hard to fathom given the weight of all that money...



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There seems a real disconnect between the two economies: financial versus real. Maybe that is about to change...from Morgan Stanley below [our emphasis]:

Excess reserves on the Fed's balance sheet will soon cross the US\$1 trillion mark. Our US economics team expects the combination of more QE asset purchases, smaller further decreases in passive QE and the wind-down of the Supplemental Financing Program (SFP) of the Treasury to drive excess reserves in the US to US\$1.2 trillion by January 2010. And balance sheets and reserves in other countries are at elevated levels too. Confronted with such massive amounts, even the normally straightforward task of draining excess reserves is no longer a simple task for central banks. While they retain so many excess reserves which are earning very low interest, commercial banks could well turn some of these reserves to lending when better opportunities show up later in the recovery, or purchase assets, pushing yields lower. More lending would lead to an increase in money supply, raising inflation risks. **Ironically, commercial banks are most likely to find willing and suitable borrowers just as central banks start to tighten on the back of a sustainable recovery, lowering the impact of rate hikes.**

QE created a surge in excess reserves: In September 2008, central banks opened up liquidity facilities to alleviate the stress from frozen fixed income markets. These operations resulted in the build-up of 'excess reserves' (ER) and an expansion in central banks' balance sheets. In the past, such a build-up in ER would have been 'sterilised' by central banks by selling government securities. This time around, however, that was not done for two reasons. **First**, we have argued that central banks have pursued QE with the intention of increasing the growth of money, given near-zero policy rates, while more ER would push overnight rates lower. **Second**, the sheer size of the increase in ER relative to the size of government securities held by or available to the Fed that could be used to drain reserves was at least partly responsible for central banks not being able to drain excess reserves. Under these extenuating circumstances, the Fed even turned to the Treasury for assistance and the Supplemental Financing Program was created to help drain ER.

So, we could see some surprises if/when the Fed starts draining (maybe they started):

“The irony may well be that just as nine months of weak economic data this year has been accompanied by a very strong market, so the strong economic data next year is likely to be accompanied by a weak stock market.”

Jeremy Grantham

Mr. Grantham, who called the rally from April till now, believes stocks are about 25% above fair value. So, let's say Mr. Grantham is right again. And let's say for grins the

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stock market and US dollar index correlation remain intact—tightly negatively correlated.

S&P 500 Index rally from March low = 65%

Dollar Index decline from March high = 16%

We know Europe doesn't want its currency to go any higher. We know from a purchasing power parity aspect the euro is back in the ozone against the buck. We know all the reasons why we all hate the dollar—so many to choose from and so little time.

Here is the rub:

Premise #1: Any dollar bounce here will likely be attributed to stock market weakness i.e. risk aversion. [Though stock traders believe the stock market is falling because of dollar strength; we think stocks are the lead dog in this game.]

Premise #2: It therefore follows that when the stock correction ends (because we can always predict those things with such accuracy—NOT!), it is time to sell the dollar again.

But what if Mr. Geithner's pleads for more risk taking by banks resonates. We know politicians have to now be putting lots of pressure on said banks to open up their purse to mom and pop on Main Street—as those guys tend to vote too.

Thus our **Potential Premise that Fools the Crowd:**

- 1) The stock market loses much of its liquidity prop as money shifts back to the real economy.
- 2) This movement of money back to the real economy accelerates US growth, especially relative to its industrialized world competitors (Europe and Japan)
- 3) This accelerated real growth allows the Fed some raw material to hint about hiking sooner rather than later—self-reinforcing process.
- 4) I think you know where I am going with this...a growth and yield surprise means expectations the US dollar bounced only on risk aversion i.e. Premise #2 above, would be scuttled.
- 5) Scuttling Premise #2 means there is something real behind the dollar rebound.
- 6) Our initial forecast, many months ago, the dollar has put in a long-term bottom in March 2008 proves true by the skin of our chinny-chin-chin.
- 7) We all live happily ever after—at least those of us positioned for a dollar rally and stock market sag.

There is only one major problem with my Potential Premise that Fools the Crowd argument. US policy in all things financial seems so flawed at almost every level. Yet, hope springs eternal from an entrepreneurial perspective (a prerequisite to being an

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entrepreneur is optimism). If you put the money in hands of real people in the real economy that make real things happen, instead of in the hands of those who only talk about making things happen, good things really can happen.

Stay tuned.

Jack Crooks
Black Swan Capital LLC
www.blackswantrading.com

On a tear....

Five closed winners in a row and two open trades in profit territory right now. Yikes! Jack and JR are on a tear in our *Forex & Currency Futures* service.

I almost hate to talk about it, because the market gods have a way of hammering you when you boast about profits. But, I want you to know how this game is played.

When a trader gets hot—in the market zone so to speak—his string of wins goes way beyond what would look anything like a normal random patten, coin flipping if you will. Same token, when cold there can be a string of many losses in a row. That’s trading. The key to long-term trading success is making sure at the end of the day your winners make more than your losers. That can only come from proper risk control. In our *Forex & Currency Futures* service we define our risk first, and think profits second. Lately, the profit side is looking very good.

If you are interested in a spot forex and currency futures service that provides actionable recommendations for both short-term and position traders, plus provides trading rationales based on both technical and fundamental setups, you might want to consider giving our service a try. You can learn more about [Black Swan’s Forex & Currency Futures service by clicking here](#).

Regards,

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