



Black Swan Capital  
**Currency Currents**

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Tuesday 9 June 2009

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### Key News

- [U.S. Wants Tougher Europe Stress Tests](#) The U.S. wants European banks to be subjected to more rigorous stress tests, to help ensure they will survive if the economy worsens. (WSJ)

Key Reports Due (WSJ):

**7:45 a.m. ICSC Chain Store Sales Index For June 6:** Previous: -0.6%.

**8:55 a.m. Redbook Retail Sales Index For June 6:** Previous: -0.3%.

**10:00 a.m. Apr Wholesale Trade:** Expected: -1.2%. Previous: -1.8%.

**4:30 p.m. June 5 API Oil Industry Report**

**5:00 p.m. ABC/Wash Post Consumer Conf For June 6:** Previous: -49.

### Black Swan Live Webinar Event Sponsored by Tom Busby's DTI

When: Wednesday 10 June '09, 11:00 a.m. CDT/12:00 a.m. EST

Topic: **Strategies for trading currency options**

To register: [http://www.dtitrader.com/trading\\_education\\_Blackswan\\_June10\\_09.htm](http://www.dtitrader.com/trading_education_Blackswan_June10_09.htm)

### Quotable

"I had only one superstition. I made sure to touch all the bases when I hit a home run."

Babe Ruth

### FX Trading – An Inconvenient Leak

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I was putting air into my bicycle tires the other day just to make sure I'd have a nice smooth ride when I hopped on. Eventually one of the tires became overinflated (or at least that's what I assume happened since the tube inside sprung a fast leak in the midst of me pumping air into it.) Most of the air escaped the tire within seconds.

Did that signal to me the tube was pretty much useless in its current state? Yes.

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Did last year's credit crisis, when deleveraging sucked the air out of the global economy, signal to anyone the financial system was pretty much useless in its current state? I had thought so.

Back to the metaphor ...

I found out later, after attempting to put air back into the otherwise useless tire tube, that it would hold almost half of the required air pressure. It was just enough air pressure that, to the eye, would give the impression it was a perfectly good tube and ready for riding. But hop up on the bike and you quickly realize you've got about enough air to get you to the end of the driveway.

Back to the financial world ...

It seems we're mostly trying to put air back into a financial system that sprung a hard-to-fix leak. At best, we're tending to the leak with a little Elmer's Glue. We were so eager to ride fast that we pumped too much air into the system. And now we're so eager to get back on the bike that we're not making the appropriate fixes to ensure the ride takes us beyond just the mailbox.

We've discussed it months ago, but much of the effort that has been taken thus far – be it in the US or abroad – has been done to stimulate credit and demand; for that's what was pumped into the system before ... when everything was moving along so expeditiously. And we're tip-toeing again the line that, should we fall across it, leads to renewed worries over the true health of the financial system.

I'll say it again in plainer terms, no metaphor this time:

We're dealing with a system that probably won't be able to hold its air once the pressure starts to build. If I were Marc Faber I'd give you a 100% guarantee that the financial system could not yet hold its air. Then again, if I were Marc Faber I'd be riding on hyper-inflated bike tires.

And if I were one of many public figures in the US or around the world I'd probably be telling you of a land full of green shoots and recovery potential. Why? Because confidence is becoming the make-shift patch; confidence is leading many to believe, in a self-fulfilling kind of way, that the worst is behind us.

No doubt we're not the same financial system now that we were before all hell broke loose. The market has effectively wiped away some excesses and taught several lessons in the process. But in light of the actions taken to fuel the Campaign of Confidence, I'm just not so sure material changes have been made.

Of course, if you've been following us in any capacity over the last several months, you probably already know our expectations depend a lot on the state of the US consumer. Right now, that consumer ain't consuming. And there's nothing in the pipeline that says

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he's going to be soon ready to start buying stuff with near the pre-crisis appetite we got used to seeing.

The headlines today include reports on permission given to 10 banks that will be able to payback government TARP bailout money. I discussed the sentiment surrounding this potential in [Currency Strategist](#) last Wednesday, when the government wasn't so fond of this earlier-than-expected repayment. (Below is an excerpt:)

Stress tests for all banks ... what a grand idea. This way we can find out which banks are capitalized just well enough to weather the worst of worst-case scenarios. We'll give them a grade of pass or fail. But regardless of the outcome, we'll also tell them how much capital they need to raise should times get a little tougher since it's obvious most of them are short on capital. A lot of attention engulfed these stress tests before the results were released. But afterwards, the market treated the diagnosis about as well as could have been hoped – the proctors succeeded in restoring confidence.

Re-enter the Feds.

Apparently now that some banks have raised capital and are more than ready to pay back TARP money loaned to them via bailout funds, their financial situation is being looked upon with a little more scrutiny ... or something, I guess. Their capital apparently is a little thinner than they were previously told was sufficient, and a little thinner than the government would like to see upon repayment of TARP money. Seems there are two ways to look at this:

- 1) The government wants to keep its fingers in the private sector pie, maintaining some authority over banks by increasing the requirements necessary before they jump ship on the Federal bailout.
- 2) The government wants to make certain that banks won't run back to its doorstep begging for more money and is doing due diligence to see that banks go about this transition prudently.

Regardless, it's being played as a way to further restore confidence by better ensuring that the banks will not false start during their recovery phase. So did the stress tests mean anything, or not?

Now that permission has been granted, should this serve as another boost of confidence? "Hey, the banks don't really need the government money; everything is back to normal. Wahooo!" [Heavy sigh ...]

Don't be fooled. Bank lending is still on hold – more or less. Counterparty risk is still a concern among banks, considering the large spread between the lowest and highest rates used in calculating Libor. Housing and automobile markets, especially in the US,

have crapped out and show few, if any, signs of recovery ... leaving new financing for these purchases dried up.

We starting to get an eerie feeling that there might be another whoosh of air escaping the financial system before things really get blown out. Will it be worse than the last wave? Who knows. But it won't be a here-today-gone-tomorrow sort of thing, I don't think.

U-shaped recovery? Maybe.

V-shaped recovery? Don't bet on it.

What about a W-shaped recovery? Unfortunately we'd only be somewhere around the middle.

Keep those tires full.

Regards,

John Ross Crooks, III  
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