



## Quotable

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“Honor is simply the morality of superior men.”

H.L. Mencken

## **FX Trading – How you know it is getting ugly out there: Paul Krugman.**

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“President Barack Obama, under pressure to bolster the U.S. economy, said on Monday he and his economic advisers are discussing additional steps to generate job growth such as more tax cuts for businesses.” (Reuters)

Officially, Paul Krugman is not one of Obama’s aforementioned economic advisers, but technically there may be a difference.

Paul Krugman, Keynesian worshiper through and through, is always arguing for government intervention and/or defending the current administration’s policies. That alone is frustrating enough. But reading his typically short-sighted economic “thought pieces” so graciously published in *The New York Times* can make your head hurt.

Back to Krugman in a moment ...

Economic sentiment today seems decisively negative, at least in what we read. Before, even though our bets were on a double-dip recession or at least another jolt in that direction, the consensus seemed less certain that we’d revisit recession. The recovery proponents, until very recently, outweighed the doomsday forecasters.

At this point the doomsday scenario is well-known. It is whether it is well-received that makes the difference. And it appears it is becoming more accepted.

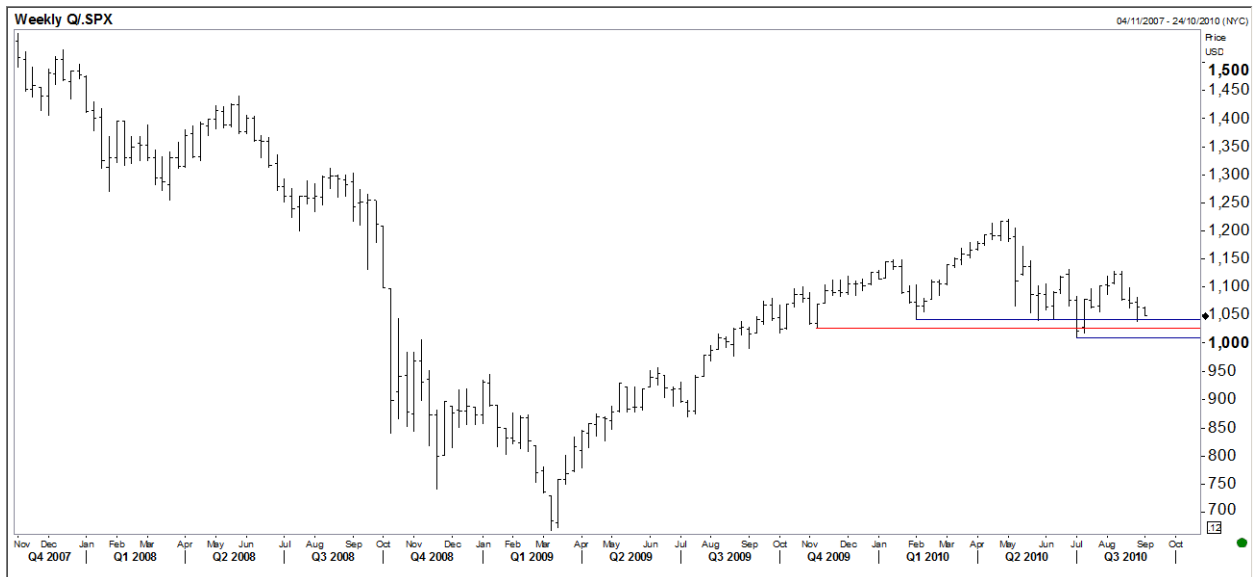
We talked about it last week, and now analysts are very much stewing over the signals being flashed by US corporations. Yes they’ve done an excellent job in shoring up their balance sheets; cost cutting and productivity increases are a wonderful thing if you can pull it off. But revenues aren’t going to be increasing now that companies are finished cutting the fat. Not if they’re unwilling to take risks and invest in expansion.

US consumer confidence is in rough shape. Deleveraging continues; the urge to spend is still contained. Consumers continue to lose value in their homes. There are now risks that wages will stagnate or, even worse, deteriorate.

Asset prices, at times over the summer, have been a bright spot ... with better-than-expected pieces of economic data sprinkled in here and there. But chances are the second quarter was a result of a rebound in market sentiment following a first quarter rally in the stock market. We've also mentioned on occasion how important the Federal Reserve believes asset prices (particularly the stock market) are to investors during harsh economic times.

So when the outlook for stocks starts to soften, what else do we have left to be optimistic about?

**S&P 500 Weekly:** a lot of near-term support between 1,050 and 1,000 ... but not much after that; there's certainly a target on the July low:



Last Friday, following the Jackson Hole summit, Ben Bernanke spoke and gave markets a boost. Stocks rocketed in response to his comments, which admittedly weren't anything special. It was typical Fed-speak that made sure everything was covered with the utmost care; no sharp objects allowed.

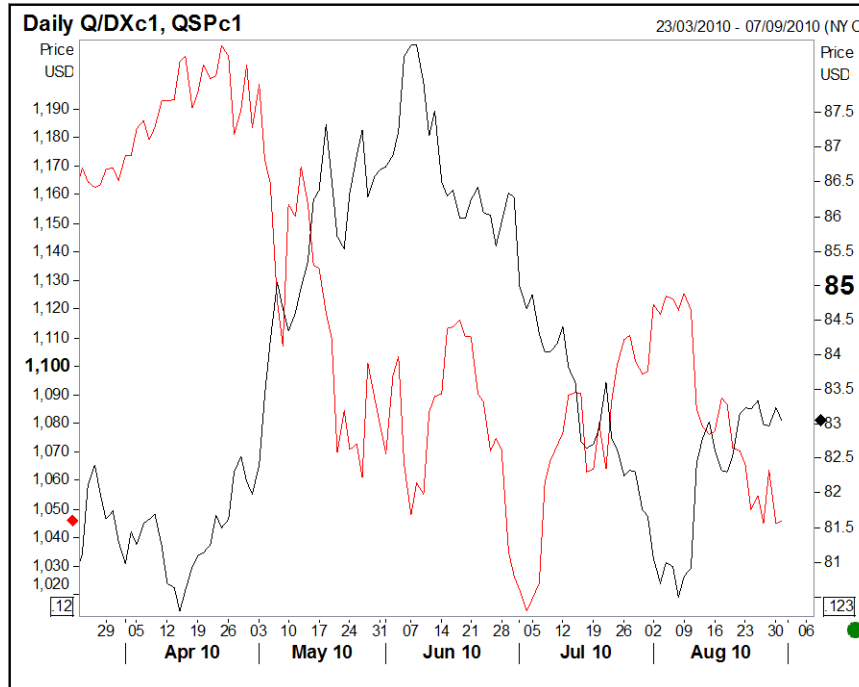
Oddly, but not surprisingly, to us, the stock market seemed to change its tune. Investors would welcome whatever quantitative easing the Fed would be willing to dish out. Who cares what they think of the economy; they're going to keep pumping money into the financial system which will make its way into asset markets ... rather than the real economy.

But all the difference a weekend can make. The Friday move in stocks appears to have been mostly a knee-jerk reaction. Yesterday and today has seen selling return and traders are far less optimistic about Federal Reserve action.

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In fact, there's a good chance most everyone is far less optimistic about the impact of the Federal Reserve, on both the markets and the economy. With monetary policy measures pushed to the side, there's only one other place to look.

Why do we worry about stock direction so? Well, because currencies are following it seems, the **mirror-like image correlation between the dollar index (black) and stocks (red)** remains pretty tight...



Cue Mr. Krugman.

Krugman is favoring a fresh new bailout, to the tune of \$800 billion.

Now, it's impossible to know the motives behind Mr. Krugman's proposal. But we can certainly wonder about the proposal's merit. And we can do the same regarding the merit of the already enacted stimulus.

For starters, we can't help but recall one of the destinations of the American Recovery & Reinvestment Act: kayak tours in Hawaii. Now we don't know if there's a connection between the Hawaiian-born Obama and that particular stimulus check, but do we really need to be stimulating Kayak tours? There must be more productive outlets we can support.

Like building Oyster beds in the St. Lucie River. That's right. Right here in Martin County, Florida where we call home, a stimulus check was cut to finance oyster bed restoration that would help naturally filter and clean the river water and revitalize our ecosystem. We don't even have time to go into all of our feelings on this. Suffice it to say this too is probably not an effective use of the stimulus money.

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So Mr. Krugman proposes we give Congress \$800 billion to divvy up as they see fit ... again. And of course that means “additional steps to generate job growth such as more tax cuts for businesses,” as Mr. Obama and his economic advisers have already said.

Yeah, right.

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## Leading the Way through Lower Highs, Lower Lows: An Opportunity!

You’re probably well aware of the correlation between major asset classes by now. And that goes to the same risk-on, risk-off trading theme that’s been driving capital flow.

The rally in stock markets through the month of July meant a similar rally in currencies, at the dollar’s expense. We called the beginning of the correction back in June when we alerted our Currency Investor members to exit a position that profited from a weaker euro. That trade netted a very nice gain. Since then we’ve been waiting for signals that the correction has come to an end, that the euro would resume its decline. We seem to have reached that point.

Sentiment has shifted back into bearish territory ... and the major global risks have not been addressed to any meaningful extent. A new, deep move lower in the euro could be triggered by a coming collapse in stocks. A failed test on the S&P 500 of critical resistance has been followed by a lower low and a lower high – the markings of a downtrend in the making. Will you be ready to play it? Will you know how?

[Currency Investor.](#)

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