Black Swan Capital

Currency Currents

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Quotable

" I am in favor of cutting taxes under any circumstances and for any excuse, for any reason, whenever it's possible. The reason I am is because I believe the big problem is not taxes, the big problem is spending. The question is, "How do you hold down government spending?" Government spending now amounts to close to 40% of national income not counting indirect spending through regulation and the like. If you include that, you get up to roughly half. The real danger we face is that number will creep up and up and up. The only effective way I think to hold it down, is to hold down the amount of income the government has. The way to do that is to cut taxes."

Milton Friedman

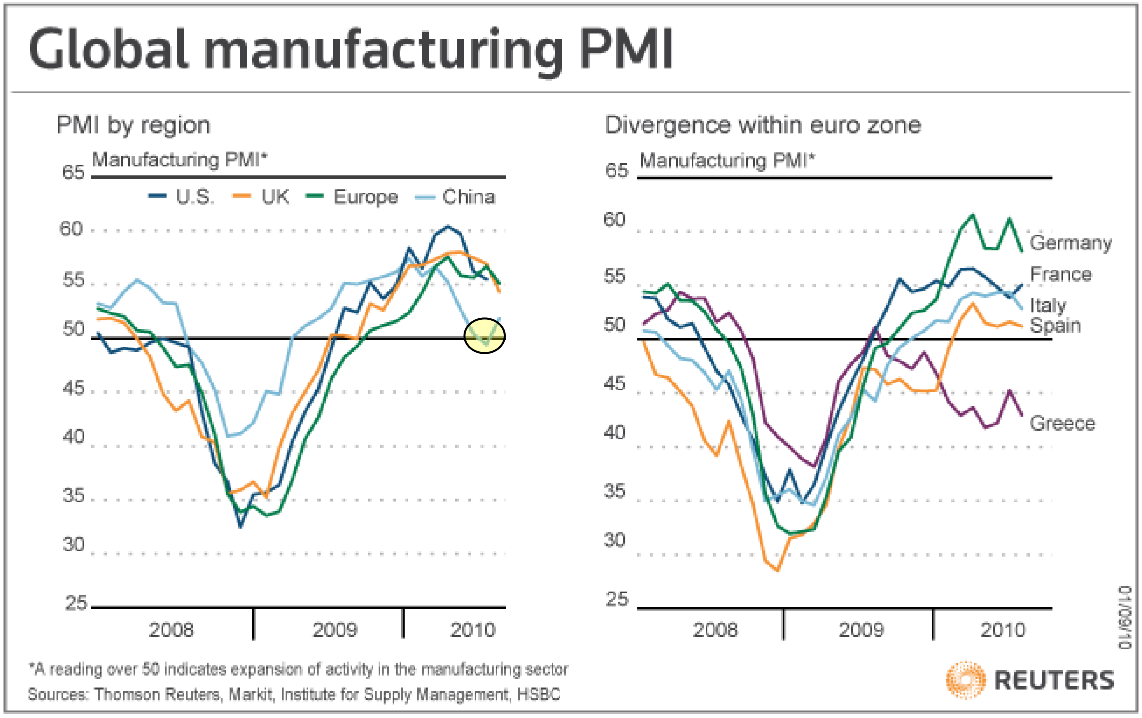
FX Trading – Risk on: China leading PMI could be good thing for growth…

We've been strident about the idea that global growth decoupling from the US is a myth. The idea being the US consumer is still the primary demand engine for the world, and Mr. US Consumer becomes all the more important as European demand heads into its austerity shell. But today's news has us wondering a bit about our stridency.

China's PMI rebounding above the 50-level this month, surprising some analysts, which includes us. We'd like to chalk it up to "official" Chinese numbers and such, but China growth seems to be validated by the stronger than expected growth reported by Australia this morning, which follows on the heels of weaker than expected growth in Canada. Hmmm … Australia is closer to China and Canada closer to the US; that may have something to do with it.

We found this chart on Reuters this morning showing the Purchasing Managers Index for the major regions, plus Eurozone. John Ross said to me, "I don't know about you, but it looks to me like US PMI is the highest among all these regions …" It looks that way to me too.

Note the China rebound back above the growth/no-growth 50-level, which sparked the commodities move higher this morning:



Reuters graphic/Scott Barber

But of course this game is all about expectations of the future, not the past. The US PMI is down about five points from its peak and trending lower. But then again, China's PMI dropped five points from its peak before rebounding this month. Also, note that China's PMI seems to be leading the pack at bit—giving weight to the view China *is* pulling the global growth wagon *and* the decoupling idea has legs.

And given the dynamics of the German export machine, its seems as China goes so goes Germany, now getting a lot more demand from there than the US, according to the latest analysis. The upshot is China and Germany and Asia and Emerging Markets pull the US along kicking and screaming. If that is the case, the yield differential favoring the rest of the pack over the US dollar could pay big dividends—we are seeing that today in the Aussie move, based on the view the Reserve Bank of Australia is back in the hiking game.

So if this seeming decoupling plays out, global risk expectations will ratchet lower, and the buck could be exposed again in a big way.

What to watch for:

- US stocks going higher
- US bond prices going lower
- German bund prices going lower
- German – US spreads widening
- Eurozone yield spreads tightening
- Commodities back in rally mode

We are looking for at least a two-day move here, as we roll into US non-farm payroll on Friday. If we get bad news again on the US job front, the decoupling theme will get a major test. Stay tuned.

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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.