CURRENCY CURRENTS
A free global-macro & market newsletter

Tuesday 31 October 2017

Quotable
"For theories and schools, like microbes and corpuscles, devour one another and by their strife ensure the continuity of life."

__Marcell Proust

Commentary & Analysis
Hawks unleashed could rock the markets


Run pug run; hawks are in the house!

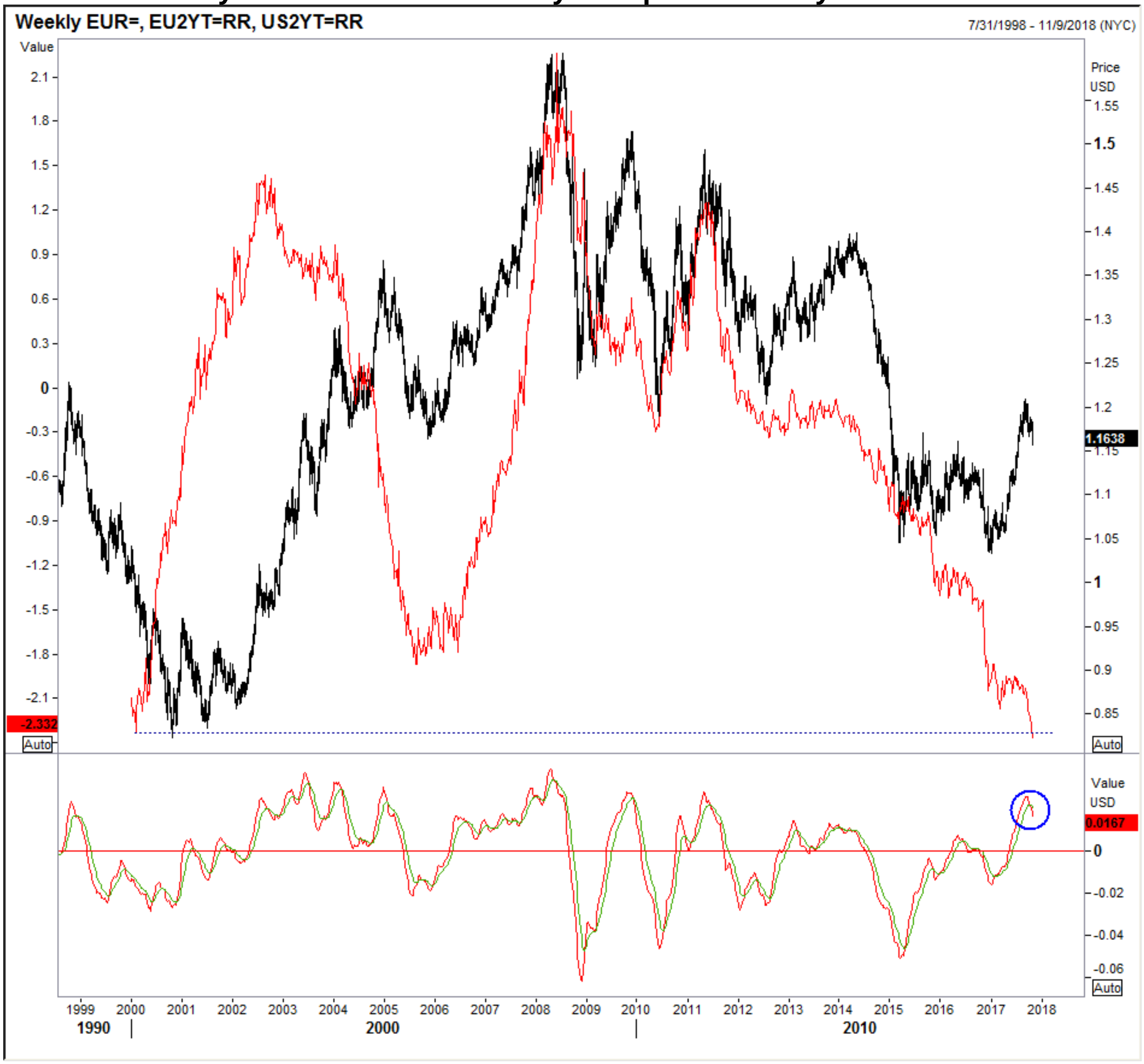
The chief hawk in this narrative is Stanford Economics Professor John Taylor (JT); aka the creator of the Taylor Rule for monetary policy. Should President. Trump pull a surprise out of his hat this week (Would it be a surprise if President Trump didn't surprise?), and appoints JT head of the US Federal Reserve Bank market will most likely get rocked in a big way as the monetary hawks emerge from their well-guarded cages.

According to the Taylor Rule, the current target for the fed funds rate should be about 2.94% instead of the paltry 1.15% it is now. Mr. Taylor's appointment wouldn't suggest an immediate 200 basis point rate hike from the Fed; but it would suggest future rate hikes will be faster and more furious than now anticipated.

Thus, here is how the market would likely react:

1) **The US dollar would soar in value**. Already the relative US dollar yield is crushing its competitors. Expectations of even higher yields would likely suck in even more hot money, making the euro an excellent funding currency, especially after Mr. Draghi so emphatically made it clear the ECB was going to hold off on hiking for much longer than many expected. Note, <u>the last time there was this big of a difference in the 2-year benchmark spread between the eurozone and United States was back in January of 2000 and then the EUR/USD exchange rate was around 0.9700</u>.

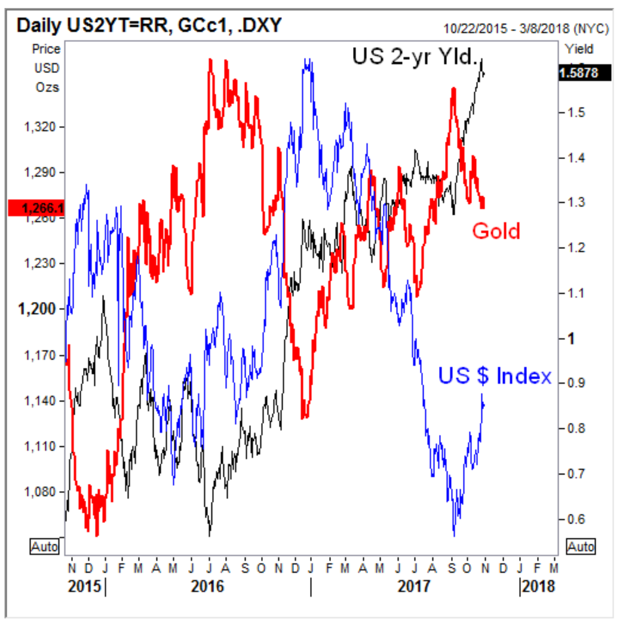
EUR/USD vs. 2-year Benchmark EU-US yield spread Weekly:



2) **Gold would take a swan dive**. We have already been expecting gold to correct lower; but if JT joins the party, gold would likely be crushed in a very big way. There is a solid negative correlation between gold and interest rates, as rising rates tend to make gold appear less attractive given it lacks yield. And over time, there has been a strong negative correlation between gold and the US dollar also. After all, gold is priced in dollars (at least until China someday changes that).

(Gold Daily Futures Next Page)

Gold vs. Dollar Index vs. US 2-year Yield: Gold's negative correlation (not always; not perfect; but over time…):



3) **Bonds would get battered.** Just the thought of a 200-basis point differential between where the Fed is now and where it should be according to the Taylor Rule would likely batter bonds in a big way initially. Whether the fundamentals flow-through to sustain a bond beat down is an open question.

10-year Treasury Note Futures (continuous) Weekly: Below the 55-week moving average; MACD has turned over; and even a standard retracement from the low back in 2000 *suggests* bond prices are heading lower.

Keep in mind, I am playing the "what if" game here when I share these charts.

The bet is President Trump names existing FOMC member, known entity, Jarome Powell as the next Fed chairman. So, no worries for Mr. Market. Well, no worries assuming JT doesn't sneak into the Vice Chairman slot. ☺ Stay tuned.

Las Vegas Traders Expo

I am speaking at the Las Vegas Money in on November 3rd, Friday. Below is a link and summary of my presentation and **sign up for a live stream** should you be interested.

https://www.moneyshow.com/events/conferences/tradersexpo/tradersexpo-las-vegas//workshop/f0113342d1b84363ac76e6d264d198a4/black-swan-foreign-currency-trading/?scode=043837

Here is **a summary of the event** and a list of speakers:

https://www.moneyshow.com/events/conferences/tradersexpo/tradersexpo-las-vegas/?scode=043837

Regards,

Jack Crooks, President, Black Swan Capital
jcrooks@blackswantrading.com
www.blackswantrading.com
772-349-6883/ Twitter: bswancap