Overview Tuesday 5 October 2010

- Some comments on the so-called "currency wars" the financial press is finally noticing. China is at the center, as usual. Gold is the beneficiary and should continue to be as long as this game is played. Only China can head off another major global conflagration. But we are not optimistic they will.
- Still picking on the crosses as euro into nosebleed seats ...
- Dollar getting whacked again today. CAD looking good; we like GBPCAD short a lot here and are looking to get short USDCAD (long CDZ0)! (See USDCAD chart in Chart Library); stopped out of EURCHF with small profit.
- More juice from the Bank of Japan (overnight announcement of more asset purchases). Expected more juice from the Fed. Rising expectation the Bank of England will add to its QE. Stocks liking it this morning. Risk appetite likes liquidity.

Economic Data (Reuters)

Market Briefs

- Japan BOJ cuts policy to 0.00-0.1% from 0.1%, plans Y5 trln asset fund.Rts
- FX US-Japan-EZ companies raising FX hedge ratios for 2011 DowJones.
- Brazil doubles foreign fixed inc.investment tax to 4% from 2%. Rts.
- Spain's Santander should sell UK stake to cut debts, E17 bln shortfall -Times.
- RBA holds its OCR steady at 4.5%, inflation likely to remain around 2.75%.
- NZ Q3 biz confidence net +6, Q2 +18; capacity utilization 90.39%, Q2 90.76%.
- U.K Sept CIPS Service PM 52.8I Vs 51.3 in Aug, 51.00 exp.
- E.Zone Sept Service PMI 54.1 vs 53.6 flash and 55.9 Aug.
- E.Zone Aug retail sales -0.4% m/m, 0.6% y/y vs 0.1/1.1% Jul, 0.2/ 1.4% exp.
- Japan Finmin Noda, hopes BOJ steps will stabilize forex. Rts
- Swiss Sept CPI +0.3% y/y, unchanged from Aug and in-line with market.
- Ireland must do more to mend finances, Moody's Hornung. Rts
- ECB's Trichet, China must make good on its flexible FX pledge. MNSI.
- ECB's Ordonez, markets over reacted to Spain in early days of crisis. Rts

Looking Ahead – Economic Data

- 14:00 ISM Non Manufacturing Index (Sep) (mkt 51.5, prev 51.5)

Looking Ahead – Events, Other Releases

- 14:15 Fed Outright Tsy Coupon Purchase (09/30/2016/ 08/15/2020) ($5.25 bln).

Quotable – *Blow-hard Buffet talking his book again?*

> The marriage of Buffett's suddenly unbridled optimism and China's perceived invulnerability is a fascinating milestone. Just two years after pushing a "buy American" campaign, Buffett is leaning toward a "buy Chinese" one.
>
> Terry Gou, chairman of Foxconn Technology Group, which makes parts for Apple Inc. iPhones, accuses BYD of stealing trade secrets. That, Foxconn claims in court documents, helped BYD double revenue from its handset business from 2005 through 2007. BYD countersued, claiming Foxconn gathered false evidence and conspired to hurt its business.
>
> Gou is critical of Buffett, too. "He doesn't know the technology," Gou told Bloomberg Businessweek last month, referring to the batteries used in electric vehicles and plug-in hybrids. **"He just used his name to speculate on the stock."**

William Pesek, full story on Bloomberg

Commentary & Analysis

A different way of saying the same thing: fiat Armageddon (except for in Europe?).

Let's start off by paraphrasing a quote we came across earlier today:

> Everyone is trying to depreciate their currency except Europe.

Here's a piece we took from Reuters today:

> The Bank of Japan is getting the message. The U.S. Federal Reserve and the Bank of England have engaged heavily in quantitative easing to avert deflation. Now the BoJ, kicked by Japan's politicians, is talking about QE and achieving "price stability".

And in last Friday's audio/visual summary we made this analogy:

> *Quantitative* easing is to the Federal Reserve ... what *qualitative* easing is to the European Central Bank

The currency wars began a while ago—the financial press is now catching on as a theme fit to print. As we all know, China is at the center of this war and the primary aggressor.

Though undeclared still, with lots of covert activity, much is becoming clear. Even Europe is stepping up to the plate to criticize China. Eurozone officials followed through on yesterday's report that they would pressure China to free up the yuan so as to reduce "competitive" pressure on American and European businesses.

> Euro area policymakers pressed China on Tuesday for a faster appreciation of its currency to help rebalance the world economy but said Chinese Prime Minister Wen Jiabao had differed with them.

[Europe takes the brunt of this as it is squeezed on both sides by China and the US. The US wants currency rolled out like toilet paper to fund global growth; China wants to remain pegged to the advantage of its one-way-bet export model; Japan doing all it can (stepped up asset purchases this morning) to keep the yen from surging more. The money must go somewhere so to the euro it goes (and comdols thanks to, you guessed it, Chinese growth and liquidity) despite the growing periphery warts -- Ireland dead in the water; ditto Greece; Spain spiraling lower; and Portugal is on the slide. Shows the power of beneath-the-surface money flow despite what the above-the-surface fundamentals might be hinting.]

Oh, and did we mention most Asian central banks are intervening regularly to keep their currencies form going higher so they can maintain some semblance of competiveness against China (see ... back to China again).

So, in retrospect, it is a powerful reason why gold is hitting new all-time highs seemingly every day. It appears gold is telling us currency wars is equivalent to fiat Armageddon. We of course aren't there yet ... but ...

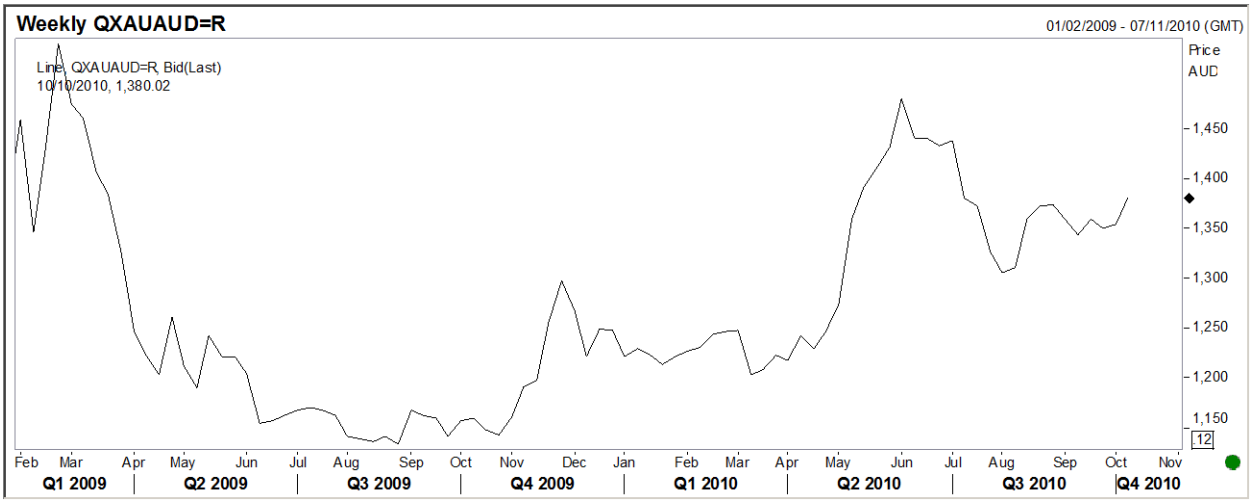
Gold Futures Weekly:

It's been a steady ride higher for gold since the credit crisis of 2008 – albeit a ride on the Space Shuttle.

But of course not *all* countries are looking to depreciate their currency (at least not at this time). At least they are not actively intervening; it doesn't mean the like what is happening.

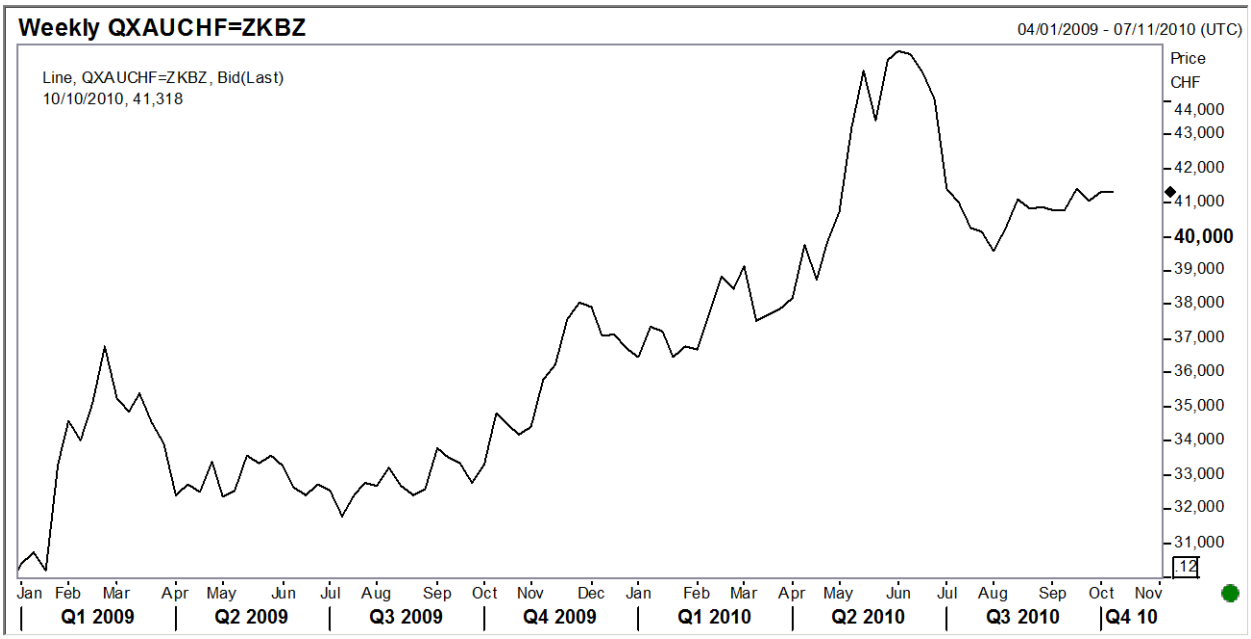
If we look at the gold price in some of these other currencies, it could mean there is still buying power out there.

Gold/AUD Weekly:



Sure, the RBA opted not to raise interest rates today, but they don't appear concerned that a steadily stronger Australian dollar is posing any problems right now; thanks to being a satellite country of, you guessed it, China. Rate hikes could resume as early as next month.

Gold/CHF Weekly:



Yes, we know the SNB gets antsy time and again, coming in to intervene in the value of the Swiss franc as it strengthens (specifically relative to the euro). But money is flowing their way so their intervention may have slowed things a bit (arguably), but effectively it hasn't helped much. Real money flow trumps central banks. Period!

And Canada's not making concerted efforts to depreciate; New Zealand isn't either. Norway? Nope. In fact, on the Economist Big Mac Index, the Norwegian currency is the most overvalued of them all. Now inching into the 70% overvaluation range against the US dollar -- yikes!

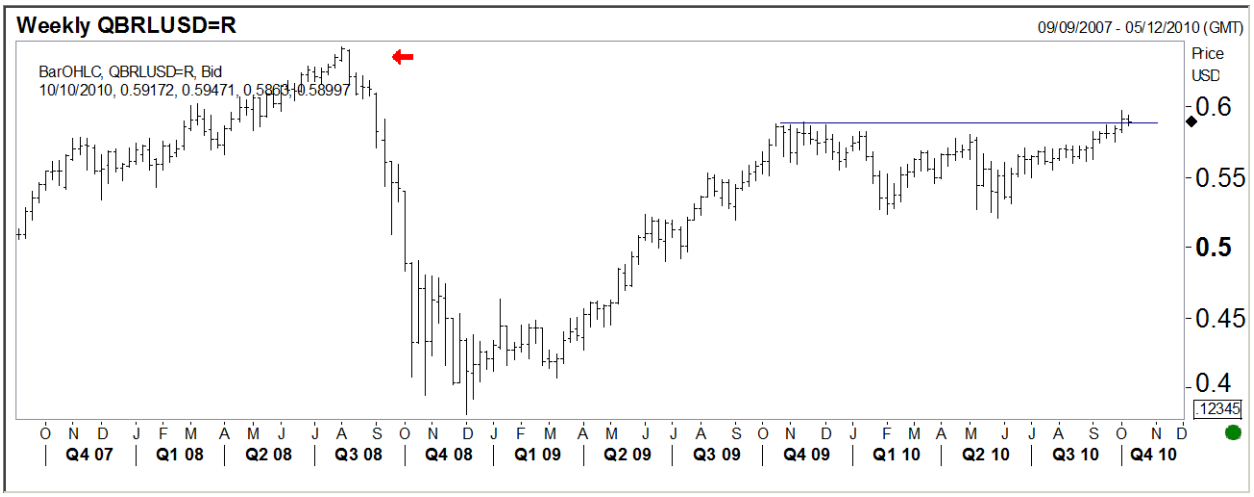
Brazil? Ok, maybe Brazil doesn't want the real to move any higher for a while; they love playing with capital controls and just recently increased a tax on foreign fixed income investment for this purpose. But again, it may be for naught.

And speaking of Brazil, its finance minister came out with some raw comments on currency wars, seemingly fearful of what this building tension between China and the West might bring. Here's what Leto Research said about it when the comments were made:

> Brazil's Finance Minister Guido Mantega stated the obvious this week, saying that the world is now in an "international currency war." This is true, and it is frightening. Although in my year-end 2009 forecast I stated that the much-touted G-20 "global governance" would collapse sometime this year, even my worst fears had not gone so far as to predict that the words "international currency war" would be uttered by a government of the G-20.

Brazil is probably twitching a bit as the real pushes up through resistance relative to the dollar. It seems the next logical stopping point is the pre-credit crunch high.

BRLUSD Weekly:



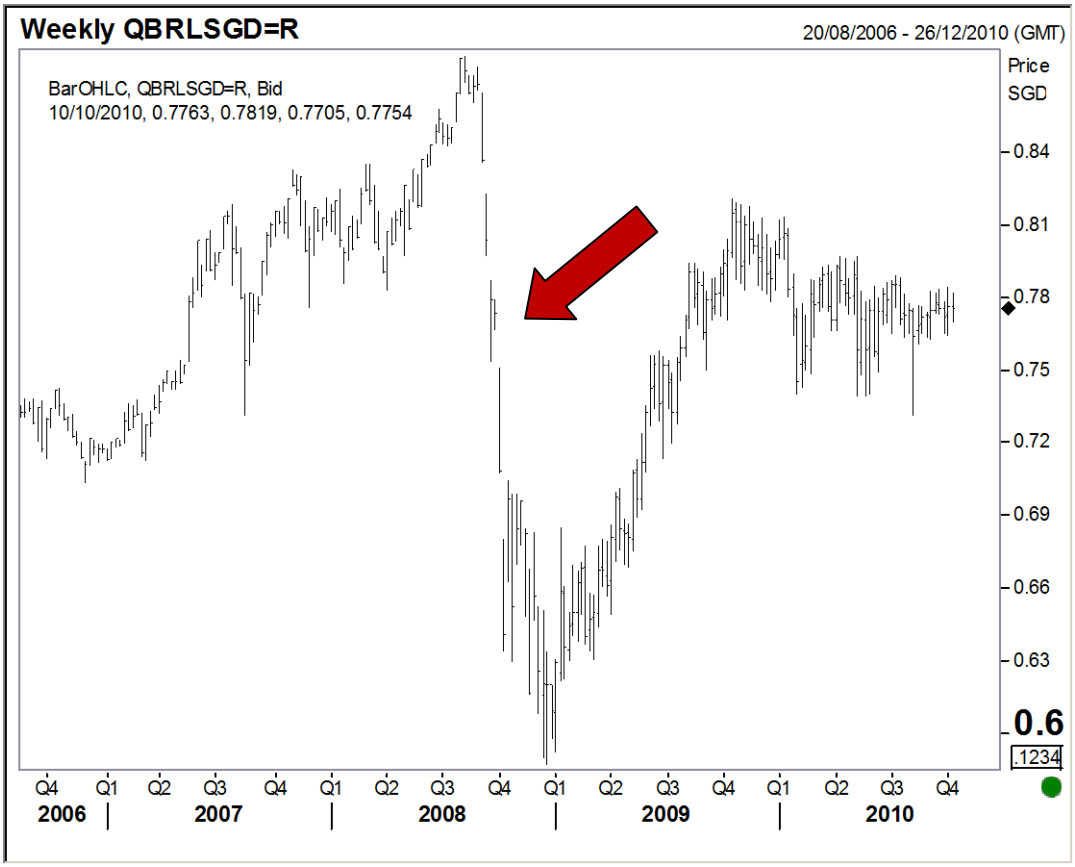
Brazil is no stranger to capital controls, but as is a concern among Japanese officials: does it make sense to step in and intervene when the US dollar has come under such pressure with an endpoint to its slide just anyone's guess?

Adapted from the immortal words of Dan Patrick:

> You can't stop the Brazilian real; you can only hope to contain it.

[Why is Brazil so vocal when other emerging/develop market countries are quiet? It is because Brazil runs a persistent current account deficit; a rising currency for a deficit country has more dangerous implications than for a surplus one. Thus it is why its currency got hit so hard during the credit crunch relative to the Asian block countries.]

Brazilian real versus Singapore dollar Weekly: Notice how this pair plunged during the credit crunch?



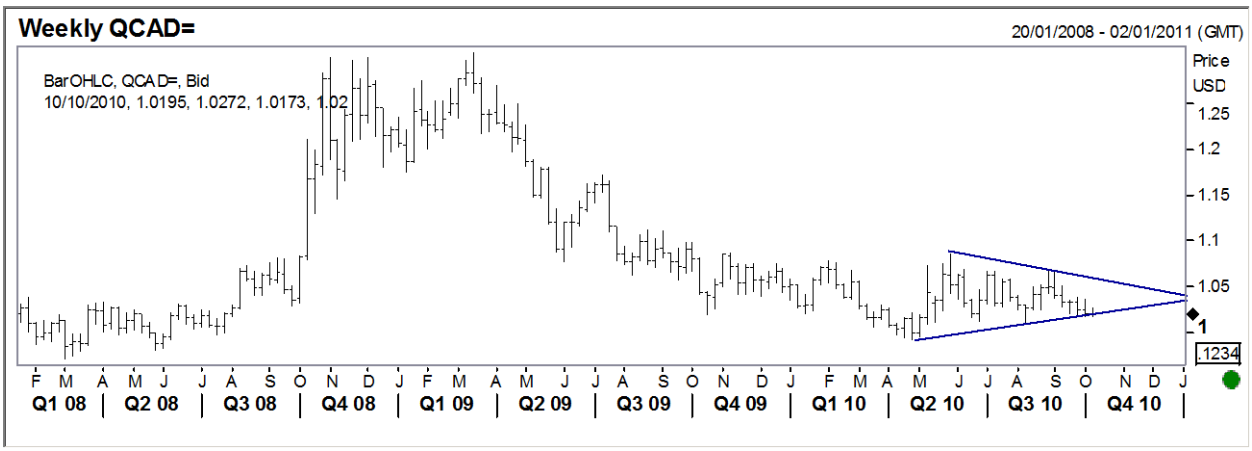
So where do we go from here? Anyone's guess! Because no one can seem to predict what China will do, other than remain belligerent and keep saying to the world: "The currency doesn't matter."

The bottom line is this: Until China gets serious about its currency valuation, it will not be able to rebalance its lopsided economy. And as the powers that be inside China (and outside) continue to pump credit into infrastructure at well below market interest rates, creating greater and greater amounts of capital dislocation, the global economy will not rebalance. Period! This path means it is only a matter of *when* we get the next global conflagration, not *if*.

For now, it seem the decision is easy: unload those ugly greenback as fast as you can. But, keep in mind what usually happens when a trade "gets easy." Just saying!

Chart Library

USDCAD Weekly: this pair is revisiting the underside of a symmetrical wedge pattern; a major breakout lower is in sight. As we've seen over the last several weeks the Canadian dollar has considerably lagged the other commodity currencies due simply to its tight-knittedness with the US. We think the Canadian dollar can play catch-up, especially if developments in the US exceed expectations that are prompted Fed QE speculation. The first wrench in that story could come Friday with a potentially better-than-expected US Nonfarm payrolls report. Keep in mind that breakouts like this on a weekly basis typically pack some serious punch.



For the above reasons we have recommended placing an order to **sell USDCAD (buy CDZ0)** on a stop, per Alert #310, roughly 10 PIPs below today's low. This has the potential to be a big and fast move; we want to be there to play it.

Trade Summary

Open Positions

Entry Date	Alert #	Symbol	Long (Short)	Entry Price	Stop Loss	Last Price	Profit PIPs	Profit Target	Percent Returns
MAJORS									
9/28/2010	301	EURGBP	Long	0.8550	**0.8620**	0.8697	147	0.8800	1.7%

10/04/2010	307	GBPCAD	Short	1.6166	**1.6260**	1.6157	9	1.5400	0.1%

Recent Activity:

We were stopped out of short EURCHF with a profit of around 35 PIPs, per our adjusted stop-loss order in Alert #309.

Open Orders
9:45 AM ET

Issue Date	Alert #	Symbol	Buy (Sell)	Entry Price	Stop Loss	Profit Target	Last Price
10/05/2010	310	USDCAD	Short	1.0155	1.0272	0.9400	1.0187
		CDZ0	Long	0.9801	0.9714	1.0617	0.9800

Regards,

Jack & JR