<u>THE FOREIGN EXCHANGE BATTLEFIELD: ADVANCES AND RETREATS</u>

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"The Cure" asks in their song "Out of This World":
"When we think back to all this and I'm sure we will
Me and you, here and now
Will we forget the way it really is
Why it feels like this and how?"

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<u>OVERVIEW AND CONCLUSION</u>

In the foreign exchange battlefield, most financial, political, and media storytellers and propagandists focus on currency cross rates between two nations, such as the US dollar versus the Euro FX or the dollar against the Chinese renminbi. However, analysis of the broad real trade-weighted effective exchange rates for a given country provides better insight into the overall currency strength or weakness for that nation. Let's concentrate on currencies of the major advanced/developed G-7 economies as well as China.

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Marketplace history of course need not entirely or even substantially repeat itself. In recent years, devoted central bank generals, via diverse strategies such as sustained yield repression and massive money printing, have battled fervently to ensure sustained economic growth, manufacture sufficient inflation, and slash unemployment. Politicians have fought fiercely to ensure recovery, especially by deploying their deficit spending arsenal.

However, recall the emergence and acceleration of 2007-09"s worldwide economic crisis. And ask to what extent the serious debt and leverage problems of the Goldilocks Era genuinely have been cured.

The recent sustained advance of the United States broad real trade-weighted dollar ("TWD") warns of erosion in global economic output rates. The TWD probably will continue to appreciate.

The substantial depreciation of the Euro Area and Japan real effective exchange rates ("EER") likewise flag weakening (and oncoming reductions in) worldwide real GDP rates. So does the slump in the Canadian EER; Canada's dive partly reflects the murderous price collapse in the commodities sector. Though Australia is not a G-7 nation, like Canada it is a developed nation and a major commodity producer. Its EER likewise has tumbled.

The United Kingdom's EER has been fairly powerful in recent months. In part, this probably reflects the comparative economic weakness of its key trading partner, the Euro Area.

Both the US dollar and Chinese renminbi real EERs marched higher during the darker days of the fearful 2007-09 disaster. Their present-day EER patterns, though not identical, likewise have been bullish; this intertwining further indicates the likelihood that growth rates in international GDP will surrender ground. Although the Chinese EER trend has been bullish in recent months, the renminbi has retreated against the US dollar; this renminbi cross rate weakness points to a slowing Chinese economy.

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The essay, “Crumbling BRICS: a Currency Perspective” (2-11-15), studies the effective exchange rates for Brazil, Russia, India, China, and South Africa (plus Mexico). Its analysis supports the key arguments and conclusions related to the advanced nations.

On 3/6/15, the S+P 500 celebrates the sixth anniversary of its 3/6/09 major low at 667. The stock marketplace rally since March 2009 obviously has been explosive. However, the TWD’s current trend and level, when interpreted alongside the real EERs of other G-7 advanced nations and China (and alongside other factors such as emerging stock marketplace, commodity, and interest rate trends), indicate that the S+ P 500 probably has established a notable top (2/25/15 high 2120) or will do so in the near future.

“Crumbling BRICS” states: “Recall the acceleration of the worldwide economic crisis (and decline in the S+P 500) in 2008 as the broad real TWD appreciated. The S+P 500’s major peak occurred 10/11/07 at 1576, but its final high was 5/19/08 at 1440, close in time to the April 2008 TWD bottom. The S+P 500 collapsed from around 1313 (8/18/08)/1265 (9/19/08). The S+P 500’s major bottom at 667 on 3/6/09 occurred the same month as the broad real TWD pinnacle.”

THE ROBUST AMERICAN DOLLAR

In his novel “The Pit”, Frank Norris describes the Chicago futures trading floor, “where the rush of millions of bushels of grain, the clatter of millions of dollars, and the tramping and the wild shouting of thousands of men filled all the air with the noise of battle! Yes, here was drama in deadly earnest- drama and tragedy and death, and the jar of mortal fighting.”

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The broad real TWD established a major bottom at 84.2 in April 2008 (Federal Reserve Board, H.10; monthly average, March 1973=100; 3/2/15 release). After climbing to 86.7 in August 2008 and 88.8 in September 2008, it jumped to almost 93.9 in October 2008. Recall the dramatic acceleration of the murderous worldwide financial crisis after mid-September/October 2008. Its March 2009 pinnacle around 96.9 represented a 15.1 percent bull advance relative to April 2008.

After deteriorating to its major and all-time low around 80.5 in July 2011, the TWD slithered sideways within a narrow avenue for about three years. Its high over that span was June 2012’s 86.2. But in recent months, as it did beginning in April 2008, the broad real trade-weighted dollar has mounted steadily higher.

A fifteen percent bull charge in the TWD from its July 2011 trough gives 92.6, a 20pc leap about 96.6 (compare March 2009); a 25pc rally reaches 100.6, a 33pc jump 107.3. The TWD’s February 2002 pinnacle was 112.8, its all-time high occurred three decades ago with March 1985’s 128.4 summit.

September 2014’s 86.4 broke through June 2012’s barrier, with December 2014’s racing up to 90.6. January 2015’s 92.1 advanced 2.1 percent over December 2014. February 2015’s 93.2 motors 1.2pc above January. The broad TWD’s 15.8 percent ascent from the July 2011 hole (93.2/80.5) surpasses its April 2008 to March 2009 leap. Significantly, its February 2015 elevation borders October 2008’s and stands within firing distance of March 2009’s 96.9 plateau.

GLOBAL CONTEXTS: CURRENCIES NOWADAYS AND 2007-09'S CRISIS

The Beatles sing in "Revolution":
"You say you got a real solution
Well, you know
We'd love to see the plan
You ask me for a contribution
Well, you know
We're all doing what we can".

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What do FX movements (trade-weighted, effective exchange rates) for the other advanced/developed G-7 economies and China reveal? Why not compare their recent travels with their adventures during 2007-09's disaster?

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The Bank for International Settlements provides real effective exchange rates ("EER"; CPI based; monthly average, 2010=100) for numerous nations around the globe. The latest BIS release 2/16/15) provides data through January 2015. The BIS currency weights (broad indices) for the trading partners of a given country are based on 2008-10 trade.

The TWD's rally during February 2015 hints that the current trends manifested in the table probably continued during February 2015.

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The trading patterns for the broad real TWD very closely resemble those reported by the BIS for the US dollar EER. After the US EER achieved a major low at 96.4 in April 2008, it leaped to 101.2 in September 2008. It soared to 106.8 in October 2008, peaking at 110.6 in March 2009. Compare the US EER 93.0 July 2011 bottom and June 2012's 99.7 interim top with those for the TWD. In September 2014, the EER blasted its way to 100.5. December 2014's EER was 104.4, and January 2015's 107.4 exceeds October 2008's height.

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The EER moves for the various currencies in the following table do not occur in precisely the same fashion. Within a given currency "era", crucial start dates and end dates sometimes differ, and the percentage advances (retreats) by the various EERs are not always the same. In addition, the times of important EER trend change points for the Euro Area and other nations do not always exactly coincide with the rally in the broad real trade-weighted dollar (whether in 2007-09 or in the current scene). The direction of current EER trends for a couple of the G-7 nations (Japan and the UK) in the current scene differs from what they were during the worldwide economic crisis. Nevertheless, nowadays the various EER travels of the G-7 nations and China (when interpreted together) unveil a present-day pattern in relation to the TWD's major trend that should inspire viewers to recall 2007-09's events.

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"War is decided only by battles, and it is not finished except by them. Thus they have to be fought, but it should be done opportunely and with all the advantages on your side." Frederick the Great, "Instructions to His Generals (chapter XXI)

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THE CURRENT FX BATTLEGROUND **THE GLOBAL CRISIS ERA (2007-09)**

EURO AREA

The large Eurozone economies, France, Germany, and Italy, also belong to the G-7. The various Euro Area members of course differ in many respects from the economic vantage point. Yet as the European periphery crisis negotiations and actions of the past few years underscores (including the recent continuation of the epic Greece saga), the often quarrelsome Euro Area nations remain stuck in the same foreign exchange foxhole from the currency (Euro FX) perspective.

Although the Euro FX was launched January 1, 1999, BIS figures adjust for the prior period.

Recent High(s)	Recent Low(s)	High	Low
101.8; April 2011	91.3; Jan 2015	112.0; April 2008	102.6; Nov 2008
101.6; March 2014			
(+ remember 111.0; October 2009)			

[January 2015's real EER level is a notable drop from December 2014's 96.5 (and October 2014's 95.6). A ten percent fall from 101.8 is 91.6, a 15pc slide 86.5, a 20pc tumble 81.4. The all-time EER low since 1994 is October 2000's 82.3.

In 2008, the cratering Euro FX EER coincided with the acceleration of the global economic crisis. Money printing by central banks around the globe, with the European Central Bank recently joining their ranks, has aimed to head off a similar crisis.

April 2008's 112.0 is the record 1994-2014 Euro EER pinnacle (a 20pc descent from this is 89.6). The Euro EER rallied up to 111.0 in October 2009, close to April 2008's ceiling (which also was close to November 1995's major top at 111.5). Yet it then began wasting away as the European "periphery" crisis erupted and persisted. Thus the major bear move for the Euro FX EER began in October 2009, even earlier than the important interim highs of April 2011 and March 2014.

Compare the timing of the significant Euro FX EER high in April 2011 with the broad GSCI's major peak at 762 (4/11 and 5/2/11). Also keep in mind the spring 2011 peak in emerging marketplace stocks (MSCI Emerging Stock Markets Index, from Morgan Stanley; "MXEF"). The MXEF's 4/27/11 summit at 1212 has not been breached.

Note the steady decline in the Euro FX EER since its April 2014 top. The Euro FX cross rate highs against the US dollar were around 1.397 (3/13/14)/1.399 (5/8/14). The broad GSCI raced downhill following 6/23/14's interim top at 673, crashing after 10/29/14's 549 minor high.

Are the Eurozone, Japan, and other nations with slumping EER currency levels hoping for sufficient growth (and to combat unemployment and escape too low inflation/deflation) engaged in desperate competitive devaluations or even ferocious currency wars?

Central bank yield repression strategies, "investment" flight to quality (safe haven) concerns, low inflation readings, and supply/demand for high quality collateral partly explain low government interest yields in nations such as Germany and the United States. Yet is toleration of negative government interest rate yields in many Eurozone countries in part a sign of willingness to engage in such ongoing currency combat?

On the Euro FX versus US dollar cross rate front, the Euro FX's bear campaign to near 1.100 has crashed beneath prominent support at 1.233 (10/28/08 financial crisis bottom), 1.204 (7/24/12; recall the ECB's "whatever it takes speech" around then), and 1.188 (6/7/10; European periphery crisis), and 1.164 (11/15/05 low).

For the Euro Area's EER, China has the largest percentage share, at 17.0 percent. The United States represents 14.3pc, the United Kingdom 10.7pc. Japan has 6.0pc, Switzerland 5.3pc, Poland 4.7pc, Czech Republic 3.7pc, Sweden 3.2pc, and Russia 3.0pc.]

UNITED KINGDOM

The British military commander, Wellington, who defeated Napoleon at Waterloo, remarked: "I have been passing my life in guessing what I might meet with beyond the next hill, or round the next corner."

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Recent High(s)	Recent Low(s)	High	Low
112.6; July 2014 112.1; January 2015	100.2; March 2013	130.2; January 2007	94.2; Jan 2009

[In 2007-09's crisis, the bearish wound suffered by the United Kingdom EER was even worse than that endured by the Eurozone EER in its decline. However, this time around, the UK EER's recent advance contrasts with the Euro Area's EER retreat. This current UK EER strength, particularly when contrasted to the Euro Area's EER feebleness, partly reflects the UK's relatively better economic prospects and that it stands outside the Euro FX Area.

The UK, like the US, is viewed by many as a recovering economy. The IMF predicts UK growth will be 2.7 percent in 2015 and 2.4pc in 2016 (2014's was 2.6pc). According to the IMF, Euro Area real GDP was merely .8pc (and negative in 2013, at -.5pc), with 2015 estimated at 1.2pc and 2016 at 1.4pc (the European Central Bank predicts expansion of 1.5pc in 2015 and 1.9pc in 2016; 3/5/15 ECB Press Conference).

The worldwide 2007-09 crisis eventually encompassed both the UK and the Eurozone. However, although that crisis of course significantly involved Europe, it did not focus (concentrate primarily on) a European (or Eurozone, or European periphery) problems. So the UK during the crisis was mixed in together with the rest of Europe.

Obviously the Eurozone has been and remains very important to the UK. However, the Eurozone's current situation (role) and troubles in the worldwide context differ to a significant extent from those it confronted during the 2007-09 period. Roughly stated, and even though the world economy is global and interconnections between important nations are strong, the Eurozone at present (and since around late 2009) has its own special problems. Nowadays, the UK does not directly endure a "European periphery crisis" (there is no Greece or other fragile nation in the UK) or as dreadful a deflation/too low inflation fear as the Eurozone (the UK began quantitative easing several years ago). So since the UK does not belong to the Eurozone, in the current global context, the UK EER is more independent of the Euro Area's situation (and EER) than it was in the global crisis era.

The UK EER attained its record peak in April 2000 at 134.3. Its record floor is January 2009's 94.2. The UK EER rally gradually gathered force following its March 2010 interim low at 96.0.

The Bank of England's effective exchange rate history extends back to 1980 (monthly average; January 2005=100). The record high was January 1981's 108.0, with the record floor February 1993's roughly 74.5. It stood at 87.2 in January 2015, a climb of over eleven pc from March 2013's 78.5 bottom.

The Eurozone represents the largest share of the UK EER, at 46.5 percent. America's weight is 11.3pc, China 11.0pc, and Japan 3.7pc.]

CANADA

Recent High(s)	Recent Low(s)	High	Low
104.3; April 2011	86.3; Jan 2015	106.8; Nov 2007	84.6; Mar 2009

[November 2007's 106.8 is the Canadian Dollar EER 1994-2014 peak. Its record bottom is November 2001's 71.7.

Unlike the United States broad real TWD, the Canadian Dollar EER slumped during the lamentable 2007-09 downturn. A similar pattern exists in the current currency landscape. Whereas the TWD travel has been bullish, the Canadian Dollar EER has moved down a bearish path.

The weakening trend for Canadian Dollar EER has lasted several years. Though Canada is an advanced (and G-7) nation, its substantial and diverse commodity outputs inspire many marketplace warriors to label the CD as a commodity currency. Note that April 2011's EER height occurred about the time as major highs in commodities in general (broad GSCI). Canada EER has plummeted alongside the accelerated decline in the broad GSCI that commenced in late June 2014 (July 2014 interim high in the Canadian EER at 93.7, slipping from prior interim tops within its ongoing bear trend of 98.6 in May 2013 and 102.4 in September 2012).

In the cross rate arena, compare the Canadian Dollar's recent low during its bear move so far versus the USD, 1/30/15 at about 1.28 (broad GSCI low in its recent bear move 1/29/15 at 372), with 3/9/09's bottom near 1.31.

At 58.4pc, the United States by far has the largest trade weight within Canada's EER. China captures 11.9pc, the Euro Area 8.6pc, and Mexico 4.3pc.]

AUSTRALIA

Recent High(s)	Recent Low(s)	High	Low
111.8; Aug 2012 110.3; Apr 2013	94.9; Jan 2015	93.8; July 2008	74.7; Feb 2009

[Australia, unlike Canada, is not a G-7 member. However, both it and Canada are developed nations (not emerging marketplaces). Since many view the Australian Dollar, like the Canadian Dollar, as a commodity currency, it pays to monitor the Australian EER alongside the Canadian one. The pattern and timing of the Australian EER's twists and turns do not exactly mirror the maneuvers of the Canadian EER, but they resemble them. Australian EER, like Canada's, fell during the worldwide economic crash. Both currencies have slumped in recent years.

The Australian Dollar's EER record high is August 2012's elevation. March 2001's 64.6 is its all-time low. Like Canada's EER, Australia's fell notably from its July 2014 level (101.5) as commodities tumbled downhill.

China is Australia's biggest trading partner, holding 21.1 percent of Australia EER. The Euro Area enjoys a substantial share, at 17.2pc. So does the US (14.4pc) and Japan (11.1pc). Thailand represents 4.7pc, Great Britain 3.5pc, and New Zealand 3.4pc.]

JAPAN

Recent High(s)	Recent Low(s)	High	Low
105.7; October 2011	69.1; December 2014	106.6; January 2009	79.4; July 2007

[During the 2007-09 worldwide economic disaster, the Yen EER trotted from its July 2007 low to 85.9 in September 2008. Like America's TWD, it thereafter soared, up to 95.5 in October 2008 and thereafter to its January 2009 apex. Although during this crisis period Japan's EER bull ascent began prior to the bull move in the US TWD, the currencies of both nations (and China) advanced.

After declining to 94.3 in April 2010, the Yen EER marched up to 105.7 in October 2011, close to January 2009's major peak. After this, the Yen EER came under assault, and began to crumble following July 2012's interim high at 102.7. By January 2013, it was 86.9. Under siege, and further propelled lower by the Bank of Japan's easy money policies and the tactics of "Abenomics", the Yen EER sagged below 80.0 after August 2013. By December 2014, it had withered to a new depth of 69.2 (and a record low for the 1994-present span), down about 34.5 percent relative to its October 2011 plateau. The Yen EER's January 2015 level hopped up only slightly, to 70.8.

Thus the Japanese EER's bloody bear trend over the past couple of years contrasts dramatically with its glorious bull charge during the worldwide financial crisis that emerged in 2007 and accelerated in 2008. The downtrend of the Yen EER in recent months also differs from the rallies in the TWD and Chinese EER.

What about a very long term viewpoint on the Yen EER? The December 2014 level fell off a cliff relative to April 1995's all-time high at 150.3, declining around 54.0 percent.

Over the past couple of years, in its quest to ensure significant real growth and vanquish the deflationary demon, Japan probably has engaged in competitive depreciation and currency warfare. In any case, Japan, despite its monumental currency depreciation and monstrous (gigantic) quantitative easing, still has mediocre economic growth and too low inflation.

Japan's economic sluggishness and low inflation in the face of its sustained EER depreciation and huge money printing program represent an important danger warning regarding prospects for worldwide economic growth. The current (and rather long-running) bearish Euro Area EER trend, especially when viewed alongside the Yen EER's slump (as well as the US TWD's significant rally both during the acceleration of the 2007-09 crisis and in the current period), provides further reason for alarm regarding future international real GDP output rates. So far the Eurozone, like Japan, has mustered only mediocre growth despite its currency weakness. And despite the European Central Bank's recent embrace of large-scale money printing via its government securities buying scheme, those watching the financial battlefield should question whether the

Eurozone over the long run will succeed any better than has Japan in generating sustained real economic growth.

According to the BIS, for the Japan EER, China has the greatest weight, at 29.5 percent. The US grabs 16.6pc, the Euro Area 14.0pc. South Korea takes 5.9pc, Chinese Taipei 3.8pc, and Thailand 3.6pc.]

CHINA

Sun Tzu states in "The Art of War" (Chapter III, "Offensive Strategy"): "what is of supreme importance in war is to attack the enemy's strategy."

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Recent High(s)	Recent Low(s)	High	Low
128.4; Jan 2015	114.0; May 2014	107.4; Feb 2009	88.7; Oct 2007
			(+ low 83.8 May 2006)

[Although China is not a G-7 member, its economy is larger than most G-7 members. Because China plays a crucial role in the global economy, currency marketplace sentinels should closely watch its foreign exchange trends and levels.

The renminbi's widely-watched current cross rate level against the US dollar level, near 6.27, indeed is about 3.8 percent lower than its 1/14/14 cross rate high of 6.04. However, this rather minor cross rate shift, when seen in the context of the context of China's forceful EER bull move, does not tell the entire Chinese currency story.

Unlike the crumbling effective exchange rates for the currencies of several members of the BRICS squadron (Brazil, Russia, India, and South Africa) and Mexico over both the current and financial crisis eras, China's EER shows a significant bullish pattern. Looking ahead, these currency patterns alongside TWD strength do not merely confirm the TWD bull move, but also emphasize the likelihood of further slowing of global real GDP.

China's EER has been on a long bull run. According to the BIS statistics, January 1994's 65.6 is the record low for the 1994-present horizon. The relatively modest 11.0 percent China EER fall from February 2009's high at 107.4 to its November 2009 bottom at 95.6 did not last long. After November 2009, China's EER marched higher, reaching 121.2 in January 2014. After dipping to 114.0 in May 2014, it resumed its advance. China's January 2015 EER established a record high, up from December 2014's 126.3.

Although the BIS states the US represents 19.0pc of China's EER, the Euro Area share is large as well, at 19.4pc, as is Japan's 15.9pc. South Korea has 7.9pc.]

CROSSROADS: THE RENMINBI VERSUS THE US DOLLAR

Awesome Chinese real GDP output rates have long impressed armies of marketplace observers. The International Monetary Fund's "World Economic Outlook Update" (1/19/15; Table 1) points out China's slowing but still enviable growth. Its real GDP grew 7.8 percent in 2013 and 7.4pc in 2014. The IMF predicts 2015's at 6.8pc, with 2016's slipping to 6.3pc.

Nowadays many perceive America as a growth engine for the world economy. American output grew 2.2pc in 2013 and 2.4pc in 2014. The IMF declares US real GDP will climb 3.6pc in 2015 and 3.3pc in 2016. However, the Federal Reserve prediction is not as optimistic; it indicates GDP will advance around 2.8pc in both 2015 and 2016 (midpoint of central tendency; "Economic Projections", 12/17/15), with the "longer run" range between 2.0-2.3pc.

In any case, China's expected expansion still significantly exceeds that for the United States. Shouldn't that make for a stronger renminbi relative to the dollar? In addition, most American political leaders express a desire for a stronger renminbi relative to the greenback. This US viewpoint relating to import/export fairness concerns indicates belief that the renminbi is not sufficiently strong relative to the dollar (some rhetoric speaks of Chinese manipulation of the renminbi).

So although the Chinese EER (its overall currency) is strong, why has the renminbi cross rate against the US dollar been weakening since 1/14/14? Its very recent low near 6.280 slipped beneath 4/30/14's 6.267 low and the 6.257 (12/12/12)/6.249 (2/20/13) bottom. The renminbi/dollar cross around 6.280 stands near 5/1/12's high around 6.277 (from which it retreated to 7/25/12's very important top at 6.396).

A strong real effective exchange rate for any given nation of course is not necessarily inconsistent with weakness in a particular cross rate for that country's currency. However, the behavior of particular cross rate trends involving that country may offer additional insight relating to significant economic trends relating to real national (as well as global) GDP output.

This cross rate variable is particularly likely to be relevant when each of the two trading partners represents an important share of their counterparty's broad real effective exchange rate. That is the case for the United States and China. Note the large and similar trade weights each has in the other's EER. According to the BIS, whereas the US constitutes 19.0 percent of China's EER, China's trade weight is 20.9pc of the US EER. The Federal Reserve's H.10 says China's weight within the TWD is about 21.3pc (greater than the Euro Area's 16.4pc, Canada's 12.6pc, Mexico's 11.9pc, Japan's 6.9pc, and the UK's 3.3pc).

Arguably the weakness in the renminbi relative to the US dollar in recent months, though not huge, indicates that the Chinese economy is and will remain weaker than many assert. The weaker renminbi versus the dollar may suggest less GDP growth in the future, not only relative to the US, but also in absolute terms. Moreover, note that China's central bank reduced interest rates effective 3/1/15 ("To Spur a Slowing Economy", according to the NYTimes, 3/1/15, p13). In November 2014, China had lowered its policy rates for the first time in two years. In February 2015, China also reduced the reserve requirement ratio, permitting banks to lend a larger share of their assets. Keep in mind recent money printing campaigns undertaken by the European Central Bank and Bank of Japan in this context. These Chinese actions, though not as dramatic, likewise respond to perceptions of economic feebleness or danger. Compare the Fed's eventual (and admittedly very cautious) plan to raise the Federal Funds rate.

Other variables hint at relatively slower Chinese real GDP growth. The Chinese property marketplace, local government borrowing, and shadow banking situations to some extent evidence existing and potential trouble. As China is a big commodity consumer, underscore the retreat since spring 2011 (not only since the late 2014 OPEC oil meeting) in commodity prices in general (not merely in the petroleum complex). Moreover, political issues often provide governments with a handy weapon for distracting constituents (the people) from economic matters. See, for example, China's quarrels with its neighbors over territorial issues and its heralded campaign to root out corruption.

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