FORWARD GUIDANCE AND THE US DOLLAR
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In the 1979 film "Being There", Chance the Gardener is a simple-minded fellow with little worldly experience who nevertheless acquires significant political and economic influence in Washington DC. He often declares: "I like to watch." (Hal Ashby, director)

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OVERVIEW AND CONCLUSION

The broad real trade-weighted United States dollar probably will remain weak. Continuing its major long run bear trend from its March 2009 high, it probably will challenge its record low of July 2011. Why?

Among assorted bearish factors, focus on two which are becoming increasingly significant. First, the Federal Reserve Board in its September 2013 meeting displayed its absence of a genuine forward guidance plan and a lack of an authentic comprehensive exit strategy. Thus marketplace faith in the Fed has declined and will do so further in the aftermath of that September gathering. Keep in mind that feeble (vague) Fed guidance and decreased confidence in the Fed occurs amidst ongoing (and long-running) gigantic money printing and interest rate repression. The central bank is doggedly determined to keep pinning the Federal Funds rate near the floor (and thus below current inflation rates and announced Fed inflation targets) for some time. So how attractive are and will be United States Treasury yields for much over much of the government yield curve? Second, America's national political players currently display weak fiscal (economic) leadership, especially as the debt ceiling limit beckons.

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The Federal Reserve Board's overall exit strategy for its extraordinary sustained accommodative policy remains far more a sketch than a complete design or coherent practical plan. Prior to its September 2013 assembly, central bank communicators strongly hinted the Fed soon would reduce its massive money printing campaign. Yet the illustrious Federal Reserve Board generals surprised the great majority of observers by not cutting back on quantitative easing. Moreover, these Fed luminaries also underlined their flexible attentiveness to a wide array of intertwining variables which will influence their tapering and other decisions. The ever-watchful Fed thus implicitly demonstrated that its loudly-proclaimed forward guidance wordplay offers Fed watchers at best only modest enlightenment and direction. America's central bank consequently did more than increase marketplace uncertainty. The Fed wounded its own marketplace credibility. By damaging its credibility, the Fed reduces the widespread belief that it can engineer or at least significantly influence "good" economic outcomes.

In September, the Federal Reserve reaffirmed its devotion to yield repression policies, not just to its quantitative easing scheme. It remains resolute in its battle to manufacture sufficient inflation. All else equal, these interrelated policies tend to weaken the value of the US dollar. The overall clarity of central bank strategy and faith in the central bank and its policies do not stand apart from currency levels and trends. In this context, the Fed's revelation that it lacks a clear and coherent forward guidance plan (exit strategy) reduces confidence in the dollar.

A great variety of considerations within and outside the United States, not just Fed policies, of course influence dollar levels and trends. For example, America has long run a notable current account deficit. In addition, many nations seek a weak home currency, or at least a relatively

feeble one, to encourage their exports and overall economic growth. Competitive devaluations (currency wars) may mitigate declines for a given currency; not everyone can depreciate at once. Scan the global financial horizon since the end of the Goldilocks Era and the onset of the worldwide economic crisis. The Fed is not the only major central bank with a very easy money policy. Look at the European Central Bank, the Bank of England, and the Bank of Japan. China also has had a lax monetary policy.

Unfortunately, the significant shortfall in forward guidance from the guiding lights at the Federal Reserve currently coincides with a badly fractured American national political scene. Of course politicians and parties disagree and compete vigorously. Yet in the United States in recent years, significant philosophical divisions, diverse and often well-entrenched interests, and quests by political players to capture attention and win elections have combined to create ongoing "overall" feeble national political leadership. Strong political individuals in combination do not necessary make a strong collective group.

The Democrat-controlled Senate, the Republican-dominated House, and the President do more than continue to engage in fierce and long-winded fights over appropriate levels of federal deficit spending and particular programs and policies. Of particular importance to the current and future economic and political scene, they now ardently battle over near term funding of government operations and fervently debate whether (and under what conditions) to raise the debt ceiling. In the absence of legislative action, the nation soon will reach its debt ceiling limit.

Failing to satisfactorily resolve the funding and (especially) the debt ceiling issues (and related deficit spending questions) will call in question America's political leadership as a whole. All else equal, growing doubts about the quality of that leadership (and related fiscal policies) tend to undermine confidence in the US dollar. Besides these current feuds, America's national political leaders continue to make no progress in resolving or even significantly mitigating the country's looming long run fiscal deficit problem. Debt crises do not occur only in emerging or developing nations or in countries on the European "periphery".

FEDERAL RESERVE "GUIDANCE"

In Bob Dylan's song, "All Along the Watchtower", we hear:
"'There must be some way out of here' said the joker to the thief
'There's too much confusion', I can't get no relief
Businessmen, they drink my wine, plowmen dig my earth
None of them along the line know what any of it is worth."

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There are numerous competing perspectives on marketplace phenomena. And of course marketplaces involve a great number of intertwining variables. Nevertheless, review the Fed's 9/18/13 statement for definite signs providing any truly helpful forward guidance to economic and political audiences. There are few if any such straightforward signs. Besides, the Fed sentinel does not appear to have any special insight or foresight into marketplace phenomena.

This guardian "decided to await more evidence". It "will closely monitor incoming information on economic and financial development in coming months". What is this evidence and information, how does it get analyzed, and how does it interrelate to produce useful policy guidance (and thereby marketplace enlightenment)? The Fed captain claims to have a toolkit, but

where is its compass? Decisions about the pace of asset purchases are “contingent” on the FOMC’s economic outlook and its “assessment” of the “likely efficacy and costs of such purchases”. Might this economic viewpoint change depending on evidence and incoming information? Contingent, likely efficacy, and costs suggest significant flexibility. “In determining how long to maintain a highly accommodative stance of monetary policy”, the Fed watchman “will also consider other information” regarding (labor marketplace/unemployment, inflation, financial developments). It speaks of “additional measures”, “indicators”, and “readings”.

Note Chairman Bernanke’s Press Conference: In light of assorted “uncertainties”, this weathervane said the “Committee decided to await more evidence that the recovery’s progress will be sustained before adjusting the pace of asset purchases.”

In any event, the Fed’s orations about the merit of forward guidance and communication and its listing of some variables and considerations do not constitute significant and clear forward guidance.

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The Fed’s remaining 2013 meetings are 10/29-30 and 12/17-18. Perhaps the Fed will offer more direction in these. Or will observers have to wait for 2014? The International Monetary Fund/World Bank conference runs October 7-13, 2013.

AMERICAN POLITICAL “LEADERSHIP”

“But your reckless disposition, mama, drove your daddy away from home.” “It’s Your Time to Worry”, Blind Willie McTell

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As funding for the federal government nears and a deadline for boosting the debt ceiling looms, look at several recent comments made regarding the sad and dangerous US political theater. The NYTimes headlines “Government Is on Path to Shutdown”. Regarding a Friday conversation between President Obama and House Speaker Boehner, “Both side described the call as brief and fruitless.” “Without a resolution, large parts of the government could shut down Oct.1, and a first-ever default on federal debt could follow weeks later.” Recall the brief government shutdown of 1995-96 (9/21/13, pp A1, A11).

“Pressed From His Right, Speaker, Yields on a Budget Showdown” (NYTimes, 9/19/13, pp A18-19). See the Financial Times article, “Obama resists debt ceiling talks” (9/16/13, p2). The President “refused to back down over the need to raise the debt ceiling, saying that the issue would drastically change the US constitution.” The FT article’s outlook: “His rhetoric increases the chance of a crisis, with the US due to hit its legal borrowing limit some time after mid-October, and many Republicans determined not to lift it unless they win concessions on Mr Obama’s signature health-care reform: the Affordable Care Act.”

In the context of these debt ceiling negotiations, will there be a downgrade of America’s credit rating, as occurred in summer 2011?

The Financial Times identifies the implications of political challenges facing the Senate Republican leader, Kentucky Senator McConnell 9/21-22/13, p3). This key Senator faces a fierce reelection fight. His “political problems [particularly pressure from conservative activists] will make it more difficult for the White House to reach a deal to extend the nation’s debt limit.” The

Senator played a key role in avoiding the "fiscal cliff" in late 2012; in late 2011 he deftly proposed a procedural mechanism enabling a debt ceiling boost without forcing Republicans to vote for it.

The long run US budget situation remains a sorry sight. See the Congressional Budget Office's "The 2013 Long-Term Budget Outlook" (September 2013). Federal debt held by the public is about 73 percent of GDP. "That percentage is higher than at any point in U.S. history except a brief period around World War II, and it is twice the percentage at the end of 2007." Assuming current laws remain in place, federal debt held by the public will decline "slightly" in relation to GDP over the next several years. However, increasing deficits will "ultimately push debt back above its current high level, reaching 100 percent of GDP in 2038". ("Summary", page 1). The NYTimes emphasizes: "Budget Office Warns That Deficits Will Rise Again Because Cuts Are Misdirected" (9/81/13, pA16).

THE BEARISH US DOLLAR OUTLOOK

"Times is so hard now: maybe things will change some day". Blind Blake, "No Dough Blues"

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Cross rates of various currencies such as the Euro FX, Chinese renminbi, Mexican Peso, Canadian Dollar, and Japanese Yen relative to the US dollar are widely-watched benchmarks. However, the broad real trade-weighted dollar ("TWD"; Federal Reserve Board's H.10 statistics) is a better indicator of the overall strength, weakness, and trends for the dollar than individual cross relationships. Some individual dollar cross rates are significant for US financial policy decision-makers, but the broad real trade-weighted dollar probably is more important to most of these key chiefs.

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For the broad real TWD, key current trade weight percentages are:

China 20.3 pc. Compare the 10.5pc in 2002 and 1990's 3.0pc.

Euro FX 16.5pc
British Pound 3.4pc (Switzerland is 1.7pc, Sweden .8pc)

Canada 12.9pc

Mexico 11.3pc

Japan 7.3pc

The combined weight of China plus the Euro FX, British Pound, Canada, Mexico, and Japan equals 71.7 percent of the TWD.

Several other key Asian nations total around 12.8 percent; South Korea's share is 3.9pc, Taiwan 2.6pc, Singapore 2.0pc, Malaysia 1.6pc, Thailand 1.4pc, and Hong Kong 1.3pc. The TWD share of other nations watched by many: Brazil 2.2pc, India 1.9pc, Australia 1.4pc, Russia 1.2pc, and Saudi Arabia 1.0pc.

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For the broad real trade-weighted dollar, March 1973 equals 100.0. The broad real TWD is a monthly average. The numbers below are rounded.

The broad real TWD in August 2013 was 85.4, with July 2013's at 85.6. Since crashing to its all-time low in July 2011 around 80.5, the TWD has remained in a range close to its prior record depths around 84.0 (October 1978's 84.1, July 1995 84.0, April 2008 84.2). The high since the July 2011 trough is June 2012's 86.3.

This current TWD weakness from the historic perspective- when reviewed in the context of the Fed's easy money policy and ongoing federal fiscal difficulties alongside feeble (low-quality) overall national leadership- signals the dollar's vulnerability and probable future decline. A sustained move under 84.0 probably would fascinate stock, interest rate, and commodity marketplaces, a test of 80.5 even more so.

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The Fed releases both monthly and daily data for the nominal trade-weighted dollar, updating the daily data once a week. The nominal TWD slumped to 94.6 in July 2011 (monthly average). A challenge to this bottom will be noteworthy. Its 102.1 level in August 2013 stood close to the highs of 102.2 reached in both July 2013 and June 2012.

As of 9/13/13 (the most recent H.10), the nominal daily TWD was 102.1. It has drifted lower relative to its minor high at 103.3 on 9/3/13. Compare the earlier nominal TWD tops at 103.4 on 7/5/13 and 103.0 on 6/1/12. Since the 6/1/12 high at 103.0, daily lows in the nominal TWD are around 98.4 (9/14/12 and 10/17/12) to 98.6 (1/14/13). Breaks of these daily lows would capture attention.

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Keep an eye on some major bear moves in the broad real TWD from the price and time perspective:

The collapse from January 1973's 107.6 (monthly average) to October 1978's major low at 84.1 ran over five years and was 21.8 percent.

Recall March 1985's major top at 128.4. It stayed under 100.0 after July1987's 100.3 (initially pierced 100.0 in this downtrend with April 1987's 98.7). The sharp stumble over a bit more than two years from 128.4 to 100.0 was 22.1pc. Compare the 21.8pc move of the 1973-78 decline and also remember the 1987 collapse in US stocks (alongside rising US Treasury yields). The broad real TWD then voyaged gradually to its final low in July 1995 at 84.0. That depth was 34.6pc beneath 1985's pinnacle.

February 2002's drop from its 112.8 summit also stands out. Its collapse to April 2008's 84.2 was 25.4 percent. This percentage decline is fairly close to 1973-78's 21.8pc and the first (and major) stage of 22.1pc in the retreat from March 1985's height. The April 2008 low occurred not long before the S+P 500's final plateau 5/19/08 at 1440; major high 1576 on 10/11/07). The further decline to July 2011's 80.5 makes the decline since February 2002 is 28.6pc.

It is a close case as to whether one should interpret the broad real TWD decline since March 2009's 96.9 high as being part of the major downtrend that began in February 2002. The slide from March 2009's elevation probably commenced an independent bear move. What are some clues justifying this viewpoint? First, recall the already lengthy duration of the February 2002 to

April 2008 voyage. Second, keep in mind the 25.4pc fall over that five year span is roughly comparable to the 1973-78 tumble and the first (22.1pc) section of the drop that started in March 1985. Finally, underline that the major rescue efforts (policy changes) of central banks (assisted by mammoth deficit spending) beginning in late 2008/early 2009 ultimately coincided with March 2009's key TWD high and the major low in the S+P 500 that month on 3/6/09 at 667.

In any event, the fall from March 2009's 96.9 to July 2011's 80.5 is itself a rather lengthy move in time and price terms. Is it sufficient to say that a major bull move in the broad real TWD began in July 2011? Another close case, but probably not. Its substantial 16.9 percent slump over that period nevertheless falls short of the other TWD declines exceeding 20pc. In addition, the rally from July 2011 to its 86.3 high on June 2012 ran about a year and was only 7.2pc. Besides, the Fed continues to print dollars via its quantitative easing program and to repress rates.

Suppose the Fed refuses to raise interest rates if inflation increases or if there is widespread net selling of US government securities (especially by foreigners) due to a fiscal crisis. The TWD likely will face intense downward pressure.

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Suppose the broad real TWD continues to decline. Where should one look for support? The 84.0 and 80.5 points are key historic levels. The next key support range is about 72.5 to 77.5. A twenty percent fall from March 2009's 96.9 gives 77.3, a 25pc one 72.7. A 33pc collapse (comparable to the entire 1985-95 venture) from February's 112.8 major top gives 75.2. A five percent break of the 80.5 record low to date is 76.5.

Where is resistance for the TWD if it instead rallies upward from July 2011's 80.5 level? A 10pc move travels to about 88.6, a 20pc one attains 96.6.

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A review of US dollar cross rates relative to the majority of its key trading partners suggests an overall renewed slump in the dollar (TWD) is underway.

**China: Note its steady rally from its 7/25/12 low around 6.396. Compare the Euro FX rally against the dollar since late July 2012. The high in the cross rate versus the dollar was 8/16/13 at 6.106, but the current level at about 6.120 is near that; a further rally in the renminbi under 6.106 would be noteworthy.

**Euro FX: 7/24/12 low 1.204 (note the low in the Chinese renminbi versus the dollar around then as well as the US Treasury 10 year note bottom on 7/25/12). Note the renewal of the Euro FX rally from its 7/9/13 low around 1.276 (near 4/4/13's 1.275). Watch the 1.371 high attained on 2/1/13.

**British Pound: Rapid advance from its 7/9/13 bottom around 1.481.

**Canada: Stronger versus dollar since mid-summer 2013. See the lows on 7/5/13 at 1.061 (compare the Euro FX 7/9/13 rally date) and 8/23/13 at 1.057.

**Mexico: The peso has rallied sharply from its 9/3/13 low at 13.47 (13.46 on 6/20/13).

**Japan. The Yen major bear move relative to the dollar accelerated from Y77.1 on 9/13/12 (high was 9/13/12 around 75.4). However, the Yen has rallied since its Y103.7 low on 5/22/13. Note the further rally from the lower lows on 7/8/13 (Y101.5; compare the timing of the Euro FX, British Pound, and Canada early July lows) and 9/11/13 (Y100.6).

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The broad real TWD dollar's levels and trends (and those of various individual dollar cross rates) interconnect in diverse ways with commodity, interest rate, and equity marketplaces. These relationships are not unchanging, and marketplace history is not marketplace destiny.

Commodities in general made major highs roughly alongside the July 2011 low in the broad real TWD. See the broad GSCI's peaks of 4/11/11 and 5/2/11 at 762.

In the opinion of many viewers, the weak dollar in recent years has assisted the huge rally in the S+P 500. What about the current situation? Will the current broad real TWD weakness, or even a further slight slide lower in the dollar, encourage optimism regarding the US economy and further bull moves in US equities? Probably not. The "weak dollar equals strong US stocks, strong dollar equals weak US stocks" road is not inevitable, particularly in the context of a long run increase in US Treasury (and other key benchmark) yields. The 10 year US Treasury note established a major bottom on 7/25/12 at 1.38 percent (see also the 1.61pc low on 5/1/13). Compare German Bund lows around 1.13pc on 6/1/12 and 7/23/12). The UST 10 year yield climbed to 3.01pc on 9/6/13 (the two year UST's high on 9/6/13 at about .53pc more than doubled its major low of .19pc on 7/23/12). If the US federal debt ceiling and budget deficit crisis worsens, the UST may not be viewed as a "flight to quality" haven. In any case, a significant challenge to 2011's record TWD low around 80.5 probably will be bearish for the S+P 500. The TWD's break of its 80.5 bottom probably would be very bearish for stocks; recall the decisive TWD move under 100.0 in 1987.

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