# Global Rebalancing: Why it could Launch the Dollar into a Powerful Multi-Year Bull Market


Presented by Jack Crooks, President of Black Swan Capital &

Steve Meizinger, Director of Education for the International Securities Exchange


*10 June 2009*

*Courtesy of Interactive Brokers*

## Disclaimer

For the sake of simplicity, the examples that follow do not take into consideration commissions and other transaction fees, tax considerations, or margin requirements, which are factors that may significantly affect the economic consequences of a given strategy. An investor should review transaction costs, margin requirements and tax considerations with a broker and tax advisor before entering into any options strategy.

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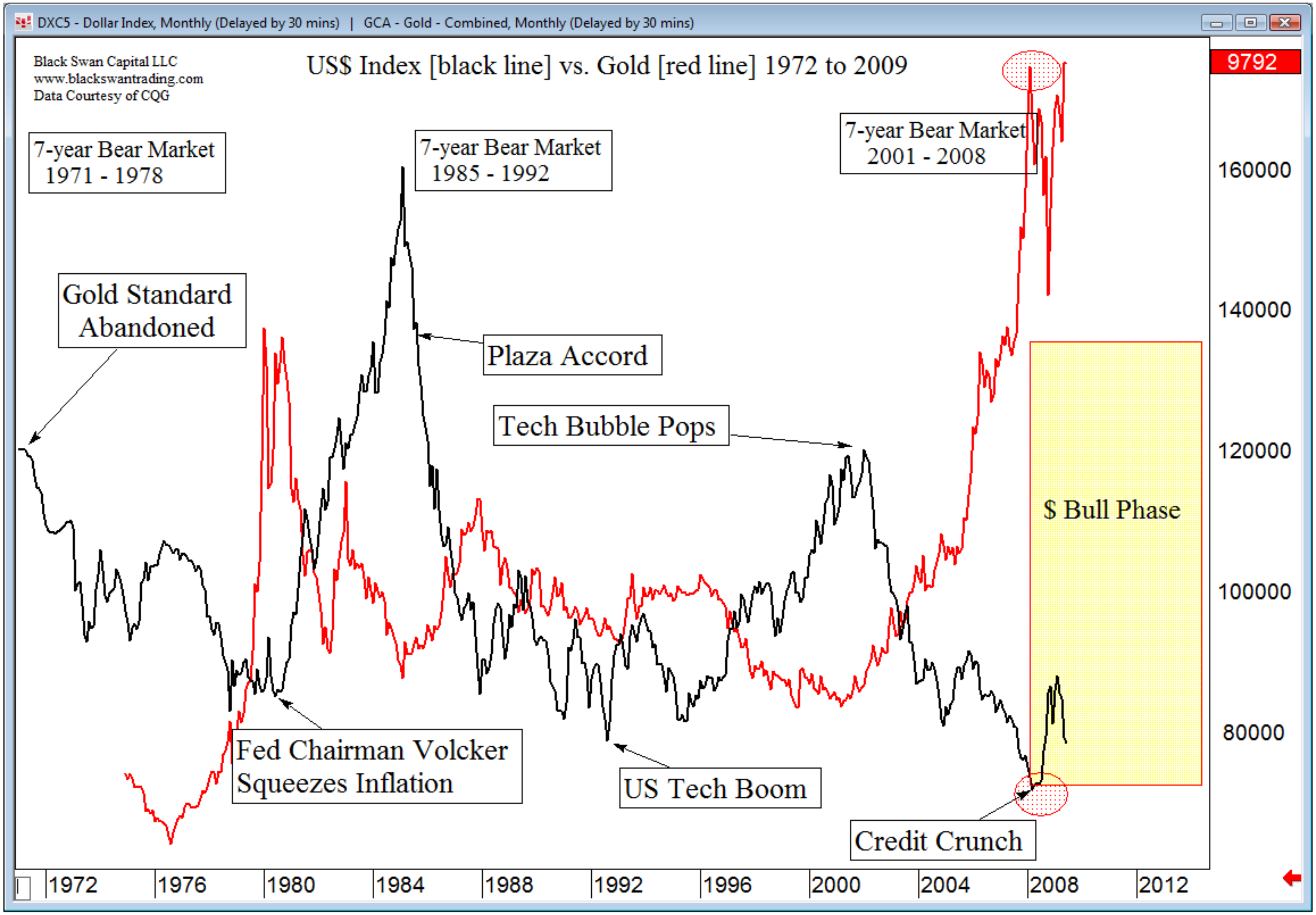
Any strategies discussed, including examples using actual securities price data, are strictly for illustrative and educational purposes and are not to be construed as an endorsement, recommendation or solicitation to buy or sell securities.

# Long View – Major Dollar Cycles

**Entering Third Major Bull Market Since Float in 1971 on Sustained Risk Aversion**



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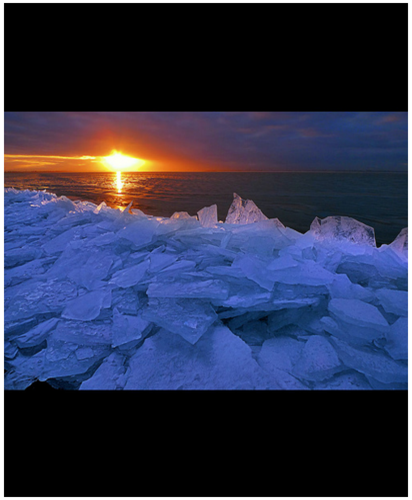
# Key Premise: Sustained Ice Age Cometh!



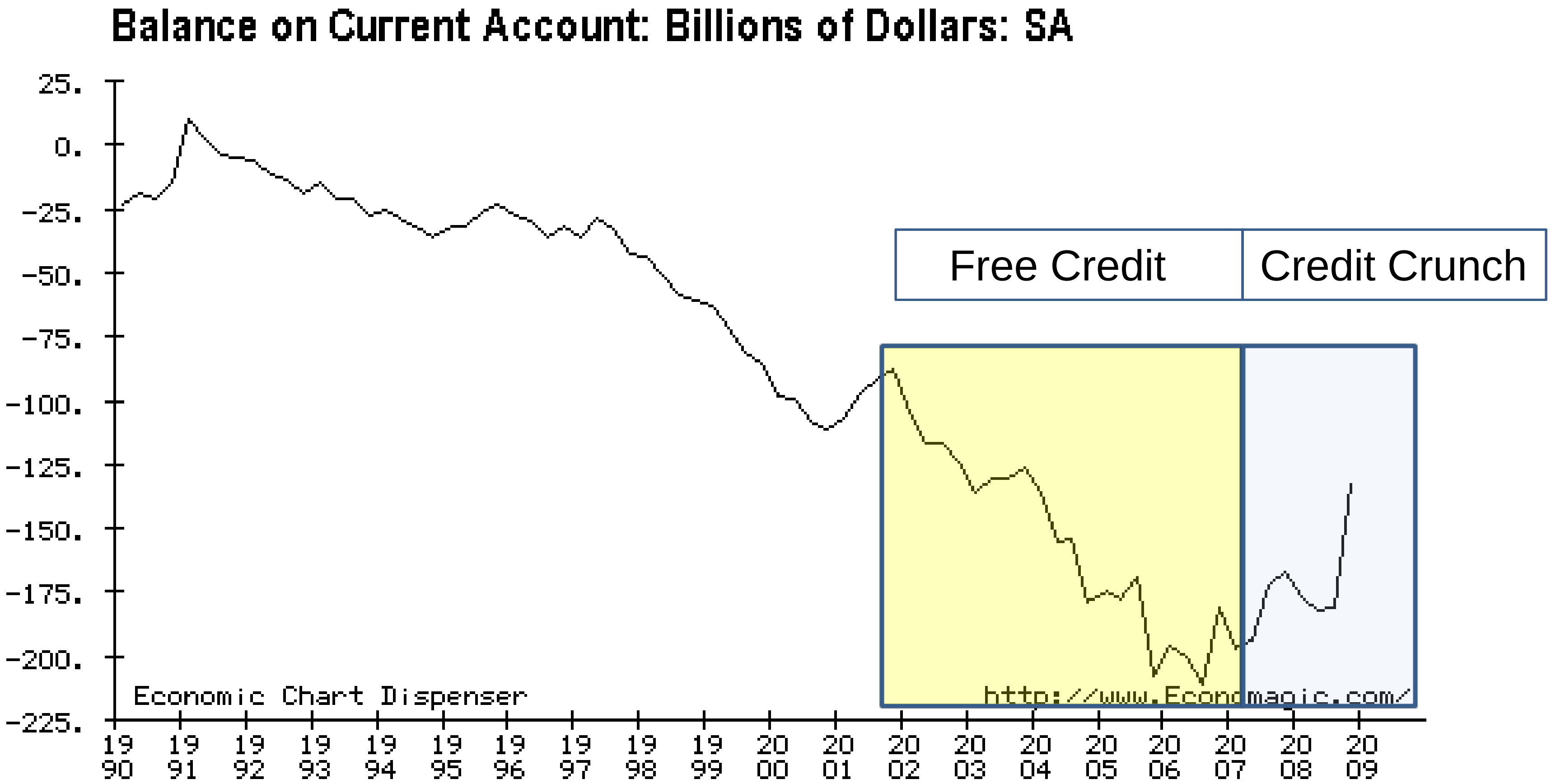
| | |
|---|---|
| ***Demand:*** Hot | Frozen |
| ***Credit:*** Flowing | Freezing |
| ***Asset Bubbles:*** Expanding | Deflating |

Risk Appetite → Sustained Risk Aversion

# Path of Destruction

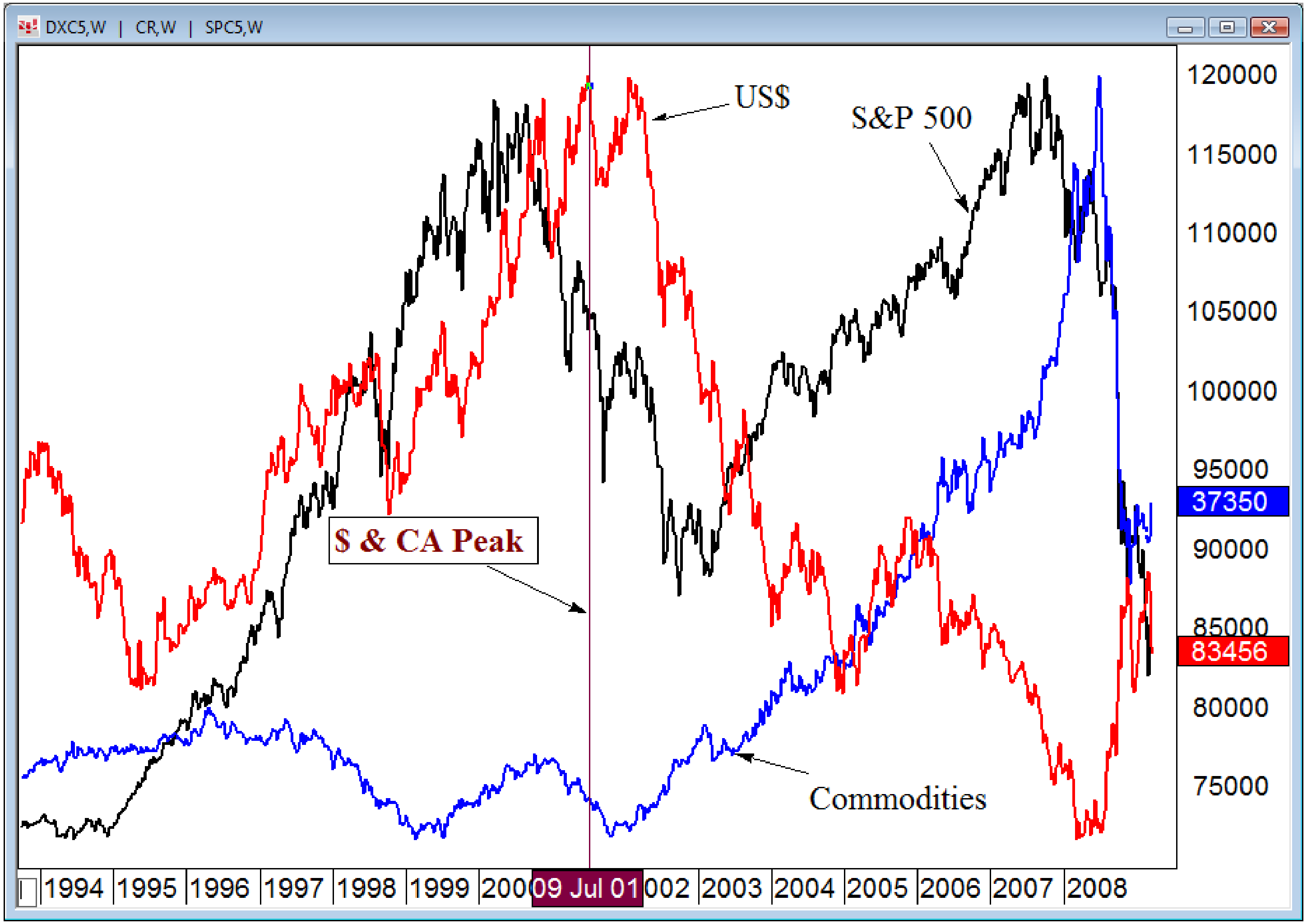
- *Wealth:* $12-$15 trillion in US household wealth from 2006 thru 2008 crushed (also globally)
  - Real Estate & Stock Market
- *Upshot:* US savings rates are expected to rise to the 10% level. If history is a guide, the rise in savings could last decades.
- *US Current A/C:* Deficit to surplus?
- *Implication:* Export-models are history!

# US Current Account Swing




Lower CA Deficit Means US Requires Less International Funding

# US Current A/C Funded Bubbles

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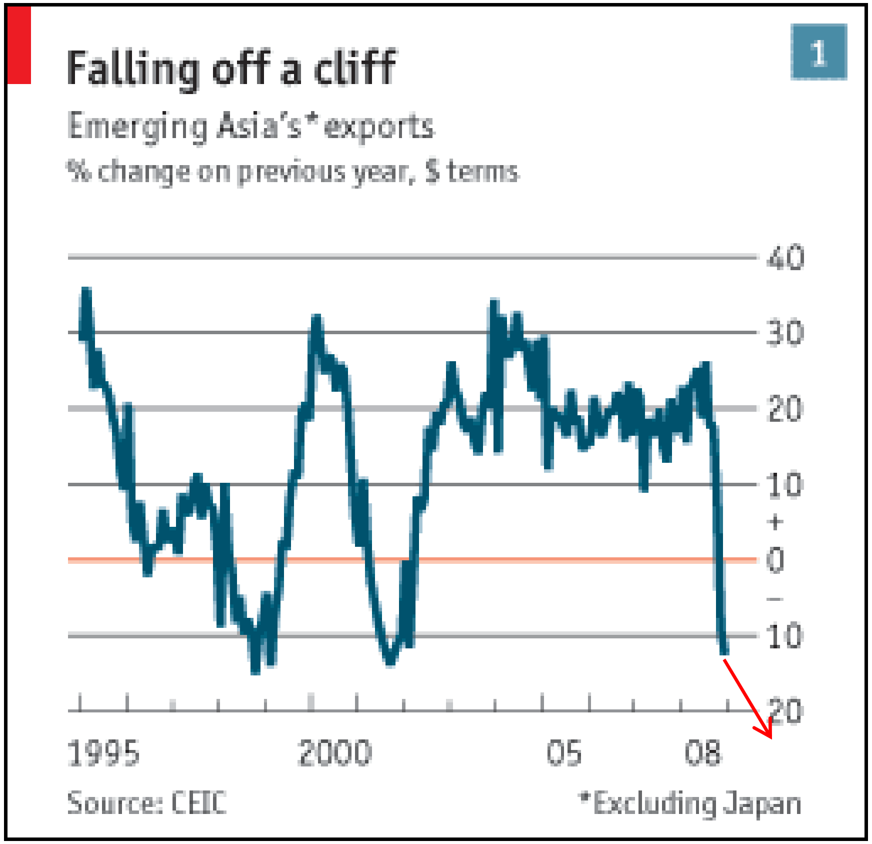
Implicit Weak Dollar Policy Funding Global Liquidity – Asian Surplus Recycling

# Export Model is History?




Source: *Economist*

*But don't worry. China will grow at least 6-8% this year!  Hmmm…..*

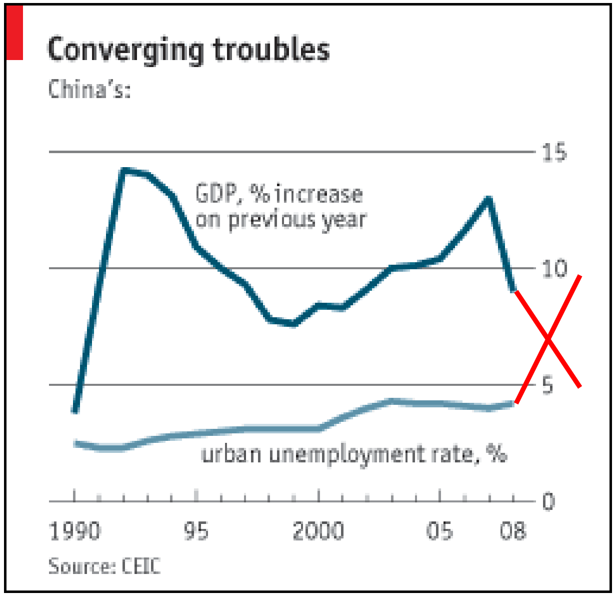
# Unhappy Convergence?

## *Will Stimulus Work?*

Chinese President Hu Jintao

"Great Leap Backwards"

- Unemployment rising
- "Incidents" surging
- Dissent brewing "Charter '08"




?

Source: *Economist*

Stimulus
Front-end loaded and V-shaped recovery dependent?

Social Unrest Thermometer?

# US in 1929 was China!

•Asian countries built FX reserves as insurance against another 1997-98 Asian Financial Crisis believing global demand would continue unabated. They didn't develop their domestic sector.

•Because global balance of payments must balance, US took on the role of recycling the "savings glut." So, who was really responsible for the credit-crunch?

•The "savings glut" stimulated consumer demand and increased debt levels everywhere, triggering excess consumption and excess production (China).

•Export model dependence and lack of domestic market relative to economy means when demand falls globally, the majority of the adjustment will be borne by the trade-surplus countries.

*Key point:* ***The US was the trade-surplus country in 1929****; it is why the US took the brunt of the global adjustment domestically. China's trade surplus now represents a much bigger percentage of its total economy compared to the US trade surplus in 1929. So, if US savings rates continue to climb and stay there, the fundamental reasoning of an export-model is history. China's adjustment could be much more severe than now expected.*

# How does all this transmit to dollar strength?

Scenario #1: China disappoints and commodities markets breakdown again, as commodities are a proxy for global growth…

Implications:

a) Dollar rallies on safe haven risk aversion run into bonds

a) Commodity currencies such as the Aussie/Canadian dollar get whacked

a) Emerging market stocks and currencies get hammered; this places the Eurozone banking system under severe strain and hits the euro

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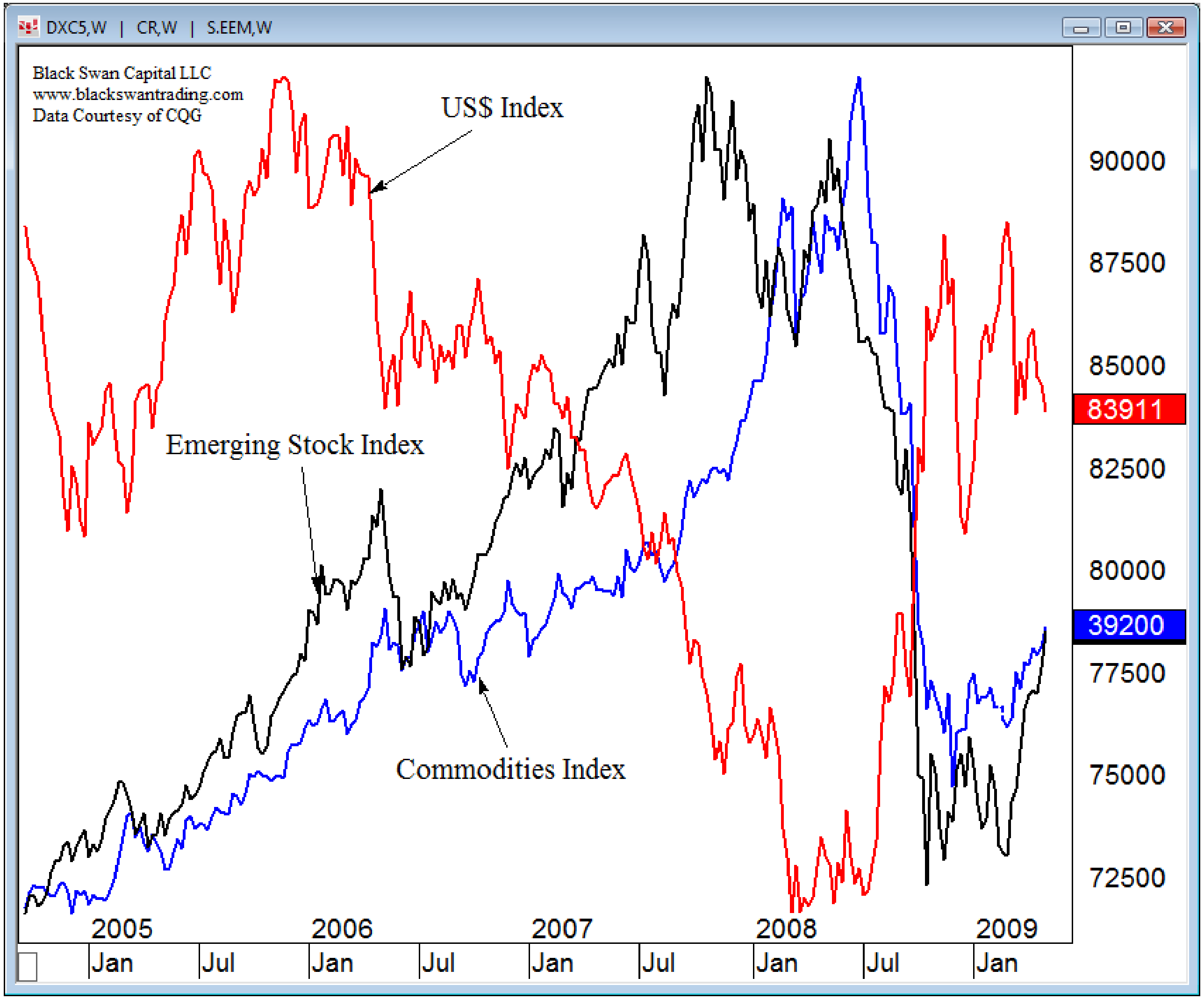
# Commodities/EM/US$

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# Emerging Markets Could Be Euro's Achilles Heel

Score: Eurozone Banks $3.7 trillion US Banks $475 billion

"The initial (Sept. 2008) batch of export-driven emerging economy bank loans when the present phase of the crisis began was $4.6 trillion – of which $3.7 trillion in the balance sheets of European banks and only $475 billion in US banks."

Leto Research

# China Disappoints

- Actions:
  1) Buy ISE listed calls on USD/CAD and USD/AUD
  2) Buy ISE listed calls on USD/EUR

Timeframe: 6-9 months

All paths lead back to 2001!

- Commodities fall another 35%+
- Euro depreciates 57%

# Options Allow Flexibility

- Options buyers have rights
  - Long Calls: the right to buy (limited risk)
  - Long Puts: the right to sell  (limited risk)
  - Short calls: the obligation to sell  (substantial risk)
  - Short puts: the obligation to buy  (substantial risk)

# Underlying is the FX Market

- The underlying is the relationship between the USD and a foreign currency
  - i.e. USD/EUR, the symbol is EUI and the current price is 71.60
    - Options can be bought/sold on the 75 strike price call, a $1.09 for a 3 month or $2.03 for a 6 month premium, translating to $109 or $203 not including any commissions
    - For this right, an investor controls the right to buy EUI at 75 (puts are available also) for 3 month or 6 months respectively

# Features Of ISE FX Options

- Options on exchange rates
- U.S. dollar based
- .50 strike prices
- Premium quoted in U.S. dollars
- European Exercise
- Cash-settled
- Noon Settlement/Option Friday
- Noon Buying Rate FRB of NY
- Available in Conventional Brokerage Account
- Continuous Two-Sided Quotes
- Trading Hours 9:30 – 4:15

# Features Of ISE FX Options

- Accessible through your options broker
- Exchange-listed securities
- Cash-settled in U.S. dollars
- European style exercise
- Can be traded as spreads

| Currency | Convention | Symbol |
|---|---|---|
| Australian dollar | USD/AUD | AUX |
| British pound | USD/GBP | BPX |
| Canadian dollar | USD/CAD | CDD |
| Euro | USD/EUR | EUI |
| Swiss franc | USD/CHF | SFC |
| Japanese yen | USD/JPY | YUK |

Investors can view the underlying rates from several leading market data vendors and financial websites, including Big Charts, Bloomberg, ILX, Reuters, and Yahoo! Finance.

**www.ise.com/fx**

INTERNATIONAL SECURITIES EXCHANGE.

# What's Your View For 2nd Half of 2009?

- Using ISE FX options you can implement your views on the FX market using cash settled options

- ISE is currently trading options on the following six pairs:

  - **EUI** USD/EUR *100
  - **YUK** USD/JPY *1
  - **BPX** USD/GBP *100
  - **SFC** USD/CHF *100
  - **CAD** USD/CAD *100
  - **AUX** USD/AUD *100

**ISE FX OPTIONS® - Exchange Rates**
Updated: 6/3/2009 5:00 PM ET

| Symbol | Convention | Last Price | Change |
|---|---|---|---|
| EUI | USD/EUR | 70.61 | ▲ 0.71 (1.02%) |
| YUK | USD/YEN | 96.01 | ▲ 0.24 (0.25%) |
| BPX | USD/GBP | 61.28 | ▲ 0.96 (1.59%) |
| SFC | USD/CHF | 107.01 | ▲ 0.86 (0.81%) |
| CDD | USD/CAD | 111.04 | ▲ 2.94 (2.72%) |
| AUX | USD/AUD | 124.88 | ▲ 3.08 (2.53%) |

Get FX OPTIONS Quotes >
ISE www.ise.com/fx

# USD/EUR ISE symbol EUI

# Options give you many choices

- Investors can select from varying strike prices and months
- Depending on your forecast for (in this case USD/EUR) EUI, an investor can select the appropriate EUI call or put based on your own goals and your own risk tolerances

# Bullish on the USD?
# How about EUI calls?

| Strikes<br>70.61 value | **3** month calls | Intrinsic value | Expiry value @58 | Expiry value @66 | Expiry value @74 | Expiry value @82 |
|---|---|---|---|---|---|---|
| 69 | 3.46 | 1.61 | 0.00 | 0.00 | 5.00 | 13.00 |
| 72 | 2.11 | 0.00 | 0.00 | 0.00 | 2.00 | 10.00 |
| 75 | 1.09 | 0.00 | 0.00 | 0.00 | 0.00 | 7.00 |
| 78 | 0.52 | 0.00 | 0.00 | 0.00 | 0.00 | 4.00 |
| 81 | 0.28 | 0.00 | 0.00 | 0.00 | 0.00 | 1.00 |

# Bullish on EUI and need more time?

| Strikes 70.61 value | **6** month calls | Intrinsic value | Expiry value @58 | Expiry value @66 | Expiry value @74 | Expiry value @82 |
|---|---|---|---|---|---|---|
| 69 | 4.92 | 1.61 | 0.00 | 0.00 | 5.00 | 13.00 |
| 72 | 3.25 | 0.00 | 0.00 | 0.00 | 2.00 | 10.00 |
| 75 | 2.03 | 0.00 | 0.00 | 0.00 | 0.00 | 7.00 |
| 78 | 1.20 | 0.00 | 0.00 | 0.00 | 0.00 | 4.00 |
| 81 | 0.69 | 0.00 | 0.00 | 0.00 | 0.00 | 1.00 |

# Bearish on USD?
# How about EUI puts?

| Strikes 70.61 EUI value | **3 month puts** | **6 month puts** |
|---|---|---|
| 69 | 1.70 | 2.15 |
| 72 | 2.85 | 3.47 |
| 75 | 4.80 | 5.25 |
| 78 | 7.25 | 7.45 |
| 81 | 10.00 | 10.10 |

If you believe that the USD dollar will weaken against the euro, EUI puts could help you implement that particular forecast

# Steve Meizinger

smeizinger@ise.com
www.ise.com

# Additional Information

- ISE FX Options Website www.fxoptions.com
- Black Swan Capital Website www.blackswantrading.com
- Black Swan Email – info@blackswantrading.com
- Black Swan Offerings
  - *Currency Currents*: Daily Free Global Macro Commentary
  - *Currency Strategist*: Daily subscription-based currency letter with specific FX Options trading recommendations

- Sign-up for Trade Alerts, get latest exchange rates: **www.ise.com/fx**
- Education Articles **www.ise.com/asksteve**
- FX Options Weekly Outlook: **www.ise.com/podcasts**
- For upcoming webinars visit: **www.ise.com/webinars**
- Visit our archives at: **www.ise.com/archives**

| Upcoming Webinars | |
|---|---|
| **Jack Crooks on "The U.S. Dollar's Achilles Heel?"** | **05/28/09, 4:30 PM** |
| Nicole Wachs on "Trading the Volatility Using FX Options" | 06/02/09, 4:30 PM |
| **Jack Crooks on "Why the EURO Could Disappear"** | **06/04/09, 4:30 PM** |
| John Person on "High Probability Trading Strategies for FX Options" | 06/09/09, 4:30 PM |
| **Jack Crooks on "Dollar Vs. Yen: Is it over for the Carry Trade?"** | **06/16/09, 4:30 PM** |
| Randy Frederick on "Using Credit Spread Strategies to Hedge Your Currency Exposure" | 06/23/09, 4:30 PM |
| **Jack Crooks on "China: Risk and Benefit to the Global Currency Market"** | **06/24/09, 4:30 PM** |
| Mike Tosaw on "Hedging Your Life with ISE Currency Options" | 06/30/09, 4:30 PM |
| Steve Misic on "FX Options Trading Based on Supply & Demand" | 07/07/09, 4:30 PM |
| **Jack Crooks on "Why are Fundamentals Important for Currency Traders and How to Develop a View"** | **07/09/09, 4:30 PM** |
| John Netto "FX Option Strategies for a Declining Volatility Environment" | 07/14/09, 4:30 PM |
| **Jack Crooks on "Using Intermarket Analysis to Find High Probability Currency Trades"** | **07/16/09, 4:30 PM** |
| All times reflected are ET (Eastern Time - New York Time) | |