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*“Dispelling **currency** myths with a little **expert knowledge**”*

published in Escape Artist October 2005

A brief exploration of how currency exchange rates relate to extreme American weather, mainstream German politics, exorbitant commodity prices and international funds seeking interest rate returns, with a passing comment on why the Pound doesn't necessarily strengthen every Thursday afternoon.

Ask any currency dealer what makes him laugh and once you get past the lists of stand-up comics and television sit-coms and have laughed about certain unrepeatable pieces of market slang, the myths that their clients state as unquestionable fact will be mentioned at some point. These urban myths are heard in every dealing room in the world and traders will store them in quote books to be recounted at every opportunity.

Astutely buying and selling any product calls for expertise and experience and requires a thorough understanding of the market involved. It is to be expected that the workings of the currency market, seen from the outside, will look like pretty simple mechanical functions but the pace of exchange rate movements and the diversity of the external influences on currency values make the process surprisingly complex.

It was probably Alexander Pope who first coined the phrase, “A little learning is a dangerous thing” and never a truer word was said. An abridged understanding of something as multifaceted as the currency market would understandably give rise to a whole host of ‘truisms’, which are more myth than fact.

I couldn't begin to count the number of times I have been told by both private clients and business people that selling Australian Dollars in December is a good idea because that's when all the tourists are visiting ‘Down Under buying all the Aussie Dollars and therefore making it stronger. It is always said with such certainty and thorough conviction and yet there is absolutely no factual evidence to support the argument. In fact trying to find a cycle in the Sterling – Aussie Dollar exchange rate is a pretty tall order at any time.

There is another myth that appears from time to time and it is the unquestionable fact that the Pound is always strongest on a Thursday afternoon. To be fair, it isn't always the Pound that is mentioned and not always Thursday afternoon but a certain currency being strong or weak on a certain day is the general theme. Such a reliable trading signal is about as likely as Camelot announcing the winning lottery numbers each week in advance to give everyone a fair crack at a multi-million pound win. The currency market is the largest speculative arena in the world; any trading pattern that stood out like this kind of neon lit sore thumb would either multiply the number of Billionaires in the world or stop trade altogether. After all, who would bet against such an obvious winner?

The currency markets are never this methodical and exchange rates, whilst they can operate in broad patterns of sorts, are as erratic as the political and economic news and views that drive them. This is why it is always worth having the assistance of a good currency specialist on your side when you are moving sizable sums across borders to migrate or to purchase property.

The argument for using a currency specialist is simply the fact that doing so will dispel the myths, add some logic and strategy to your currency plans and ensure that you trade at the right time for the right reasons. Trying to assess the best time to lock in an exchange rate is tricky without the right information and resources.

The currency market, like all financial markets, is driven by political and economic pressures which move exchange rates through the fear and greed of traders. Traders will sell currencies that they fear might weaken and buy currencies where they feel there is a gain to be made from their strength.



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This cause and effect was amply illustrated by a number of recent events and the market's reaction to those situations. 'Is the Dollar going up or down?' is a simple question to ask and really ought to be met with a one word answer but, before making that assessment, a trader has to contend with a combination of a multitude of factors and determine whether the question is being asked about the expected movement today or this week or even this year. The answer may be 'Up today, sideways for the rest of the week and then declining over the following six months' but the forecasting process may involve any number of variables, some factual, some rumour, some drawn from political rhetoric and some from the testimony of a central banker. The cause and effect of each factor has to be assessed in chronological and economic significance and then – and only then – can a realistic answer be given to this question.

As an example, no one was at all surprised that the US Dollar weakened in the days before hurricane Katrina made landfall on the US coastline. Such a destructive force and the uncertain outcome of its arrival was bound to have a negative effect on the US economy and international investors, fearful of the damage it would do to the US currency, sold their US Dollar holdings. This same fear also caused panic buying amongst oil traders; driving crude oil prices to historic \$70 a barrel highs.

After Katrina blew through the Deep South, the dreadful consequences of the storm became clear. The loss of life, the economic damage and the restrictions it placed on America's oil refining capacity were worse than expected and the US Dollar remained on the back foot for a week or so. It only began to strengthen again when economists began to calculate the positive impact of the vast investment necessary to rebuild the devastated cities in New Orleans, Mississippi and Louisiana.

When a second storm, "Rita", a category 5 hurricane, closed in on the same coastline, the US Dollar unsurprisingly lost ground again. However, when Rita was downgraded to a Category 4 storm, Texans were evacuated in their droves and Rita's path looked set to miss the main oil production regions; the US Dollar began to rally, pushing the Pound down to \$1.75 and the Euro as low as \$1.20.

Further North, Canada, with its oil exports, could expect the economy to benefit from the hikes in oil prices and that suggested that further interest rate rises in Canada could be expected. This dragged international investment funds into Canada and the Canadian Dollar strengthened. It hit its strongest level against the US Dollar in 13-½ years and pushed the GBPCAD exchange rate to the lowest in 11 years, remaining there until UK inflation spiked up to 2.4%. UK inflation is not immune to the effects of higher energy prices but the size of the spike did take traders by surprise and this brought calls for the Bank of England to hike UK interest rates to stave off further inflation. They seemed to drown out the calls from the British Retail Consortium and others to lower UK rates to stimulate retail activity and boost the economy.

The Bank of England, having only dropped UK interest rates by 0.25% in August, was very unlikely to lift rates back to 4.75% so soon but that didn't stop the enthusiasm of yield hungry investors who piled into the Pound in preference to the Euro, where interest rates are just 2.0%;. This buying binge caused increased demand for Sterling and affected a rise in the GBPEUR exchange rate.

Apart from the sparse interest rate returns, the Euro was also held back by the uncertain political situation in Germany where the election result returned no clear majority and the sore loser, Gerhard Schroeder, refused to cede control to his arch rival Angela Merkel despite Mrs Merkel's party gaining a slim advantage in seat numbers. Schroeder's final capitulation took three weeks of wrangling and kept the Euro on the defensive the whole time. Even when the deal to allow Mrs Merkel to become Germany's first female Chancellor was announced, the Euro remained subdued as analysts awaited details of the concessions she had undoubtedly been forced to make in order to get Schroeder to step down.



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Meanwhile, in New Zealand, another election left an equally confused picture where no overall majority was gained and a scrappy hastily arranged coalition was shuffled into place. Oddly enough, New Zealand uses a very similar voting system to Germany and the result was uncannily similar to that seen between Mrs Merkel and Herr Schroeder. This confusion didn't weaken the Kiwi Dollar in the same way that it did the Euro. The NZ economy is in far better shape than the Eurozone with strong exports, a buoyant housing market, bustling retail sales and, most importantly, at 6.75%, one of the highest interest rate returns in the industrialised world. Consequently, far from rushing away from the Kiwi Dollar, international investors are clamouring to own them to take advantage of the yield and are even borrowing funds in lower interest rate environments like Europe, to invest in New Zealand and make a profit on the interest rate differentials.

As I am sure you can imagine, it takes a great deal of market knowledge, timely information and detailed analysis to see all of these influences and determine whether now is the right time to buy your Dollars or whether there is a better exchange rate waiting in the wings. Anyone with more than just their holiday money to exchange would do well to speak with a specialist currency dealer to assess where, when and how they should swap their funds.

If I may audacious enough to misquote Alexander Pope, failing to acquire a little knowledge from someone with a lot of knowledge is a very dangerous thing.

David Johnson is an FX Consultant with Halo Financial Ltd, a specialist foreign exchange company providing expert currency exchange services to both companies and private individuals. If you are at the start of buying an overseas property or in the process of buying currency to migrate, it is never too soon or too late to save money on foreign exchange. Halo Financial can be contacted on +44 (0)20 7350 5474 and their website can be viewed at www.halofinancial.com