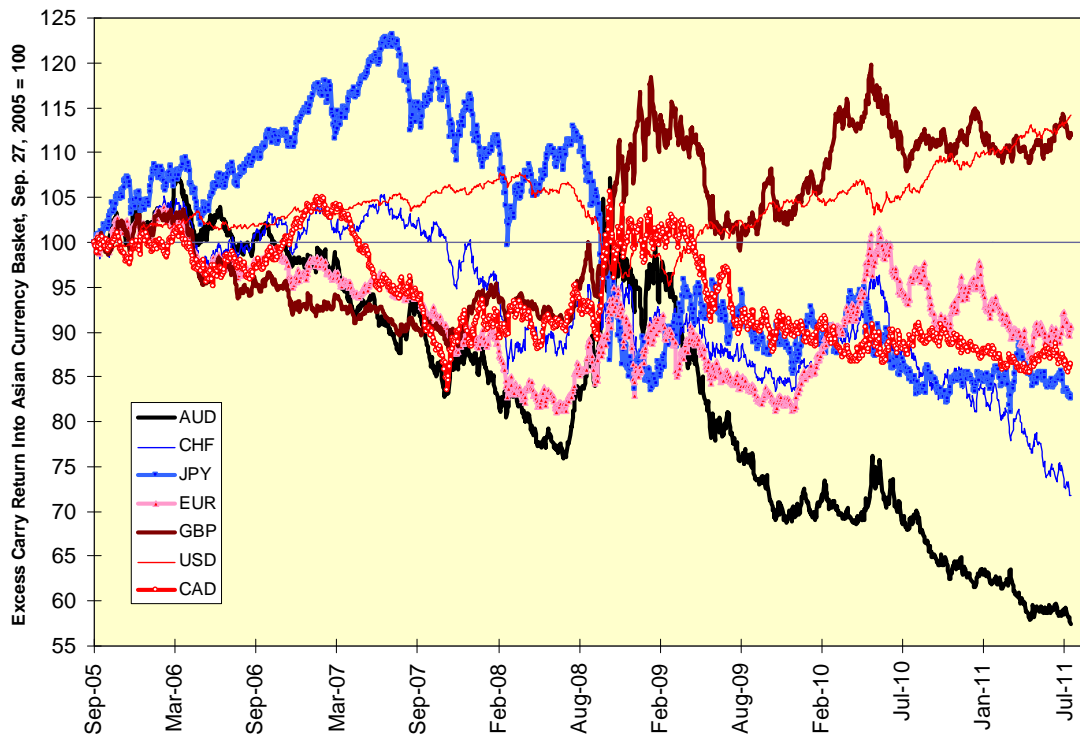


## Asia Not Picking Up Currency Pieces

An old saying in politics is when your opponent is beating himself up, get out of the way; this has been honored in the breach on a national level in recent weeks. Amazingly, the spectacle has yet to trash the bond market and while the dollar has been under some pressure, no one is scrambling to get long the euro at any price. The two currencies have done an excellent job of [propping each other up](#) by mutual foul odor.

Does this mean a basket of Asian currencies, specifically an index created by Bloomberg and J.P. Morgan that excludes the Japanese yen and Australian dollar, have benefited by default, no pun intended? No, not really. If we map the excess carry returns of major currencies into the Asian index, we see it has reached a post-1997/1998 Asian crisis high against the dollar, but has lost against all other currencies except for the British pound.

### Asian Currencies Not As Strong As They Appear Outside Of USD & GBP

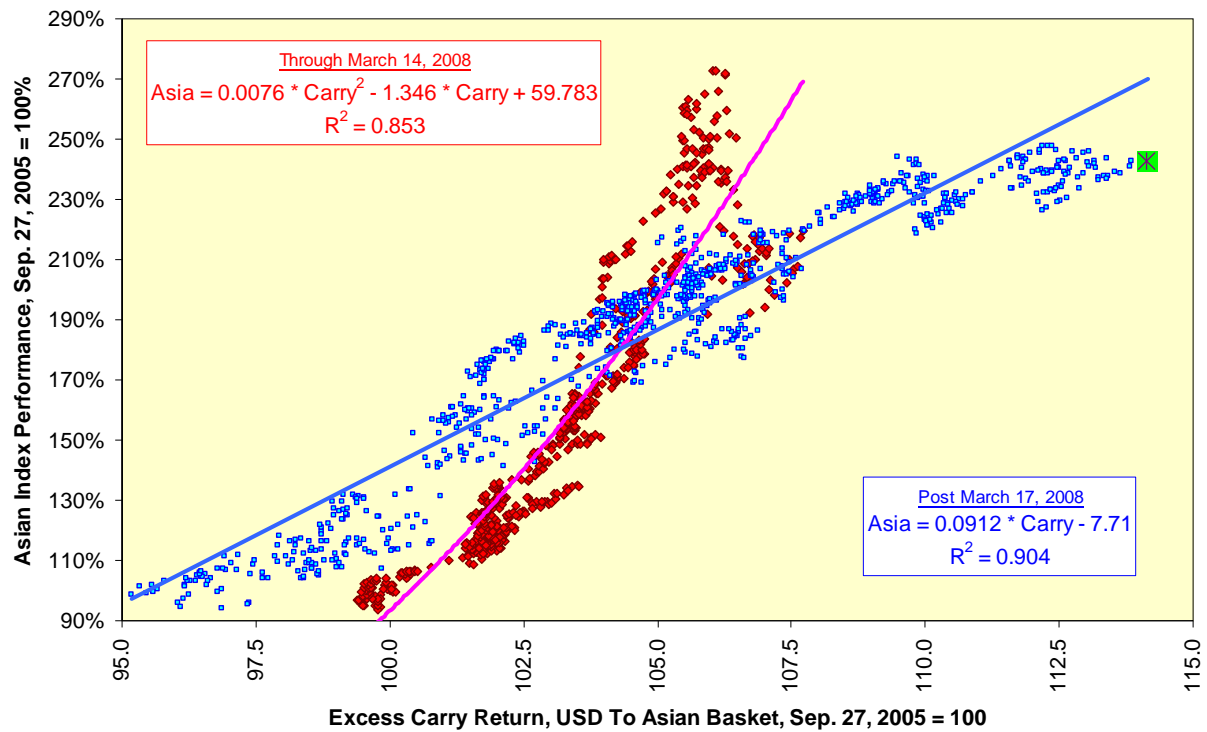


The Australian dollar, Swiss franc and Japanese yen all have gained substantially against the Asian basket in recent months. It would not be fair to impute absolute strength to the Asian basket when a more accurate assessment of affairs is the dollar has been knee-capped by American economic mismanagement.

### The Carry Trade

If we construct a stock index with the same weights as the Asian currency index and map it against the excess carry return from the dollar, an interesting pattern emerges over the post-September 2005 history. Through the Friday before Bear Stearns' collapse in March 2008 – and I can remember that Sunday night and its \$2 per share bid like it was yesterday – the Asian index rose as a quadratic function of the excess carry return. Restated, the weaker the USD became and the cheaper it became to borrow vis-à-vis the Asian currency basket, the more Asian stocks rallied.

### Asian Equities As Function Of USD Carry Trade



That picture changed after March 2008. The relationship is now a linear one, but is starting to weaken. As the dollar weakens to against the Asian basket, with the last datum marked in green, the Asian equity index is stalling. This is a roundabout way of saying there is no escaping a global equity downturn regardless of the yawning carry into Asia.

But, put your Federal Reserve hat on and look at the bright side: They have been saying the debauched dollar is not contributing to capital inflows and asset inflation around the world. As of the last few weeks, they are right. Congratulations; I always knew you were good for something.