

Euro Panic Buying Op

The condition of Europe has become the psychological linchpin governing the world's financial markets. Even the notoriously insular American investors are fretting about Europe's woes on an hour-by-hour basis, which is incredible. The euro currency has become the focus of the global Europe fears, trying unsuccessfully to shoulder this crushing burden. The result is the euro's recent panic-like plunge.

I sure don't use the word "panic" lightly. In stock-market terms, a panic is a 20%+ plunge in the headline stock indexes in 3 or 4 weeks. In October 2008, the flagship S&P 500 (SPX) plummeted 30% in 21 trading days! Panics always cascade into existence in weak markets from already-low prices. *Before* that October 2008 panic month hit, the SPX had already fallen over 22% in its [cyclical](#) bear market.

This is in contrast to crashes, which erupt in very strong markets usually near the ends of secular bulls. In stock-market terms, a crash is a 20%+ decline in the headline indexes in 2 or 3 *days*. Since the euro's recent plunge emerged out of weakness and lows, it definitely isn't a crash. The definition of a panic is "a sudden widespread fear concerning financial affairs leading to credit contraction and widespread sale of securities at depressed prices in an effort to acquire cash". This definitely fits the euro situation.

Currencies move much slower than the stock markets in general, so the 20% stock metric is certainly too steep to define a currency crash or panic. Over a brutal 4-week span ending this week, the euro plunged 9.5%! For the gigantic currencies which usually move with glacier-like lethargy, such a fall over such a short span is certainly "panic-like" if not a true panic.

While technicals measure and quantify panics, it is *psychology* that spawns and sustains them. And in sentiment terms, the euro is definitely deep in the throes of an epic panic. The bearishness, pessimism, and fear surrounding the euro is mind-boggling. Nearly everyone expects it to continue lower in an endless death spiral. A growing fraction of traders is even predicting *parity* soon, the euro trading at \$1.00 even. That is *another* 18% lower from this week's lows!

Fear has to be *extreme* to drive a panic, and we are certainly seeing the euro plagued by extreme fear today. But extreme emotions are never sustainable. Excessive fear quickly burns itself out. Soon everyone who wants to sell has already sold, and when selling pressure climaxes the panic is over. And somehow the world marches on as the news that whipped up the emotional frenzy quickly fades from memory. The more extreme the emotions the less sustainable they are, and hence the shorter the event.

This is why panics, and the ridiculously-low prices they generate, represent the best buying opportunities ever witnessed in the financial markets. In early [March 2009](#), I was railing against the same type of fear extreme in the US stock markets. I wrote, “Despair reigns supreme and seemingly only fools hold out hope that things will materially improve anytime soon. ... When things look the bleakest is exactly when we need to hold our noses and buy. ...all the ingredients are in place for a monster rally.”

And indeed between that very week and late April 2010, the SPX rocketed 79.9% higher in one of the biggest stock-market rallies of modern times. The brave contrarians like our subscribers not afraid to buy into extreme fear made fortunes, but the vast majority of investors lacked the courage and missed most of the upleg. Due to the euro’s deeply-oversold technicals and extreme fear, I believe a similar epic buying opportunity exists in it today.

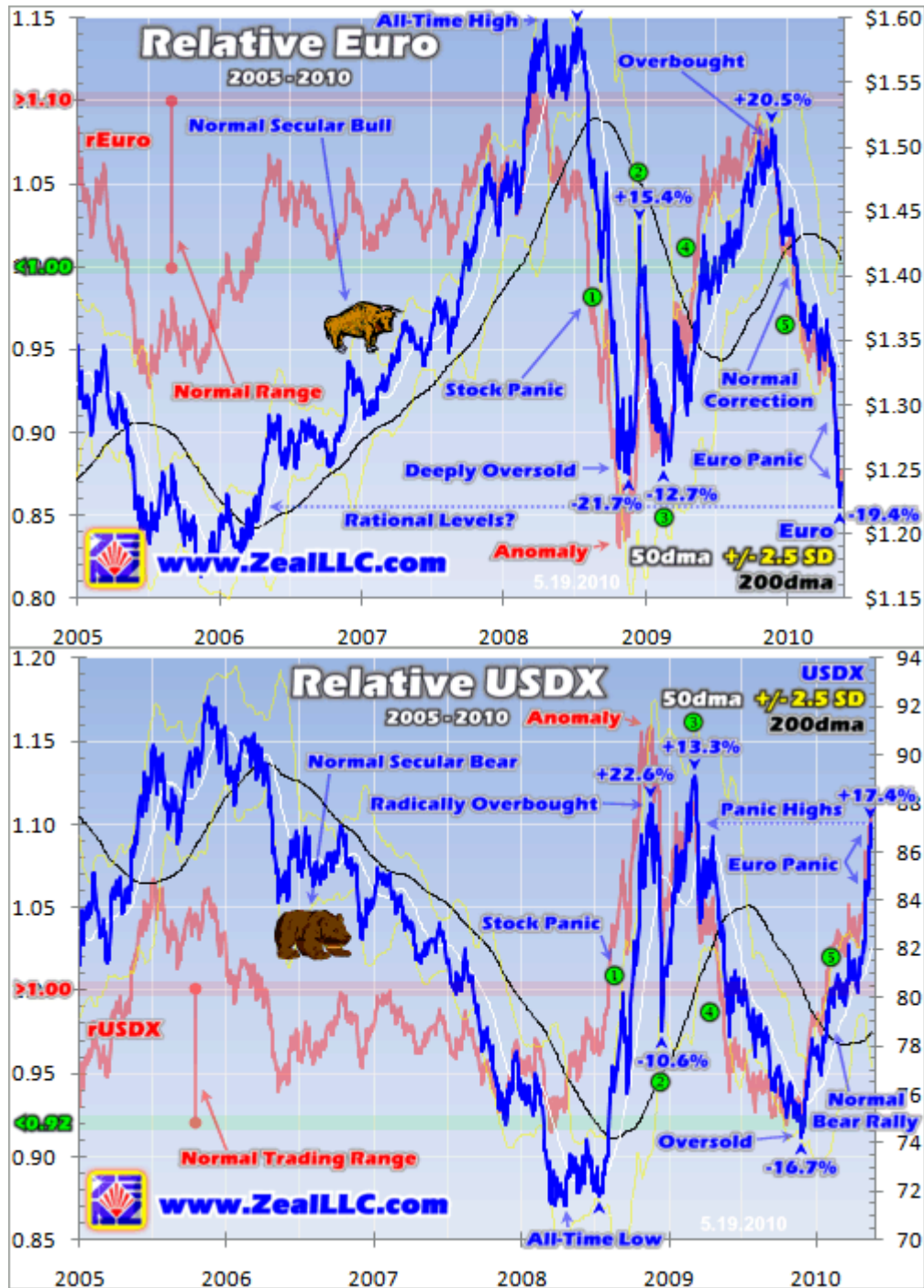
Most would laugh derisively at this heretical assertion. They would bludgeon it with many fundamental arguments on why the euro *has to* continue plunging. Yet the majority said the same thing at the March 2009 stock-market lows. They argued fundamentally that a new depression was upon us, and that the new big-government-socialist regime in Washington would suck the life out of any recovery. But despite these popular and seemingly-logical arguments, the stock markets still soared 80% in just over a year.

Lows driven by extreme fear are never sustainable because extreme fear itself is never sustainable. Investors faced with a new situation today that terrifies them will quickly adapt to that new reality. And within weeks this very same situation will no longer terrify them. Their extreme fear will evaporate as the threat becomes old news and routine. If you are scared of snakes now, a few weeks working in a reptile garden will largely eliminate that visceral fear response.

Europe has problems, no doubt. But big government and out-of-control spending has been a problem all over the world for centuries. And it has grown far worse in the decades since gold’s iron discipline was kicked out of the world currency system. Yet somehow, over the past decades and centuries life has soldiered on despite endless government excesses. *No matter what happens* in Greece, it doesn’t matter! At less than 3% of Europe’s GDP, Greece is trivial. So are the other troubled countries.

The incredibly bullish outlook on the euro today is not based on fundamentals, but technicals and sentiment. There is no better time to buy anything than when everyone thinks it is heading to zero in the heart of a panic. Nathan Rothschild’s famous quote of “buy when there’s blood in the streets” is one of the core tenets of contrarianism. With today’s wild popularity of the euro-to-zero trade, and the universal extreme fear, this time-proven wisdom has never been more appropriate for the euro.

The charts really drive home this point. These two charts of the euro and US Dollar Index need to be digested as a pair. The USDX is the premier metric for measuring the US dollar's progress, and the euro dominates it at 57.6% of its weighting. Also rendered are each currency's [Relativity](#) trading bands, or where they are trading as absolute multiples of their baseline 200-day moving averages. These define extremes and show how wildly out of whack the euro has become.



Prior to late 2008's [once-in-a-century](#) stock panic, the euro was in a strong *secular bull* while the dollar was in a strong secular bear. These major trends had started way back in the summer of 2001 and had a rock-solid fundamental basis. While both the euro and dollar are inherently-flawed fiat-paper currencies backed by nothing but faith in their issuing governments, the euro was much less mismanaged than the dollar was.

Europe was not expanding its broad money supply as fast as Washington, so its inflation risks were lower. Europe's central bankers, having witnessed firsthand the devastating impacts of runaway inflation in the last century, have always been far more conservative than the Americans running the Fed. Europe was paying higher interest rates, making the euro more attractive to global investors. And the world's central banks were way over-allocated in US dollars and under-allocated in euros, so they diversified out of dollars into euros. Naturally the euro marched higher while the dollar drifted lower.

You can see each currency's relative trading range in the years before the stock panic. They generally were pretty tight. The euro tended to meander between its 200dma during healthy corrections to 10% above its 200dma near the peaks of big uplegs. At the same time the dollar drifted between its 200dma during bear-market rallies and 8% below its 200dma in big downlegs. These are perfectly-normal secular-bull and secular-bear behaviors respectively.

By April 2008, the euro had hit an all-time high while the US dollar hit an all-time low. And for the following few *normal* pre-panic months, the euro consolidated near its highs while the dollar consolidated near its lows. It was these levels, driven by 7 years of carefully-thought-out capital migrations, that were the best pre-panic fundamental read on where these competing currencies ought to be trading. Contrast those spring-2008 levels to today's hysteria-driven extremes.

2008's panic was actually two-phased, a bond panic closely followed by a stock panic that drove general fear to previously-unimaginable levels. As investors lost faith in bond and stock markets worldwide, they [flooded into](#) US dollars and US Treasuries as safe havens. This drove the biggest and fastest US dollar rally ever witnessed, an epic 22.6% USD_X spike in just 4 months!

Since the euro is the dollar's primary competitor, it naturally plunged over this epic-dollar-rally span. The euro hit deeply-oversold levels around \$1.25 after falling 21.7%. Was this panic euro plunge driven by poor euro fundamentals? Of course not. It was simply the fallout from a mass exodus into safe-haven dollars after the first true stock panic of modern times. Provocatively in November 2008, the euro bottomed and the USD_X topped on the *very same day* the SPX bottomed. The stock woes drove dollar buying, and the euro was simply collateral damage.

Provocatively, near the euro lows in late 2008 mainstream consensus argued the same thing about the euro and dollar that we hear today. They claimed the euro wasn't viable after a decade of life and a powerful secular bull. They claimed Europe couldn't handle the financial stresses of the panic since it was a fragile patchwork of countries with disparate interests and needs. But the reality was the euro was deeply oversold and the dollar radically overbought. Emotional extremes that couldn't persist drove these anomalies.

As the stock markets soared up out of their irrational panic lows in December 2008, the euro rocketed 15.4% higher in less than 4 weeks while the inflated dollar collapsed 10.6%. This trend held until the stock markets started rolling over again, when worries about the imminent socialist takeover of Washington inflamed fears that a new depression was inevitable in the States. So once again between mid-December and the March 2009 stock-market lows, flight capital rushed into the dollar so the euro took a serious hit.

Then again in early March 2009, the USDX made new highs and peaked on the very days the SPX made new lows and hit its ultimate bottom. Its 13.3% rally drove a parallel 12.7% euro plunge. Once again the euro bounced near \$1.25. As you know if you were the least-bit interested in the markets in March 2009, the fear and despair then were overwhelming and utterly unsustainable. As those emotions faded, the oversold euro soared while the overbought dollar plunged.

By late November 2009, when the stock markets were no longer scary, the euro had rallied 20.5% to around \$1.50 and the dollar had lost 16.7%. But by that time the euro was overbought and the dollar was oversold, as I warned our subscribers about heading into November. Near the edges of their relative trading ranges, the euro was due for a correction while the dollar was due for a [bear-market rally](#). And indeed as expected those healthy interim reversals to rebalance sentiment soon came to pass.

Remember that both bull-market corrections and bear-market rallies tend to reverse near their 200dmas. So for both the euro and the dollar, these healthy short-term reversals looked normal into February 2010 when they hit their respective 200dmas. Absent all the Europe hysteria, the euro and USDX probably would have reversed decisively sometime in February (where it averaged \$1.37). The euro would have continued back up while the dollar ground lower on the same fundamentals that had driven these currencies *for many years* prior to the panic anomalies.

But the festering Europe fears gradually drove the euro lower while the dollar caught a bid, extending their reversals far beyond where probabilities suggested they ought to stop. The result is the nearly-vertical and unsustainable euro plunge and dollar spike we've witnessed in the last month or so. As you can see

in these charts, this hyper-emotional event drove both the euro and dollar to crazy extremes.

As of this week, the euro was back down to early-2006 levels. Is this rational? Given the euro's superior fundamentals (slower monetary growth, more conservative monetary policy, higher interest rates, under-allocation by central banks), does it make any sense for this currency to erase several years' worth of bull-market gains in several months? Is it rational to see the euro now trading below its lows from the stock panic, when global investors really feared a new worldwide *depression*? No way.

On the other side of this coin, today's dollar levels look just as irrational. The USDIX is back up *near its panic highs!* We are talking about places it went when the VIXO fear gauge was running in the high 80s in October and November 2008 and the mid-50s in early March 2009. Lately it has only been in the low 30s, so general fear isn't even close to as high as the last time the USDIX saw these levels.

And given Washington's out-of-control spending, the asinine zero-rate policies of the Fed, the Fed's incredibly [inflationary monetary growth](#), central banks' massive over-allocation in US dollars, and the terrible yields on US Treasuries, does it make sense for the US dollar to be trading at levels last *sustained* in early 2006? Nope. Today's dollar highs are merely an emotionally-driven anomaly just like they were during the stock panic. The extreme fear hammering the euro and driving the dollar buying will be no more sustainable than the stock-panic fear was.

Investing and speculating are about buying low and selling high. The reason contrarians are the most successful at this game is because we ignore our own emotions and *buy into extreme fear* and sell into extreme greed. Extreme fear and greed manifest themselves on the charts as exceedingly large moves in short periods of time. The faster and more anomalous any move, the more intense the emotions that drove it and hence the less sustainable it is.

As I wrote last week in an essay on [euro gold](#) challenging €1000 for the first time ever, I am no fan of the euro. Like the US dollar, it is a fiat currency backed by nothing but faith in its issuing governments. It will slowly devalue towards zero just like all paper currencies. But fundamentally it *is* the lesser of these two fiat-paper evils. It has been in a strong secular bull while the dollar has languished in a long secular bear. These fundamentals didn't suddenly evaporate due to little Greece's sovereign-debt problems.

The euro is radically oversold today while the dollar is radically overbought. Fear permeates every aspect of the euro while greed clouds traders' fundamental judgment on the dollar. Neither of these emotions, nor the extreme price anomalies they have recently driven, are sustainable. Going long the euro today

is as good of bet as going long the SPX was near its March 2009 lows. When everyone expects anything to go to zero, when the entire financial media harps on this incessantly, it is an epic buying opportunity.

Interestingly, I suspect this euro-plunge causality might not be working in the direction everyone assumes. Today everyone thinks Greece fears are driving Europe worries which are hammering the euro, commodities, and stock markets while the dollar rallies as a consequence. But perhaps, just like during the euro's late-2008 plunge, *the US stock markets* are the stealthy dominant driver.

The SPX topped at 1217 in late April. It had relentlessly rallied 15.2% since early February, a huge and very unbalanced move with almost no meaningful down days. This [SPX levitation act](#) made traders very nervous, and everyone was looking for a healthy pullback to rebalance sentiment. They *wanted an excuse* to sell stocks, and the latest round of Greece fears conveniently created one.

Remember that the European sovereign-debt worries are nothing new. We've been hearing about Greece, Portugal, Spain, and sometimes Italy for *at least 6 months* now. And indeed, the euro had weathered the ceaseless drumbeat of Europe pessimism rather well between late November when it was overbought and mid-April. When the SPX first broke above 1200 that month, the euro was running \$1.37. That was on the low side, appropriate for a correction, but nowhere near extreme.

Then as soon as the SPX selling started, the euro got sucked in. Just like [during the stock panic](#), a big flight-to-safety sell-everything-buy-dollars trade emerged. The USDX tended to get bid higher on days the SPX fell, thus the euro also fell on days the SPX fell. So perhaps this whole euro panic is more the result of dollar flight capital spawned by the biggest pullback of this SPX cyclical bull. The financial media always tries *to justify* existing price movements, but the factors attributed and causality are often muddled.

At Zeal we are lifelong students of the markets and pride ourselves on being hardcore contrarians. We buy low and advise our subscribers to follow when prices are oversold and few others want to buy. This gives us excellent entry points for very profitable trades. Today's radically-oversold euro is one of the most extreme low-price anomalies I've ever seen. I can't imagine it not reversing soon and violently, with the resulting euro relief rally being blisteringly fast just like it was in early 2009.

This has huge implications for commodities stocks, as the rallying dollar and falling stock markets have really depressed them lately. We are heavily deployed in precious-metals stocks, which should thrive as the dollar retreats and gold surges. We are also taking advantage of the weak commodities prices to deploy into other commodities-stock sectors. [Subscribe today](#) to our acclaimed

[weekly](#) or [monthly newsletters](#) and take advantage of the *awesome* buying opportunities these wild markets are offering!

The bottom line is the recent precipitous plunge in the euro was either a panic or panic-like event. It was driven by extreme fear that simply isn't sustainable. The fate of Greece, or the other small peripheral debtors, is irrelevant. The euro fell too far too fast and hit totally irrational levels that have nothing to do with fundamentals, and everything to do with runaway emotions. Odds are this will soon reverse with a big and fast euro rally.

This has widespread implications for the US dollar, the US stock markets, and commodities stocks. A fast-rallying euro will directly hammer the dollar and calm Europe fears, leading to new stock-market and commodities buying. The commodities stocks, many very oversold thanks to this SPX pullback, have the potential for exceptional gains. But as usual, only the emotionally-neutral contrarians will capitalize.

Adam Hamilton, CPA

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Questions for Adam? I would be more than happy to address them through my private consulting business. Please visit www.zeallc.com/adam.htm for more information.

Thoughts, comments, or flames? Fire away at zelotes@zeallc.com. Due to my staggering and perpetually increasing e-mail load, I regret that I am not able to respond to comments personally. I will read all messages though and really appreciate your feedback!

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