



## EES - What Russian war means for the Euro

The conflict in Georgia is greatly affecting the Euro across the board. What does this all mean, and where should investors go?

FX is extremely sensitive to politics, because a shift in a domestic political system can be directly connected to a currency's value. For example, the Chinese government announcement that the Yuan would float, albeit a 'soft peg' to the USD, shattered the relationship between a previously pegged Yuan and the USD. Many watching the situation in Georgia are unaware how this impacts them, and how it impacts FX. Also, this war, like many wars, is an information war, and the media spin leaves viewers with a less than accurate picture of reality.

The strength of the Euro over the past 5 years has been in part, not European strength as much as American weakness. A combination of economic factors in the US has made investors fear the USD and purchase non-USD based assets in Euros and other foreign currencies. Also, the Fed has been lowering US interest rates to a finally negative real interest rate.

The recent strength in the USD is not USD strength per se, but Euro weakness. The fear is that Europe will be involved in a war with Russia, and energy will be involved. Russia supplies 25% of the EU's energy needs and over 50% to many Eastern European states<sup>i</sup>, and the EU is Russia's largest trading partner, totaling \$285 Billion<sup>ii</sup>.

Immediately after the 4% drop in the Euro in 2 days, Bank of America issued a warning to its' customers summarizing the situation that, although the USD is showing signs of recovery, a war in Europe does not solve the fundamentally flawed US economy, and they expect further USD weakness<sup>iii</sup>.

Russia's involvement in Europe is not only energy. The US has planned military bases in many eastern-bloc countries, one of which has been signed during the crisis in Georgia<sup>iv</sup>.

One problem with Europeans is they cannot agree. This is what makes Europe charming and culture-rich but politically complex. USA is a 'melting-pot' which has become a mono-culture based on corporatism, while American's argue their thinking lies in the same direction. Since the US Civil war, US mono-culture has solidified the mainstream in a view that always agrees on some tenets, this is not the case in Europe. Entry into the EU and the Euro passed referendum in many EU states by thin margins, there are those who would like to revert back to national currencies.

One main difference between the Euro and other currencies: the Euro does not have a government behind it. Individual EU states retain their sovereignty, and those states central banks have essentially no power to influence the Euro directly, except for lobbying the ECB. So the Euro is a designer currency hanging on a thin margin, which could be toppled by a severe energy crisis should the situation with Russia escalate. US involvement in Eastern European countries will only increase the chances of Russia's will to turn off the lights.



Russia has already quietly begun selling oil in Rubles<sup>v</sup>, and announced the Ruble is fully convertible (since 2006)<sup>vi</sup>. While by itself these actions are not market-shattering, combined with the potential conflict in Georgia, and Russia's aggressive policy to capitalize on their vast wealth in natural resources, a situation is brewing in Europe which can be potentially explosive. Any turmoil can be seen as bad for the Euro, regardless of the actual damage done. The disadvantage of Europe is its history: Europe has been involved in wars and currency devaluations. As poor as the US economic numbers are, the US is involved in foreign wars at its leisure, there is no compelling reason the US should be involved in any war.

Russia can also affect emerging markets which it may be forced to trade with, such as India, China, and Brazil. Russian oil could help a growing Chinese economy and decrease Russia's dependence on European customers. In a complex environment a static forecast is not possible, but it is clear any instability or even the perception of instability close to Europe will be negative for the Euro. Elite E Services believes the next bubble to pop will be the Euro bubble.

Long term, this is a buying opportunity for hard commodities such as Wheat, Swiss Francs, Oil, and Gold. Whatever happens in this war, the supply side in the Oil market is controlled by unfriendly countries such as Venezuela and Iran. If Russia is now added to the list of unfriendly countries, we can expect Oil to increase long term, as Russia will use this as a bargaining chip in any negotiations.

This move has been excellent for CTA's trading momentum and trend-based strategies. For short term gains in the FX or Commodities markets, investors can seek CTA's with established track records or automated trading systems, which are performing very well in environments like this. In fact, desynchronized markets are ideal for systems that monitor and analyze discreet price data vs. fundamentals.

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Elite E Services is a registered CTA with the CFTC and NFA Member (#373609). [eliteeservices.net](http://eliteeservices.net)

<sup>i</sup> [http://www.thebulletin.us/site/index.cfm?newsid=20014257&BRD=2737&PAG=461&dept\\_id=576361&rft=8](http://www.thebulletin.us/site/index.cfm?newsid=20014257&BRD=2737&PAG=461&dept_id=576361&rft=8)

<sup>ii</sup> [http://online.wsj.com/article/SB121867961126739479.html?mod=googlenews\\_wsj](http://online.wsj.com/article/SB121867961126739479.html?mod=googlenews_wsj)

<sup>iii</sup> <http://www.bloomberg.com/apps/news?pid=20601101&sid=aBhayT2s6mCQ&refer=japan>

<sup>iv</sup> <http://www.spiegel.de/international/0,1518,572266,00.html>

<sup>v</sup> <http://www.iht.com/articles/2008/02/25/business/place.php>

<sup>vi</sup> <http://www.guardian.co.uk/business/2006/jun/30/2>