George Soros and the British Pound – A case study

I had a fascinating email exchange this past week with a Factor member from Cambridge University. Together we briefly pieced together the events leading up to the showdown between George Soros and the Bank of England over the value of the British Pound in 1992. The Factor member reconstructed the global macro factors that led Soros to his conviction the BoE would not be able to maintain the Pound's peg level within the European Exchange Rate Mechanism (ERM) – specifically in relationship to the D-Mark. In turn, I reconstructed the chart developments during the period leading up to Soros' victory over the BoE.

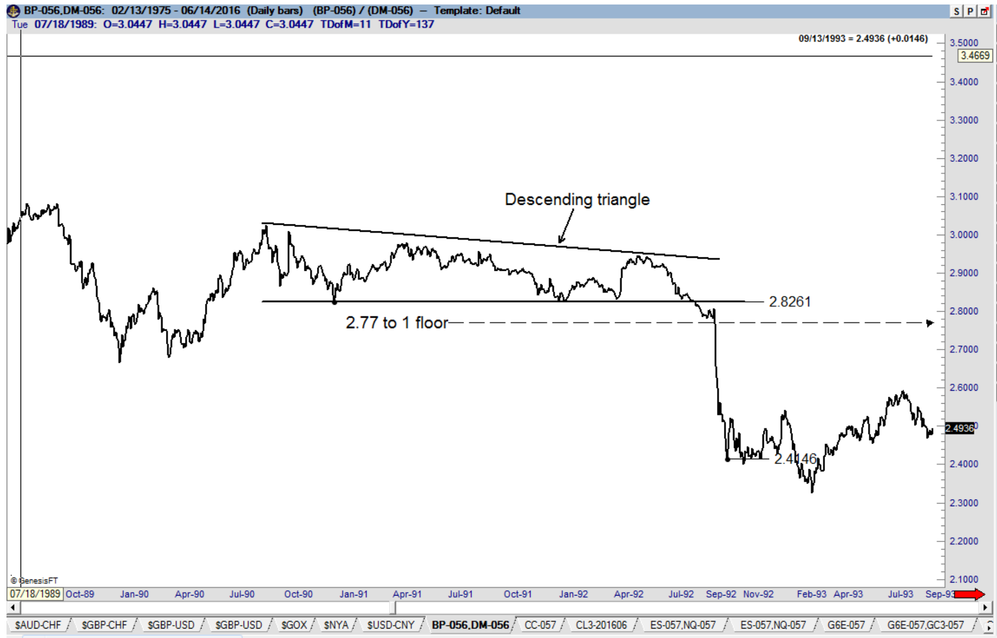
Often mentioned in foreign exchange lore is the trade in which George Soros reportedly made more than $1 billion from a short position in the British Pound vs. the D-Mark in the early 1992. In fact, the Soros short bet on the Pound is legendary.

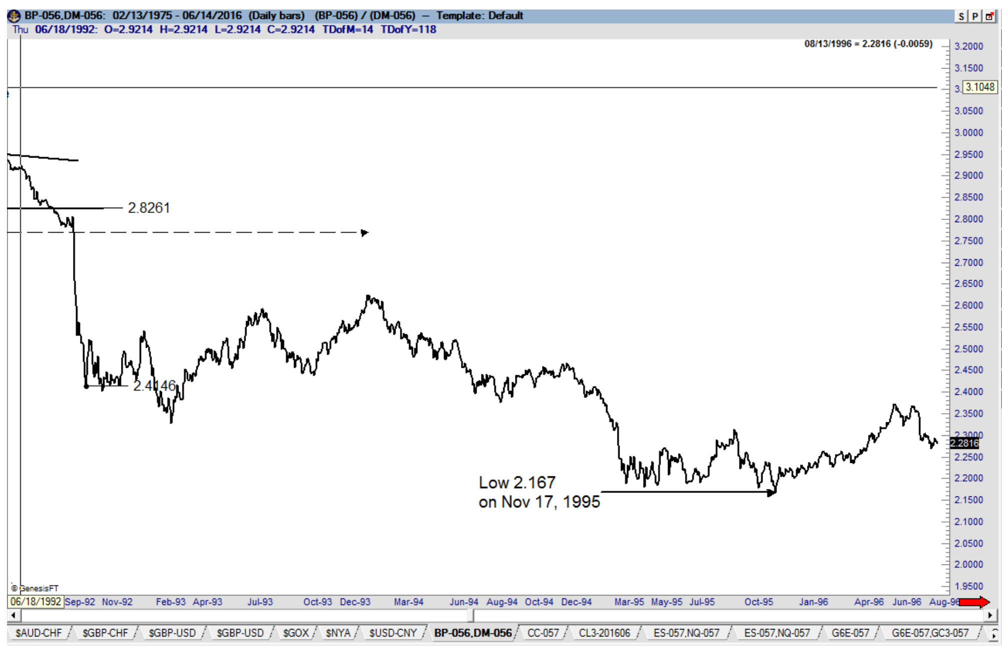
Following is the story that was told by price charts leading up to Black Wednesday, Sep 16, 1992.

From at least the mid-1970s through late 1980s the British Pound lost value against the German D-Mark, as shown on the monthly graph. Note on this graph the formation of a 9-plus year continuation H&S pattern. This pattern was completed in Jan 1986. Using the conventional targeting methods of classical charting principles, this pattern established an eventual objective for the cross of 2.16 to 1 using a monthly closing price graph and 2.43 to 1 based on the quarterly closing price chart (not shown).

In Oct 1990 -- leading up to the creation of the European Union and the proposition of a single Euro currency -- the British government agreed to a peg the GBP against D-Mark at 2.95 (DMs per GBP). Further, The Bank of England agreed to intervene in the forex markets by massively buying Pounds should the GBP/DM cross reach a floor price of 2.77 DMs per GBP.

The global macro conditions at the time (inflation and interest rate differentials between Germany and Great Britain) lead traders such as Soros to doubt the ability of the BoE to defend the 2.77 floor. Soros established an enormous short GBP position on his belief that the ERM would give way.





The daily chart tells the tale. From Oct 1990 through Aug 1992, the Pound remained above 2.826 (DMs per GBP). In the process, the daily chart established an extremely well-defined descending triangle. This is a powerfully bearish chart configuration. During this time Soros was a vigilant short seller of Pounds. In fact, <u>I think a very strong case can be made that Soros and the BoE were the two major forces that set the boundaries of this triangle</u>. The descending triangle – as expounded by Richard W. Schabacker – perfectly explains the buying and selling dynamics between Soros and BoE. The lower boundary of the triangle gave way on Aug 13, 1992 and gradually declined through Sep 15, when the cross closed at 2.7695, breaching the 2.77 floor.

Overnight on Sep 15 leading into Sep 16 the BoE was no longer able to defend the Pound. The collapse had begun. From Sep 16 through Oct 5 the GBP/DM declined to a low of 2.4146 -- in the process Soros made in excess of $1 billion.

The real damage had been done in a matter of days in Sep 1992. GBP/DM gradually declined for the next three years, bottoming at 2.167 on Nov 17, 1995. This low exists to this day.

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