



POTOMAC  
STRATEGIC INVESTMENT

# CAPITOL MARKET REVIEW

In This Issue: Day Two, Rally Loses Steam, Commodities Perk-Up on Iranian News, Eastman Kodak Could File for Bankruptcy

At the Close: SPX 1277 US10Y 1.97% Gold \$ 1613 Oil \$ 103.23 Jan 4, 2011

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The second day of US trading saw subdued interest in equities. Stocks ended the day flat, but it took a peculiar ten point rally off the European closing low of 1267 to accomplish the task.

Volume in today's equity markets was 30% lower than the second day of trading in 2011. Low volume markets are not normal for this time of year as large pension/institutional investors are rotating their asset class allocations, therefore generating strong seasonal volume.

Saber rattling between Iran and the US continued, with the US rejecting Iranian demands that US Carrier Groups stay out of the Gulf. Away from the US/Iranian dialogue, came new rumblings that EU Member States are also about to ban Iranian oil imports, further isolating Iran. The US has long sought further sanctions against Iran, now it seems other developed nations are finally supporting the US position.

On the Iranian news, both gold and oil rallied strongly. In a perverse way, this favors Iran. Like many oil producing nations, Iran always favors higher crude prices. Fears of a European recession and cooling growth in China had oil prices dropping. CMR is of the opinion that in spite of announced bans and embargoes, often times nations cheat. Assuming tensions ease in the next few weeks, it wouldn't be surprising to discover that someone continued to buy Iranian crude.

The other phenomenon important to track in January are the predictions of economists. The themes of many economic reports signal that the US will continue to be the sharpest of a dull set of knives. This along with also popular, US is the cleanest shirt in an otherwise drawer of dirty shirts, are the two metaphors that have been repeated for months. The theory is that due to the reserve currency status of the US Dollar, the fact that the US dealt more affirmatively with its credit crisis, and that since the crisis occurred in 2008, three years of recovery, (at zero interest rates,) will lead to a stronger US GDP in 2012 is a theme many economists are advancing; election year politics also figures into projections for US growth.

CMR agrees with those who say that the US is further along in its recovery. However, CMR also sees the current malaise as a function of a structural problem that is impacting the entire socio-economic system in the US and will therefore take longer to conclude than main-stream economists predict. CMR rejects the strong US recovery analysis, siding with those who see subdued economic growth, punctuated by one quarter that will print stronger, but be revised lower.

The debt hangover continues and will impact equities, housing and employment throughout 2012. Statistically, the US will look better than the Eurozone in many respects. However, hope for strong employment growth and more "normal" economic activity are just that. Hopium will continue to be the economic and political drug of choice for 2012.

CMR is also somewhat melancholy to note that Eastman Kodak, one of the great American brands, is said to be facing bankruptcy. NYSE is considering de-listing the shares and the financial press maintains an announcement could come in the next few days.