



POTOMAC
STRATEGIC INVESTMENT

CAPITOL MARKET REVIEW

In This Issue: Markets Swing Back to Euro-Watching, See Nothing Worthy of a Rally

At the Close: SPX 1280 US10Y 1.95% Gold \$ 1611 Oil \$ 101 January 9, 2011

The markets gaze again turned toward Europe in anticipation of another meeting between Germany's Merkel and France's Sarkozy. And just as they have for all of the previous meetings, Merkel and Sarkozy announced something that does not solve the macro problem of Europe but makes a headline of no significance.

The newswires tell us that Sarkozy and Merkel are now in agreement on a transaction tax for securities traded in the Eurozone. However, there is little chance of passage. What was ignored by the leaders of France and Germany were continued reports of ECB support for sovereign debt. The ECB is expanding its balance sheet, (as the Federal Reserve did during the 2008 crisis here,) but its not helping as key interest rates in the Eurozone remain at unsustainable yields. In addition, macro news coming out of key European economies continues to flash recession. (CMR believes Europe is already in a recession.) Lastly, billions in sovereign debt is coming due and will have to be rolled in the next six months. No transaction tax can pay this bill.

As markets opened in the US, investors turned cautious. Stocks were higher, but considering the season, market action continues to be historically uninspiring. Traditionally, large institutional investors rotate sectors at the beginning of every calendar quarter. This triggers index buying and/or selling depending on how allocation formulas dictate. Many had hoped institutions would sell their Treasury securities and allocate additional assets to equities. It hasn't happened.

Just as there is an Almanac of American Politics, there is a Stock-Traders Almanac and its axioms are not being followed. Indeed, considering the manner in which assets have been trading for the past year, the relationships between stocks, bonds and commodities continues to vex both bankers (sell-side,) and investors (buy-side,) alike.

Its as if the concept of "kicking the can down the road" has now impacted not only global political leaders but also global investors. CMR has long maintained that the amount of time to solve the Eurozone crisis grows shorter every day. That unlike the US, Europe's deadline for action is much sooner. This is a view CMR continues to believe in.

At the close today, Alcoa led off another round of quarterly earnings. (Alcoa is always the first company to report its quarterly earnings.) Alcoa posted a loss. This reflects subdued global growth, as well as continued management miscalculations by Alcoa. 2012 guidance was also below trend; hardly an inspiring way to begin a new year.

The only positive economic news comes from an expansion in consumer credit. After a number of quarters where American consumers were cautious regarding the use of credit, Americans used plastic to pay for Christmas. In addition, the US is also buying cars again. Remarkably, consumers may find it hard to convince their employers to raise their wages. And they may have difficulty getting a mortgage, but almost anyone can again buy a new car as credit is suddenly plentiful for autos.

Lastly, perhaps one of the poorest choices for White Chief of Staff, Bill Daley, today resigned. Washington was underwhelmed. Daley had already given away much of his authority. His reward? More time with his family and Co-Chair of the Obama 2012 Campaign.