



POTOMAC
STRATEGIC INVESTMENT SYSTEMS

CAPITOL MARKET REVIEW

In This Issue: China Demands Everyone Smoke Hopium, Wall Street Edges Higher, EU May Reject NYSE Deutsche Bourse Merger

At the Close: SPX 1292 US10Y 1.96% Gold \$1632 Oil \$102 Jan. 10, 2012

In overnight news, The Peoples Republic of China has decided it's tired of watching its stock market decline and has therefore mandated that Chinese institutional investors buy Chinese equities.

As measured by the leading China ETF, (the FXI,) Chinese stocks dropped nearly 20% in 2011. Considering that there have been multiple rumors regarding the health of China's banking sector, (questionable real estate and business loans,) China has decided it would be productive and advisable for Chinese institutions to own more equities. Assuming many investors had been caught short, (or in equity hedges,) the move in key Chinese stocks and indexes was only mildly bullish. Shares of FXI did quickly trade above recent technical "tops," but overall Chinese stocks are still trading at levels seen during the August swoon. Any sustainable, meaningful, rally in China stocks would see the FXI trade consistently above \$40.00, which is still a good 10% from the current \$37.00 level.

As has been noted in previous CMR's, the early days of a new year are always closely monitored for hints and patterns. The New Year is also earnings season, which makes early reports important catalysts. CMR differs with the view that yesterday's results from Alcoa were strong. Guidance isn't worth much in January as corporations have an entire year to alter their view. Inflation, poor economic conditions and even weather can all conspire to turn a rosy outlook in January into a sober re-assessment in June. Caution remains the buzzword for equities and economic growth in general.

In spite of a global cheerleading for stocks, US bonds continue to flash recessionary fears, same with commodities. The US10Y Treasury remains below 2%. This is not bullish. Healthy economies do not see banks keeping billions on account with their central banks, *at negative interest rates*, (Euro banks park deposits at ECB,) if solvency and fear are not rampant.

The collective will of the mature/established economies, (US and Eurozone,) as well as the stronger emerging nations, (as the latter now fear their domestic consumers cannot sustain growth,) are acting symbiotically not necessarily to drive global equities higher, but rather making it very difficult for these indexes to drop. The result are slowly rising markets with very low volume. These are not markets of conviction.

CMR sides with economists who see growth trends as precarious. ZIRP in the US are helping, but in the absence of sustainable end-demand, US corporations are not expanding production, or adding workers. Subdued growth continues to be the dominant theme.

Away for markets, CMR notes that the pending global merger between the parent company of the NYSE and Deutsche Bourse, (creating a global exchange with extraordinary reach,) may be facing rejection in Europe. This had been a controversial deal from the outset and considering that Euro regulators have been considering taxes for securities transactions its not surprising that this merger may now be facing a dubious future.