



POTOMAC  
STRATEGIC INVESTMENT

# CAPITOL MARKET REVIEW

In This Issue: Global Markets Restless, Lack True Direction. Even Republicans Are Attacking Capitalism.

At Mid-Day: SPX 1289      US10Y 1.90%    Gold \$1638    Oil \$101      Jan. 11, 2012

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European policymakers have done something many thought was impossible. They have worn out global investment interests. Lacking the ability to gauge whether the entire Euro system is going to implode in spectacular fashion, or if policymakers will finally take the requisite steps to solve the crisis, global investors are truly exhausted.

Enough capital has been removed from troublesome markets. Hedges are in-place to protect certain losses. A blueprint is known, (a combination of sovereign haircuts, budget cuts and monetary inflation,) yet nothing has changed. No action has been taken. The next trigger date comes at the end of January. However, if recent history is a guide, that date will be pushed-back.

CMR continues to maintain that during this dangerous time-period, Europe is in recession. And considering Europe's role as both a producer and consumer of global goods and services rivals the US, a recession in Europe is cooling global growth in emerging economies as well as the US. Every day the Euro crisis remains unsolved is another day where global investors will place assets in US markets thus causing a slow rally in the US Dollar, keeping our Treasury yields artificially low, keeping inflation in-check and allowing the US time to repair economic damage dating back to 2008. It's a remarkable time in economic history. However, since the Euro crisis must be solved, the benign environment in the US is finite. CMR sides with those who see the end-game within six months.

Away from the Euro crisis, New Hampshire provided "favored son" Mitt Romney with another victory further cementing his position as the Republican nominee for the Presidency. In the process of chalking up a win, capitalism absorbed another blow. This time the wound was inflicted by Republicans. Attacking the venture capital/private equity business model is a naïve and dangerous political strategy. Accusing Bain and other VC/PE investors of something akin to capital market extortion is further evidence of how little political leaders, (in both political parties,) understand the role of private equity in global capital markets.

The attack is meritless on more levels than this service can detail in a daily "one-pager." However, a few key points need illumination. The concept of private equity was for many years under control of old-line investment banks. The fact that entrepreneurs were willing to take the risk of providing private equity capital outside of traditional banks is a positive for anyone who believes capital should not be concentrated in the hands of a few banks.

Second. Private equity financing is normally done in conjunction with current shareholders. The vast majority of PE deals are not hostile. While there are questions as to whether these deals ultimately work, there is no question that the intent is to provide viable operations in the future. It is true that some divisions are sold, and some jobs are lost, but it is not the concept that takes those jobs, it is the evolution of the business model of the company, not the private equity firm. Also, the capital provided is both the firm's funds as well as those of other institutional investors.

Lastly, virtually every public pension fund has assets invested with private equity. Every major union, every municipal pension fund has an allocation to private equity. Are these largely Democrat controlled funds to be attacked for their support of private equity? It is preposterous to attack an important component of the financial system to win 11% of a vote instead of 10%.