



POTOMAC
STRATEGIC INVESTMENT SYSTEM

CAPITOL MARKET REVIEW

In This Issue: Economy Spotty, Stocks Higher in Slow Trading, The Mysteries of De-Coupling...Iranian Oil Embargo Delayed, Does it Matter?

Into The Close: SPX 1295 US10Y 1.92% Gold \$1650 Oil \$98.97 Jan. 12, 2012

US stocks initially sold-off on weak economic data. Retail sales were announced this morning and disappointed. (CMR previously noted that American consumers had charged Christmas 2011.) Weekly jobless claims again posted a number above 400,000. Both numbers caught market bulls off-guard. After an early morning swoon, stocks built a base, (of course after Europe closed,) and have been slowly trending higher throughout the day. The question is why?

De-coupling is the financial market answer. As has been noted in previous CMR's, global investment trends are on hold. Two macro factors moved global equities higher since 2008. American artificial stimulus programs, (fiscal and monetary,) put into place by the US Fed, Obama Admin and Congress. This has led to a liquidity bubble and a stock market bubble. But as yet, not to a US inflation or economic growth bubble.

The other macro trend had been the emergence of the emerging. The term BRIC, came into vogue in the past few years propelling trillions in capital investments and consumption. Then Europe reversed the positive momentum of multiple global economies and markets. Europe's inability to solve its ongoing credit crisis has served to cool emerging economies and provide stability to the US where assets continue to be parked. The de-coupling now mentioned quite often refers to the trading patterns of certain asset classes and investments. Not too long ago, the strengthening US Dollar meant a sell-off in US equities. Now as the US Dollar continues to gain strength, US stocks are rallying. The global macro carry trade circa 2011, (a complex set of currency, sovereign bond, and stock positions,) has been unwound to the point where the relationships are said to have de-coupled. One could also argue as to which came first, the trade or the economic backdrop of the trade, but unwinding is unwinding.

These massive trades could be "put-on" again; or could be shifted to other currencies, sovereigns, commodities and stocks. But in order to build these transactions, global investment funds must trust the corresponding counter-parties, (think overseas banks and clearing houses.) Considering that global investors loathe the political risk in the tape, many have decided to pull their "value-at-risk," (VAR,) for now.

Away from the technical aspects and idiosyncrasies of the tape, comes the drama unfolding in Iran. Tensions between Iran and many world governments are high. Another Iranian nuclear scientist was killed in a dramatic, public execution. (Two unidentified assassins on a motorcycle planted a car bomb on the scientist's car as it navigated Iranian rush hour traffic.) Sanctions announced by the US, and the corresponding full-court-press by the US State Department to get global powers to further isolate Iran via an embargo on Iranian oil, suffered a setback when the European Union decided to postpone the embargo for months, pushing it into the warmer summer months. However, the larger question is whether the embargo would have worked regardless of the timing. Before the EU action, India announced it would not go along with the embargo and US Treasury Secretary Geithner was rebuffed in his visit to China, where he had asked the PRC to both support the embargo and reason with Iran on the nuclear issue.

While reform pressures within Iran continue to build, forecasting an Iranian Spring is increasingly not going to be prompted by starving Iran of its petro-dollar income. Political cynics have noted the Obama Admin. is now aggressively pressing its political agenda, domestic and international.