



POTOMAC  
STRATEGIC INVESTMENT

## CAPITOL MARKET REVIEW

In This Issue: France and Austria to Lose S&P AAA Rating...Italy, Spain and Portugal Close Behind...Greece Considers Default...JP Morgan Disappoints...US Markets OK

Into the Close: SPX 1284 US10Y 1.84% Gold \$1634 Oil \$98.60 Jan 13, 2012

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News leaked out today that Standard and Poors is going to downgrade the sovereign debt of both France and Austria, perhaps as early as 4:01 pm US east-coast time.

On the heels of the Austria and France news, similar rumors are circulating that S&P will also soon downgrade Italy, Spain and Portugal. The difference is Austria and France will be downgraded one notch. Italy, Spain and Portugal, two notches.

The downgrade news had been in the market since the summer and has not had a dramatic impact thus far. There have been requisite losses in sovereign markets and in the value of the Euro itself. But overall losses are within expected trading ranges.

The more disturbing news is coming from Greece where talks regarding a solution for Greece's sovereign debt were said to be breaking-down. This, as the "troika" (European Commission, ECB and IMF,) are scheduled for a Tuesday meeting in Athens. If Greece cannot decide on a course of action (in conjunction with its banks,) the Eurozone may well have its Lehman moment.

Even before the European sovereign news hit the tape, US stocks were poised for losses due to a dour earnings report from JP Morgan. While many analysts are calling for a bottom in home prices and therefore some much-needed stability in the mortgage market, the larger banking model continues to generate sub-par revenues and profits.

Few on Main Street will shed tears for Wall Street bankers, but if JP Morgan is reporting lackluster quarterly numbers only a handful of banks will be able to do better. The S&P 500 still has a high percentage of banks and bank-related companies. Therefore, overall earnings increases for the index, and by extension growth in the economy, could also lag. (CMR sides with those who see another sub-par year for stock indexes and US GDP.)

In spite of negative news on the tape, US markets are stable. US bonds and the US Dollar are also stable. Equities are down less than 1%, (70bps.) Overseas, there are also rallies in Euro sovereigns not impacted by the S&P downgrade.

By way of example, consider the US and Germany. In spite of serious deep-rooted federal budget issues, massive US deficit spending and instability in the \$14 Trillion US mortgage market, the benchmark US10Y bond is trading 1.86%. Who would loan the US money for 10 years at less than 2%? Same with Germany; any German sovereign less than one-year will return LESS than the original investment. Think about that for a moment. A five-year German bund is 0.70%.