



POTOMAC  
STRATEGIC INVESTMENT

## CAPITOL MARKET REVIEW

In This Issue: Conflicting News from Europe...Uneven Earnings Season Continues...Al Jazeera Claims to have Photographic Evidence of Gadaffi's Death

At the Open: SPX 1210      US10Y 2.18%      Gold \$1622      Oil \$ 85.79      Oct. 20, 2011

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In overnight trading China's Hang Seng index slumped nearly 2% to 17,983, a multi-year low. On rumors regarding a rift between France and Germany, European markets also sold-off. European bourses are currently down roughly 1.5%

With the crucial Eurozone policy meeting just days away, the conflicting newsflow is forcing traders to the sidelines. While Greece endures another day of violent protests, no positive details are emerging from central Europe. The press reports are claiming that Germany and France cannot settle their differences. However, CMR maintains this is a simplistic view. A number of Eurozone finance ministers believe the situation is so dire that truly extraordinary action is required. The more conservative block, is deeply concerned about inflation and moral hazard. Sound familiar?

CMR has concluded the outcome is unknowable and therefore predicting the next few days, even with the best (leaked,) information at-hand, is fools folly.

US earnings continue to reflect somber mood of the global economy. Many US companies are reporting earnings in-line with Wall Street estimates. However, on the conference calls following their announcements, CEO's voice concern about the future. Thus far, CMR's position on the cycle itself and ramifications for 4<sup>th</sup> quarter GDP remain; earnings will be spotty, GDP growth at 1.5%.

There is no doubt that US stocks would rally with the creation of a funding structure in Europe. However, while the initial rally might propel stocks above 1250 even if the SPX were to trade above 1300 CMR agrees with those who claim another tight trading range would be established albeit at a higher index point.

The next few days are impossible to predict, the eventual outcomes are not. Europe will either enact a conservative EFSF plan or throw caution to the wind and leverage the ECB, (and by extension Germany,) in an effort to pump liquidity into the common market. The conservative approach will lead to years of austerity, a recession and below trend growth looking out at least two years. A levered EFSF and ECB will cause problems for Merkel and Sarkozy; will lead to an initial whiff of growth and Eurzone inflation. However, unless European Member-States enact fiscal reforms, monetary stimulus will prove transitory.