



POTOMAC  
STRATEGIC INVESTMENT

## CAPITOL MARKET REVIEW

In This Issue: European Finance Ministers to Meet this Weekend. No Agreement Will Be Announced...Nothing Else Matters

At Mid-Day: SPX 1235 US10Y 2.22% Gold \$ 1640 Oil \$ 88.60 Oct. 21, 2011

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In overnight trading Asia markets were slightly lower in nervous trading. As the world turned, Europe rallied. Euro bourses are all higher led by the DAX up 3%. The US market gapped higher currently up 2%.

Considering the lack of positive news regarding a plan to solve the Euro crisis this is a confusing day. The "MarketBeat" section of the Wall Street Journal has posted a comment from legendary floor broker, Art Cashin who has characterized this as a "flying horse moment." For those of you who don't know Cashin, you should. His daily notes are widely circulated and more than any floor broker, Art is the conscience of the NYSE. It would be sacrilege to paraphrase Art, so here are his comments, directly quoted.

*Let me try to walk through the concept another way. It concerns a fable about a disciple of Heraclitus.*

*Heraclitus, as you recall from sixth grade, was a Greek philosopher in the fifth or sixth century B.C. (okay, so my memory is a touch inexact). Heraclitus in his own way was the father of chaos theory. He said you could never step in the same river twice, since the water you first stepped in was swept away and the next step was into new and different water. He likened reality to a flame. It looks the same in form but is ever changing.*

*Anyway, this disciple of Heraclitus (whose name I've forgotten) was condemned to death for his teachings. He begged for his life and promised that if death were postponed, he would teach the king's horse how to fly within a year.*

*The king, naturally fascinated, complied. A friend of the prisoner admonished him for conduct unbecoming of a philosopher. Why postpone the inevitable? Die with grace.*

*The ex-prisoner replied that before, there was but one possibility. He would be executed. Now there were four possibilities. Within the year – the king could die – I could die – the horse could die.....or I could teach the damn horse to fly.*

*The market might be hoping for enough extra time to teach the horse (Europe) to fly (stop being stupid).*

CMR has dutifully tracked the European credit crisis for months. On many days the news has been illogical. The best journalistic minds are out of adjectives and metaphors. Global investors are exhausted trading the cross-currents. Many have decided to take their chips off the table.

CMR continues to side with those who believe Europe hasn't announced a plan because there is no agreement on a concept. Furthermore, deadlines continue to be extended. Trillions in Euros



are at stake. And the conflict pits four distinct groups against each other: Eurozone Sovereigns, Eurozone banks, citizens of the common market, and global investors.

If the banks are allowed to transfer their losses, (via a leveraged EFSF, or a unified Euro bond,) leading European sovereigns will lose their AAA credit ratings. Angela Merkel could lose her Presidency. If a smaller bail-out facility is created and banks are forced to mark assets they cannot transfer to market, a number of these institutions will quickly become insolvent. Nervous European citizens are at-odds as conservative “savers” (mostly in the North) do not want to fund reckless spending, (moral hazard.) Investors have already largely withdrawn from the Eurozone. The private credit markets have completely shut-down and many Sovereign bond auctions have met with skeptical investors who are forcing yields higher. Beyond Greece burning, Eurozone leaders all understand that it is impossible to fund either Spain or Italy if Eurozone rates move much higher.

For CMR, the European bottom-line remains. There is no solution without serious ramifications. Recent trading patterns in currencies, sovereigns, and equity indexes should be viewed with skepticism. Many traders have been covering shorts, or otherwise closing-out trades as they see the Euro problem extending even into the G20 Summit in November.

There will be no resolution announced this weekend. The earliest some indication will emerge is now said to be Wednesday. In the interim, asset valuations are trading purely on momentum and other computer/algo metrics. The macro story, exemplified by currency cross-rates, sovereign bond yields, gold and oil are all locked-in...waiting on Europe.