



POTOMAC  
STRATEGIC INVESTMENT

# CAPITOL MARKET REVIEW

In This Issue: Conflicting Newsflow Overwhelms Policymakers and Investors Alike

At Mid-Day: SPX 1250 US10Y 2.04% Gold \$1759 Oil \$93.81 Nov. 3 2011

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Once again, all eyes are on Greece as news reports indicate Prime Minister Papandreou will enter into negotiations with opposition political leadership on forming a new government. In political terms, Papandreou appears to be attempting to contain the damage from an outright no-confidence vote and collapse of Greek political leadership.

Remarkably, global markets remain higher on the day. In overnight trading Asian markets were down 2%. However, equities rallied into the European open. At mid-day US time, Europe equities were up about 2% and US markets are also higher, although US equities are up 1% on the day.

CMR agrees with analysts who believe Greece faces a series of difficult choices and could be without a stable government for the next few months, maybe longer. What is known is that the Greek opposition has not thus far signaled it will support the recently announced bail-out/austerity package. (CMR also agrees with those who say that if the package is adopted by the Parliament, it will lead to Greek bank failures and therefore even further unrest.)

In spite of the news on Greece, US politicians and investors should not lose sight of the fact that the Greek package was drafted with Italy, Portugal, Ireland and Spain in mind. Eurozone policymakers remain far more concerned about Italy. Just yesterday the Italian Parliament rejected elements of austerity important for the EU and ECB. The bail-out package, the “haircuts” on sovereign debt and other elements of the Greek package must be viewed against a backdrop as to how these standards would be applied to Italy.

The Italian sovereign market is a multi-trillion dollar asset pool with a large percentage rolling-over in the next twelve months. As CMR has noted previously, Italy cannot float its portfolio with the 10-Year Italian Sovereign above 6.5%. During the dark days of the crisis...just a few days ago...Italian sovereign debt touched 6.4% and has since backed-off to 6.04%.

In reporting today on the Fed meeting and press conference, most fed-watchers concur with CMR’s report yesterday; specifically that QE3 is not off-the-table, and that the Fed continues to be confounded by the inability of the US economy to shake-off the 2008 US credit crisis.

The other news of the day is the announced rate cut by the ECB. In his first meeting as President of the ECB, Mario Draghi, today reversed actions taken by his predecessor and lowered Eurozone interest rates by 0.25%. The news was greeted as a positive in that most ECB-watchers had expected no changes in rates. In spite of Eurozone hawks led by Germany, CMR believes the only way out of the Eurozone crisis comes with printing more Euros. Lower rates will lead to monetary inflation.