



POTOMAC
STRATEGIC INVESTMENT

CAPITOL MARKET REVIEW

In This Issue: Its Europe Again! Investors have Concluded there is no Deal...In Spite of the Sell-Off Leading Global Markets Still are Holding Key Technical Levels...Oil and Gold Higher on Israel/Iran Concerns

At Mid-Day: SPX 1250 US10Y 1.98% Gold \$1784 Oil \$95.21 Nov. 7, 2011

Asia and European markets were both lower on negative newsflow regarding Greece and Italy. As markets rolled into the US open, stocks took another turn lower. The culprit was a tepid auction for EFSF bonds.

When the EFSF was heralded as the savior for the Eurozone credit crisis, its initial auctions were on the order of €40B. Today's auction had been reduced to €3B. The Eurozone primary dealers were unable to find investors for the full amount and had to take a percentage of the auction. In addition, the Euro itself continues to weaken as traders anticipate monetary inflation throughout the Eurozone.

In addition, the other troubling news on the wires today was something CMR has mentioned several times before. Italian sovereign debt yields continue to rise. On the Eurozone close, the Italian Sovereign 10Y closed with a yield of 6.6%. Even more concerning, the 5Y Italian Sovereign closed at 6.70%. This "inversion" is a clear warning sign for fixed-income investors. And if there is a lesson to be learned by the US credit crisis of 2008 its that stocks don't matter nearly as much as bonds.

Europe's problems continue to benefit the US as the benchmark US10Y again closed below 2.0%. A closing low below 2% indicates either a US recession or dislocation in global markets. Considering the reports from US corporations and recent US economic data, the rally in the US10Y is a function of global distress.

Beyond Europe also comes news that Israel may be contemplating action against Iran. The Israelis have long maintained that they will act unilaterally if they believe Iran is about to join the nuclear club. Much to the consternation of the current Administration, most global investors concur with this view.

CMR agrees with those who believe Israel is not bluffing on this point. Israel will attack even if the odds of success are slight and the political ramifications complex and unknown. While an argument can be made for gold being higher due to the Euros decline, Oil up 1.0% is a reaction to the Israel news.

US stocks have been lower all day. It's a simple global macro trade. As the Euro sells-off the US Dollar rallies. The calculus that has kept the US markets where they are is a function of a relatively "cheap" US Dollar. Therefore, as Euro weakens, the US Dollar rallies, and US stocks sell-off. This is a technical trade put in place by global macro investment entities.