



POTOMAC  
STRATEGIC INVESTMENT

## CAPITOL MARKET REVIEW

In This Issue: European Markets Refuse to Sell-Off...Macro News Remains Muddled...Berlusconi Wins, then Agrees to Resign

At the Close SPX 1275 US10Y 2.07% Gold \$1785 Oil \$97.00 Nov. 8, 2011

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Global stocks continue to catch a bid. Reasons are more technical than fundamental. Nothing has changed in the macro picture. Greece is still unresolved. In order to pass reforms demanded by Eurozone leaders, Berlusconi, (like Papandreou before him,) had to agree to resign. Sovereign yields in both Greece and Italy are unsustainable. Yet Eurozone and US stocks continue to stage a quiet rally.

However, politicians should not assume the European credit/banking crisis is solved. The macro math remains. Regardless of the actions of the Greek Parliament, the Greek populace may still reject what its legislators have voted for. The same is true in Italy. Away from the vagrancies of equity index valuations, bond yields and bond spreads tell a different story. Spreads are widening, some yield curves are inverted.

Greek debt, to the extent its quotable is selling at 200%. Italian sovereign debt inverted yesterday and continues to remain at levels where no one in the Eurozone can finance. Next year, Italy must “roll” €400 Billion. Who is going to buy this debt? If Italian yields rise to a level where foreign investors are willing to take a risk, billions in additional euros will have to be paid. Italy cannot afford it. Europe cannot afford it.

In the past few days, investment interest in EFSF bonds has dried-up to the point where the investment banks, (the European version of primary dealers,) were forced to take a percentage of the deal on their already strained balance sheets.

In the wake of the G-20 Summit, Merkel and Sarkozy floated ideas mentioned a range of ideas to deal with the crisis, but as yet no consensus has emerged. Here is one idea that seems to have some merit; a Co-Investment Fund, (CIF.)

A CIF would be somewhat like what TALF was in the US. The goal would be to use leverage in a CIF that cannot be used in the EFSF. As is the case with all the issues being debated in Europe, much is happening behind the scenes. However, it should be noted that in each of the two Member-States where unpopular action has been taken the Prime Ministers were forced to resign and their governments failed.

CMR believes equity indexes are moving higher as portfolio managers who have lagged in performance are now racing to “bid-up” a handful of companies that will bolster performance. Volume on all equity exchanges continues to be below even the subdued numbers of the past six months. Furthermore, as was also noted in earlier CMR’s, investors have just again re-learned a painful lesson. When MF Global failed it was due to a leveraged investment made by Wall Street legend Jon Corzine. Many investment observers noted that Corzine may well be proved right in the long-run. But as is the case with many investments, leverage and time often trump analysis and strategy.