



POTOMAC  
STRATEGIC INVESTMENT SYSTEM

## CAPITOL MARKET REVIEW

In This Issue: Credit Downgrades for Eurozone Member-States, Technical Trading Continues in US Equities, System Could Still Face Crisis Before Year-End.

At Mid-Day: SPY 1239 US10Y 2.00% Gold \$1667 Oil \$97.96

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Overnight trading was quiet until news of Eurozone credit downgrades hit the tape. Immediately, risk assets were sold and flight to safety trades were again in-vogue.

US equities dropped to support levels in the 1230 range. US Treasuries saw capital inflows, commodities sold-off across the board; including gold and oil.

The year-end story is now in the tape. US stocks will remain range-bound. Optimistic predictions about 1300 in the SPX, (and 12,500 in the Dow,) should be ignored. The real key now will be if the downside will hold. The S&P500 is vulnerable to gaps lower at 1200, 1150, 1120 and then at 1080. The 1080 number would be a function of bad news in both the Eurozone and macro-economic news in the US.

Outside of equities, bonds continue make it clear that European banks and Eurozone sovereigns are locked in a bizarre stand-off. Eurozone political leaders do not want to lose their AAA credit ratings. Eurozone banks, (who own huge percentages of Eurozone sovereign debt,) do not want to be forced into insolvency. The hand-in-glove relationship between Eurozone governments and their banks poses a symbiotic conundrum.

Events of the past week make it clear that Eurozone central bankers and political leaders still do not have an answer to the crisis. The ECB announced that it will not aggressively monetize debt. The IMF lacks the capital and requisite support from Eurozone Member-States, (and the US,) to provide capital via convoluted lending concepts. There has been little in true fiscal reform. And lastly, without a blueprint global investors consider to be credible, foreign investors are reluctant to invest.

Given this backdrop, CMR maintains that all major ratings agencies, (S&P Moody's and Fitch,) will announce downgrades of both Eurozone Sovereigns and banks. Some of these downgrades could come before year-end.

Considering the fact that most retail investors have long ago given up on investing in these markets and that even the most sophisticated global funds are being thrashed by the volatility and political risk in the tape, 2% moves in equities and similar violent moves in currencies and bonds will continue to roil markets through year-end. The only factor that will support global markets is the thin volume and the ability of banks and central banks to catch traders leaning too far in one direction.

In addition, CMR continues to believe that the negative news regarding MF Global is still impacting markets. Reading in between the lines of Governor Corzine's first Hill testimony, CMR believes Corzine was not alone in this highly leveraged speculation. In addition, MF investor funds remain unaccounted for, and the potential for other banks and investors (counterparties,) to be forced into similar losses remains.