



POTOMAC  
STRATEGIC INVESTMENT

## CAPITOL MARKET REVIEW

In This Issue: ECB Long-Term Refinancing Operation Allows Banks Euro Banks to lower their Interest Rate Exposure, Does Nothing for the Value...BankAmerica settles Mortgage Fraud Charges with DOJ for \$335 Million

Nearing the Close: 1240 US10Y 1.96% Gold \$ 1613 Oil \$98.78

Dec. 21, 2011

The European Central Bank, (ECB) announced that 523 different Eurozone banks borrowed €489 billion, (roughly \$ 630+billion,) through a recently announced “Long Term Refinancing Authority,” (LTRO,) in a move seen as allowing banks to lower their interest rate exposure and re-pay loans already secured through other ECB programs.

In spite of the “feel good” sound of the deal, markets quickly concluded the following. First, far too many banks rushed to borrow funds, signaling that these banks were desperate for additional funding. Second, on its face the amount borrowed is dramatic. However, the banks in question may well have been using the new lower costs funds, (lower rates and 3 year maturity,) available from the LTRO to pay-back other higher interest rate loans also taken out from the ECB.

Several investment services likened today’s announcement as being similar to having an enormous amount of credit card debt, but being able to roll that debt to a lower interest credit card. The debt remains.

Analysis from several European research departments claimed that Eurozone banks already owed the ECB €250 billion. Therefore, press reports regarding a €500 billion euro lending facility are inaccurate.

Talk around Wall Street was that news of the ECB lending facility had been leaked yesterday, which prompted the short covering rally, (stock indexes were 3% higher on Tuesday.) Therefore, today, all the good news had already been factored into valuations. Furthermore, Oracle announced surprisingly bad news after the close last night and the follow-through today took the tech sector lower.

Late this afternoon, Attorney General Holder announced that BankAmerica and the DOJ had settled litigation regarding rampant mortgage fraud, (committed by Countrywide years before BAC purchased the company.) In the agreement, BankAmerica will pay \$335 million to settle charges. While equity shares of BankAmerica rallied on the news they are still trading at \$5.25, a 30% loss of value just since November. CMR continues to maintain BAC will need to raise additional equity capital.

Lastly, the National Association of Realtors today announced data on home sales. Lost in the announcement is the fact that due to anomalies detailed in recent press reports, since the credit crisis of 2008, the NAR had been over-estimating housing data. The blunt point is that the housing crisis was worse than what the NAR was claiming. The news regarding correcting the data comes as some research services are pointing to a firming market for new home construction and existing home sales. It remains to be seen if these trends are sustainable.