

## Thought for the Week: Monday, May 3<sup>rd</sup>, 2010

### What Happens in Greece stays in Europe?

This Thursday saw one of, if not THE, wildest trading days in our memory. It reminded us of the day the Senators voted NO to TARP. It also served to remind us all how much we rely on technology.

Remember Bird Flu? Didn't that cause a dramatic stock market drop for a few days??

#### **So what happened: A temporary irrational stock market glitch or a systemic problem which may predicate the return of the Doomsday Scenarios?**

In our opinion, the main cause of yesterday's dramatic events was the **lack of liquidity across Europe** as a result of the **lack of confidence in the ECB's conviction** to unwind their Debt & Derivatives.

To break this statement down:

- The economy of **the 'Developed World' is chock full of debt and derivatives** (financial instruments, leverage and inter-organization arrangements no one fully understands). This brought everyone to the edge of default. The U.S. Government and the U.S. consumer have made concerted steps to reduce both debt and derivatives. In the case of our government, the need to clear derivatives has taken precedence over reducing debt – think of financial methadone.
- The **U.S. has made hard decisions, swallowed some bitter pills and pumped liquidity in to their financial systems**. Now it's the turn of Europe to do the same.
- The ECB has the ability to plug the holes in the sovereign balance sheets of the PIIGS (Portugal, Italy, Ireland, Greece and Spain). Unfortunately, **politics and media management stood in the way of conclusive action**.
- **The ECB dragged their feet** and understated their willingness to act in defense of Greece and the other PIIGS. These countries are heavily in debt that they have little or no ability to repay. Austerity may help, and so will debt restructuring, but they are in this situation because of the Euro and they **need the European Union to stand behind them**.
- Markets therefore realized that **The United States of Europe isn't so united after all**. Maybe the European Central Bank should be called the North European Bank.

*In the 1970s, Henry Kissinger's complained:  
"If I want to call Europe, who do I call?"*

**The ECB needs to get off its derrière and schnell!**

**Our belief is the ECB will establish a fund to assist those in debt and stabilize the Euro. Ignoring the financial issues, the European Politicos have too much invested in economic union not to do this.**



**We expect this to bring U.S. markets back to some reality.** GDP and employment data has been fairly good recently. Earnings growth should return as the dominant market theme.

**Bull markets generally require sharp corrections** to continue upwards; we have been predicting a correction for a number of months now. Volume has been so low; an economic shock like this with a spike in volume was always a risk.

That said, we remain vigilant as even good news could be ignored now the **markets are spooked**. There's plenty of things to worry about especially with financial markets so nervy.

### **Did a 'fat finger' trading error cause the 1,000 point drop on the Dow?**

Probably not, we are highly suspicious that a trading system would allow \$16,000,000,000 to be entered as 16b when \$16,000,000 could be entered as 16m (the saying "mind your p's and q's" becomes mind your b's and m's!). Moreover, who allows such a large trade without pre-trade compliance?

This is all arbitrary to the main issues and the truth is probably closer to **programmed/quantitative trading systems flicked switches at the same time and created a run on the exchange**. Who knows what happened to PG!

### **Is Greece Responsible?**

The Greek Tragedy certainly sparked the negative sentiment across global markets but everyone has known about this for many weeks.

But the **real culprit is the European Central Bank's reaction to the Greek situation and the fact that there's still a great deal of debt to be worked out in Europe**.

### **Why did this affect U.S. Stocks and Bonds?**

In our opinion, the lack of liquidity across Europe (banks partially stopped lending to each other and the price of risk-sensitive instruments such as Credit Default Swaps (insurance to cover default on loans) soared) provided the U.S. with **an uncomfortable reminder of 2008**. It also shone the light on the credit situation stateside.

Our own balance sheet isn't exactly strong with **debt and deficit ratios not that far behind the PIIGS**.

Some key differences are our GDP, which continues to improve, and **our ability to act in our own interest on matters such as currency, economy policy and interest rates**.

**We don't expect the strengthening of the Dollar** vs the Euro to have a noticeably negative effect on the U.S. revenues. In fact, the Dollar fell against the Yen.

Neither do we feel American will be saddled with much of Greece's debt. The biggest estimate we've seen is \$8Billion; a rounding error on our economy.

Short term, the crisis made **investors run to the relative safety of U.S. Treasuries**. This demand will allow us to keep interest rates lower for longer.

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**Past performance is not indicative of future results. This commentary is not intended as investment advice or an investment recommendation it is solely the opinion of our investment managers at the time of writing. Nothing in this commentary should be construed as a solicitation to buy or sell securities.**



**What did DIAS Do?**

Conservative DIAS portfolios held **approximately 10% cash prior to last Thursday** which was not affected.

Equity based portfolios also had **ETFs which were short the S&P 500** – SDS for example which is two times the inverse of the S&P.

These measures **did not prevent reduction in value in all portfolios**; however, the tilting effect of the above, and our ability to position for a recovery should the European action be successful, will be meaningful over time.



***If Cinco de Mayo (5th of May) commemorates the Mexican victory over the French at the Battle of Puebla, why were they fighting the French in the first place??***

**Answer:**

**In 1861, Mexico suspended interest payments to France on their debts. The French attacked Mexico to force repayment of these debts.**

**Isn't it ironic that anyone enjoying a cold cerveza on **Cinco de Mayo** celebrated the **non-repayment of sovereign debt?****



**IMPORTANT CONFERENCE CALL**

**ON MONDAY, MAY 10<sup>TH</sup> at 12 Noon EST- CHRIS BERTELSEN WILL HOLD A CONFERENCE CALL TO ADDRESS LAST WEEK'S MARKET TURMOIL.**

**He will answer questions at the end of the Call.**

**DETAILS TO FOLLOW BY SEPARATE EMAIL**