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Your comments

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European mid-term exam grades.

My grade for the European policies after my recent trip to Europe (April 28-May 12) is a disappointing D-, just above the F (for failure) mark.

I have listened to daily promises and recovery plans delivered by politicians at news conferences, summits and other events around the continent and often wondered whether they (the “wise ones”) truly comprehend the severity of the problems they are facing.

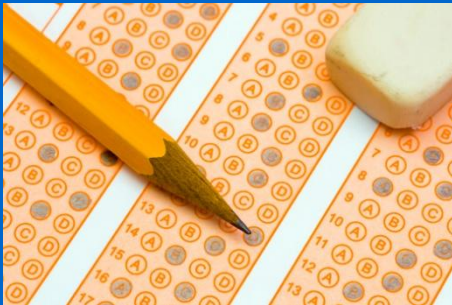
Greece escaped on the eleventh hour (at least for now) thanks to the European Union's \$ 1 trillion aid package. Yet days after the announcement, Greek credit swaps implied that the country has a 47% probability of default within the next five years (Bloomberg) – a clear message from the world markets that the aid alone will not suffice. Restructuring is the safest and perhaps the only way to get out of this disastrous situation. The current government is definitely taking drastic measures in the right direction, however, the political cost may prove catastrophic for any re-election campaign efforts in four years, unless several other changes take place.

Allow me to elaborate, as this subject offers enough material to write a book. I am not referring to the recent events in Athens where three, actually four innocent lives were lost (one victim was 5 months pregnant). That was the result of the actions of a handful of brain-dead anarchists who capitalize on peaceful demonstrations by angry workers protesting the austerity measures. These terrorists blended in with the people and at the opportune time threw their Molotov bombs inside the building, which burned with the working people trapped inside. Needless to say, such actions have nothing to do with the current crisis in the country and everything to do with the anarchists' meaningless and useless beliefs. So, the country is not getting burned to the ground and the Greek people are not killing each other.

Greece has to clean up its public services sector, and redirect a good portion of these resources into other more productive sectors, such as the private one. Consolidation of the endless and often times counter-productive committees and sub-committees is definitely a welcome effort by the Papandreou government. Going forward I expect much more restructuring within the government entities in order to improve productivity; hopefully sooner rather than later.

That of course implies layoffs from the public sector- something that is not allowed by the constitution. Until that changes (and it has to), re-allocating employment positions within the public sector in areas with immediate needs and better productivity might help. At this point one cannot help but wonder how much more the average worker can take, before a Greek Tragedy occurs. Not much is my answer.

At the same time the Greek people are not quitters. They have faced adversity numerous times in their rich history and every time have fought to the bitter end. My feeling, after talking with many while in Athens, is that they are willing to sacrifice a lot, and they are. However, they also expect to see justice served against those who allegedly stole or embezzled tens if not hundreds of millions from the government (including high-ranking government officials from previous administrations). Also included in this list are tax-evasion artists. All of these hoodwinks need to be punished (it is fine with me to jail crooked politicians); and please get rid of the ridiculous law which provides amnesty to ministers and parliament members! Returning stolen goods does not only apply to foreigners who stole Greek antiquities, it also applies to Greek nationals who stole from their government and fellow citizens.



When I see the above come into fruition, I will certainly consider Greek government bonds for my portfolios.

So then, was my D- on the European Union based on the Greek paper alone? Of course not. The rest of the members also failed to show clear and consistent proposals to deal with the current crisis.

For example, Merkel's decision to ban short-selling isolated her from the EU partners and was ill-received by world markets. Actions like this show that the EU is not the genuine political union it appears to be. In my previous Market Update (March 18, 2010) I expressed my concern regarding a single monetary policy and its effectiveness (or lack thereof) on 16 separate fiscal policies. These concerns remain and intensify.

Perhaps a single fiscal policy for Euro zone members could be the answer. Budgets and taxes would be decided centrally, thus member states would be prevented from running unaffordable deficits. A similar approach works within a singular country; however, I see a few challenges applying this model to several countries.

1. Any country considers its budget a national issue and giving up control of this is no different than giving up part of your sovereignty, a very unlikely scenario for Euro zone members.
2. Another challenge will be the enforcement of a central fiscal policy. What if a member nation's budget proposal is rejected by Brussels? Do the local politicians accept the rejection or do they implement their own policies anyway? They are, after all, elected by their people to serve their country – not necessarily

Brussels.

3. How does a central committee handle 16 different budgets with all the "baggage" that comes with it? Just the thought of it, given the current market conditions and political landscape, gives me a headache....

Similar analysis would produce the same questions regarding the euro and its future. I watch the markets daily, and every day I see a plethora of proposals, plans and ideas regarding the current crisis in Europe. In the end I am not convinced that there is one with the right foundation to produce promising results in the near future. It is not that there is a lack of brilliant minds with bright ideas to do so; it is that they happen to vote for different governments, and different governments are not different states or districts. They are different nations.

I will wait patiently.

U.S. markets and grades.

The grade for the United States is marginally better at C-. The low grade is a result of the question marks surrounding the massive debt the U.S. currently has.

As I write this column I see on my monitors the latest on the situation with North Korea and the banking industry in Europe. Initial market reaction has the S&P 500 index trading at 1,052 (the lowest level since November), as a result of higher bank borrowing costs (slowing credit) and a report that North Korean leader Kim Jong-Il ordered his military to prepare for combat.

Are we falling off the cliff? I don't think so. In fact, I am going bargain hunting again. I did so the last time we had a similar correction and at the end of the day I was quite happy. These are just a few of the bullets I pay attention to:

1. Over 1,500 analysts surveyed by Bloomberg predicted that companies in the S&P 500 will earn a combined \$81.13 a share, up 17 percent from 2009 and implies a price-to-earnings ratio of 13.2. The average multiple is over 20.4 over the last two decades according to Bloomberg sources.
2. The dollar index (U.S. currency against the euro, yen, pound, Canadian dollar, Swedish krona and Swiss franc) climbed for the second day, rising 0.9 percent.
3. The U.S. economy is now showing the first signs of significant employment growth, according to William Dudley, President of the Federal Reserve Bank of New York.

That is not to say that I am convinced that the U.S. will enjoy a healthy and speedy recovery. I do believe that we are turning the corner,



however, and that even with sluggish economic growth ahead we will manage to see better days going forward (at least better than our European friends).

Outlook.

Europe: The challenges facing the Euro zone and the union in general are quite complex and too challenging for the current policies to handle. Until we see the EU members forming a fiscal policy that reflects each member's current status and capabilities, I will continue to question the future. Is Greece going to be able to fulfill its future debt obligations? How bad is the situation in Spain, Portugal and Italy? Given that no answer(s) can satisfy the markets immediately, I expect the euro to remain under pressure. Trading range between 1.20 to 1.30 against the USD in the coming weeks.

United States: The few promising signs for a recovery scenario might be overshadowed by the current geopolitical events in the Far East. Having faith that even the toughest dictator will avoid war, given possible involvement of several nations, I see the current market pull back as a healthy correction and an opportunity to look for investing opportunities. Albert Edwards a global strategist at Societe Generale estimates that the S&P 500 will fall to less than 500, which is 26 percent below its bear-market low of 676.53 in March of 2009 (Bloomberg, May 21, 2020). I am certain some investors subscribe to his position. I don't.

Commodities: The dollar's strength against the euro reduced the appeal of commodities to investors. Crude oil for July delivery fell to \$68.69 a barrel at the NY Mercantile Exchange at 2:30 PM ET. Likewise most commodities felt the downward pressure, while precious metals advanced providing, once again, a "Haven Asset" for worried investors. At levels close to \$1,197 gold is still below its high of \$1,249.70 reached last month.

Your comments and suggestions are always welcome.
Personal regards,

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