

I would like to start the new year by sending warm wishes to all for good health and prosperity. It is my sincere hope that 2012 becomes the turning point for economic recoveries the world over.

There are so many starting points for discussion that I really don't know where to start. Every day there are new developments, and when a topic seemed to be of great interest (such as the recovery in the U.S.), another one took over, like the possibility of European countries defaulting on their loans, and the consequences for the global economy. I will try to address as many of these topics as I can within the limited space of this Market Update, and will offer my opinion on what may happen going forward.

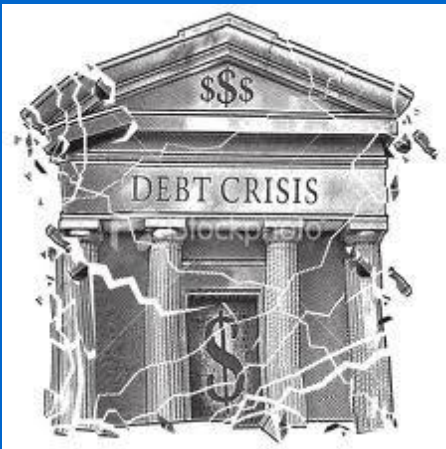
Over the last few years, my friends in Europe have periodically asked me if Greece has any chance for recovery. Based on what I have seen, I would reluctantly say no, unless dramatic changes in the current socio-political system happen. They haven't thus-far. Now the question is no longer whether Greece will default on its obligations but rather if Greece will leave the euro.

It is my opinion that Greece defaulted a long time ago (over a year), but the politicians for obvious reasons do not want to admit it. In my last Market Update, dated October 19, 2011, I mentioned that the Greek 10-year bond was trading around 40, i.e. a discount of 60 percent. Today it is trading at 22.5 – or at a discount of 77.5 percent. In simple English, that means that if you bought this issue two years ago at par (100) and you want to sell it today, you will get 22.5 percent of your investment. That is clearly a return equivalent to bankruptcy; and whether the politicians want to admit it or not, it doesn't change anything. Furthermore, Greece is "locked out" of the international markets. Therefore, Greece's capability of issuing new debt to generate funds



for growth investments is extremely limited at best. Borrowing money from the EU with next to impossible repayment terms is not exactly effective use of international funds.

All the recent changes (or shall I say cuts), in just about every sector of the economy, has had very little effect if any, on stimulating the economy or convincing foreign investors to look at Greece. All I see every day is more taxes on the Greeks, more cuts on their compensations, more layoffs; and although some of these painful actions are necessary, they went overboard to the point where the average Greek is on his/her knees desperately looking for something, anything to hold on to. Nobody from the circle of 'brilliant minds' who govern the country has bothered to look at the growth needs of the Greek economy and to create new productive job opportunities for the people who are losing their jobs, or pay attention to the young generation who never had a job in the first place. Instead they are using every euro they receive from the EU to pay existing debts that grow exponentially. This is a dead-end road.



The Swiss government offered to assist with the opening of numbered accounts belonging to Greek Parliament members, so that any "discrepancies" can be brought to justice. Several years later, to date, this has not happened. The opposition leader mentioned that such an action is "humiliating" for the Greek parliament and he suggested that only the accounts of past Prime Ministers and a few other high-ranking officials be opened. I find this position to be humiliating for the entire country. Is there a reason that the numbered accounts of all the parliament members who have such account(s) should not be opened in the allegedly most corrupt economy of the EU? I say that if you are taxing the people to death, then you (the government officials) should show to these people every euro you own and where it came from. Because if it came from government projects or private sector project kickbacks, then whoever stole this money should go to jail for a very long time, and all of his/her property should be confiscated and returned to the public. A very simple concept of justice, which seems all too foreign to the Greek politicians!

So then, is Greece leaving the euro? Well, every official in the EU stated time and time again that this is not an

option. Reality check dictates otherwise. If the GDP of Greece does not grow, or at least show signs of future growth, how are the Greeks going to pay their ever growing debt? Borrowing money from the EU with "unbearable" terms just to cover current debt obligations so far has shown zero effect on the country's economy. Doing simple math calculations, I can't see how Greece can be bailed out of this mess, without significant and sustainable GDP growth. Are European taxpayers willing to keep supporting Greece when they see no promising results in all the changes that are taking place? I would take a wild guess and say...no! Enter the drachma! Really? Let's take a look at a few highlights from the past year or two, and then you decide, whether this can happen or not.

These events are copied from a December 12, 2011 article in Bloomberg (NYT), and another one dated November 6, 2011.



- Over the past year, the Greeks have withdrawn almost 40 billion euros, in deposits from the banking system, equal to about 17 percent of the nation's GDP.
- November 2, 2011: European leaders cut off aid payments to Greece and say Greece must decide soon whether it wants to stay in the euro, even though the ultimatum is at odds with the Maastricht Treaty's assertion that monetary union is "irrevocable".
- October 26-27: EU leaders hold 14<sup>th</sup> crisis summit in 21 months.
- October 21: EU, ECB IMF issue draft sustainability report on Greece which said debt dynamics remain "worrying".
- October 3-4: EU leaders hint that private investors may have to accept a bigger haircut on their Greek bonds than what was included in a July 21 agreement.
- September 15: ECB offers banks unlimited dollar loans for three months as worsening debt crisis sparks concern some institutions struggling to access U.S. currency.
- May 24: ECB governing council member Christian Noyer says Greek restructuring would be "horror story."
- May 9: S&P cuts Greece two levels to B from BB

threatens further cuts.

It is a very complex issue for Greece to leave the euro, as it will create legal and political nightmares at many different levels. But what if?

Well I don't want to speculate on this very sensitive issue, but the "what if" scenario may have very unpleasant effects at least for the short-run.

The drachma will be devalued immediately, perhaps 40 percent or more? People line up to withdraw their deposits only to find out that their deposits are frozen, until order is restored? Then there's the issue of bond holders receiving their return in devalued drachmas? Of course a devalued currency and a new monetary policy may very well create an attractive opportunity for foreign investors, assuming the current archaic government system undergoes a successful "facelift".

The implications of Greece leaving the euro are much more complex than the above points, and I hope it doesn't happen as this may present much bigger question marks for much larger economies such as Spain and Italy and other peripheral countries.

At this time I can see the pressure on the euro remaining, with its trading range closer to 1.2 to 1.3 against the U.S. dollar. In brief, the outlook for the euro in the coming months seems weak, very weak.

Germany, Europe's largest economy, shrank roughly 0.25 percent in the fourth quarter of 2011 from the third. Some economists expect the same for this quarter. Although the definition of a recession is defined as two consecutive quarters of declining GDP, I don't see this at the present time as worrisome. If the euro continues its fall and we experience any member country leaving the Eurozone, then I will be very concerned about the German economy and the outlook for the EU recovery.

The industrial production in Spain, Europe's fourth largest economy, fell the most in two years according to the National Statistics Institute in Madrid.

In the U.K the trade gap widened to 8.64 billion pounds from 7.87 billion pounds in October, according to the



Office of national Statistics.

### **The U.S. economy.**

While Europe is trying to put out fires on multiple fronts, the U.S. is in full gear for the November Presidential elections. The economy will be the focal point in upcoming political debates and battles, and rightly so. Unemployment in the U.S. is still over 8.5 percent, and according to past election years statistics, no U.S. President has been re-elected with unemployment over seven percent with one exception, Ronald Reagan at close to 7.5 percent.



Will this be brought down closer to 7 percent by the November elections? Doubtful. Overall, I believe that the U.S. has leveled off and on occasion we have begun to see signs of recovery, albeit weak ones. I am of the opinion that the U.S. will lead the way out of the current world recession.

Jan Hatzius, Goldman Sachs Chief Economist said in Frankfurt that the effects of Europe's debt crisis may cost the U.S. as much as half a percentage point in Economic growth this year. However, I believe that it will not derail the economic recovery in the U.S., but a delay is possible.

### **Going forward:**

I expect a very bumpy ride on the EU recovery trip, with the final destination at least 1-2 years ahead. The corresponding recovery in the U.S. will be a less bumpy ride, although not a smooth one by any means.

In the end, I would focus my primary investments on the U.S. markets, with a special interest in the European markets for bargain opportunities as they present themselves on pull backs or corrections.

Developing economies may have the possibility for higher returns, but at a higher risk. I am not especially comfortable establishing large positions in these markets, but I do not exclude the possibility of looking at selective markets for diversification purposes.

As always I welcome your comments, suggestions and

questions.

***Personal regards,***


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