

Private Wealth MANAGEMENT



Euro Doritos: “So, Spend All You Want, We’ll Print More”

You might remember the old Doritos commercial with Jay Leno telling us not to worry about how many Doritos we eat. “So, crunch all you want, we’ll make more!” was his advice to Doritos fans. It now seems that the biggest fans of the *Doritos Dogma* are the heads of the central banks of the world’s most developed economies (US, Europe, Japan, etc.). As governments try to cure debt with more debt, the central bankers around the world continue printing more and more money as if there are no repercussions; this cannot go on forever.

The problems we spoke of in March about Greece’s fiscal problems and how there was no easy solution began to spiral out of control in the last few weeks and has affected financial markets around the world. What really got people’s attention was the massive sell-off in stocks on May 6th when the Dow Jones briefly dropped almost 1,000 points intraday before coming back towards the last hour of trading. Rumors are still circulating as to what exactly caused the decline. Some say, a trader mistakenly entered an order to sell \$15 Billion instead of \$15 Million—this is rather silly. Others say that it was a conspiracy by the bankers to scare members of Congress against acting on any potentially harmful financial reform—I doubt it, but it makes for a good story. I think the answer is simpler than that—after a massive rally in global stocks over the last 15 months, the stock market was due for a pullback so the correction comes as no big surprise. What did surprise market participants was the intensity of the sell off and that can be attributed to the fact that bids disappeared and sell orders mounted as a flight to safety took hold. To make things worse, certain exchanges switched to “Self Help Mode” which highlighted the problems with the exchanges different operational risk controls. Suffice it to say that on the afternoon of May 6th, there were very few buyers of stocks around the world. Now let’s discuss why so many traders, in my

opinion, were looking to take risk off the table in the first place...

The Real Problem – Too Much Debt

The real problem here and abroad is one of debt. What started as ill advised debt on personal balance sheets (bad mortgage loans) has been transferred to public balance sheets with central banks becoming the “buyer of last resort” rather than the “lender of last resort.” Keep in mind this is happening all over the world. We are all too familiar with unprecedented moves by our Federal Reserve as its balance sheet has ballooned since the start of the financial crisis. Now the European Central Bank has jumped on the bandwagon as it struggles to stop the bleeding which started in Greece and has since spread to Portugal & Spain.

Last week, European governments, the European Central Bank, and the IMF announced a gargantuan (almost \$1 Trillion) rescue package that may be nothing more than a very expensive way to buy some time. As Martin Wolf of the Financial Times of London proclaimed, “This is a panic-driven response to market panic.” We want to reiterate that one can not cure a debt problem with more debt unless it is accompanied by high levels of growth. Europe has just the opposite —its economy will be forced to shrink in the near term rather than grow. The worst case scenario could ultimately mean the Euro could cease to exist a decade from now.

We continue to believe that central banks around the world are in uncharted waters, and those waters are getting deeper and more turbulent every week. The biggest risk to a currency, we feel, is the politicizing of its central bank, and it seemed last week that this risk is spreading globally.

This is not time to be a hero in the stock market—it is a time to focus on global macro themes and on top-

down asset allocation. That said, we are still underweight equities, and overweight cash and alternative assets. Furthermore, while inflation will ultimately rear its ugly head at some point in the future, we believe the current environment is more

deflationary hence our preference for bonds and other fixed income investments.

As always, please feel free to send us your comments and questions.

Respectfully,
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Disclosure: Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rate rise and are subject to availability and change in price.

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