



Week In Review

February 17, 2012

Greece

Wednesday's Eurozone finance minister meeting was cancelled, pushing a final decision on releasing Greece's bailout funds until next Monday, at the earliest. Meanwhile, the Greek parliament enacted the agreed upon cuts into law, and all party leaders (including Samaras) submitted written pledges to leave the cuts in place following elections. Most European leaders (including Merkel) are in favor of releasing the bailout funds, although some key players (including Schaeuble) are in favor of withholding the funds and allowing a default. If the finance ministers agree to release the funds then Greece will have to set up an escrow account with segregated funds to pay the next 6 to 9 months of bond maturities. The ECB has reportedly agreed to distribute any profits on its Greek debt holdings to national governments, which can then be used for further Greek debt reduction. Also, the ECB has agreed to swap its Greek government bonds with identical terms that will be exempt from any collective action clauses (CACs) that Greece may retroactively insert into the terms of their outstanding debt. The ratings agencies have indicated that they will consider Greece in technical default if CACs are used to force participation in the private sector exchanges on holdout bondholders who do not agree to the exchange.

Our Take: Next week will more than likely see an announcement that the bailout funds will be released contingent upon sufficient private sector exchanges and ratification by national parliaments. Germany, Finland and the Netherlands may have close votes. Greece will then make their formal debt-swap offer. If "voluntary" participation will not reduce Greek debt enough to meet the bailout terms, then Greece will probably use CACs to force sufficient participation. This would most likely trigger CDS, severely testing the banking system.

The Rest of Europe

Spanish and Italian yields crept higher, but they remained well-contained even in the face of the Greek issues. Italian and Spanish government debt auctions continued to go smoothly, and those two countries are continuing to implement pro-growth reforms.

Our Take: Investors seem to view Greece as an exceptional and contained case, and so they are not fleeing from the large peripheral nations' debt right now. If the Greek CDS trigger, continued investor confidence in the large peripheral nations will depend upon the extent of any accompanying financial crisis and the need for government recapitalizations of banks.

Employment

The Bureau of Labor Statistics reported weekly initial jobless claims for the week ending February 11 fell 13,000 to 348,000. This represents the lowest level of initial claims since March 2008. Continuing claims fell 100,000 to 3.43 million for the week ending February 4, reaching a low not seen since August 2008.

Our Take: This report took economists by surprise as the consensus was for rising initial jobless claims. The employment picture continues to slowly improve.

Inflation

January inflation numbers from the Bureau of Labor Statistics showed CPI up 0.2% and PPI up 0.1% for the month while CPI rose 2.9% and PPI 4.1% during the trailing twelve months.

Our Take: Low inflation is necessary for the Fed to continue to follow their current easy money policy. Both CPI and PPI are running considerably higher than the Fed's 2.0% acceptable inflation bogie. The Fed remains confident that future inflation will be contained but if employment, and thus the economy, continues to improve, the Fed may have to rethink their dovish policies sooner than they had anticipated.

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Municipals

On Tuesday, S&P raised its outlook to positive and reaffirmed their A- long-term rating on California GO debt. The positive outlook comes seven months after the outlook moved from negative to stable. S&P indicated that an upgrade could occur in the future if the state's revenue meets the budget forecasts.

Our Take: S&P's rating on California GO debt is still the lowest of any state. While California is making progress to close their budget gap, it still has a long way to go to shore up its finances. However, an improving economy should help all municipalities' financial profiles.

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