

# The UNITED Perspective

## Special Bulletin

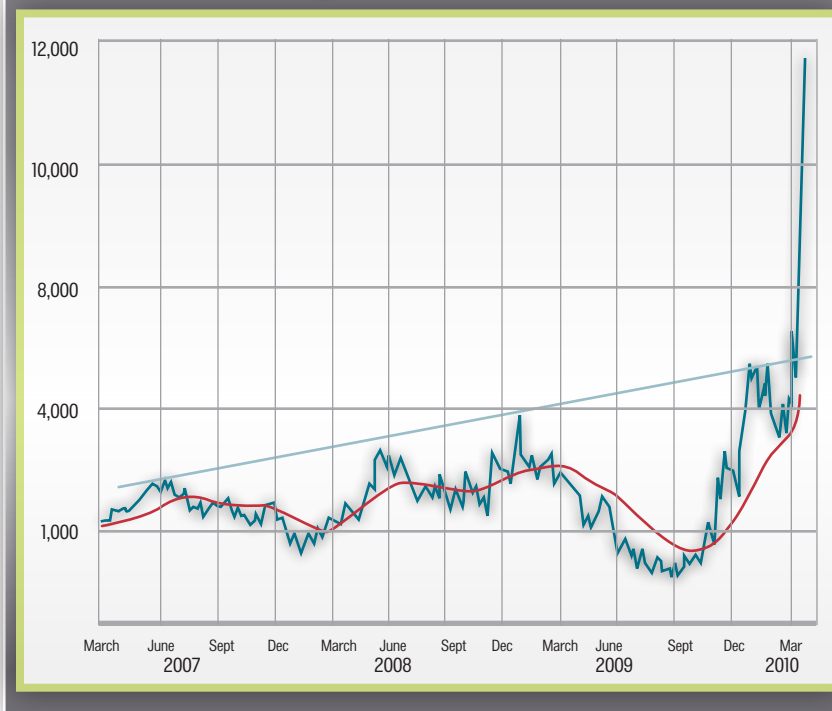
May 2010

### WHEN THESE PIIGS CAME TO MARKET

Since the beginning of the financial crisis two years ago, we have been bombarded with acronyms (like CDS, MBS et al) depicting the culprits of our financial and economic problems. This year there has been yet another unattractive acronym that has made the financial headlines: **PIIGS**. We had hoped to not have to write about why they matter to all of us. However, the recent unfolding crisis in Europe no longer allows us the luxury of staying quiet about this new term. PIIGS refers to the European countries that have issued massive amounts of debt to support their economies over the past few years. They are *Portugal, Italy, Ireland, Greece, and Spain*. All are rich in history and beauty, and are certainly great places to vacation; however, they are all facing daunting economic challenges. Unfortunately, now their problems are becoming ours.

A direct consequence of the global financial crisis of the last *two years has been the enormous mushrooming of sovereign debt (government issued) within countries around the globe*. This was due to a necessary and concerted effort to shore up local economies and the world financial system as a whole. This has resulted in a *severe deterioration of the balance sheets for many developed nations and even states and municipalities* within our nation. Currently, the financial markets are deciphering among the various countries and ascertaining who is weak, and who is strong. Which countries have time and resources to mend their debt bloated balance sheets and which countries do not?

Greek 5-Year "Sovereign" Bond Yield  
Daily Close Since 2007



SOURCE: JOHN MAULDIN'S 'OUTSIDE THE BOX'

The financial world has centered its attention on the unfolding “Greek tragedy” in Europe. In the near term, Greece is having difficulty raising the necessary money to refinance maturing debt that is coming due this year. The country’s debt to GDP ratio has risen significantly and is expected to be 135% by 2011. Standard & Poor’s rating agency has downgraded Greece’s sovereign debt to junk; currently having the dubious distinction of the lowest rating of any EU member. Greek bonds have sold off and the country’s financing costs have risen sharply. This has put Greece in a precarious position and has forced the Greeks to run to the European Union (EU) and the International Monetary Fund (IMF) for assistance. The EU, specifically France and Germany were at first reluctant to extend a bailout but with the IMF accepting a portion of the financial burden, a rescue plan of \$145 billion was patched together in late April to give Greece time to get its financial house in order.

Though the current focus has been on Greece, the remaining PIIGS, Portugal, Italy, Ireland and Spain are also in a fragile financial state as well. With assistance already having been extended to Greece, *the EU and the IMF face a difficult dilemma because Europe is sliding down the slippery slope of a welfare nation establishment, and begs the question of who will be next in line for a “handout”?* There is a very real possibility that the Euro stops being a major reserve currency because many of the individual countries have no ability to create country specific solutions because they are all tied together by one currency. All of this adds uncertainty, and leads to elevated risk and volatility.

Projected Debt-to-GDP in PIIGS, assuming no policy change

DEBT AS % OF GDP	2007	2008	2009	2010	2015	2020
Portugal	63.6	66.3	77.4	84.6	115.2	151
Ireland	25.1	44.1	65.8	82.9	141.7	215
Italy	103.5	105.8	114.6	116.7	119.3	122
Greece	95.6	99.2	112.6	124.9	176.3	237
Spain	36.1	39.7	54.3	66.3	101.8	143

SOURCE: DANSKE BANK

### DÉJÀ VU ALL OVER AGAIN?

Is Greece the 2010 version of Bear Stearns in 2008, the first bank that had to be taken over by the government and sold to JP Morgan? Instead of private financial institutions being rescued, will this be the beginning of a series of sovereign nations and government entities needing financial support because the private capital markets will no longer fund their mounting debt and enormous deficits?

*The quandaries that Greece, Portugal, Italy, Ireland and Spain are facing will come with a high price.* Any financial assistance will likely be on the condition that strict austerity measures are implemented. These policies will vary but will include curtailment on government spending and budget deficit targets spanning a number of years.

### WHAT DOES THIS ALL MEAN?

- » The reduced spending from this handful of European countries will impact overall global growth and corporate profitability.
- » The meaningful and ongoing decline in the Euro will also have an impact.
- » The stringent austerity conditions placed on Greece and eventually the other PIIGS nations will significantly lower their future growth rates and their respective standard of living, leading to social unrest and instability.
- » It may mean a revaluation of pricing for global financial assets. As these events unfold, it most certainly will increase uncertainty and volatility.
- » There will also be the concern of significant “contagion risk” affecting not only the other countries in the EU, but could attribute to volatile and disruptive financial markets around the globe.
- » The US, as well as Western Europe and Japan have high budget deficits and mounting debt levels. If we do not get our own sovereign finances in order, we may face an economic scenario of higher real interest rates and reduced economic growth.
- » The risks could spread to certain states and municipalities as well.

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### SO WHAT SHOULD WE DO WITH THIS INFORMATION?

We have had a very good market run and we are probably due for a period of higher volatility, especially in the short term, so don't be surprised if we go back to large swings in the market. Market valuations are still reasonable so we should be fine after the turbulence. In the meantime this is a good time to be overweight the dollar and to own US based assets, after all we have already suffered through our own storm just two years ago. We won't be completely sheltered; the world is far smaller and more interconnected than it has ever been. We recommend as always that your portfolio reflects your needs and your tolerance for risk. Your adviser uses your financial master plan to create the right solution for you and they have many different alternative allocations strategies, from strategic allocation to dynamically shifting allocation services that all have different advantages for different kinds of markets. The most important thing we do is to work with you and your family to craft the right strategy for all seasons.

If you have any concerns about any aspect of the strategies we are implementing, please be sure to let us know so that we can talk about whether changes might make sense given our outlook. Usually *a change in the market should not require a shift in your strategy unless something has changed in your personal situation*. We are making several adjustments in most portfolios throughout the quarter to reflect our collective best thinking and the specifications of the strategy. We are here every day working with your managing partner and your wealth counseling team overseeing your portfolio and assuring that we are disciplined about rebalancing, diversifying and monitoring every aspect of your portfolio under our care.

*Thank you for your continued trust and confidence,*

*Joseph J. Duran, CFA® and the United Capital Investment Committee*