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Germany Prepares For a Grexit

The US Presidential election is over and the world has woken up from the political rhetoric and propaganda to realize that the problems it faced before November 6 are still in place. Indeed, one could very well make the case that the US Presidential Election distracted most people from the fact that things were in fact getting markedly worse in the financial system.

Let's start with Europe.

Greece has managed to get through its latest budgetary crisis (a €5 billion bond redemption due this Friday) by the skin of its teeth. In this case, the ECB permitted Greece to redeem asset-backed-securities (read: total and complete garbage) in exchange for funds.

This deal occurred commensurate with the usual promised budgetary cuts on the part of Greek politicians (none of which will be met as usual) along with the Greek populace rioting in Athens. This has been and will remain the deal in Greece right up until someone cuts off funding. At that point Greece will leave the EU, default or both.

Timing this will be quite difficult, but Germany has already given us clues that it is preparing for a Greek exit.

> **Debt crisis: German finance ministry examines cost of Greek exit**
>
> **A special working group, led by deputy finance minister Thomas Steffen, is working on scenarios in the case that Greece is forced to withdraw from the 17-nation bloc, the Financial Times Deutschland reported on Friday.**
>
> "Colleagues are making calculations about the financial consequences [of an exit] and are considering how a domino effect on other euro member states might be prevented," it quoted a finance industry source as saying.
>
> The ten-member working group, **which is made up of officials from various finance ministry departments**, wanted to be fully prepared for a possible "negative scenario," the source added.
>
> Last week, **German finance minister Wolfgang Schaeuble said it would be "stupid"** not to make contingency plans in case Europe's rescue efforts

> failed, adding that the debt crisis must not become a **"bottomless pit"** for Germany.
>
> http://www.telegraph.co.uk/finance/financialcrisis/9496397/Debt-crisis-German-finance-ministry-examines-cost-of-Greek-exit.html

This news story received almost no coverage from the mainstream media, despite its import.

Firstly, this is the first time Germany has *officially* moved to prepare for a Grexit. Germany has certainly threatened to kick Greece out, but it has never actually taken formal, official steps to prepare for this.

Since August 24 2012, it has.

There is good reason for this and we get clues from German Finance Minister Schauble's "bottomless pit" comments in the above article.

Schauble made this comment once before back in February 2012 before the second Greek bailout:

> Schaeuble pointed out that German opinion polls show a majority of Germans are willing to help Greece.
>
> **"But it's important to say that it cannot be a bottomless pit**. That's why the Greeks have to finally close that pit. And then we can put something in there. At least people are now starting to realize it won't work with a bottomless pit."
>
> **Schaeuble said Greece would be supported "one way or another" but warned the country needed to do its homework on improving its competitiveness and hinted <u>it might have to leave the euro zone to do that.</u>**
>
> http://www.reuters.com/article/2012/02/12/us-germany-greece-idUSTRE81B05N20120212

Note that in reference to Greece being a bottomless pit, Schauble was already hinting that Greece may leave the EU even *before* the second Greek bailout occurred. The fact that Schauble has now formed a working group to measure the impact of a Grexit while again referring to Greece as a "bottomless pit," shows clearly that he is about done with propping up Greece… and for good reason.

Currently Germany is on the hook for €751 billion in EU backstops. The German economy is only €2.5 trillion. Put another way, Germany is on the hook for an amount equal to of its GDP.

Anyone who believes Germany will actually pony up this cash is dreaming. The single largest transfer payment in history was the German Marshall Plan, which was $13 billion at a time when US GDP was just $200 billion.

This constituted a transfer of slightly over 6% of US GDP.

That is the single largest transfer in history… and Germany is going to bailout Europe by an amount equal to over FIVE TIMES this?

This is simply not going to happen. Germany will play ball with the EU by signaling its efforts to keep things together, but the German's have in fact been implementing a contingency plan for nearly one year now.

I broke this story in February 2012. I haven't seen it mentioned anywhere else. I wrote:

> *…Germany has put into place a contingency plan that would permit it to leave the Euro if it had to.*
>
> *As a brief recap, this contingency plan consists of:*
>
> 1) *Legislation that would permit Germany to leave the Euro but remain a part of the EU.*
> 2) *The revival of its Special Financial Market Stabilization Funds, or SoFFin for short, to which Germany has allocated 480€ billion Euros to in the case of a banking crisis (the **fund will also permit German banks to dump their euro-zone government bonds if needed**).*

This occurred back in February. And Germany now has a formal working group assessing the cost of a Grexit? The EU is on borrowed time. I mentioned earlier this year that German tourism companies have put contingency plans for the return to the Drachma in the contracts for their Greek subsidiaries. However, now even large US-based multinationals are implementing contingency plans for a Grexit.

The list includes JP Morgan, Bank of America Merrill Lynch, Visa, PricewaterhoursCoopers, Boston Consulting Group, Juniper Networks, and others.

Meanwhile, as Greece continues to distract the markets, France, the other primary prop for the EU besides Germany, is now experiencing an economic contraction on *par with that of 2008-2009.*

Indeed, France's September's auto sales numbers were worse than those of *September 2008* (the month Lehman collapsed). The country's PMI reading is back to April 2009 levels. Even the French Central Bank, which would hold off as long as possible before unveiling bad news, has announced the country will re-enter recession before year-end.

Over the past few weeks, an extraordinary cry of alarm has risen from chief executives who warn that the French economy has gone dangerously off track. In an interview to be published on Nov. 15 in the magazine l'Express, Chief Executive Officer Henri de Castries of financial-services group Axa (CS:FP) warns that France is rapidly losing ground, not only against Germany but against nearly all its European neighbors. **"There's a strong risk that in 2013 and 2014, we will fall behind economies such as Spain, Italy, and Britain," de Castries says.**

On Nov. 5, veteran corporate chieftain Louis Gallois released a government-commissioned report calling for "shock treatment" to restore French competitiveness. And **on Oct. 28, a group of 98 CEOs published an open letter to Hollande that said public-sector spending, which at 56 percent of gross domestic product is the highest in Europe, "is no longer supportable." The letter was signed by the CEOs of virtually every major French company.** (The few exceptions included utility Electricité de France, which is government controlled.)

http://www.businessweek.com/articles/2012-11-14/french-ceos-help

We get additional confirmation that France is in big trouble from its partner in propping up the EU, Germany.

German Finance Minister Wolfgang Schaeuble has asked a panel of advisers to look into reform proposals for France, concerned that weakness in the euro zone's second largest economy could come back to haunt Germany and the broader currency bloc.

Two officials, speaking on condition of anonymity, told Reuters this week that Schaeuble asked the council of economic advisers to the German government, **known as the "wise men", to consider drafting a report on what France should do…**

"**The biggest problem at the moment in the euro zone is no longer Greece, Spain or Italy, instead it is France, because it has not undertaken anything in order to truly re-establish its competitiveness, and is even heading in the opposite direction,**" Feld said on Wednesday.

"France needs labour market reforms, it is the country among euro zone countries that works the least each year, so how do you expect any results from that? Things won't work unless more efforts are made."

http://uk.reuters.com/article/2012/11/09/uk-germany-france-economy-idUKBRE8A80MN20121109

France will be a bigger problem than Spain or Italy for the EU?!?! That is one *heck* of an admission from a German official. If France deteriorates then it's game over for the EU. The current bailouts mean Germany is already on the hook for an amount equal to 30% of its GDP. If France tanks the amount will balloon astronomically. At that point it's game over.

The French banks are already anticipating this:

Let's take advantage of this before the market really realizes how bad things are going to get. Once these patterns break down in a big way, both banks are going to ZERO.

Action to Take: Short Societe General (SCGLY on the pink sheets or GLE.PA on the Paris stock exchange).

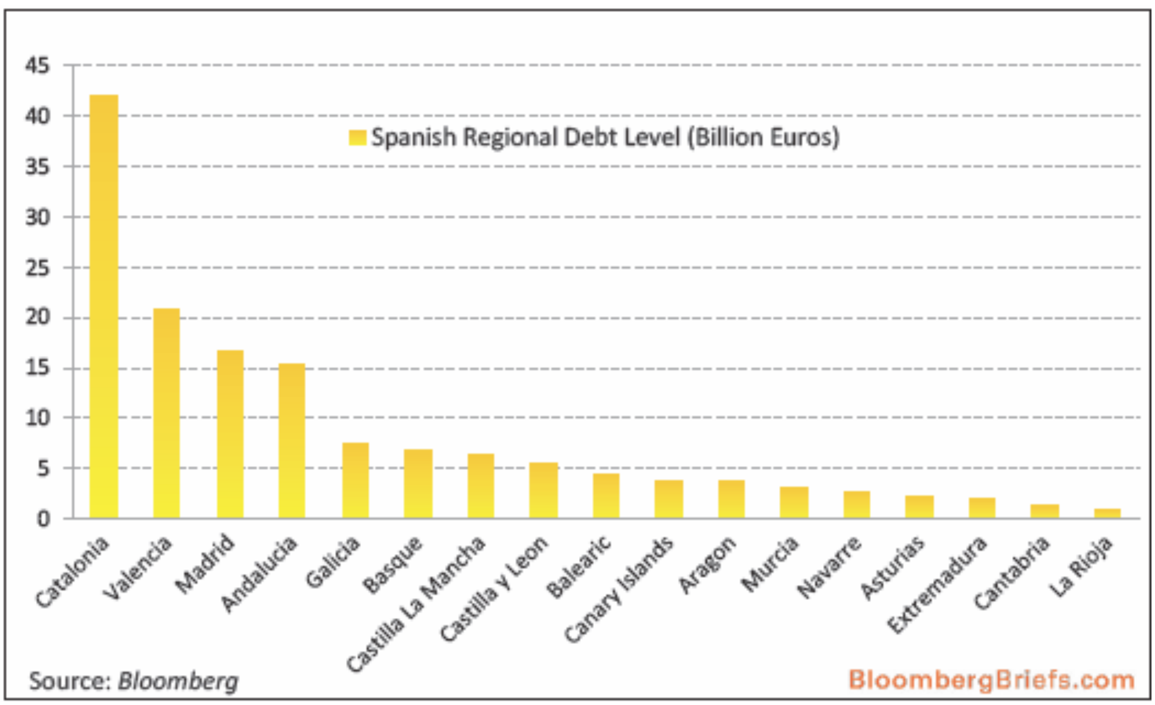
Action to Take: Short BNP Paribas General (BNPQY on the pink sheets or BNP.PA on the Paris stock exchange).

Elsewhere in the EU, Spain's financial system is at truly apocalyptic levels.

If you've been reading me for some time, you know that Spain has already experienced a bank run equal to 18% of *total deposits* this year alone (another story the mainstream media is avoiding). However, what you likely don't know is that an on annualized basis, Spain has experienced portfolio and investment outflows **GREATER THAN 50% OF ITS GDP.**

To give this number some context, Indonesia only saw outflows equal to 23% of its GDP during the Asian Financial Crisis. Spain is experiencing more than DOUBLE this.

I've long averred that Spain will be the straw to break the EU's back. By the look of things this is not far off. The country's regional bailout fund has only less than €1 billion in funding left. As the below chart shows, this will barely make a dent in the regions' debt problems:



Indeed, things are far far worse than is commonly know. Valencia for instance owes its pharmacies over €500 billion. In some areas there is no longer *insulin*.

In the region of Andalusia some government workers haven't been paid in eight months and are working for free while *begging for food.*

And Catalonia is pushing to *secede from Spain entirely*. It is about to hold early elections this Sunday. The frontrunner for the election is current President Artur Mas who is pushing for secession. And he is not alone either: over 1.5 million of Catalonia's 7.5 million inhabitants turned out for an independence rally in September.

Again, Spain as a country is finished. Things are so bad that British Airways (many wealthy Brits vacation in Spain) is putting a contingency plan for *SPAIN to leave the Euro.*

The markets know this too. Spain's Ibex has in fact broken *down* since the ECB announced its "unlimited" bond buying program in September:

Far more dangerous is the Ibex's break back below its long-term bull market trendline:

As you can see, the Ibex is back below its trendline. This is a classic collapse pattern:

1) Trendline broken
2) Attempt to reclaim trendline fails
3) The REAL collapse

The fact that this has occurred AFTER the ECB announced unlimited bond buying should give you a sense of how bad things have gotten in the EU financial system.

As you can see, the Ibex has failed to reclaim its trend line. With that in mind, it's time to short the Spanish ETF (EWP).

Action to Take: Short the Spain ETF (EWP).

Moreover, Spain's biggest bank, Santander (SAN) is on its way to ZERO:

Action to Take: Short Santander (SAN).

Now for the US.

The S&P 500 was rejected by the upper trendline in its trading range and is now set to test its lower trendline around 1,250.

There is certainly no shortage of reasons for this. Earnings have been terrible (the big market leaders like Apple and Google have disappointed), the US economy re-entered a recession in June (according to the ERCI which is a much better predictor of recessions than the NBER). The fiscal cliff looms. And then of course there is Europe to worry about.

Looking at the S&P 500 chart, I think we might get one last push upwards, possibly to 1,400, before things get REALLY ugly into year-end.

At that point it'd be time to open our Crisis trades in a big way.

Apple needs to bounce now or it's going to $450 per share in a flash:

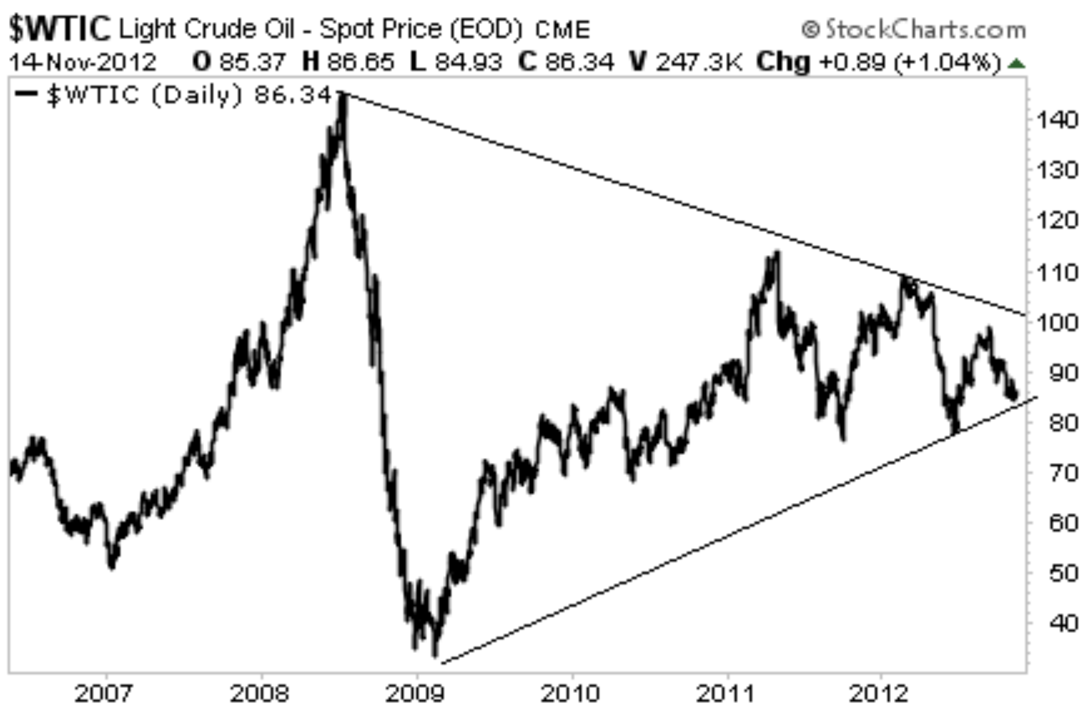
Other spending bellweathers such as Tiffany's (TIF) are ready to be shorted now:

Action to Take: Short Tiffany's (TIF).

Women's hand bag company Coach (COH) is looking grim:

Once we take out $50, this company is going to $25.

Other big red flags in the system include Oil:



As well as Copper:

A question lurking at the back of my mind is whether or not Treasuries will sell off when the big collapse begins. If they *do* then its checkmate for the Fed and the US will face its own sovereign debt crisis a la Greece:

Finally, Gold and Silver are ready for their next legs up:

This concludes this week's issue. I hope you understand how truly horrific things are getting in the EU. We may see one last breath before the Great Crisis hits in earnest (see the discussions of Collateral in last issue) but after that things will get truly awful in short order.

Be prepared.

Best Regards

Graham Summers

OPEN POSITIONS

Inflation Portfolio (OPEN BUYS NOW)					
Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Gold bullion	N/A	3/17/10	$1,120	$1,726.00	54%
Silver bullion	N/A	3/17/10	$17.50	$32.63	86%
Corn ETF	CORN	8/8/12	$51.61	$46.14	-11%
Rogers Agriculture ETN	RJA	8/17/12	$9.80	$9.19	-6%
Vista Gold	VGZ	9/24/12	$3.66	$3.01	-18%
First Majestic Silver	AG	10/1/12	$23.17	$21.65	-7%
Timber ETF	CUT	10/17/12	$19.08	$18.33	-4%

*** Averaged in second price of $1.64 on October 17 2012.**

Deflation Portfolio (OPEN BUYS NOW)					
Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Dollar ETF	UUP	5/23/11	$21.79	$22.20	2%
Rydex Dollar 2x Strategy	RYSDX	12/14/11	$14.39	$13.76	-4%
UltraShort Euro ETF	EUO	6/25/12	$21.45	$20.45	-5%
UltraShort China ETF++++	FXP	6/25/12	$28.97	$23.02	-21%
Russia ETF (SHORT)	TRF	6/25/12	$13.21	$13.50	3%
UltraShort Consumer Goods*	SZK	7/25/12	$72.96	$69.73	-4%
Italy ETF (SHORT)	EWI	9/28/12	$12.03	$11.95	3%
France ETF (SHORT)	EWQ	9/28/12	$20.98	$20.86	2%
BNP Paribas (SHORT)	BNPQY	11/14/12	$25.11	NEW	SHORT!
Societe General (SHORT)	SCGLY	11/14/12	$6.17	NEW	SHORT!
Spain ETF (SHORT)	EWP	11/14/12	$26.93	NEW	SHORT!
Santander (SHORT)	SAN	11/14/12	$6.99	NEW	SHORT!
Tiffany's (SHORT)	TIF	11/14/12	$60.31	NEW	SHORT!

++++ Averaged in second price of $26.77 on July 5 2012 at 10:57AM
*** Announced a four to 1 reverse split on September 20 2012.**

Previous Closed Positions							
Investment	**Symbol**	**Buy Date**	**Buy Price**	**Avg. buy price**	**Sell Date**	**Sell Price**	**Gain**
UltraShort Euro ETF	EUO	7/28/11	$17.32		9/12/11	$18.87	9%
UltraShort China ETF	FXP	8/9/11	$36.58	$34.63	9/21/11	$37.60	9%
(Added to)		9/2/11	$32.68				
UltraShort Emerging Markets ETF	EEV	8/9/11	$40.30	$37.27	9/21/11	$39.60	6%
(Added to)		9/2/11	$34.23				
UltraShort Brazil ETF	BZQ	8/9/11	$23.40	$20.72	9/21/11	$21.90	6%
(Added to)		9/2/11	$18.03				
IamGold	IAG	5/25/11	$20.95		9/21/11	$23.10	10%
UltraShort Russell 2000 ETF	TWM	8/9/11	$62.75	$57.36	9/22/11	$58.79	2%
(Added to)		9/2/11	$51.97				
UltraShort Real Estate ETF	SRS	8/9/11	$19.50	$17.31	9/22/11	$17.33	0%
(Added to)		9/2/11	$15.11				
UltraShort Financials ETF	SKF	8/9/11	$88.73	$82.59	9/22/11	$87.63	6%
(Added to)		9/2/11	$76.44				
UltraShort China ETF	FXP	9/28/11	$41.04		9/30/11	$45.02	10%
UltraShort Emerging Markets ETF	EEV	9/28/11	$42.90		9/30/11	$46.00	7%
UltraShort Brazil ETF	BZQ	9/28/11	$24.07		9/30/11	$26.28	9%
Bank of American (Short)	BAC	9/28/11	$6.46		10/3/11	$6.06	6%
Citigroup (Short)	C	9/28/11	$26.84		10/3/11	$24.90	7%
Goldman Sachs (Short)	GS	9/28/11	$98.97		10/3/11	$93.60	5%
JP Morgan (Short)	JPM	9/28/11	$31.64		10/3/11	$30.19	5%
Bank of America (Short)*	BAC	11/1/11	$6.48		11/14/11	$6.09	6%
Citigroup (short)*	C	11/1/11	$29.19		11/16/11	$27.46	6%

Goldman Sachs (Short)*	GS	11/1/11	$106.64		11/14/11	$98.73	8%
JP Morgan (Short)	JPM	11/1/11	$32.65		11/17/11	$30.84	6%
Deutsche Bank (Short)*	DB	11/1/11	$37.45		11/21/11	$34.90	7%
Santander (Short)*	STD	11/1/11	$7.91		11/17/11	$7.32	8%
HSBC (Short)*	HBC	11/1/11	$42.03		11/16/11	$38.95	8%
UltraShort Emerging Markets ETF*	EEV	11/1/11	$34.78		11/21/11	$38.12	10%
UltraShort Real Estate ETF*	SRS	11/1/11	$40.09		11/21/11	$44.03	10%
UltraShort Financials ETF*	SKF	11/1/11	$65.13		11/21/11	$71.41	10%
UltraShort Emerging Markets ETF*	EEV	11/1/11	$34.78		11/23/11	$39.50	14%
UltraShort Brazil ETF*	BZQ	11/1/11	$19.04		11/23/11	$21.37	12%
UltraShort Real Estate ETF*	SRS	11/1/11	$40.09		11/23/11	$46.04	15%
UltraShort Financials ETF*	SKF	11/1/11	$65.13		11/23/11	$75.23	16%
UltraShort Brazil ETF*	BZQ	11/1/11	$19.04		11/25/11	$22.40	18%
UltraShort Real Estate ETF*	SRS	11/1/11	$40.09		11/29/11	$44.45	11%
UltraShort Financials ETF*	SKF	11/1/11	$65.13		11/29/11	$71.47	10%
UltraShort Emerging Markets ETF*	EEV	1/1/11	$34.78		12/14/11	$37.16	7%
Ultrashort Silver ETF	ZSL	12/14/11	$15.57		12/28/11	$17.60	13%
UltraShort Euro ETF	EUO	9/12/11	$19.13		1/5/12	$20.80	9%
Ultrashort Silver ETF	ZSL	3/6/12	$10.27		3/15/12	$10.75	5%
MSCI Euro Financial Fund (Short)	EUFN	3/21/12	$18.37		3/29/12	$17.48	5%
BNP Paribas (Short)	BNPQY.PK	3/21/12	$24.99		3/29/12	$23.70	5%
Societe General (Short)	SCGLY.PK	3/21/12	$6.34		3/29/12	$5.83	9%
Credit Agricole (Short)	CRARY.PK	3/21/12	$3.27		3/29/12	$3.08	6%

Societe General (Short)	SCGLY.PK	3/21/12	$6.34		4/2/12	$5.64	12%
Credit Agricole (Short)	CRARY.PK	3/21/12	$3.27		4/2/12	$2.97	10%
MSCI Euro Financial Fund (Short)	EUFN	3/21/12	$18.37		4/3/12	$17.34	6%
BNP Paribas (Short)	BNPQY.PK	3/21/12	$24.99		4/3/12	$22.78	10%
Santander (Short)	STD	12/14/11	$7.11	$7.63	4/4/12	$7.21	6%
(Added to)		1/27/12	$8.15				
BNP Paribas (Short)	BNPQY.PK	4/13/12	$19.96		4/23/12	$18.73	6%
Societe General (Short)	SCGLY.PK	4/13/12	$4.67		4/23/12	$4.38	6%
Credit Agricole (Short)	CRARY.PK	4/13/12	$2.55		4/23/12	$2.33	9%
UltraShort Brazil ETF	BZQ	5/2/12	$16.26		5/10/12	$17.85	10%
Deutsche Bank (Short)	DB	12/14/11	$35.33	$39.89	5/15/12	$37.24	7%
(Added to)		1/27/12	$44.44				
Santander (Short)	STD	4/13/12	$6.44		5/15/12	$5.85	9%
MSCI Euro Financial Fund (Short)	EUFN	4/13/12	$16.19			$14.88	8%
UltraShort China ETF*	FXP	11/1/12	$32.64	$27.93	5/17/12	$30.89	11%
(Added to)		1/27/12	$23.22				
UltraShort Materials ETF*	SMN	11/1/12	$20.23	$17.48	5/17/12	$19.00	9%
(Added to)		1/27/12	$14.73				
Barclays (Short)	BCS	12/14/11	$10.65	$12.37	5/18/12	$11.28	10%
(Added to)		1/27/12	$14.09				
UltraShort Russell 2000 ETF	TWM	5/16/12	$33.53		5/21/12	$34.88	4%
Spain iShares (Short)	EWP	5/2/12	$25.16		5/21/12	$23.56	6%
UltraShort Euro ETF	EUO	1/27/12	$19.78		5/23/12	$21.32	8%
Banco Sabadell (Short)**	SAB.MC	5/16/12	$1.55		5/29/12	$1.34	14%
Banco Popular (Short)**	POP.MC	5/16/12	$2.00		5/29/12	$1.63	19%
BNP Paribas	BNPQY.	5/16/12	$16.59		5/30/12	$15.51	7%

(Short)***	PK						
Credit Agricole (Short)***	CRARY.PK	5/16/12	$1.90		5/30/12	$1.76	7%
National Bank of Greece (Short)	NBG	5/16/12	$1.55		5/30/12	$1.45	6%
Credit Suisse (Short)	CS	5/30/12	$19.34		6/14/12	$18.02	7%
PowerShares Double Short Oil	DTO	6/12/12	$53.78		6/21/12	$58.93	10%
Junior Gold Miners ETF	GDXJ	6/12/12	$21.10		6/21/12	$19.52	8%
Deutsche Bank (SHORT)	DB	6/25/12	$34.23		7/13/12	$31.38	9%
Santander (SHORT)	SAN	5/30/12	$5.25	$5.77	7/20/12	$5.20	11%
Average In		7/9/12	$6.29				
Spain ETF (SHORT)	EWP	6/12/12	$23.28		7/20/12	$21.39	9%
Italy ETF (SHORT)	EWI	7/11/12	$10.61		7/23/12	$9.52	11%
Credit Suisse (SHORT)	CS	6/25/12	$18.09		7/23/12	$16.46	10%
UBS (SHORT)	UBS	7/11/12	$10.79		7/23/12	$9.90	9%
Barclays (SHORT)	BCS	7/11/12	$10.25		7/24/12	$9.42	9%
Societe General (Short)	SCGLY.PK	5/16/12	$4.00		7/24/12	$3.64	9%
Rogers Agricultural ETN	RJA	6/12/12	$8.19	$8.79	8/8/12	$9.80	-10%
			$9.39				
Soybeans ETC	SOYB	8/8/12	$26.03		8/23/12	$27.80	7%
UltraShort Gold	GLL	12/14/11	$19.76	$19.61	9/5/12	$15.58	-21%
HSBC* (short)	HBC	12/14/11	$37.07			$46.34	-14%
UltraShort Brazil+	BZQ	5/23/12	$85.47			$65.74	-23%
UltraShort Emerging Markets++	EEV	5/23/12	$31.33			$24.72	-21%
EU Financials ETF (SHORT)	EUFN	6/25/12	$14.59			$18.16	-24%
Goldman Sachs (SHORT)	GS	6/25/12	$91.22			$119.99	-32%
Citigroup (SHORT)	C	7/11/12	$25.87			$34.08	-32%
Spain ETF	EWP	7/25/12	$20.15			$29.42	-32%

(SHORT)								
Italy ETF (SHORT)	EWI	7/25/12	$9.49				$13.19	-27%
France ETF (SHORT)	EWQ	7/25/12	$18.18				$22.14	-14%
UltraShort Russell 2000 ETF	TWM	7/25/12	$32.51				$25.75	-21%
UltraShort S&P 500	SDS	7/25/12	$16.09				$13.41	-17%
Credit Suisse (SHORT)	CS	8/22/12	$19.07				$22.46	-18%
Centamin Mining	CEE.TO	5/25/11	$2.01	$1.83			$0.97	-47%
			$1.64					

- **Opened 12/14/11 at 11:13AM, averaged in second prices on 1/27/12**

**** Opened 12/14/11 at $19.76 averaged in second price of $19.46 on 5/23/12 at 11:50AM**

+ Averaged in second price of $78.31 on July 5 2012 at 10:57AM

++ Averaged in second price of $28.24 on July 5 2012 at 10:57AM