PRIVATE WEALTH ADVISORY

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The Great Debt Implosion Pt 2

The situation in Europe is in its final chapters.

The mainstream media is looking at the superficial political changes taking place (Greece and Italy) and missing the reality of the situation.

Let's take a look at the math.

Italy sports a Dept to GDP ratio of 120%. Including unfunded liabilities, Italy's REAL Debt to GDP is over 360%. We've been told that Italy recently passed a number of austerity measures to bring its debt levels under control. However the *actual* austerity measures are ridiculous:

> The austerity measures passed by the Senate today include a pledge to raise 15 billion Euros from real-estate sales over the next three years, **a two-year increase in the retirement age to 67 by 2026**, opening up closed professions within 12 months and a gradual reduction in government ownership of local services.

So… Italy is going to raise 15 billion Euros (an amount equal to half of one percent of Italy's GDP) and raise its retirement age by *two years in 2026*… and *THESE ACTIONS* are going to balance its financial situation?

Short-Term Trends
-liquidity freeze beginning in Europe
-Italy on the ropes
-No G20 support for EFSF
-Fed hinting at more easing (symbolic)

Intermediate Trends
-Germany and/or France to leave the Euro and possibly the EU
-More PIIGS defaults
-Equities fall, Treasuries and US Dollar outperform

Long-Term Trends
-Global debt implosion.
-China hard landing
-Corporate, banking, and federal defaults.
-US household de-leveraging.
-Energy prices higher.

It's time to face reality. The reality is that the Italian bond market is already beginning to prepare for a default. The European Central Bank (ECB) is now intervening in the Italian bond market on a *daily* and sometimes even *multiple times per day* basis.

Despite this intervention, Italy's ten-year bond yield recently cleared 7%. If you'll recall, Greece, Ireland, and Portugal all began requesting bailouts when their 10-year notes cleared 7%. The only difference is that this time around, NO ONE can bail out Italy. And no one wants to either.

Indeed, with a GDP of $2.05 trillion, Italy is the third largest economy in Europe. The European economy as a whole is slowing dramatically (Year over Year GDP growth for the third quarter was 1.4%... compared to YoY growth of 2.4% in the first quarter). And Italy's economy is one of the weakest n the Eurozone.

In this climate, Italy needs to roll over an amount of debt equal to over 30% of its GDP ($615 billion) by the end of 2012. And when you add in NEW debt issuance to meet Italy's deficit, the number balloons up to 40% of GDP or $820 billion.

So Italy needs to refinance its debts at a time when interest rates are soaring… and its economy is tanking. Even worse, this is a country in which tax evasion is so ingrained that former Italian Prime Minister Silvio Berlusconi once called it a "natural right."

Let me give you some numbers to think about. Italy is the seventh wealthiest country in the world. And yet, according to Italy's Economic Minister Giulio Tremonti, less than 800 citizens in this country of over 60 MILLION declared incomes of more than one million Euros in 2010.

Think about that… 11th wealthiest country in the world… and only 796 people out of 60 million have incomes greater than one million Euros per year.

It is estimated that tax evaders skip out on 120 BILLION Euros' worth of taxes EVERY YEAR in Italy. In fact, rich Italians are so loathe to pay taxes that the Government has hired famed NY advertising firm Saatchi & Saatchi to create a campaign that compares tax evaders to parasites, hoping this will convince wealthy Italians to pay up.

WHO would lend money to a country under these circumstances?

Only a Central Bank.

As noted before, the ECB is buying Italian debt on a daily basis. Banks and other investors are taking advantage of this to unload their Italian debt holdings:

> ## Banks to dump more Italian debt
>
> **European banks are planning to dump more of the €300bn they own in Italian government debt,** as they seek to pre-empt a worsening of the region's debt crisis and avoid crippling writedowns – a move that could scupper the European Central Bank's efforts to bring down soaring yields…
>
> **With the ECB providing a bid for Italian bonds that might not otherwise exist, board members at some of Europe's largest bank say now is the time to accelerate disposals.** Many are also reversing long-standing policies

of buying into new Italian bond issues, denying Rome an important base of support.

"Our traditional buying days are no longer," said one board member at a European bank, one of Italy's 10 biggest creditors, who added that the bank has also sold off previous bond purchases. "Unless there is more certainty on Italians changing direction, it will be very tough for them to find buyers."

http://www.ifre.com/banks-to-dump-more-italian-debt/1615206.article

With a GDP north of $2 trillion, Italy is too large to be bailed out even by the ECB. And we're fast finding out that the other mega-bailout fund, the leveraged European Financial Stability Facility (EFSF), isn't capable of helping either.

Supposedly, the EFSF was going to raise one TRILLION Euros to bail out/ recapitalize Europe's banking system. The only problem is that no one wants to put up the funds.

Euro zone rescue fund may not reach 1 trillion Euros

Euro zone countries had hoped to increase the EFSF's lending capacity by December, combining bond insurance with investment vehicles**. But after the government in Athens fell and bond markets pushed Rome to the brink of a bailout that the Euro zone cannot afford to give, the Luxembourg-based EFSF thinks it may be <u>more realistic to aim for less leverage.</u>**

"The political turmoil that we saw in the last 10 days probably reduces the potential for leverage, **so that may be only by three to four times, instead of four to five,"** the EFSF source said.

www.reuters.com/article/2011/11/11/us-Eurozone-efsf-regling-idUSTRE7AA3D520111111

Indeed, of the one Euro bond auction the EFSF *has* staged, it actually had to resort to buying its *own* bonds to insure the auction didn't *fail.*

Eurozone bail-out fund has to resort to buying its own debt

The European Financial Stability Facility (EFSF) last week announced it had successfully sold a €3bn 10-year bond in support of Ireland.

However, The Sunday Telegraph can reveal that target was only met after the EFSF resorted to buying up several hundred million Euros worth of the bonds.

Sources said the EFSF had spent more than € 100m buying up its own bonds to help it achieve its funding target after the banks leading the deal were only able to find about €2.7bn of outside demand for the debt. However, The Sunday Telegraph can reveal that target was only met after the EFSF resorted to buying up several hundred million Euros worth of the bonds.

http://www.forbes.com/sites/timworstall/2011/11/13/Eurozone-crisis-efsf-buys-its-own-bonds/

In plain terms, the EFSF won't work… which means that the bailout game is ending. The markets realize this, which is why the PIIGS indexes have broken into *very* dangerous territory:

Let's start with Italy first. The big picture weekly chart of Italy's market reveals an enormous triangle pattern that has recently broken out to the downside:

Regardless of how you draw this chart (using the 2007 top or the final line before the major gap down during the Crash of 2008), the downside target for this chart is in the single digits (roughly 3). This implies that we have MAJOR downside to go.

Indeed, from a closer perspective, we see that Italy's market is now on the verge of breaking into the 2009 gap down.

Here again, the chart predicts a move into the single digits on this ETF. I would suggest shorting this ETF once we take out support with conviction.

In simple terms, the technical picture is horrendous for Italy. What's striking is that the situation is really not much better for France, one of the allegedly "more stable" markets.

Once again we see a massive triangle pattern predicting a break into the single digits.

The close-up for the technical picture is also similar to that of Italy in that we see the French market on the verge of breaking into the gap down formed during that final leg down to the March 2009 lows.

Now let's compare these two charts to Germany, the only European country that is remotely solvent (though even it sports a Debt to GDP ratio of 80% and has yet to recapitalize its banks):

Here we at least have several lines of support before the final gap down formed in March 2009.

European investors who are forced to remain in the market due to retirement reasons should be shifting away from PIIGS equities into Germany. I am not saying that Germany will be free from downside risk in the event of a collapse, but it will fare better than the PIIGS.

So What's Next?

With the European End Game now in sight, the primary question that needs to be addressed is whether Europe will opt for a a period of massive deflation, massive inflation, or deflation followed by inflation.

Indeed, with Europe's entire banking system insolvent (even German banks need to be recapitalized to the tune of over $171 billion) the outcome for Europe is only one of two options:

1) Massive debt restructuring
2) Monetization of everything/ hyperinflation

These are the realities facing Europe today (and eventually Japan and the US). Either way we are talking about the destruction of tens of trillions of Euros in wealth. The issue is *which* poison the European powers that be choose.

Personally, I believe we are going to see a combination of the two with deflation hitting all EU countries first and then serious inflation or hyperinflation hitting peripheral players and the PIIGS.

In terms of how we get there, I believe that in the next 14 months, the following will occur.

1) Germany and possibly France exit the Euro
2) ALL PIIGS defaulting on their debt
3) Potential hyperinflation in the PIIGS and peripheral EU countries

Regarding #1, we are already beginning to see hints of this development in the press:

> **DEATH OF THE EURO: SECRET PLOT TO WRECK THE CURRENCY**
>
> Ministers are understood to be deeply concerned that French President Nicolas Sarkozy and Germany's Chancellor Angela Merkel are secretly plotting to build a new, slimmed down Eurozone without Greece, Italy and other debt-ridden southern European nations.
>
> Well-placed Brussels sources say Germany and France have already held private discussions on preparing for the disintegration of the Eurozone.
>
> http://www.express.co.uk/posts/view/283060
>
> **FRENCH AND GERMANS EXPLORE IDEA OF SMALLER EURO ZONE**
>
> German and French officials have discussed plans for a radical overhaul of the European Union that would involve setting up a more integrated and potentially smaller Euro zone, EU sources say.
>
> "France and Germany have had intense consultations on this issue over the last months, at all levels," a senior EU official in Brussels told Reuters, speaking on condition of anonymity because of the sensitivity of the discussions.
>
> "We need to move very cautiously, but the truth is that we need to establish exactly the list of those who don't want to be part of the club and those who simply cannot be part," the official said.

http://www.reuters.com/article/2011/11/09/us-Eurozone-future-sarkozy-idUSTRE7A85VV20111109

With no one willing to foot the bill for the EFSF the markets are hoping Germany will step in and save the day. However, the German constitution forbids Germany from backing Euro-bonds.

German EconMin: court verdict rules out Euro bonds

German Economy Minister Philipp Roesler said on Thursday the constitutional court's ruling on Euro aid made it clear that joint Euro zone bonds were not an option.

Addressing left-wing opposition parties in the Bundestag lower house of parliament, Roesler said: "You continue to talk up Euro bonds although the constitutional court yesterday made it clear that as transfer union such as the one you propose on the left will never be possible, never be allowed."

"We don't want it politically, either, and we will not let the German taxpayer be obliged to pay for the debt of other countries," he said in a parliamentary budget debate.

http://www.reuters.com/article/2011/09/08/Eurozone-germany-Eurobonds-idUSB4E7K600L20110908

Moreover, Germans will simply not permit the monetization of debt. Weimar's hyperinflation happened in the early 1920s and is still fresh in the memories of the German people (those who lived through it undoubtedly told their children and grandchildren about it). So the German people will not tolerate price instability in any form.

Germany is not alone in having little or no desire to attempt to backstop the system. Indeed, NONE of the G20 countries wish to support the EFSF from a monetary standpoint (yet another sign that the bailout game is ending).

No new Euro zone money for debt crisis at G20

The Euro zone won verbal support but no new money at a G20 summit on Friday for its tortured efforts to overcome a sovereign debt crisis, while Italy was effectively placed under IMF supervision.

Leaders of the world's major economies, meeting on the French Riviera, told Europe to sort out its own problems and deferred until next year any move to provide more crisis-fighting resources to the International Monetary Fund.

> "There are hardly any countries here which said they were ready to go along with the EFSF (Euro zone rescue fund)," German Chancellor Angela Merkel told a news conference.
>
> http://www.reuters.com/article/2011/11/04/us-g-idUSTRE7A20E920111104

So… everyone claims they want to support the EFSF… but no one wants to commit the money. Moreover, Germany's constitution forbids the backing of Euro bonds… and the EFSF itself has failed to stage even a three billion Euro bond offering under normal market conditions.

Again, the bailout game is ending. Under these conditions, I believe Germany and France will push to either:

1) Leave the EU
2) Draft legislation that allows countries to leave the *Euro* but remain in the EU
3) Propose kicking out the PIIGS from the Euro

Whichever one of these options Germany opts for, the Euro will collapse. Indeed, the primary reason the Euro has been rallying since October is due to French banks and others selling assets (buying Euros) to recapitalize themselves.

Put another way, the Euro rally is in fact NOT a sign of currency strength. Instead, it is a sign that the major players are moving to cash (Euros) in an attempt to lower their exposure to PIIGS' debt.

Greece Set the Precedent… More Defaults Are Coming

Aside from Germany and possibly France moving to exit the Eurozone (or at least the Euro), I believe we're going to see other insolvent European nations following Greece in choosing to default on their debt.

Consider that Greece went for a default even *after* getting two bailouts and some debt relief at a time when Germany was STILL in the EU and willing to support the bailouts.

Now that Germany is rumbling about cutting off the money, oher countries are already clamoring for help. As noted earlier in this issue, Italy's ten-year bond yield has cleared 7%: the level at which Greece, Ireland, and Portugal sought bailouts. But notice Italy *hasn't* been clamoring for a bailout the way Greece did.

So I expect more European defaults over the coming months. And once Germany bows out of the Euro, **the defaults will be rapid**.

More defaults alone will kick the Euro off a cliff. And when Germany moves out of the Euro, the currency is absolutely FINISHED. I believe the market has already begun to expect this as the Euro is forming something of a Head and Shoulders pattern:

The long-term chart shows the Euro on the verge of breaking into the downward channel that dominated its movements ever since the Great Crisis began in '08.

Once we get below 135, the door is open for a move below the May 2010 panic low of 118. Before we get there, I expect we'll see the Euro break below 135, then possibly rally to retest this line. This move will likely happen in the next month. And once the Euro *fails* to reclaim its trendline, I'll suggest adding to our Euro Short positions.

Finally, with monetization off the table for Germany, and the PIIGS defaulting, I believe we're going to potentially see VERY serious inflation in the PIIGS and peripheral countries.

Indeed, we're already getting a taste of this from Belarus, an eastern European country that didn't go into the EU and has recently found what happens when currency devaluations kick into high gear:

> ## Railroaded By Hyperinflation, Belarus Is Now Running Out Of Meat
>
> **Belarus which devalued its currency by 36% in May, is considering another forced devaluation of up to 15% to lower its exchange rate and stem a balance-of-payments crisis**. The ruble whose official central-bank rate is 5,107 per dollar, is going as low as 9,000 on the streets, according to Bloomberg.
>
> With gold and foreign exchange reserves falling 22% to $4.2 billion in the year to August, locals queue outside licensed exchange booths to get foreign currency.
>
> The central bank has raised its refinancing rate to 27% which will be effective September 1. **In a bid to curb inflation which soared to 36.2%, the central bank has increased rates by 1,650 basis points this year, according to Dailymarkets.**
>
> http://articles.businessinsider.com/2011-08-31/markets/30128686_1_currency-exchange-rate-belarusian#ixzz1duMMS5DJ

This situation is coming to Greece and the other European nations whether they are kicked out of the Euro OR Germany backs out of the Euro: either development will see a MAJOR collapse in the Euro. Either way, the EU in its current form is finished.

These developments will have an even greater impact on the markets than Lehman Brothers' bankruptcy. We've already profited beautifully from the markets recent leg down. Even LARGER profits are coming when the Euro Crisis *really* kicks into high gear.

Why NOT To Own Physical Gold OR Store Your Gold With Someone Else

On a final note, I've warned many times that investors should look to own PHYSICAL Gold bullion and that they should NEVER store their bullion with someone else. The MF Global debacle has proved, beyond a shadow of a doubt, the dangers inherent in keeping your position in paper Gold and with someone else.

Indeed, famed trend forecaster Gerald Celente has had his MF Global Gold account "looted" as he put it:

> GERALD CELENTE: My Gold Account Was Emptied By MF Global
>
> **When MF Global filed for bankruptcy, commodity accounts that had open positions were moved to new brokers, but only about 60% of the collateral to back up those trades were moved with it**. That's because once the $600 million missing from customer segregated accounts was discovered, James Giddens (the trustee) froze all client accounts. **Celente's account wasn't emptied by Giddens, as he claims, but it is frozen and he doesn't have access to it. And there's a real chance he won't be made whole, as many predict the $600 million will never be found -- in which case the funds will be distributed pro rata based on claims.**
>
> No one has been able to touch the money in their MF Global accounts, and almost all the clients have pushed the blame onto Giddens for not releasing the funds. Celente does the same, but in a much more extreme manner.
>
> **What's curious about Celente's situation is that he said two of his positions were closed. That could've been because he didn't put up more margin after his collateral wasn't completely transferred**. Another explanation could be that Celente didn't file a claim by last Friday for open positions that were not transferred to a new broker -- then his trades would've been liquidated.
>
> http://www.businessinsider.com/the-truth-behind-how-gerald-celente-got-screwed-by-mf-global-2011-11#ixzz1duIrIBId

Gerald Celente is one of the more astute analysts out there. His experience should be a lesson to *anyone* who believes it's safe to have a sizable position in paper Gold. Similarly, this situation is also a warning on why NOT to store one's Gold with someone else.

Again, if you want exposure to Gold, buy physical bullion and DO NOT store it with anyone else.

Conclusion

To recap this week's issue:

1) Germany will NOT backstop the Euro any more. It will either leave the Euro OR created a new Eurozone with France
2) Italy will default as will the other PIIGS
3) A currency collapse will hit the Euro
4) The markets will Crash when this happens

I am monitoring the markets closely and will issue new trades as needed. For now, we've already profited beautifully from the recent volatility. I plan on having us add to our Euro short as well as our UltraShort ETFs in the coming weeks once the market begins to break down in earnest.

This concludes this week's issue of ***Private Wealth Advisory***.

Thank you for reading,

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	$1,765.00	58%
Silver bullion	N/A	3/17/10	$17.50	$33.77	93%
Centamin Mining	CEE.TO	5/25/11	$2.01	$1.71	-15%

Deflation Portfolio (OPEN BUYS NOW)					
Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Dollar ETF	UUP	5/23/11	$21.79	$22.05	1%
UltraShort Euro	EUO	9/21/11	$19.13	$18.84	-2%
JP Morgan (short)	JPM	11/2/11	$32.65	$31.48	4%
Deutsche Bank (short)*	DB	11/2/11	$37.45	$37.16	1%
Santander (short)*	STD	11/2/11	$7.91	$7.41	7%
UltraShort China*	FXP	11/2/11	$32.64	$29.63	-9%
UltraShort Emerging Markets*	EEV	11/2/11	$34.78	$34.07	-2%
UltraShort Brazil*	BZQ	11/2/11	$19.04	$18.15	-5%
UltraShort Materials*	SMN	11/2/11	$20.23	$18.68	-8%
UltraShort Real Estate*	SRS	11/2/11	$40.09	$40.89	2%
UltraShort Financials*	SKF	11/2/11	$65.13	$65.93	1%

* opened November 1 2011 at 9:41AM

RECENTLY CLOSED POSITIONS

Company	Symbol	Buy Date	Buy Price	Sell Price	Gain
Bank of America (short)*	BAC	11/2/11	$6.48	$6.09	6%
Citigroup (short)**	C	11/2/11	$29.19	$98.73	8%
Goldman Sachs (short)*	GS	11/2/11	$106.64	$97.46	6%
HSBC (short)**	HBC	11/2/11	$42.03	$38.95	8%

* Sold 11/14/11 at 11:12AM

** Sold 11/16/11 at 10:10AM