

PRIVATE WEALTH ADVISORY

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Europe's Lehman Event

Deflation, particularly the dreaded debt deflation that Central Banks fear, is fast spreading throughout the financial system as the European banking system collapses.

Indeed, the EU, in its current form, is most certainly in its final chapter as both the political environment and market conditions have rendered all proposed "solutions" to the crisis moot.

To wit, the most recent proposals from EU leaders are:

- 1) To draft new budgetary requirements for EU members.
- 2) To move the launch of the Emergency Stability Mechanism (ESM) one year ahead of its original launch date to July 2012.
- 3) To send the IMF 200 billion Euros to use as aid in dealing with the EU Crisis

The media hailed these proposals as a bold step towards solving the current EU Crisis. However political and market realities show all of these proposals to be absurd, if not impossible.

Regarding #1, the EU *already* had budgetary constraints via the 1991 ratification of the Maastricht Treaty (all members were to maintain Deficit to GDP ratios lower than 3% and Debt to GDP ratios lower than 60%) which NO ONE has followed (not even Germany). So how does a new set of budgetary requirements change *anything*?

Secondly, in order to enact these new budgetary requirements, there needs to be unanimous consent from all EU members. Even if there *was* unanimous consent here (there isn't nor will there be), basic math shows these new budgetary requirements to be pointless: how on earth does anyone expect a country like Greece, which is *still* bankrupt after two bailouts and quite a bit of debt forgiveness, to get its budget under control (hint: it would have to wipe out *at a minimum* 50% of ALL of its outstanding debt).

Short-Term Trends

- Deflation is the primary risk to portfolios.
- The EU in its current form will soon be broken up.
- The Fed cannot act until we see systemic risk or a major bank collapse.

Intermediate Trends

- More PIIGS defaults.
- Systemic deleveraging.
- Extreme volatility.

Long-Term Trends

- Global debt implosion.
- New alignment of politico-economic powers.
- Trade wars and very likely REAL warfare

As for the proposal to move the launch of the ESM a year earlier... the EU has already *failed* to fund ONE bailout fund (the EFSF hasn't been able to raise even ten billion Euros in capital). So the idea that launching a second bailout fund earlier than originally intended is pointless.

The final and most absurd proposal concerns EU nations sending 200 billion Euros to the IMF for use in combating the EU Crisis. Setting aside the fact that this is completely insane (bankrupt EU countries are going to give money to the IMF to bail out *other* bankrupt countries?!?!), the political environment in Europe won't permit this to happen.

Case in point, Germany's Bundesbank (its central bank) which is the *real de facto* monetary backstop for the EU today, has said it will send additional funds to the IMF ONLY IF:

- 1) The German parliament agrees to the move (it won't)
- 2) Other EU members do the same (who has the funds?!)
- 3) Other, non-EU members do the same (how could this work? No one in the G20 let alone the EU wanted to send money to the EFSF!!!)

In simple terms, the Bundesbank is willing to give more money to bailout Europe if everyone else in the developed world does the same. This is a strong signal from Germany that the money tap is being closed off and additional funds are not forthcoming: the Germans know their demands are impossible to meet.

We get confirmation of this from recent developments in the German legislature:

German parliament wants more say over EU deals: report

German lawmakers from Angela Merkel's coalition want more say in agreements made with European partners, a paper to be presented to MPs says, **firing a warning shot to the chancellor that all major deals to save the euro zone must go past them first.**

The paper, approved by parliamentary floor leaders from Merkel's Christian Democrats (CDU), the Christian Social Union (CSU) and Free Democrats (FDP), **calls on the government to inform and consult parliament when they deal with EU issues or involve the use of EU institutions.**

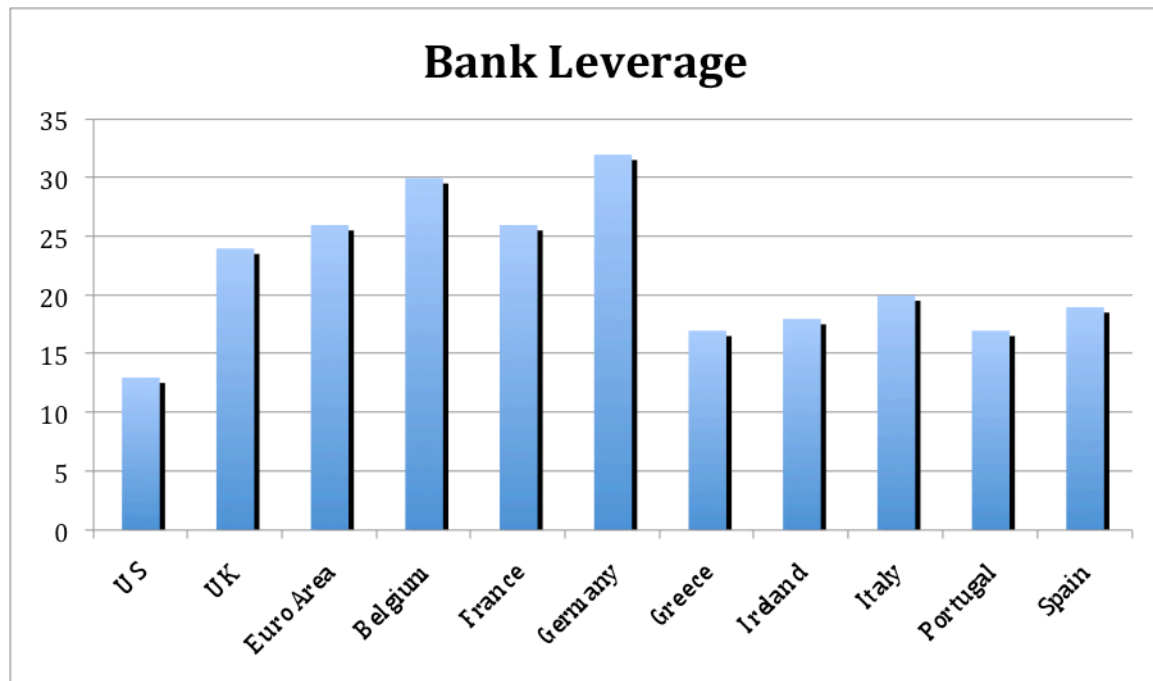
<http://www.reuters.com/article/2011/12/12/us-eurozone-germany-parliament-idUSTRE7BB1RV20111212>

So while German leader Angela Merkel *talks* about moving forward to maintain the Euro, the German political landscape is rapidly becoming less concerned with the EU and more concerned with domestic issues.

Indeed, in the last month, Germany has:

- 1) Asked its major banks to raise capital as soon as possible
- 2) Introduced legislation to nationalize its major banks in the event of Crisis
- 3) Introduced legislation allowing it to leave the Euro but stay in the EU

These are smart moves. German banks post some of the highest leverage ratios in Europe: higher than Italy, higher than Ireland, even higher than Greece. In fact, German banks are actually sporting leverage EQUAL to that of Lehman Brothers when it went bust.



To make matters worse, Germany has *yet* to recapitalize its banks. Indeed, by the German Institute for Economic Research's OWN admission, German banks need 147 billion Euros' worth of new capital.

Mind you, this is just NEW capital demands. In addition to this, German banks need to roll over 40% of their total outstanding debt within the next 12 months.

In simple terms, Germany has begun focusing more on its own problems rather than European problems. This indicates to me that Merkel's statements and proposals are merely *verbal* interventions and little else. The German central bank has shown itself unwilling to commit more funds unless the whole world jumps in as well. And German lawmakers are moving to constrict Merkel's authority regarding additional bailouts.

Against this backdrop of political intrigue, European corporations are moving quickly to prepare for the end of the Euro:

European CEOs Move Cash to Germany In Case of Euro Breakup

Grupo Gowex, a Spanish provider of Wi-Fi wireless services, is moving funds to Germany because it expects Spain to exit the euro. German machinery maker GEA Group AG is setting maximum amounts held at any one bank...

“A couple of weeks ago I would never have thought about having conversations on the probability of the euro disappearing, but now there is more speculation on such a scenario,” Wolters Kluwer NV (WKL) CEO Nancy McKinstry said in a Nov. 29 interview at the company’s headquarters outside Amsterdam...

Kingfisher Plc (KGF), Europe’s largest home-improvement retailer, has considered plans for the possibility of a collapse of the euro region and will focus on cash generation to account for that possibility, Chief Executive Officer Ian Cheshire said.

<http://www.bloomberg.com/news/2011-12-09/wary-european-ceos-move-cash-to-germany-to-protect-against-breakup-risk.html>

There are signs that these moves are the result of warnings from political leaders. Britain’s Prime Minister, David Cameron, walked out of EU discussions on Friday. While the UK never formally adopted the Euro as its currency, this decision to walk will have a significant psychological impact for political leaders of more involved EU countries: it sets a precedent for choosing to opt-out of negotiations.

Cameron also appears to be warning UK banks that the Euro will be broken up in the near future:

PREPARE FOR END OF THE EURO, BANKS TOLD

ALARM at the economic turmoil in Europe intensified last night after the Government admitted **preparations for the chaotic collapse of the euro were being “stepped up”**.

Downing Street is understood to be embroiled in intensive “contingency planning” for Greece and possibly Italy, Spain and Portugal quitting the eurozone.

British banks have been urged by the City’s watchdog to brace themselves for the collapse of the single currency...

Following the FSA warning, the Prime Minister's spokesman said: "We have been stepping up our contingency planning but I don't want to get into detail on that."

He said the Government, the Bank of England and the FSA were working together "**ensuring they have the capacity to take action**" in the event of **Greece or other countries quitting the euro.**

Last week Andrew Bailey, a senior executive at the FSA, said: "**We must not ignore the prospect of the disorderly departure of some countries from the eurozone.**"

But the decision of Mr Sants to intervene by ordering Britain's high street giants to increase their preparations for a euro exit was seen as a significant escalation of the crisis.

<http://www.express.co.uk/posts/view/287039/Prepare-for-end-of-the-euro-banks-told>

Central banks are also exploring the possibility of printing their old pre-Euro currencies in anticipation of this event:

Banks Prep for Life After Euro:

Countries Study Printing Their Own Notes in Case Monetary Union Unravels

Some central banks in Europe have started weighing contingency plans to prepare for the possibility that countries leave the euro zone or the currency union breaks apart entirely, according to people familiar with the matter.

The first signs are surfacing that central banks are thinking about how to resuscitate currencies based on bank notes that haven't been printed since the first euros went into circulation in January 2002.

<http://online.wsj.com/article/SB10001424052970203413304577084483874422516.html>

Connecting the dots, I believe:

- 1) Political discussions to end the Euro have already occurred at the highest levels (Germany is most assuredly involved here).
- 2) Politicians, while verbally promising to support the Euro in public, have warned leading financial institutions, corporations, and Central Banks to prepare for the end of the common currency.

Truly, the end of the Euro is the only viable outcome. When push comes to shove, there are only two ways to deal with a debt problem:

- 1) Massive money printing (a la Weimar)
- 2) Default

Germany will not permit the EU to pursue option #1. So option #2 is all that's left. With that in mind, we opened our European banking shorts again this morning.

Indeed, the long-term charts for all of them indicate we have officially entered Crisis mode and are heading down in a big way.



Having been rejected by key resistance at \$40, Deutsche Bank is likely going to \$30 in the near future.

Action to Take: Short Deutsche Bank (DB) if you haven't already done so.

STD (Banco Santander Cent Hisp) NYSE © StockCharts.com
13-Dec-2011 Op 7.43 Hi 7.54 Lo 7.15 Cl 7.23 Vol 4.5M Chg -0.36 (-4.74%) ▼



In Santander (STD)'s case, \$8 was the line in the sand. We're now going to \$7 then \$6.

Action to Take: Short Santander (STD) if you haven't already done so.

HBC (HSBC Holdings PLC) NYSE © StockCharts.com
13-Dec-2011 O 38.16 H 38.72 L 37.48 C 37.79 V 2.5M Chg -0.41 (-1.07%) ▼



Quite similar to Deutsche Bank, HSBC (HBC) has been rejected by key resistance at \$40 and is going to \$35 then \$30 in the near future.

Action to Take: SHORT HSBC (HBC) if you have not already done so.



This is perhaps the ugliest chart of the four. We are literally on the ledge of a cliff here. And once we take out \$10, we're going to \$5 in no time:

Action to Take: SHORT Barclays (BCS) if you have not already done so.

While I believe Europe is on the verge of a banking collapse, I WOULD NOT put a lot of money to work shorting these banks. The reason is that political leaders and central banks Be will do whatever they can to stave off a banking collapse. So while we're ultimately heading down down DOWN, we WILL see sharp moves to the upside in the process.

Anyone who was short financials in 2008 will know what I'm talking about. Collapses never happen in a straight fashion. So expect a volatile ride down. And keep your position relatively small.

On a final note, I've been informed that some brokers will not short these banks, while others will. I do not know the reason for this inconsistency, but I do know that optionsxpress is one broker who WILL short these stocks.

As debt deflation grips Europe and the EU breaks up, we will see the Euro plunge to new lows. Indeed, the markets are already anticipating this:



When the Euro broke down below 133 or so, it officially entered levels not seen since the Euro Crisis of 2010. Put another way, the Euro is now officially trading in Crisis mode. And once it breaks the FINAL line of support at 130 (we're just about there), we are going to new lows, below even the 2010 low of 118.

This move will result in the US Dollar exploding higher.



This chart forecasts a move to the mid-80s.

We already have exposure to these two currencies with our **PowerShares DB USD Index (UUP)** and **UltraShort Euro ETF (EUO)**.

However, given the nature of what's happening, I'd like to add a bit more juice to our Dollar longs, so I suggest **Rydex Strengthening Dollar 2x Strategy (RYS DX)**.

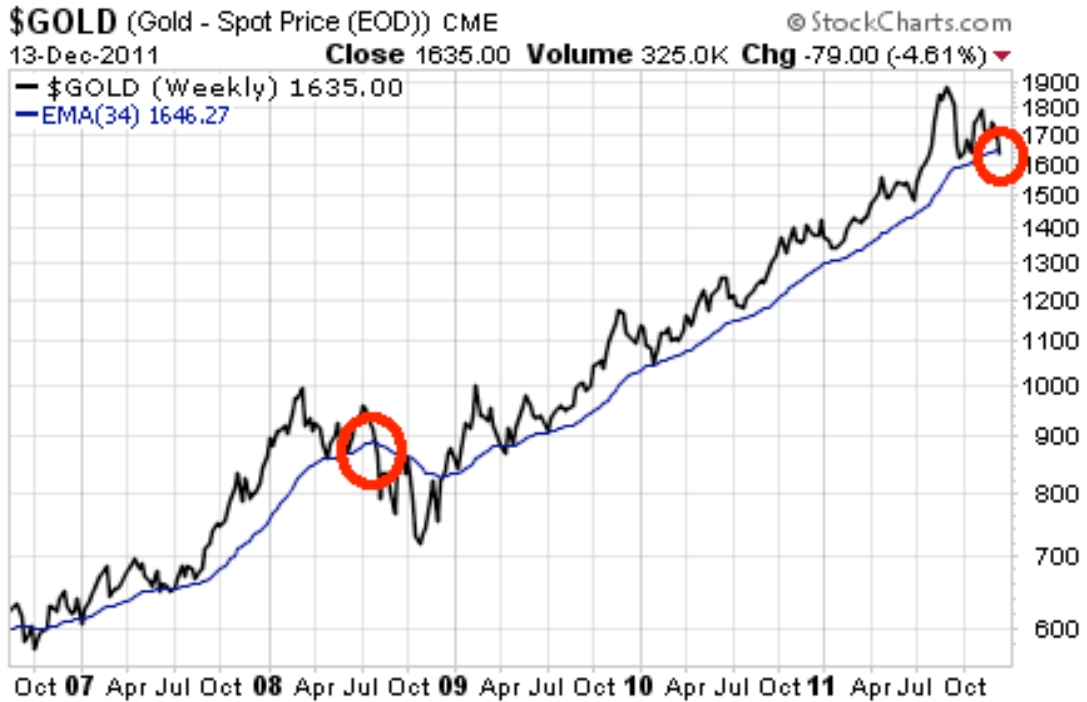
RYS DX, returns 2X the Dollar's performance. So if the Dollar rallies 5%, RYS DX rallies 10%, and so on. It's essentially a play on the Dollar with a little extra juice.

Action to Take: Buy the Rydex Strengthening Dollar 2x Strategy (RYS DX).

As the US Dollar rallies, we *will* see weakness in the commodities space including precious metals. Indeed, Gold has recently broken its trendline. Once we take out \$1600, we will see a sharp sell off.



Indeed, the weekly chart shows we are on the verge of breaking below the 34-week exponential moving average: the same move we saw before the 2008 collapse:



For this reason, we opened a Gold Short today with the **UltraShort Gold ETF (GLL)**.

Action to Take: Buy the UltraShort Gold ETF (GLL) if you haven't already done so.

While the situation is relatively ugly for Gold, it's downright brutal for Silver:



Here we've already taken out the 34-week exponential moving average. Once we take out \$30 we're going to \$20 in short order.

For this reason we opened a Silver Short in the form of the UltraShort Silver ETF (ZSL).

Action to Take: Buy the UltraShort Silver ETF (ZSL) if you haven't already done so.

Other signs of deflation to be aware of...

Copper is on the verge of breaking a large triangle pattern to the downside:



\$3 is the line in the sand here. Once we take that level out, we're heading into 2008 Crash levels.



Agricultural commodities are already in Crisis mode and heading towards their 2008-2009 lows. This is important as agricultural commodities anticipated QE lite and QE 2 before all other asset classes. They also anticipated the current round of deflation/ economic collapse as far back as February 2011. So the fact they're at 2008 levels should be a major warning that other asset classes will soon follow.



Back to Europe...

I've said before that I believe we will see a collapse of the banking system in Europe. By the look of things, the EU banking system is rapidly approaching its "Lehman event."

Eurozone banking system on the edge of collapse

If anyone thinks things are getting better then they simply don't understand how severe the problems are. **I think a major bank could fail within weeks," said one London-based executive at a major global bank.**

Many banks, including some French, Italian and Spanish lenders, have already run out of many of the acceptable forms of collateral such as US Treasuries and other liquid securities used to finance short-term loans and have been forced to resort to lending out their gold reserves to maintain access to dollar funding.

<http://www.telegraph.co.uk/finance/financialcrisis/8947470/Eurozone-banking-system-on-the-edge-of-collapse.html>

Indeed, Germany just formally passed legislation to permit it to nationalize large banks today:

Commerzbank faces bail-out by state

The German government has begun preparations for a possible state bail-out of Commerzbank if it fails to present a convincing plan by January 20 to fill a €5.3bn capital gap identified by regulators.

German chancellor Angela Merkel's cabinet on Wednesday agreed a bill to reinstate a state-backed bank rescue fund next year, a move that could pave the way for state aid to Commerzbank, Germany's second-largest bank by assets.

<http://www.ft.com/intl/cms/s/0/94e6388c-2652-11e1-85fb-00144feabdc0.html#axzz1gYUYyiYA>

As the European banking crisis spreads, US Banks, particularly the TBTFs which have the most derivative exposure, will be dragged down as well due to the interconnectedness of the financial system.

I've posted their charts below as well as the key support lines. Once we take these out, it's time to short the TBTFs.

The ugliest chart of the bunch is Bank of America (BAC) which could enter a death spiral if it breaks below \$5 per share: many institutions cannot invest in companies with share prices under \$5, so if BAC breaks below this level there will be INTENSE selling pressure and liquidations:



Here's Citigroup:



Goldman Sachs (GS):



And JP Morgan (JPM):



On a final note, many commentators seem to believe that Ben Bernanke is literally on the verge of launching QE 3. I do not think this is correct. As I've noted in

previous issues of *Private Wealth Advisory* the political climate in the US has grown increasingly *against* Bernanke and his loose money policies.

Indeed, we've now gone from Presidential candidates making snide remarks about Bernanke to outright suggesting that he be fired:

Gingrich wants Bernanke fired and Chris Dodd and Barney Frank imprisoned

Former House Speaker Newt Gingrich on Tuesday said he understood the anger expressed by the protestors on Wall Street - but said the real culprits who should be thrown from power are in Washington.

"If they want to really change things, the first person to fire is (Federal Reserve Board Chairman Ben) Bernanke, who is a disastrous chairman of the Federal Reserve, the second person to fire is (Treasury Secretary Timothy) Geithner," Gingrich said in the Republican debate sponsored by Bloomberg and the Washington Post.

http://www.cbsnews.com/8301-503544_162-20118945-503544.html

In this environment, Bernanke and the Fed are going to be in damage control mode. We've seen this in Bernanke's decision to open the Fed up to Q&A sessions with the press as well as him holding town-hall meetings in which he actually addresses the public. He even went so far as to write a letter to Congress whining that the media's recent portrayal of the Fed's actions have been unfair and inaccurate.

More recently, we see various Fed mouthpieces promoting the notion that Bernanke is a normal guy just like the rest of us:

Bernanke Joins Bargain Hunters Who Refinance

Ben Bernanke lives in a three-bedroom, 2,100-square-foot, attached town house near the Capitol. It has an appraised value of roughly \$850,000, not far from the \$839,000 he paid for it in 2004. A public record search shows he owes \$672,000 on the home, after refinancing his mortgage twice.

One refinancing was in late 2009. The other was in late September, shortly after the Fed announced a new program, known as "Operation Twist," which aimed to drive down long-term interest rates.

Mr. Bernanke holds a 30-year mortgage. He was required to send proof of employment, including pay stubs, before the bank approved the loan, according to a person familiar with the matter.

After a decade in Washington, Mr. Bernanke doesn't seem to have been swept up by the nation's capital.

He occasionally shoots baskets in the Fed's dreary, underground gym. The closest he came to showing a wild side was when he was a professor at Princeton: He bought a Chrysler Sebring convertible, according to someone who knows him.

On most nights he's home with his wife, Anna, reading on his Kindle after dinner, say people who know him. In the past 18 months, he has told others, he has read 200 books on the Kindle.

<http://online.wsj.com/article/SB10001424052970204336104577094700478530784.html>

The article is written by Jon Hilsenrath, Bernanke and the Fed's favorite reporter/leak. Over the last three years, the Fed has "tested the waters" regarding the public's reaction to their intended monetary policies by leaking stories to Hilsenrath in advance.

So this latest article attempting to humanize Bernanke can be seen as a pseudo-press release from the Fed and Bernanke himself: notice how Hilsenrath emphasizes that Bernanke has taken advantage of the Fed's policies to refinance his mortgage, portraying Bernanke as a man who practices what he preaches.

In an environment such as this, the Fed will NOT be able to enact any large monetary schemes without some kind of Lehman Event/ systemic collapse happening first. The political environment and the public simply will not permit it.

So the idea that QE 3 is coming is completely misguided. Until Bank of America collapses or some other item of huge import, the Fed's hands are tied. Fed Presidents will intervene verbally to try and prop the market up, but we will NOT see more money printing/ intervention without systemic risk first rearing its head. Investors should realize this and position their portfolios accordingly.

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

- 1) The most pressing issue today is debt deflation in Europe which could quickly spread throughout the Financial System.
- 2) This is Dollar positive and Euro/ commodities/ stocks negative.
- 3) EU leaders have no real solutions to the Crisis and are just playing for time.
- 4) European corporations and banks have already been warned to prepare for the end of the Euro.
- 5) Europe is on the eve of its Lehman event.
- 6) Bernanke and the Fed will not act decisively until we see systemic risk or a major bank collapse.

We've positioned our portfolio to profit from all of this. I'm watching the market and political arena closely and will issue updates as needed. Barring any new developments you'll hear from me in two weeks' time.

Until then...

Good Investing!

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	\$1,579.00	41%
Silver bullion	N/A	3/17/10	\$17.50	\$28.98	66%
Centamin Mining	CEE.TO	5/25/11	\$2.01	\$1.33	-34%

Deflation Portfolio (OPEN BUYS NOW)					
Company	Symbol	Buy Date	Buy Price	Current Price	Gain/Loss
Dollar ETF	UUP	5/23/11	\$21.79	\$22.62	4%
Rydex Strengthening Dollar 2x Strategy	RYSDX	12/14/11	\$14.39	NEW	BUY!
UltraShort Euro	EUO	9/21/11	\$19.13	\$20.20	6%
UltraShort China	FXP	11/2/11	\$32.64	\$31.89	-2%
UltraShort Materials	SMN	11/2/11	\$20.23	\$20.44	1%
Deutsche Bank*	DB	12/14/11	\$35.33	\$35.49	0%
Santander*	STD	12/14/11	\$7.11	\$7.11	0%
HSBC*	HBC	12/14/11	\$37.07	\$37.16	0%
Barclays*	BCS	12/14/11	\$10.65	\$10.64	0%
UltraShort Gold	GLL	12/14/11	\$19.76	\$19.69	0%
Ultrashort Silver	ZSL	12/14/11	\$15.57	\$15.39	-1%

* Opened 12/14/11 at 11:13AM

RECENTLY CLOSED POSITIONS

Company	Symbol	Buy Date	Buy Price	Current Price	Gain/Loss
UltraShort Emerging Markets ETF*	EEV	11/2/11	\$34.78	\$37.16	7%

***Sold remaining position 12/14/11 at 11:41AM**