Private Wealth Advisory

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Europe Will Collapse in May-June

Starting back in August, I began suggesting that we were approaching a Systemic Crisis/ Crash scenario in the markets.

The technical and fundamentals both supported this forecast, but I completely underestimated the degree to which the Central Banks and EU would attempt to prop up the market.

At that time, I thought it likely we'd see a Crash, which would then be met with another round of stimulus, which would push the economy temporarily into the green. It seemed the most logical outcome given that we were heading into an election year with a President whose ratings were at record lows.

Instead, the Federal Reserve, particularly those Fed Presidents from Financial Centers (Charles Evans of Chicago and Bill Dudley of New York) began a coordinated campaign of verbal intervention, hinting that more easing or QE was just around the corner.

These verbal interventions coincided with coordinated monetary interventions between the Federal Reserve and other world Central Banks: first on September 15 2011 and again on November 30 2011.

The effects of both coordinated moves were short-lived in terms of equity prices, but they *did* send a message that the Central Banks were willing to intervene in a big way to maintain the financial system. This in turn helped to ease interbank liquidity problems in Europe (more on this in a moment) and maintain the belief that the Fed backstop or "Bernanke Put" was still in effect.

Short-Term Trends

-Markets are forming a top.
-Deflation is just around the corner.

Intermediate Trends

-Very very ugly charts indicating European collapse in May-June
-China economic deterioration to affect commodities and global GDP
-Downward revisions coming from BLS regarding employment and GDP

Long-Term Trends

- -Global debt implosion.
- -Markets to go to new lows either nominally or in terms of purchasing power depending on whether we get hyperinflation or severe defltation
- -Trade wars and very likely REAL warfare

Another issue that served to push the markets higher was European leaders' decision to go "all in" on the EU –bail out project. I've tracked those developments closely in previous issues of ***Private Wealth Advisory***.

Regarding this factor, I also underestimated the extent to which leaders would push to hold things together. After all, Greece had already received bailouts in excess of 150% of its GDP and *still* posted a GDP loss of 6.8% in 2011. It's hard to believe they'd want to accept *more* austerity measures and *more* debt.

Moreover, political tensions between Greece and Germany had reached the point that Greeks were openly comparing German Chancellor Angela Merkel and Finance Minister Wolfgang Schauble as Nazis while the Germans referred to Greece as a "bottomless hole" into which money was being tossed.

Looking back on it, the clear reality was that Germany wanted to force Greece out of the EU but didn't want to do it *explicitly:* instead they opted to offer Greece aid provided Greece accepted austerity measures so onerous that there was no chance Greece would go for it.

Well, Greece surprised many, including myself, and went for it. And so the EU experiment continues to exist today. However, before the end of this issue I will make it clear precisely why this will not be the case for much longer and why we are on the verge of a systemic collapse in Europe.

For starters, unemployment in Greece as a whole is now over 20%. For Greek youth (aged 15-24) it's over 50%. The country is in nothing short of a Depression.

Indeed, Greece has now experienced five straight years of contraction bringing the total contraction of Greece's GDP to 17%. To provide some historical perspective here, when Argentina collapsed in 2001 its total GDP collapse was 20% and this was accompanied **by full-scale defaults as well as systemic collapse and open riots**.

With new austerity measures now in place there is little doubt Greece will see a GDP contraction of 20%, if not more. I expect we'll see other "Argentina-esque" developments in the country as well. Put mildly, the Greek issue is not resolved.

With that in mind, I would look to short the National Bank of Greece (NBG) once it breaks below $3.

The one thing that would stop me here would be if Greece staged a full-scale default. While the political leaders and others view a total default as a nightmare (and it would be for Greek pensions, retirees, and many EU banks), it is only a total default that could possibly solve Greece's debt problems and allow it to return to growth.

Defaults are akin to forest fires; they wipe out all the dead wood and set the stage for a new period of growth. We've just witnessed this in Iceland, which did the following between 2008 and 2011:

1. Had its banks default on $85 billion in debt (the country's GDP is just $13 billion).
2. Jailed the bankers responsible for committing fraud during the bubble.
3. Gave Icelandic citizens debt forgiveness equal to 13% of GD.

Today, just a few years later, Iceland is posting GDP growth of 2.9%: above that of both the EU and the developed world in general. In plain terms, the short-term pain combined with moves that reestablished trust in the financial system (holding those who broke the law accountable) created a solid foundation for Iceland's recovery.

Now, compare this to Greece which has "kicked the can" i.e. put off a default, for two years now, dragging its economy into one of the worst Depressions of the last 20 years, while actually *increasing* its debt load (this latest bailout added €130 billion in debt in return for €100 billion in debt forgiveness).

Iceland staged a REAL default, and has returned to growth within 2-3 years. Greece and the Eurozone in general have done everything they can to put off a REAL default with miserable results. I'll let the numbers talk for themselves:

Country	**2011 GDP Growth**	**2012 GDP Growth Forecast**
Iceland	2.9%	2.4%
EU (all 27 countries)	1.5%	0.0%
17 EU countries using Euro	1.4%	-0.3%

* Data from EuroStat

The point I'm trying to make here is that defaults can in fact be positive in the sense that they deleverage the system and set a sound foundation for growth. The short-term pain *is* acute (Iceland saw its economy collapse 6.7% in 2009 when it defaulted). However, a combination of defaulting and debt forgiveness (for households) *can* restructure an economy enough for it to begin growing again.

However, EU leaders refuse to accept this even though the facts are staring them right in the face. The reason is due to one of my old adages: politics drives Europe, NOT economics.

And thanks to the Second Greek Bailout (not to mention the talk of a potential Third Bailout which has already sprung up), we now *know* that EU leaders have chosen to go "all in" on the EU experiment.

Put another way, EU leaders will continue on their current path of more bailouts until one of two things happens:

1) The political consequences of maintaining this strategy outweigh the benefits
2) The European markets force EU leaders' hands (hyper-inflation or widespread defaults and the break up the EU).

Regarding #1, this process is already well underway for those countries needing bailouts. Investors <u>must be aware</u> that the Governments of Ireland, Portugal, Spain, and Italy have all watched/are watching the Greece situation closely.

Moreover we can safely assume that the topic of defaulting vs. asking for bailouts in return for austerity measures has been discussed at the highest levels of these countries' respective Governments (more on this in a moment).

These discussions are also underway at those countries that are providing bailout funds. German politicians have won major political points with German voters for playing hardball with Greece. As I've stated before Germany may in fact be the country that ends up walking if EU continues down its current path of bailout madness.

With that in mind, there are three key political developments coming up.

1) Ireland's upcoming referendum
2) Greece's upcoming election
3) France's upcoming elections (April and May)

Regarding #1, Ireland will be staging a referendum regarding the new fiscal requirements of the EU sometime before October. While the actual date has yet to be set, Ireland will likely stage its referendum *after* the French elections in (April and/or May… more on this in a moment).

Ireland has already staged two referendums which Irish citizens voted *AGAINST* until various concessions were made. This time around the primary concession being discussed is potential debt forgiveness (the country definitely needs it). Indeed, according the Boston Consulting Group, Ireland needs to write-off some €340 billion in debt just to make its debt levels "sustainable."

So Ireland could easily be a wildcard here. The country is already in recession. So we need to monitor developments there as this referendum could go very, very wrong for the EU.

However, the BIG election of note is that of France where the current frontrunners are Nicolas Sarkozy (Angela Merkel's right hand man in trying to take control of the EU) and super-socialist François Hollande.

A few facts about Hollande:

1) He just proposed raising tax rates on high-income earners from 41% to 75%.
2) He wants to lower the retirement age to 60.
3) He completely goes against the recent new EU fiscal requirements Merkel just convinced 17 EU members to agree to and has promised to try and renegotiate them to be looser.

Currently polls have Sarkozy and Hollande securing the top slots in the first round of the election on April 22. This would then lead to a second election in May which

current polls show Hollande winning (this has been the case in all polls for over two months).

However, there's now another leftist wildcard coming into the mix: communist Jean-Luc Mélenchon who is now taking 11% in the polls (he was at 5% last month). And Mélenchon's primary campaign message? **Rejecting austerity measures completely via "civic uprising."**

Now, Mélenchon *could* end up taking votes away from Hollande therby allowing Sarkozy to win. It's difficult to say how this will play out. But if Sarkozy loses to either of these candidates, then the EU in its current form will crumble as Germany loses its principle ally in pushing for fiscal reform and austerity measures.

Finally, let's not forget Greece where politicians are now pushing for an election on April 29 or May 6 (the Second Bailout was passed based on new parliamentary elections being held soon after).

This could be yet another wildcard as it is around the time of the French elections, which Greek politicians will be watching closely. Remember, the key data points regarding Greece's economy:

1) A 20% economic contraction over the last five years
2) Unemployment north of 20% and youth unemployment over 50%
3) Unfunded liabilities equal to 800% of GDP courtesy of an aging population and shrinking working population (which is shrinking all the time as youth leave the country in search of jobs)

These facts will not play out in a victory for "pro-bailout" politicians. So the Greece deal, which is supposed to solve Greece's problems, could actually be in danger based on a change in politics.

Remember, as stated before, politics rule Europe, not economics. And Europe now appears to be shifting towards a more leftist/ anti-austerity measure political environment. If this shift is cemented in the coming Greek, French, and Irish elections/ referendums, then things could get ugly in the Eurozone VERY quickly.

That's the political analysis of Europe. Now let's take a look at what the various EU economies/ markets are telling us.

Spain's current economic condition matches that of Greece… and it hasn't even begun to implement aggressive austerity measures. Unemployment is *already* 20+% *without* any major austerity measures having been put in place.

Anecdotal reports show Spain to be an absolute disaster. Spanish banks GREATLY underplay their exposure to the Spanish housing market ("officially" prices are down 20% but most likely it's a lot more than that).

In simple terms, things are getting worse and worse in Spain… and the market knows it: we've just formed a small triangle pattern on the lower end of a larger triangle pattern:

When this lower trendline breaks all hell will break loose. Why? Because the lower trendline is in fact part of a MASSIVE trendline that goes back 10+ years:

Once this line is broken (likely around May) we're going to shocking lows. Possibly even 4,000 on the $IBEX. We won't get there all at once. But the GREAT COLLAPSE of Europe will have begun.

In the case of Italy, we have a weakening rally coming up against resistance.

The main line to watch here is 11. And when Italy takes out 11, we will trigger one of the largest Head and Shoulders patterns I've ever seen:

The target for this pattern is sub 5.

Even safe-haven Switzerland, which has decided to start playing currency wars with the EU is looking positively *ugly*. Here we're coming up against MAJOR resistance with the making of a massive H&S pattern as well.

And finally France, the alleged second most powerful member of the EU: once again we're coming up on MAJOR resistance and forming an H&S pattern:

These charts are telling us in no uncertain terms that the markets are expecting a truly horrific collapse sometime in the not so distant future. Timing this precisely is difficult but the window between May-June is the most likely time, as it will coincide with:

1) The end of seasonal buying (November-May)
2) The French, Greek, and Irish elections/ referendums all of which could go very wrong for the EU (April-May)
3) The end of the Fed's Operation Twist 2 Program (June).

Now, having said all of this I have to admit I have been *very* early on my call for a Crash. I'm fine with admitting that. Calling a crash is difficult under normal conditions, let alone in a market that is as centrally controlled as this one.

Indeed, going back to March 2009, it is clear that the Fed has been the ONLY prop under the markets as QE 1, QE lite & QE 2, and now Operation Twist 2 have all been announced any time stocks staged a sizable correction (15+%).

In fact, on a weekly chart of the S&P 500 going back four years, we find two items of note:

1) The Fed will only tolerate a 15% drop or so in stocks before it announces a new monetary program:

2) Each successive Fed program has had a smaller and smaller impact on stock prices:

Aside from these monetary interventions, we also have to deal with the Fed's verbal interventions: every time stocks start to break down some Fed official (usually Charles Evans or Bill Dudley) steps forward and promises more easing… or the Fed

releases some statement that it will maintain ZIRP an additional year… and VOOM! stocks are off to the races again.

With that in mind, I will admit I've been caught into believing a Crash was coming several times in the last few years. In some ways I was right: we got sizable corrections of 15+%. But we never got the REAL CRASH I thought we would because the Fed stepped in.

So what makes this time different?

Several items:

1) The Crisis coming from Europe will be far, far larger in scope than anything the Fed has dealt with before.
2) The Fed is now politically toxic and cannot engage in aggressive monetary policy without experiencing severe political backlash (this *is* an election year).
3) The Fed's resources are spent to the point that the only thing the Fed *could* do would be to announce an ENORMOUS monetary program which would cause a Crisis in of itself.

Let me walk through each of these one at a time.

Regarding #1, we have several facts that we need to remember. They are:

1) According to the IMF, European banks as a whole are leveraged at 26 to 1 (this data point is based on reported loans… the real leverage levels are likely much, much higher.) These are a Lehman Brothers leverage levels.

2) The European Banking system is over $46 trillion in size (nearly 3X total EU GDP).

3) The European Central Bank's (ECB) balance sheet is now nearly $4 trillion in size (larger than Germany's economy and roughly 1/3 the size of the ENTIRE EU's GDP). Aside from the inflationary and systemic risks this poses (the ECB is now leveraged at over 36 to 1).

4) Over a quarter of the ECB's balance sheet is PIIGS debt which the ECB will dump any and all losses from onto national Central Banks (read: Germany)

So we're talking about a banking system that is nearly four times that of the US ($46 trillion vs. $12 trillion) with at least twice the amount of leverage (26 to 1 for the EU vs. 13 to 1 for the US), and a Central Bank that has stuffed its balance sheet with loads of garbage debts, giving it a leverage level of 36 to 1.

And all of this is occurring in a region of 17 different countries none of which have a great history of getting along… at a time when old political tensions are rapidly heating up.

As bad as the above points may be, they don't even come close to describing the REAL situation in Europe. Case in point, regarding leverage levels, PIMCO's Co-CIO Mohammad El-Erian (one of the most connected insiders in the financial elite) recently noted that *French banks* (not Greece or Spain) currently have 1-1.5% capital relative to their assets, putting them at leverage levels of nearly 100-to-1.

http://www.marketwatch.com/story/sovereign-debt-spiral-seen-imperiling-europe-2011-09-23?pagenumber=2

And that's *France* we're talking about: one of the alleged key backstops for the EU as a whole.

To be clear, the Fed, indeed, Global Central Banks in general, have never had to deal with a problem the size of the coming EU's Banking Crisis. There are already signs that bank runs are in progress in the PIIGS and now spreading to France (see El-Erian's comments in the article above).

I want to stress all of these facts because I am often labeled as being just "doom and gloom" all the time. But I am not in fact doom and gloom. I am a realist. And EU is a colossal mess beyond the scope of anyone's imagination. The World's Central Banks cannot possibly hope to contain it. They literally have one of two choices:

1) Monetize everything (hyperinflation)
2) Allow the defaults and collapse to happen (mega-deflation)

If they opt for #1, Germany *will* leave the Euro. End of story. So even the initial impact of a massive coordinated effort to monetize debt would be rendered moot as the Euro currency would enter a free-fall, forcing the US dollar sharply higher which in turn would trigger a 2008 type event at the minimum.

Moreover, we need to consider that the Fed is now so politically toxic that Ben Bernanke is literally going on the campaign trail to attempt to convince the American people that the Fed is an honest and helpful organization. Put another way, there is NO CHANCE the Fed can announce a large-scale monetary policy unless a massive Crisis hits and stocks fall *at least 15%.*

Finally, regarding my third point… if the Fed *were* to announce a new policy it would have to be MASSIVE, as in more than $2 trillion in scope. Remember, the $600 billion spent during QE 2 barely bought three months of improved economic data in the US and that was a pre-emptive move by the Fed (the system wasn't collapsing at the time).

So given that the Fed will only be able to announce a large scale program in *reaction* to a Crisis, whatever it *did* announce would have to be ENORMOUS, a kind of shock and awe, attempt to rein in the markets.

Moreover, it would literally be THE LAST QE the Fed could hope to ever announce as political outrage from the ensuing Dollar collapse and inflationary pressures would likely see the open riots and/or the Fed dismantled (this has happened twice before in the US's history).

In simple terms, the Fed's hands are tied until a huge Crisis hits. And then, *if* the Fed acts it's going to have to go "all in" with a massive program. If it does, we will *still* experience a Crisis, as the Dollar would collapse pushing inflation through the roof as well as interest rates (which in turn would destroy the banks as well as the US economy).

In simple terms, this time around, when Europe goes down (and it will) it's going to be bigger than anything we've seen in our lifetimes. And this time around, the world Central Banks are already leveraged to the hilt having spent virtually all of their dry powder propping up the markets for the last four years.

Again, this time it *is* different. I realize most people believe the Fed can just hit "print" and solve everything, but they're wrong. The last time the Fed hit "print" food prices hit records and revolutions began spreading in emerging markets. If the Fed does it again, especially in a more aggressive manner as it would have to, we would indeed enter a dark period in the world and the capital markets.

Country	**GDP**
European Union	**$16 trillion**
United States of America	$14.5 trillion
China	$5.8 trillion
Japan	$5.4 trillion
European Central Bank	**$3.8 trillion**
Germany	$3.2 trillion
US Federal Reserve	**$2.8 trillion**
France	$2.5 trillion
United Kingdom	$2.2 trillion

Banking System	Total Assets	Total Assets Relative to GDP	Total Assets Relative to Central Bank Balance Sheet
Europe	$46 trillion	287%	1,210%
US	$12 trillion	82%	428%

Again, this is not Doom and Gloom, this is *reality*.

Regarding the timing of this and our portoflio, I have been quite early with our European bank shorts. We've doubled down on all of them and still remain in the red. This will not last much longer (at the most two more months). And what's coming will more than make up for our patience. If things play out as I expect, we could see all of these positions in the high double digits before the summer.

These are the best, most easily accessible means of shorting the European banks on an individual basis. If you're uncomfortable shorting individual banks or have difficulty finding a broker than can fill those orders, I suggest shorting the MSCI **Europe Financials Sector Index Fund (EUFN)** which is basically a fund made up of holdings in various EU banks (including the ones we're shorting individually).

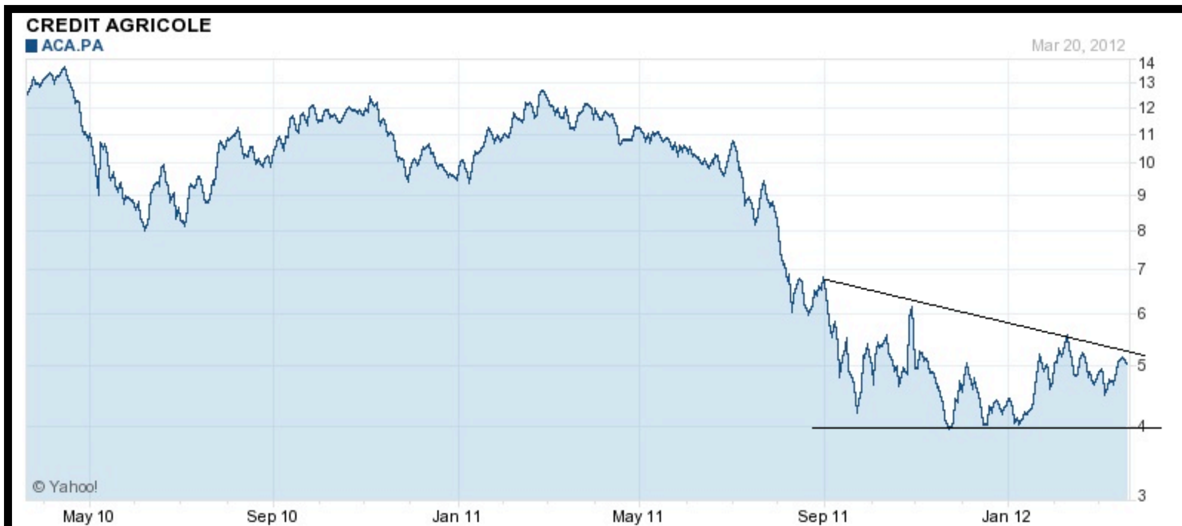
The technical set-up for this trade is good today as well: we're likely going to 16 if not new lows in the coming weeks.

Action to Take: Short the Europe Financials Sector Index Fund (EUFN).

If you're an international investor or an US-based investors who can short pink sheet stocks, you might also consider shorting the French banks whether it be BNP Paribas:

You could also try Societe General:

Or the ugliest of the big French banks, Credit Agricole:



I'm adding all of these to our current Deflation portfolio, though I know not everyone will be able to participate in them.

In conclusion, I will admit that my predictions of a Crash over the last three years have been wrong, as any market collapse has been thwarted thanks to Central Bank intervention. However, the coming Crisis in Europe is going to be unlike anything we've seen in our lifetimes. It will be both larger in scope than 2008 AND it will occur at a time when both the ECB and US Federal Reserve have already used up all their ammunition.

Put another way, *this time it IS different.*

We now have a confluence of seasonal, fundamental, technical, and political factors all pointing to a Crisis hitting the Eurozone sometime between May and June. Consider everything we've done so far this year to be in preparation for this.

I'm watching the markets closely and will issue updates as needed. But I am now more convinced than ever that we are heading into a storm that will make 2008 look easy by comparison. For

Good Investing!

Graham Summers

Investment Watchlist: Trades we've yet to open.

UltraShort Emerging Markets ETF	EEV
UltraShort Brazil ETF	BZQ
UltraShort Russell 2000	TWM
UltraShort Nasdaq	QQQ
UltraShort Real Estate	SRS
UltraShort Financial	SKF
Apple (short)	AAPL
National Bank of Greece (short)	NBG

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	$1,651.00	47%
Silver bullion	N/A	3/17/10	$17.50	$32.18	84%
Centamin Mining	CEE.TO	5/25/11	$2.01	$1.21	-40%

Deflation Portfolio (OPEN BUYS NOW)					
Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Dollar ETF	UUP	5/23/11	$21.79	$22.11	1%
Rydex Strengthening Dollar 2x Strategy	RYSDX	12/14/11	$14.39	$13.69	-5%
UltraShort Euro	EUO	9/21/11	$19.13	$19.34	-2%
UltraShort China	FXP	11/2/11	$32.64	$25.13	-10%
UltraShort Materials	SMN	11/2/11	$20.23	$14.81	-15%
Deutsche Bank* (short)	DB	12/14/11	$35.33	$50.92	-22%
Santander* (short)	STD	12/14/11	$7.11	$8.16	-6%
HSBC* (short)	HBC	12/14/11	$37.07	$44.87	-11%
Barclays* (short)	BCS	12/14/11	$10.65	$15.59	-21%
UltraShort Gold ETF	GLL	12/14/11	$19.76	$17.25	-13%
BNP Paribas (SHORT)	**BNPQY. PK**	**3/21/12**	**$24.99**	**SHORT!**	
Societe General (Short)	**SCGLY. PK**	**3/21/12**	**$6.34**	**SHORT!**	
Credit Agricole (Short)	**CRARY. PK**	**3/21/12**	**$3.27**	**SHORT!**	
MSCI Euro Financial Fund (SHORT)	**EUFN**	**3/21/12**	**$18.37**	**SHORT!**	

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

RECENTLY CLOSED POSITIONS

Company	**Symbol**	**Buy Date**	**Buy Price**	**Current Price**	**Gain/ Loss**
Ultrashort Silver	ZSL	3/6/12	$10.27	$10.75	5%