



**EXCELSIA**<sup>®</sup>  
Investment Advisors

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"Success is relative. It is what we can make of the mess we have made of things."

T.S. Eliot

The Eurozone could certainly be referred to as a mess. This weekend, the Greeks and private investors are re-negotiating the 50% voluntary "haircuts" agreed to in October. The main sticking point is related to the coupon payment, which is expected to be around 4%. The Germans and IMF are pushing for an even lower rate in an effort to bring the Greek debt-to-GDP ratio down to 120% by 2020 (never mind that Italy is currently at these levels). The consequences of a failure to agree to terms could induce a disorderly exit for Greece from the euro and trigger payments for credit default swap (CDS) contracts. The latter could lead to trouble for the already fragile European banks that sold the CDS insurance contracts.

The more important implication of these negotiations is that the rules of investing in sovereign, risk-free debt has materially changed. When the euro began its existence in 1999, it was considered to be a riskless investment. As such, banks were not required to reserve capital against this risk-free investment. A pension fund or insurance company could safely invest their capital against future liabilities with the knowledge that a sovereign country would not default on their debt. Today, however, we have Greece and perhaps others, who are in serious danger of default. The current negotiations the Greeks are having with private investors regarding voluntary "haircuts" exclude the ECB, IMF and other public institutions. Consequently, private investors must now accept the fact they purchased a security with credit risk and was not compensated accordingly. Rest assured Mr. Market will not forget these series of events.

The ECB intervened in December offering unlimited access to funds for European banks. The move was critical as a freeze-up of inter-bank lending would be disastrous. The banks have borrowed nearly half a trillion euros through this program and currently have the funds on deposit **with the ECB**, as banks do not have confidence in each other, nor are they are willing to risk the capital through lending. Again, we have the can being kicked down the road.

The fiscal discipline that will be required of periphery countries to remain in the euro area will greatly inhibit any chance of growth and recovery. The weaker countries are overloaded with debt and run trade deficits with their stronger northern neighbors. As part of the euro currency, they have lost their independence to be able to print money, depreciate their currency and reduce the value of their debt through rising inflation. The only solution if they remain in the Eurozone is to become more competitive through increased productivity and significant cuts to salaries, benefits, retirement and other social welfare programs. Despite the dire consequences of inaction, the political will remains absent in these countries to make these difficult changes. The politicians may realize what needs to be done, but they also realize it is political suicide to actually implement the tough changes.

In the US, we continue to deal with political paralysis, which will continue until after the November election. Fourth quarter earnings reports have begun with 77 companies from the S&P 500 having reported. The equal-weighted increase has been 1%, with the market-cap weighted increase at 5%. If financials are excluded, the equal-weighted increase has been 7.4%, with the market-cap weighted increase at 9.7%. The results reflect a drag from financials and relatively stronger earnings from larger, multi-national companies.

Next week, there are a number of economic reports that are listed in the attached chart. The economic activity has been better overall than expected. The Fed meets Tuesday and Wednesday and Chairman Bernanke is expected to reveal a new protocol for sharing information with increased transparency. It remains to be seen if or when the Fed will announce a new round of quantitative easing, or QE3. The economic results and the favorable start this year in the stock market may be keeping the Fed on hold for now. I believe a program that would allow homeowners the ability to take large capital losses on their homes would have a greater impact than the continued manipulation of interest rates. Mortgage rates are not the issue. The banks are not lending and many people are weary of trying to “catch a falling knife” (ie, no confidence of when housing prices will stabilize). A favorable tax treatment for losses and a program to flush out the foreclosure pipeline is needed for the reset button to be pushed. Until the inventory is moved, a recovery in housing will continue to be a drag on economic growth.

Please let us know if you have any questions.

All the best,

Troy

## Economic Data – Week of January 23, 2012

Date Time	Event		Survey	Actual	Prior	Revised
01/24/2012 10:00	Richmond Fed Manufact. Index	JAN	7	--	3	--
01/24/2012 21:00	2012 State of the Union Address					
01/25/2012 07:00	MBA Mortgage Applications	20-Jan	--	--	23.10%	--
01/25/2012 10:00	House Price Index MoM	NOV	0.10%	--	-0.20%	--
01/25/2012 10:00	Pending Home Sales MoM	DEC	-1.00%	--	7.30%	--
01/25/2012 10:00	Pending Home Sales YoY	DEC	--	--	6.90%	--
01/25/2012 12:30	FOMC Rate Decision	25-Jan	0.25%	--	0.25%	--
01/26/2012 08:30	Chicago Fed Nat Activity Index	DEC	-0.1	--	-0.37	--
01/26/2012 08:30	Durable Goods Orders	DEC	2.20%	--	3.80%	3.70%
01/26/2012 08:30	Durables Ex Transportation	DEC	0.90%	--	0.30%	--
01/26/2012 08:30	Cap Goods Orders Nondef Ex Air	DEC	0.90%	--	-1.20%	--
01/26/2012 08:30	Cap Goods Ship Nondef Ex Air	DEC	0.60%	--	-1.00%	--
01/26/2012 08:30	Initial Jobless Claims	21-Jan	370K	--	--	352K
01/26/2012 08:30	Continuing Claims	14-Jan	3500K	--	--	--
01/26/2012 09:45	Bloomberg Consumer Comfort	22-Jan	--	--	-47.4	--
01/26/2012 10:00	Revisions: Leading Indicators					
01/26/2012 10:00	Leading Indicators	DEC	0.70%	--	0.50%	--
01/26/2012 10:00	New Home Sales MoM	DEC	1.60%	--	1.60%	--
01/26/2012 10:00	New Home Sales	DEC	320K	--	315K	--
01/26/2012 11:00	Kansas City Fed Manf. Activity	JAN	--	--	-4	--
01/27/2012 08:30	GDP QoQ (Annualized)	4Q A	3.00%	--	1.80%	--
01/27/2012 08:30	GDP Price Index	4Q A	1.90%	--	2.60%	--
01/27/2012 08:30	Core PCE QoQ	4Q A	0.90%	--	2.10%	--
01/27/2012 08:30	Personal Consumption	4Q A	2.40%	--	1.70%	--
01/27/2012 09:55	U. of Michigan Confidence	JAN F	74	--	74	--

**Source: Bloomberg**

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