THE OMNIVEST MARKET VIEW

Tom Sowanick
Co-President
Chief Investment Officer
tom@omnivestgrp.com
Tel: +1 609 921 7939

Eleni Athanatos
eleni@omnivestgrp.com
Tel: +1 609 986 1001

Europe Needs to Adopt a Form of QE2

July 12, 2011

The sooner the ECB announces that they will adopt a sovereign buy-back program to offset speculative selling pressures, the sooner global financial markets can get back to the business of allocating capital. And while we know that buying bonds ala our own QE2 program is no panacea, it has provided much needed air cover to allow Washington to finally address a plan to both reduce our national debt load, while at the same time pass policies to increase government revenues.

The current environment in Europe is more akin to a three ring circus, where the audience is in a prolonged period of suspense of anticipating the next act while watching the conclusion of the current act. In real terms, this means that as Greece is reaching the completion of a financial aid package, investors begin to focus on Italy or Spain or Ireland - as the next circus act.

Certainly, the debate will rage on as to whether QE2 in the US was beneficial to the economy and thereby throw into question why the ECB would even engage in such activity without a clear previous precedent of success. Whatever investors think regarding its overall success or failure, QE2 has actually been very successful in allowing the US to borrow in the Treasury market (an incremental $1 trillion) without pushing Treasury yields punishingly higher. QE2 has allowed the US to escape the financial pressures which are usually associated with the ills suffered from “crowding out” which is when too many borrowers overwhelm willing lenders.

Should the ECB engage in purchasing all sovereign European credits, without respect to credit quality (say for the next 12 months) and state so publicly, it would put an immediate end to bond hooligan activity. Such action would push yields significantly lower for those countries considered to be at risk. However temporary this action may be, it would clearly lend a very large hand to those in need.

Unfortunately, Europe is not the only region that has needed and will continue to need some form of aid (whether financial, institutional or fiscal) to work through its problems. In fact, nearly every developed region around the world is suffering from the same fiscal imbalances as Greece. Japan has been able to sidestep their bountiful deficit /GDP funk because their bond market is mostly closed to foreign investors. Europe does not have Japan’s luxury because its debt is owned across many borders and by many financial institutions. The US may yet prove to be the greatest risk country to global financial and economic stability, as it may need to recognize that having the world’s largest and most liquid bond market also means that the US is the world’s largest debtor nation with a very global diversified investor base.

In short, we should let the ECB get to its other important job (other than tackling inflation); to maintain financial market stability.