THE OMNIVEST MARKET VIEW

Investments

Tom Sowanick

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

Can it Happen Here?

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Greek interest rates have soared in the past week as concerns have risen about the viability of the combined financial rescue program between the EU and the IMF. Two-year Greek yields have moved from 4.42% on March 26th to 6.40% and 10-year yields have risen from 6.19% to 7.14% as of this morning. The real reason market yields have risen so sharply is that Greece relies on external financing to fund its deficit, which is currently estimated to be 175% of GDP.

By way of comparison, Japan's public debt is 192% of GDP, of which only 6% is financed with external funds. With so little debt financed externally, the Japanese government has nearly complete control over its interest rates. Conversely, Greece has to rely on external investors trusting their credit quality and financial resolve. As a result Japanese 10-year yields are only 1.38% while Greece must pay 7% for ten-year financing.

In the US, our external debt as a percent of GDP is a striking 96% and will likely continue to grow as US investors look for higher returns outside of the US or simply move away from low yielding Treasury debt.

The gentle tiptoeing around the decision to publicly label China a "currency manipulator" relates directly to its ownership of $755.8 billon of US government debt. China is the next-to-largest owner of US debt, second only to Japan with a record $768.8 billion. It is no wonder that Treasury Secretary Geithner has delayed the timing of this important decision.

Heavy reliance on external funding for public finances is a very dangerous proposition. It is important that US investors and government officials listen to what the markets are saying about Greece and develop a bit of humility about our own weakening financial condition. Two-year yields at 1.14% are not indicative of a country with a deficit at 10% of GDP and external debt at 96% of GDP. Any other country with these financial characteristics would suffer from credit rating downgrades. Investors would demand significantly higher risk premiums to continue to supply funds to such a larger debtor nation. The argument that it could never happen here because the US has the world's largest and most liquid bond market is nearly laughable. The US did not become the largest debtor nation merely to provide investment instruments to global investors. We became the world's largest debtor because Congress could not make difficult decisions about cutting wasteful spending.

It is also very risky for US investors to look at "how strong the US dollar is against the euro" without looking at how weak the dollar is against most other currencies. A broad-based weakening of the dollar away from the euro should serve as a warning regarding our dependence on foreign capital inflows.

Moreover, yields are rising for the US relative to Canada, Brazil, Mexico, France, Germany and the UK with little impact on supporting the US dollar. Perceptions about the stability of US credit quality maybe shifting as US yields rise relative to our trading partners.

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