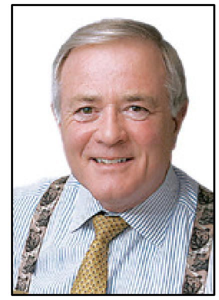
DJC
THE DAILY JOURNAL OF COMMERCE, PORTLAND, OREGON



William Rutherford

Stocks surge on hopes of resolution of Europe debt issues

Published December 12, 2011

As officials continue to struggle to save the European Union, save the euro and resolve sovereign and bank debt issues, global leaders are making concessions.

The long simmering sovereign debt crisis in Europe has brought the EU to the verge of breakup. Some analysts have been predicating its demise in the very near future. Meanwhile, the fate of the euro also hangs in the balance.

Both of these matters threaten the stability of Europe, politically and financially. European leaders have long struggled to find a solution, but without success. The problem is difficult because all member states must agree to any proposed solution.

Germany and France have emerged as the dominant voices of the struggle, but even French sovereign debt is under siege. Other peripheral, AAA-rated European countries have found their debt under attack, S&P has warned them all. Clearly an answer is needed.

A European summit was scheduled for Dec. 9. In the days leading up to the meeting, some developments have occurred and some concessions have been made.

Angela Merkel, the German chancellor, wants tougher rules written into the treaties governing the European Union. However obtaining these consents will be a long process that may last years. Nicolas Sarkozy, the French president, although generally supportive, has reservations. One wonders how the treaties could be amended without the common effort of the French and Germans.

Others want the European Central Bank to back up European banks and sovereign states. But the ECB has maintained that this is beyond the mandate of the ECB. Anyway, the Germans do not support this notion, because they know they will be the ultimate backstop. Additionally, a recent auction of German bonds failed to draw enough bids and interest rates rose, so one wonders how strong the German is backing anyway.

However, since Merkel has called for stiffer rules, Mario Draghi, recently installed as ECB president, hinted that if the treaty states adopted new, stringent, rules the ECB might be counted on for support. It is not clear how that would happen without a change in the ECB's charter, which could take time.

In the meantime the International Monetary Fund indicates that it might be counted on for support. The IMF, of course, gets its money from member states, so this brings in other global sovereigns. Thus, the IMF goes hat in hand to Brazil for money, even as the IMF is itself in the process of lending to Brazil.

Also, the IMF might bring in China, which is all too happy to play a role to obtain more leverage and power in the west. But the Chinese find the timing inconvenient, which may only mean that they want a better deal. And France is going to former colonies to borrow. The world is turned upside down.

The U.S. has not been idle. Leading from behind, President Obama has said that the resolution of the European crisis was hugely important for the U.S., but the American ambassador to the EU stressed that the U.S. was not making a financial commitment, or increasing its commitment to the IMF. Obama also met with European labor leaders in a show of support.

As these developments progressed, the market experienced its best week in years. The rally began when the U.S. Federal Reserve and other central banks acted in concert to both lower interest rates on currency swap arrangements, and to increase the dollars available in the currency swap facility.

Neither of these actions addressed the European problems directly; however, they did enhance liquidity, which was essential because of the refusal of U.S. investors to lend to foreign banks and governments. This refusal had caused an acute shortage of dollars in the world, and made it much more difficult for the world economy to function.

The expanded facility makes it easier for central banks to obtain U.S. dollars, which of course will find their way into the various economies. It will expand the U.S. Federal Reserve's balance sheet even further, and could even be seen as a form of quantitative easing because the swap facility will make interbank and other lending easier. Many of the dollars will find their way back to the U.S.

Much rests on what comes out of the Dec. 9 meeting. U.S. markets have rallied sharply on the promise of progress on European debt, but Europe has disappointed many times during this crisis. These actions may turn out to be nothing more than a prelude to a false dawn.

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