CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

March 4, 2012

Europe: Calm Now…
...Social Unrest Lies Beneath

The ECB's Long-Term Refinancing Operation, truly enormous in its scope, has effectively removed risk of a banking crisis for the present. This safer environment has permitted European policy makers to proceed with their actions to mitigate the sovereign debt crisis.

Unfortunately, the approach is flawed economically, by imposing austerity when growth is needed, and procedurally, by its undemocratic imposition important matters on Greece and other countries by heads of governments of other European countries, especially Germany.

Social unrest, anger with Germany, strikes and riots will punctuate 2012.

By

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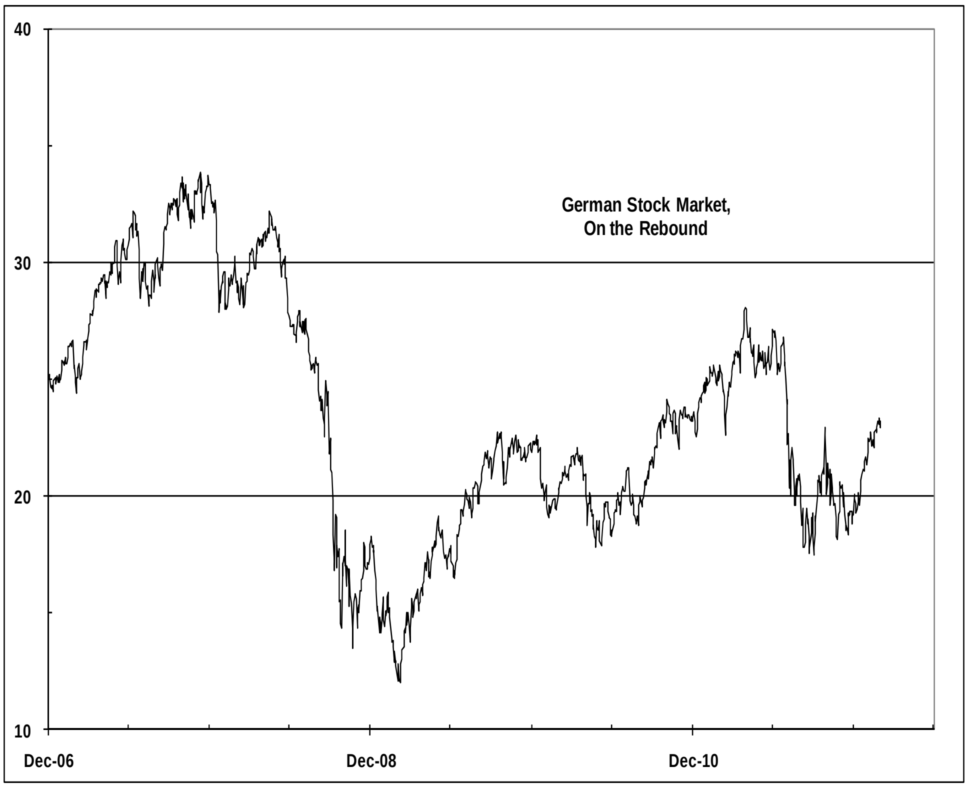
It is beyond question that the massive low-interest loan program by the European Central Bank (ECB), exceeding €1 trillion, to hundreds of European banks has essentially eliminated the risk of a banking crisis in Europe--at least for the time being. From the brink of catastrophic crisis in November and December, calm has been restored, permitting policy makers in Germany, the European Union (EU), the International Monetary Fund (IMF) to fashion their new arrangements to lend to Greece. This, in turn, has--at least for the time being--removed the risk of a disorderly default by Greece on its sovereign debt. This is all for the better. These conditions have permitted Core to invest more in growth-oriented assets and to cut our positions in the most risk-averse assets.

The European crisis is by no means over; two key matters loom ominously. Firstly, Germany (and the EU and IMF) have imposed a regime of fiscal austerity--cuts in government spending and increases in taxes--as the means of resolving the debt crisis. It is abundantly clear already that this austerity is causing the economies of the highly-indebted countries to shrink. Austerity worsens the indebtedness of the countries; growth is needed. The most recent example is offered by Spain. Despite adhering to the EU-imposed scheme, its deficit in 2011 was higher than agreed to and it projects worse for 2012. Unemployment in Spain exceeds 20% and is nearly 50% for young people. As a result of the almost-certain economic contraction that flows from austerity, Greece and Portugal will need new rounds of loans. Spain's worsening recession suggests that it may also find itself in the bailout queue. Today's calm and confidence will give way to further bouts--minor or major--of anxiety.

The second matter concerns the anti-democratic process by which the radical regimes are being imposed on the indebted countries. Since the austerity measures are rightly seen by citizens as cutting their living standards, and because the austere conditions are, for practical purposes, imposed by Germany and its allies, the Netherlands and Finland, people are becoming increasingly restive about giving up to Germany fundamental decisions about taxation and government spending. There have been periodic riots in a number of countries over the last two years. The anti-democratic nature of the decision-making process and the increasingly straitened conditions of the so-called 'peripheral' countries make it very likely that more and worse social unrest lies ahead. The democratic fabric in Europe is being abraded. This is not a good thing.

Core's investments. Since the first round of the ECB's bank financing at the end of December and as fears of a Lehman-like banking crisis have receded, *We recently invested in German and Swedish stocks. A chart of Germany's stock market is shown below. Both countries' markets fell sharply in 2011 as the Eurozone crisis worsened. Despite our expectation for weakness in its economy, the German stock market should continue to rebound from the lows of late last year.*

Core has made a series of investments in equities. A goodly portion of these are in American stocks. The economy here, and especially the labor market, has been improving. Moreover the United States is not engaging in drastic contractionary austerity programs as are the Europeans and the British. We have invested also in German and Swedish equities, despite the situation there. European stock markets generally fell very sharply as the crisis worsened last year, far more than US markets. Even though economic growth in these countries will probably be weaker than in the US this year, their stock markets are likely to rebound well from the deep selling in 2011. We may add other equity positions in the weeks ahead, but we are mindful that risk from the Euro-zone crisis is still with us. Although we have reduced the positions, we still retain our ultra-cautious 'safe-haven' investments in the Japanese yen, the US dollar and long-term US treasuries. For our Capital Preservation portfolios that hold no equities, we added positions in high-yield US corporate bonds and mortgage-backed securities, positions that will benefit from the better economic environment.



Housekeeping matters. Certain of the investments Core has made in recent years have been in securities that are required to report investment income to investors on Forms K-1. Most of you will have received one or more of these in this tax-reporting season for 2011. There is no investment significance to this form of legal organization of the underlying security that gives rise to the tax requirement to report income on Form K-1. Most securities in which we invest report dividend and/or interest income on Forms 1099. The K-1s include an explanation of where on tax returns the various entries go. This is simply one more demonstration of the complexity of America's taxation system.

Remember that we can provide concise and accurate information for your tax returns about realized capital gains and losses. Simply call or email us if you require this or other tax information.

Also recall that Schwab offers extremely low transaction fees (commissions) for accounts that elect to receive reports electronically rather than by regular mail. In general, the difference is between $20 per trade for paper confirmations and monthly statements as against $9 per trade if one elects the so-called eConfirm approach. Under Schwab's rules, we cannot make this election for you, but we can walk you through the fairly simple process. The cost savings are substantial; we urge you to take advantage of eConfirms if you have not yet done so. Call us if you wish to set up eConfirms or if you have questions about this. Note that we can readily print and mail to you any monthly statements from Schwab you may need, in case things should go astray on your computer system.

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