

# Global Financials Update

January 20, 2012

## Global Market Update

The S&P 500 index rose again this week (+1.7%), bringing the return up to +4.6% for the first three weeks of the year. After suffering sharp losses in 2011, financial stocks have led the rally with many of last year's worst performing stocks enjoying big gains. Bank of America, which lost 58% last year, is up over 24% to start the year. Financial stocks have moved higher as economic data continues to point to moderate economic growth and the situation in Europe potentially stabilizes. A number of S&P 500 companies have begun announcing fourth quarter earnings and the results have been mixed so far. Most of the large U.S. banks reported positive earnings this past week, which helped boost stock returns.

Stocks in Europe have also rallied to start the New Year and hit a five month high this week. The Stoxx Europe 600 Index is up +5.6% already in 2012, its best start since 1987. Greek and European officials met with private creditors this week in order to negotiate the terms of a debt swap, which would effectively exchange the existing bonds for new securities and include a significant write-down in value. Greek officials have threatened to default on a March bond payment if an agreement is not reached in the near-term. European leaders involved in the negotiations expect a deal to be reached in the next few days. In addition to the Greek talks, economic data remains weak, leading to speculation that the ECB may reduce interest rates even further. Expectations of additional stimulus in the U.S. and possibly China have also helped fuel the rally in global stocks.

## Industry Developments

- Nine Euro zone countries were downgraded by S&P last weekend, with France and Austria losing their AAA credit ratings. Other countries that were downgraded include Italy, Spain, Portugal, Cyprus, Malta, Slovakia, and Slovenia. Importantly, Portugal was cut to non-investment grade or junk status and only Germany maintains a stable outlook and AAA rating (several others have a AAA rating).
- S&P downgraded the European bailout fund (EFSF) on January 16, dropping its AAA credit rating one notch to AA+. The fund went ahead with a bond offering the day after the downgrade and enjoyed strong investor demand, indicating that the move would have little initial impact on yields or investor confidence.
- Reports indicate that the IMF is seeking to raise an additional \$600 billion to have available to aid future financing needs of struggling European countries. The IMF currently has capacity to lend approximately \$380 billion, but would like to have close to \$1 trillion available based on their estimates of potential needs.
- As the European Central Bank, European Union, and Greece seek to negotiate a deal with private bond holders, it has been reported that a group of hedge funds that collectively own more than \$200 billion in Greek debt are fighting for a better deal. Private investors in Greek bonds were initially expected to take a 50% write down based on earlier agreements, but sources have said the Greek government is now pushing for a 75% write down and have threatened to default on a March bond payment if an agreement is not reached.

## Global Economic Data

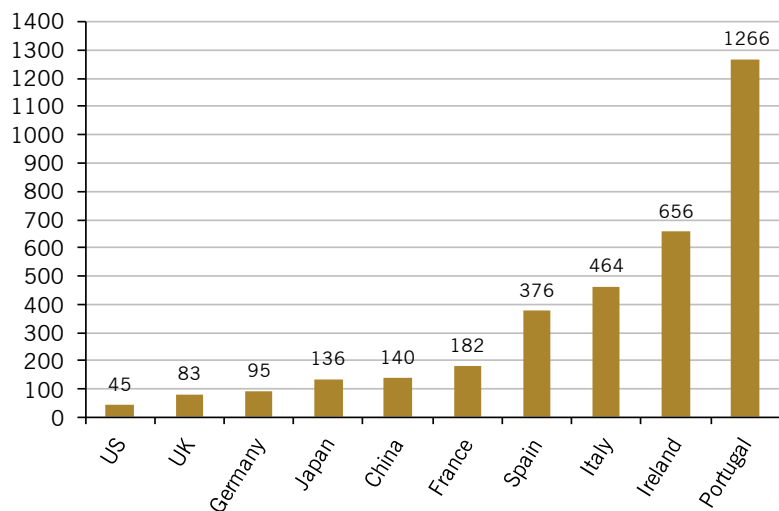
- German GDP fell by 0.25% during Q4 (quarter-over-quarter) highlighting concerns over economic conditions in Europe. German economists also cut 2012 forecasted economic growth to 0.75%, well below 2011's 3.0% growth rate.
- January 17: Chinese economy grew at 8.9% in Q4, slightly better than consensus expectations of 8.7%. Slowing in the real estate and export sectors led to a decline in the growth rate, which was as high as 10.4% in 2010. Investors are hoping that China will implement new stimulus measures to stem the slowdown in growth.
- January 18: U.S. December Industrial Production gained 0.4% for the month after falling in November. Most notably, the manufacturing component improved 0.9%.
- January 20: Existing home sales in the U.S. rose 5% in December, increasing for the third straight month. The level of homes on the market has fallen to 2.4 million, which is the lowest since March 2005.

## Bank CDS & Sovereign CDS

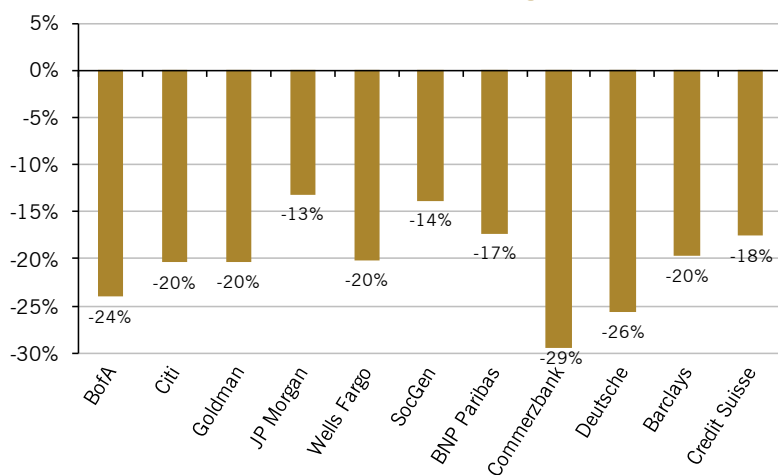
The data below shows CDS pricing for U.S. banks, European banks, and various countries. CDS pricing not only accounts for the chance of technical default, but also for a hyperinflationary revaluation of the currency. As a result, many believe this makes CDS spreads a more accurate indication of the real risk in government bond markets. CDS pricing is quoted in basis points and refers to the annual payment required to insure a specific amount of debt. For example, 50 bps equates to a \$50,000 per year payment to insure \$10 million of debt.

- Pricing on sovereign CDS has dropped notably in January as the situation in Europe continued to work toward a resolution. Portugal was the sole outlier of the countries tracked on the graph with its price rising as its debt was cut to non-investment grade or junk status.
- Bank CDS has dropped even more sharply in January on the more positive outlook for the European sovereign situation coupled with generally positive earnings reports that are showing signs of stabilization. The drop in U.S. and European bank CDS pricing was broad with CDS pricing on all of the banks tracked on the graph falling between 13% and 29% during the first 20 days of January.

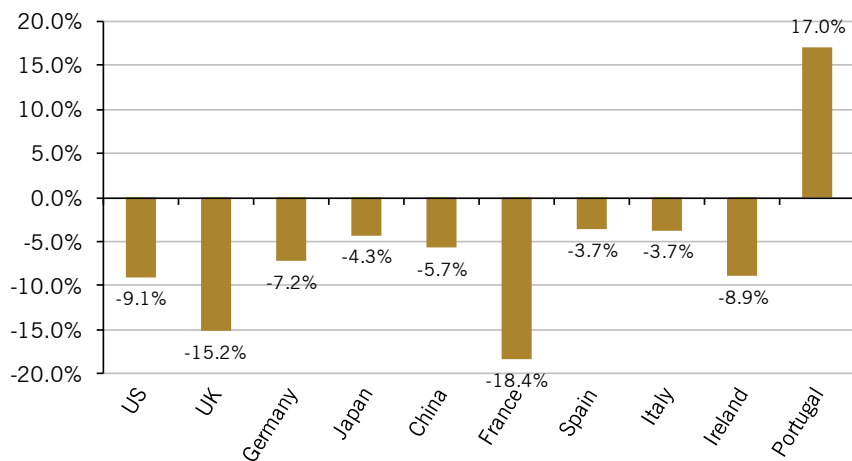
Current CDS Prices - Sovereigns



YTD CDS Price Changes - Banks



YTD CDS Price Changes - Sovereigns

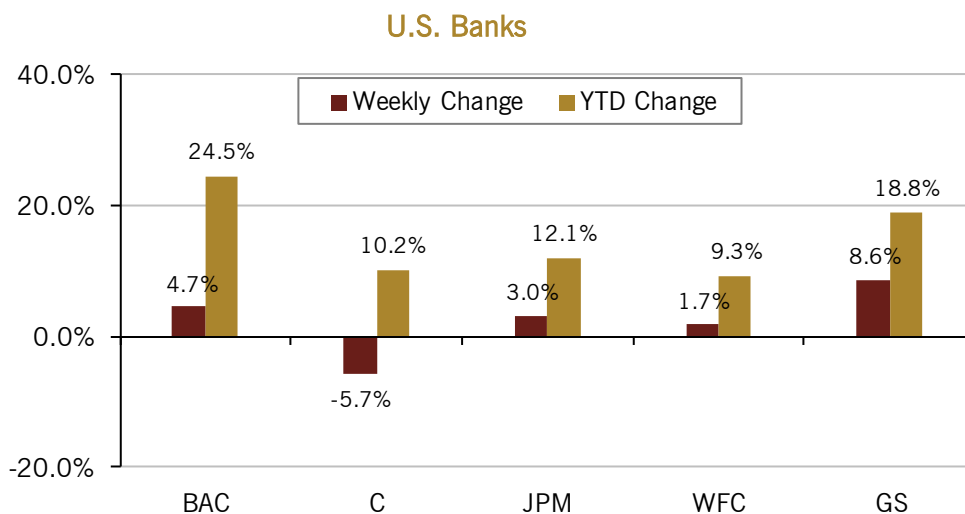


Source: Bloomberg

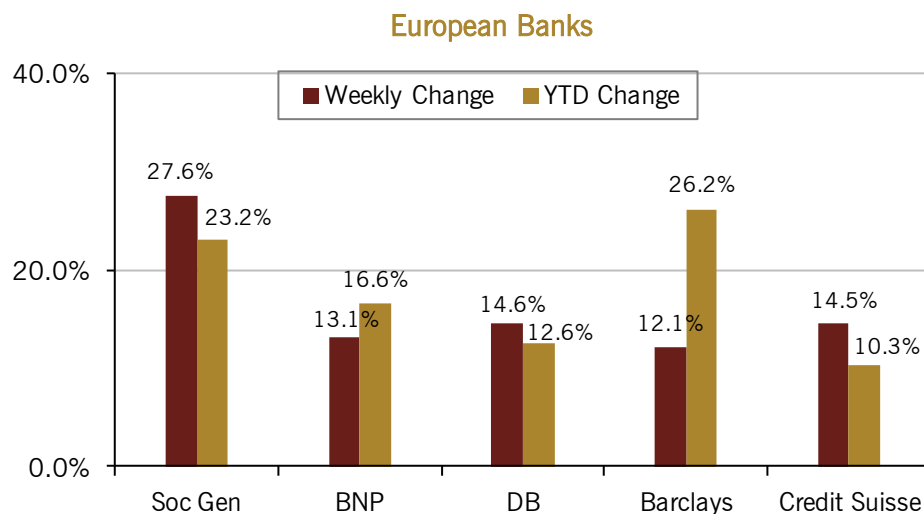
## Equity Market Performance

Bank stocks in both the U.S. and Europe have rallied strongly to start the year on European optimism and hopes for additional easing in the U.S., Europe, and China.

- In Europe, bank stocks rose significantly in the past week as Greece worked to finalize a debt swap with private investors in order to avoid a near term default. In addition, weak economic data and deflationary pressures have opened the door for the ECB to lower interest rates benefitting banks.
- Most large U.S. banks announced Q4 earnings this past week with fairly weak results leading to a large divergence in weekly returns. Year-to-date returns remain strong as financial stocks have led the S&P 500 Index higher to over the first three weeks of the year.



Source: Bloomberg



Source: Bloomberg

## Bank Lending

- U.S. Dollar LIBOR fell slightly over the last few weeks but remains much higher than just three months ago. Meanwhile, Euro LIBOR rates have fallen significantly in 2012 as fears in Europe have moderated in recent weeks.
- U.S. bank lending activity, both on the consumer and commercial sides, has increased nearly 1% over the past three months. Banks have also slightly increased their cash holdings over the past week.

Bank Lending / Assets					
	Weekly Change (%)	Change (%) 3 mo		Current	3 months Ago
Commercial and Industrial Loans	0.2%	0.9%	USD 3-mo LIBOR interest rate	0.56%	0.29%
Consumer Loans	-0.2%	0.6%	EUR 3-mo LIBOR interest rate	1.13%	1.50%
Interbank Loans	-0.1%	-9.2%			
Cash Assets	0.4%	-5.3%			

Source: Federal Reserve

## Disclosure

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