

Hello CFG clients . . . Brian here. This past week saw several events unfold that follow-up on my last email ***Greece Can Not Help But Have An Impact On You And Me!***

First, on Tuesday (04/27), analysts at Standard & Poor's downgraded Greece's sovereign debt to junk status. What this means, in a nutshell, is that not only will the country itself have a hard time issuing new debt, but Greek banks will have a hard time raising money from the European Central Bank using Greece government debt as collateral. As a result, the yields on 2-year Greece bonds last Tuesday hit an intra-day high of 21%. Think about that for a moment . . . investors are requiring a 21% return for investing in the country of Greece. This puts a spotlight on how dire the Greece situation is.

Later on Tuesday, Standard & Poor's downgraded Portugal's debt two notches. Investors did not see this downgrade coming, and as a result markets plunged around the world with the Dow shedding over 200 points.

Then on Wednesday (04/28), Standard & Poor's downgraded Spain's debt a notch from AA+ to AA. While not as dire as a drop to junk status, these downgrades on 3 European countries set the tone that they must get their financial house in order.

If you'll recall, my 02/08 email was when I first addressed the Greece situation as a financial sickness that has the potential to spread like a flu bug . . . well, you're witnessing the beginning of a European financial contagion that has the potential to spread around the world. Italy and Ireland are the next countries on the verge of catching the "bug" and then . . . well, let me point to the article below that helps put it all in perspective.

The Dominos Are Lining Up for a Sovereign Debt Crisis!

by [Bryan Rich](#)

Boy, what a week! I've been warning about a troubled euro and a building sovereign debt crisis for some time. And the bond and currency market activities this past week are a clear example that the momentum is picking up.

There's a bumpy road ahead ... and not just for Greece.

For those of you who aren't closely monitoring this drama in Europe, you should be. As I've explained in recent *Money and Markets* columns, the events in Greece will likely impact your investments and the economy, both in the U.S. and abroad.

And if you haven't followed the events of the past five days, here's a brief recap of what's transpired, the impact on global financial markets, and what to expect from here on out ...

First, the Greek government's official request for a rescue package from its European partners and the IMF did *not* calm fears. Instead, the Greek bond market shifted into another gear of panic. Investors and speculators rushed out of Greek debt, driving up two-year borrowing costs for the Greek government to over 18 percent.

But that wasn't all. The contagion factor started rearing its head.

The grim outlook for Greece sent investors and speculators looking at the next likely victim, Portugal. And Portugal's debt was aggressively sold, sending yields jumping to more than three times the levels of early last month.

And downgrades soon followed. S&P downgraded Portugal's credit rating two notches and downgraded Greece by three notches, to junk status.

There was more ...

With the Portugal domino starting to wobble, the biggest, most threatening weak spot in the euro zone, Spain, came under the spotlight. As a result Spanish bonds were dumped, and S&P responded in kind, with a downgrade on Spain and warnings of possible further downgrades.

All of this sent the euro tumbling further, and sent shockwaves through global financial markets.

This is a scenario I've expected to unfold since Dubai failed to make good on their sovereign debt last year.

And these recent events in Europe are just a few more steps in what will likely be early innings of a full blown global sovereign debt crisis.

For those who have convinced themselves that a V-shaped economic recovery is underway, and that the problems in Europe will stay in Europe, they should be very careful.

Here's why ...

The Global Picture

This most recent recession shares two key features found in three other recessions in the past fifty years:

- 1. Global synchronization* — According to the IMF, at the trough of the recent recession a whopping 65 percent of world economies were in a recession, too.
- 2. Financial crisis* — In recessions associated with a financial crisis, the recoveries were slower because households are in saving mode, credit is tight and demand is weak.

And based on the IMF's study of 122 recessions, for recessions that coincide with financial crisis **recoveries tend to be slower**. In fact, advanced economies should expect 5+ years of weak economic activity.

It all boils down then to knowing where the global economy stands after emerging from the most severe economic downturn since the Great Depression. For that answer, let's look at:

The Four Stages of Collateral Damage of Past Financial Crises

Stage #1—Deficits ...

When tax revenues decline and government stimulus spending rises, countries tend to swiftly turn budget surpluses into deficits. And for countries already running deficits, the deficits just get bigger.

Stage #2—Debt ...

Facing weak growth and dwindling tax revenues, those deficits turn into debt. Soaring debt with questionable growth prospects ultimately flash warning signals to global investors.

Stage #3—Downgrades ...

Those warning signals turn into credit downgrades.

Stage #4—Default ...

And finally, credit downgrades tend to drive borrowing costs higher, which can force the fiscally fragile into default.

History also shows that sovereign debt defaults can be contagious.

Whether or not Greece receives funds from its European partners, the structural hurdles facing Greece put a default scenario squarely on the table.

Perhaps that's why the head of the IMF planted the seed last week, noting his plans to discuss a debt restructuring with Greece as part of the Greek rescue agenda.

Nonetheless, the dominos for a sovereign debt crisis are clearly in line.

As fears over deficits and debt continue to spread, expect the problems in Europe to test the lifespan of the euro, and ultimately present challenges to global financial markets and global economic recovery as fears spread to the UK, Japan and the U.S.



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