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Investment Digest

Worries Abound: Greece, Holiday Spending and the Fiscal Cliff

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Germany's election cycle may be giving Greece extra time, suggests Richard Cookson in *Market Insights* (October 5, 2012). Cookson heads Citi Private Bank's Global Investment Committee, whose views guide the asset allocation used by many managed accounts at Citi Personal Wealth Management. "The softening of the German government toward Greece appears to have more to do with Germany's election cycle than to any well-thought-out economic strategy," he says. Cookson notes that Germany will have federal elections within a year and "Chancellor Angela Merkel presumably thinks that a Greek exit and default would do little for her party's election chances because of the potential economic carnage." But any effort to delay a Greek exit "weakens donor countries' negotiating positions with Spain and Italy, since those countries can take comfort from the treatment—or lack of it—meted out to Greece."

Corporate bond issuers continue to benefit from low interest rates, Michael Brandes observes in *Bond Market Monthly* (October 4, 2012). Companies are refinancing maturing debt at attractive rates, while increasing liquidity and strengthening balance sheets. "Many companies are also hoarding cash given heightened uncertainties and weakening growth prospects," he adds. "Many of these issuers appear well-positioned should an event that disrupts capital markets occur." Within corporate bonds, Brandes notes that global high-yield debt has returned 9.1% so far this year. "There have been only two other periods since 2000 that high grade corporate debt markets posted higher returns during the first three quarters of the year (11% and 15% in 2001 and 2009, respectively)," he writes. "In our view, this year's gains are much more impressive than prior episodes since U.S. Treasury and German Bunds yields are substantially lower today."

Some of the employment sectors hit hardest by the recession are healing, Robert DiClemente notes in *U.S. Economics Weekly: Market and Policy Comments* (October 5, 2012). "Employment in distressed sectors is steadying and upward revisions have preserved prevailing payroll gains averaging near 150,000," he says. "Both job growth and smoothed changes in the labor force show modest acceleration in the past year." State and local governments have provided one area of possible improvement. "Over the past several months we have been monitoring increases in job postings among state and local governments as well as dwindling announcements of job cuts in the sector," he writes. "These trends now are showing up in the payroll data, where employment has steadied. Outright gains in local government jobs over the summer may have been exaggerated by seasonal factors, but the larger story may be that the downtrend is ending."

Concerns over the "fiscal cliff" could slow consumer spending, Steven Wieting says in *Morning Comments* (October 8, 2012). He believes that a major test will come later this year. "In considering fiscal cliff impact before 2012 is out, we would note the critical period in December," he writes. "The public has become accustomed to high drama and last-minute fiscal deals. If a hard deal is struck to mitigate the fiscal cliff, it should likely be expected in late December." Wieting points out that retail sales are brisk in the final two weeks of the year, particularly the days just before Christmas. "While 'no deal' before key members of Congress leave for the holidays would not preclude a deal under pressure before the year is out, it is conceivable that news flow around the cliff issue and consumer concerns would be heavily weighted to that critical period for spending," he warns.

Going over the "fiscal cliff" may pull more taxpayers into the AMT, George Friedlander says in *Municipal Market Comment* (October 5, 2012). Each year, Congress has limited the number of taxpayers who pay the Alternative Minimum Tax, or AMT, by indexing the exemption from the AMT, a mechanism known as the "AMT patch." This mechanism has kept the number who pay the AMT at around four million. If the patch is not extended, Friedlander expects those affected to reach over 30 million. Some investors, who own private activity municipal bonds that are subject to the AMT, would be better off selling them and replacing them with non-AMT munis. "The good news is that, in the view of our economists, the problems associated with not dealing with the fiscal cliff are probably so onerous as to induce a divided Congress to deal with this problem," Friedlander notes. "Nevertheless, holders of AMT paper, in particular, need to be aware of the potential risks, should a comprehensive solution to the fiscal cliff not be enacted."

There's both good news and bad news for global stocks, Hasan Tevfik and colleagues write in *Global Equity Outlook 4Q 2012* (October 10, 2012). "The bad news for global equities is that profits are slowing around the world and EPS (earnings per share) expectations need to be cut further, in our view. The current downgrade cycle is not over," he says. "The good news is that equity valuations remain cheap and central banks are prepared to embark on additional easing." Tevfik notes that global stocks advanced 6% in the third quarter and are back to their highs for the year. "Citi Equity Strategists believe the combination of even easier central bank policy and cheap valuation should ensure global markets rally a further 9% to the end of 2013," he writes. "However, the global corporate earnings cycle is clearly rolling over and is not helped by a slowing world economy."

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