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May 6, 2010

## Is Greece Lehman Brothers II?

*The Endless Greek Crisis*

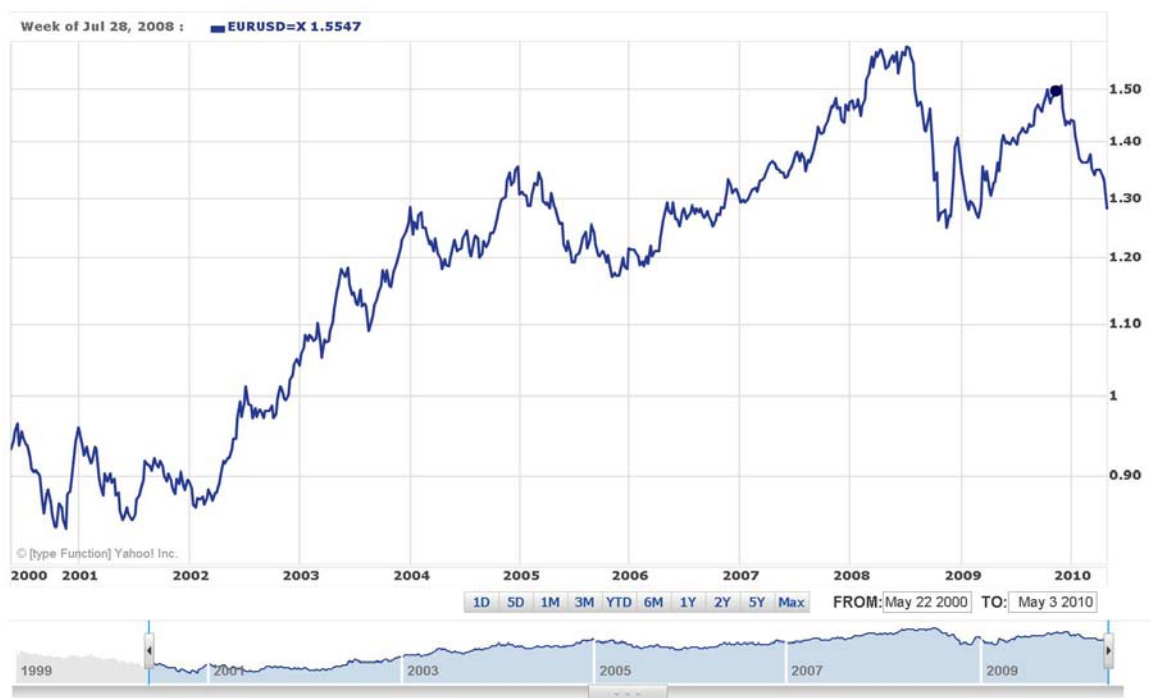
Markets around the world rioted today as Europe dithers about what to do with dodgy loans made to Greece and the rest of Club Med (Portugal, Spain, and Italy).

Throughout this crisis we have been leaning heavily on our international research sources, Bank Credit Analyst in Montreal, and GaveKal Research in Hong Kong. Both have been saying that while the crisis is real, it is not a replay of Lehman Brothers and so we should not expect a market meltdown like we saw in 2008.

It felt a lot like 2008 this afternoon, but corrections of 10% or more are part of stock investing and at this point we are down 7% from the April top.

Also, there is a way out for Europe if someone would make a decision instead of sitting around the table playing economic chicken with each other.

### A Round Trip to a \$1.00 Euro?



Here's what we hear from BCA and GaveKal: The most likely solution to the Club Med debt problem is for the Euro to drop even more than it has already. How does this help? When nations owe more than they can repay, the currency markets take down the value of the currency to the point where the debt becomes manageable and attractive to cash rich buyers.

If southern Europe owes 1.5 trillion Euros, that debt burden can be reduced by allowing the value of the Euro to fall against the dollar and maybe more importantly, the Chinese Yuan. Then banks and investors from the US and Asia can buy the European bonds at a lower price (in dollars).

No one knows how low the Euro needs to go to entice bond buyers from outside Europe to buy. We're guessing \$1.00 since it's a round number, but all we really know is that \$1.26 for the Euro is too high.

The other way out is for Greece and others to leave the Euro and go back to the Drachma, Peseta, and Lira. We actually think this will happen eventually, but it cannot happen fast enough to end the current crisis.

The end will come when the European Central Bank agrees to buy Club Med bonds with rubber checks---while this sounds shocking, it is what central banks do. This would be similar to what our Federal Reserve did in early 2009, when it began buying mortgage backed bonds in this country. That operation is finished and contributed to the successful stabilization of markets in 2009.

The ECB has it within its power to end this crisis, but it must act.

### **Should we act?**

For us the question is simple---should we cut back on stocks or continue with our strategy of investing in a US/Asia recovery? Here's what we are hearing from those research sources we respect:

While painful in the short-term, long-term investors should stay invested and be looking for opportunities to buy. This is also the view of the one highly technical service we use, Lowry Research. Just this morning they wrote: "While the market does appear to be vulnerable to a further correction, all of our indicators suggest the primary uptrend remains intact."

So back to the question in our headline: Is Greece Lehman Brothers II?

Here's why the answer is "No."

- Much less leverage in the system. Everyone from Hedge Funds to formerly indebted individuals have pulled back and are busy paying down debt, rather than looking to refi. Corporations were cash rich in 2008 and are only more so now.
- US and Asian banks don't own Club Med government bonds. In 2008 US Mortgage bonds were held by European banks---the disease spread quickly.
- The biggest hit this time will be European banks (again) and the European Central Bank has shown that it will do just about anything to prevent those banks from failing, unlike what we did with Lehman.

One last point: This isn't the first time nations have defaulted on their sovereign debt. Twenty years ago it was northern Europe, not the south, that was in trouble. From Ireland to Sweden, governments tightened their belts, currencies fell in value and a fresh start was made possible.

Thirty years ago it was South America. That time our banks owned the debt. Remember "Brady Bonds"? Those bonds bailed out our banks and then Latin America took a huge

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step backward. The table below shows what happened to our stock market in the six years it took for 16 countries to default---as you can see, stock investors did well.

| Year | Defaults  | S&P 500 Annual Return |
|------|---|-----------------------|
| 1980 | Bolivia, Nicaragua  | 32.42%                |
| 1981 | Honduras  | -4.91%                |
| 1982 | Argentina, Dominican Republic, Ecuador, Mexico, Panama, Venezuela | 21.41%                |
| 1983 | Brazil, Chile, Costa Rica, Peru, Uruguay                          | 22.51%                |
| 1984 | Cuba  | 6.27%                 |
| 1986 | Paraguay  | 18.47%                |

Countries that did not default include: Colombia, El Salvador, and Guatemala

Ten years ago we suffered through the Asian currency crisis--again, not a good time to sell stock.

We do not want clients to think we are complacent. Anyone who lived through 2008 cannot take days like this lightly. But we do have significant resources to help us through this and we will continue to listen to their advice, pass it on to you, and in the end act as we must to preserve and grow client capital with a long-term perspective.

Best regards,



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PS We are reluctant to comment on what appears to be major trading errors that obviously made today's market much worse. If we have more to add on this issue once the facts are known, we'll send something out.

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5/6/2010

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