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### THE EURO

As I write this, expectations of continued growth in the global financial markets, if not the global economy, have been deeply damaged by a meltdown in the Greek economy. Essentially, the Greek government practiced intentionally bogus accounting, and is now facing more of a debt burden than it can realistically afford.

What this means for us is that our holdings are down in general, albeit not by much. In fact, relative to the S&P 500 Index, we are looking great. As of May 10<sup>th</sup>, 2010, the S&P 500 was essentially unchanged year-to-date. The high mark so far this year was up about 6%. Now that is all gone, but the gains from last year's recovery remain intact. Our Andresen & Associates accounts are averaging a few percentage points better than that.

In the international sector, our mutual funds are diversified and are relatively low risk, by design. Asset allocators such as First Eagle are approximately at break-even for the year. Due to managers' skills, our Templeton Global Bond fund is up over 4% for the year. Kudos to that management team!

Our hardest hit fund currently is Harbor International, down about 10%. We rebalanced this five-star fund substantially in late 2009 and early 2010. It has brought year after year of outperformance to us. Given the track record, it will likely provide a venue for bargain hunting.

More importantly, however, the Greek debacle is an example that what we DON'T know now can become very important later. You may remember that in early 2008, when the dollar was plunging, various misinformed pundits opined that the euro should replace the dollar as the global currency. That was seriously discussed then. Given our recent experiences, it is now vastly less likely.

**GRAPH 1** depicts the world's debt hangover as a percentage of each individual nation's economic output. As you can see, due to the global real estate bubble and lush social programs, the debt burdens of European countries are some of the worst. Inevitably, working off this debt and paying it down will shape the nature of the coming decade.

Working off debt takes time in the best of circumstances. These are not the best of circumstances.

The governments of nations that are awakening to the reality of past over-spending have several choices. First, they can do nothing and continue to pay large entitlements to citizens. That will result in repeated Greek-style financial meltdowns, higher interest rates, and eventually ongoing economic stagnation.

Countries with an independent currency could stall increasing debt and gradually inflate the debt down as a proportion of economic production. That would mean higher interest rates and slower economies. Since many of the countries in Europe embrace the euro as the national currency, they can't choose this path since there is no real central bank for the euro, beyond the bank in Germany.

As Germany is compelled to bail out its spendthrift smaller euro-siblings, we are likely to see more of what we have recently witnessed: German taxpayers will shoulder the bailout burden in the short run, to save their own economy. German voters will also thrash politicians who repeat this behavior, and thus Germany may leave the euro in three to five years. The result may be a "euro-light" wherein only spendthrift, smaller economies remain, priced like the Mexican peso: badly.

**GRAPH 2** depicts the euro versus the dollar. As you can see, the euro markdown is underway. What happens next depends on what euro governments decide.

Governments can't raise taxes without creating capital flight and dampening their economies. The only long term solution seems to be the least palatable politically: governments must choose to cut back spending. But this is very painful: European government spending includes ample health care and retirement benefits. Curbing these will be the un-anaesthetized tooth extractions of government. In the short and mid terms, for the next decade, decisions to reduce spending will increase social unrest globally, and dampen consumer spending as well. Beyond that, reduced debt globally will result in a more robust global economic future.

The bottom line is that without any unexpected inputs, the next decade is likely to be a challenge, politically and economically. What this model DOES NOT include is the prospect of new technology increasing productivity and wealth. This is quite possible. We don't know what will happen, but given what we DO know, prudence is attractive.

Our plan is to gently search for bargains, possibly through small purchases of funds such as Harbor International. A

global economy which goes sideways for ten years will contain within it many bargains, and very good returns are still quite possible. We just need to hire good pickers, not index funds.

We're going to stay conservative in terms of bond selection and duration, since credit quality remains suspect.

Most of all, we're going to stay diversified and stay the course. It's our kind of market environment after all. ■

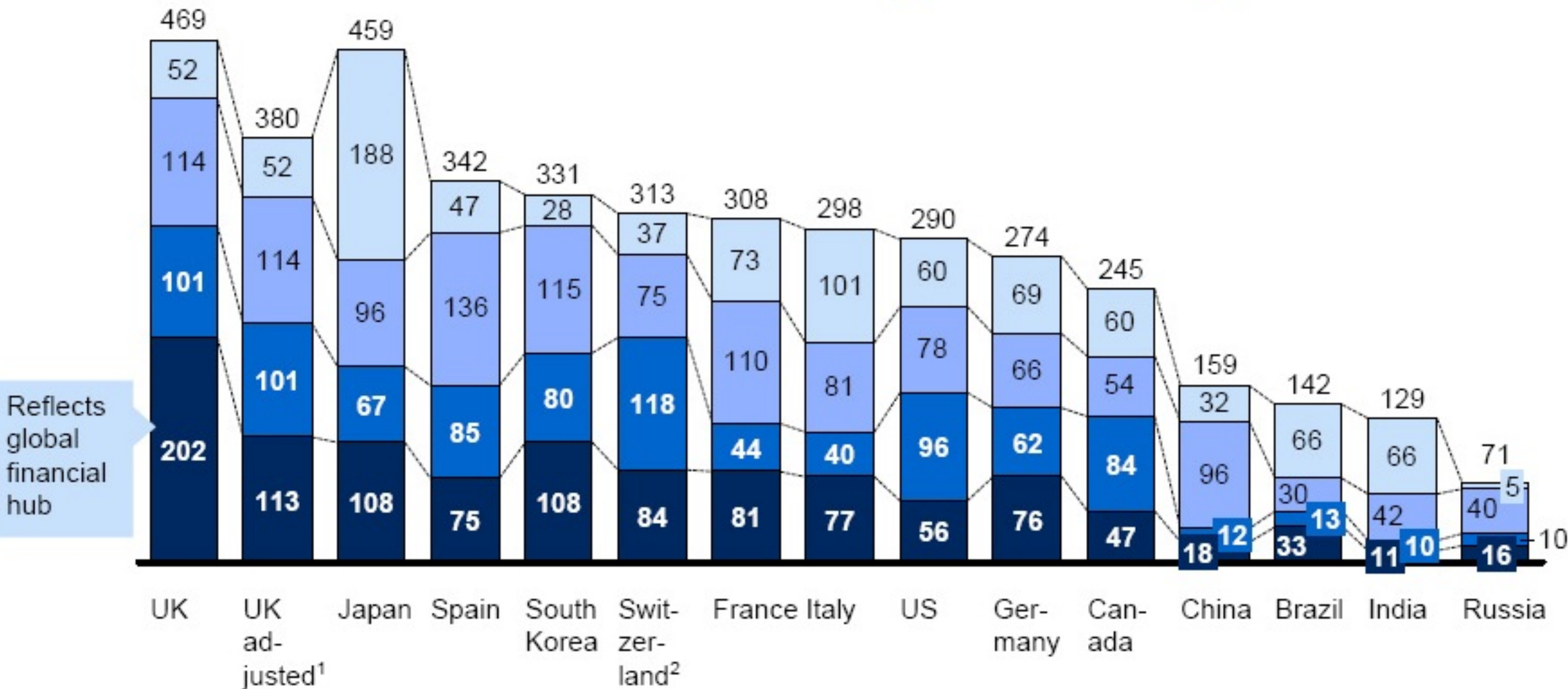
<b>05/11/2010</b>	<b>Value</b>	<b>YTD %</b>
Dow	10748	3.1%
Van 500 Index	106.65	4.3%
Van Total Bond Index	10.52	3.0%

# The sectoral composition of debt differs across economies

Debt by country, 2008  
% of GDP

GRAPH 1 (SOURCE-- HAVER ANALYTICS; MCKINSEY GLOBAL INSTITUTE)

- Government
- Households
- Nonfinancial business
- Financial institutions



## Compound annual growth rate of debt in local currency, %

2000-08	10.2	0.3	14.5	10.8	4.5	7.7	6.3	8.1	2.5	6.1	15.1	15.1	16.5	31.6
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<sup>1</sup> The UK financial sector was adjusted to reflect its position as a financial hub. See the technical appendix for details.

<sup>2</sup> Data for Switzerland represent year-end 2007.

## GRAPH 2

U.S. / Euro Foreign Exchange Rate (DEXUSEU)  
Source: Board of Governors of the Federal Reserve System



Shaded areas indicate US recessions.  
2010 research.stlouisfed.org