IdahoTrust

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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

Is Greece the Achilles' heel of the European Union? The global financial crisis has brought to light some of the fundamental problems within the European Union. Developed market growth has slowed and some countries are approaching stalling speed. Emerging markets are dealing with the rapidly changing global economic landscape. Perhaps most importantly, European leaders are now starting to develop a cohesive plan to resolve the debt crisis.

The European Union and the Euro

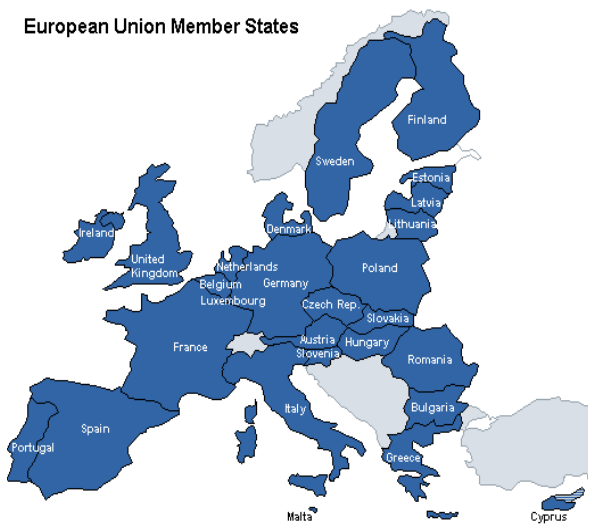
In 1993 the European Union was formed. The Union was designed to enhance political and economic integration within Europe. Today there are 27 member countries in the European Union; of which, 17 have elected to use the euro rather than their own currency. The euro was introduced in 1999 and circulated as a physical currency in 2002.

Economically the formation of the European Union has been a success. A shared currency and ease of transportation of goods and services has aided Europe's ability to compete with the US in terms of wealth, power and influence. In fact, since the euro's inception in 1999 it has strengthened Europe's presence in the global economy and rivaled the US dollar in international markets.

If the euro has been such a success why is it now causing problems? The global financial crisis has brought to the forefront some of the problems that the European Union has had from its inception. The European Union and the creation of the euro united countries economically but did so without sufficiently coordinating fiscal and budgetary policies. One problem is that countries that use the euro are now married to the economic policy of the entire European Union and lack control to stimulate or slow down their own economies. By yoking economies together that are moving at different speeds individual countries have lost some control over their economies, and the fiscal requirements that have been in place to regulate member countries have not been adequate.

Greece and other countries have generously helped themselves to the debt markets of the European Union. Debt levels have ballooned and these countries are now struggling to meet their obligations with the prospect of rising financing costs. Greece and Italy are carrying debt levels of 143% and 119% of their respective GDPs.

This level of debt causes the more fiscally disciplined countries like Germany to cover the bill of other countries' indulgence and public support to do so is dwindling. Public support has and will come into play with key votes to expand the European Financial Stability Fund (EFSF), of which Germany is responsible for one quarter, and implement new austerity packages. The plan now is to expand the funds available to indebted countries and to put into place a system of firewalls and bank recapitalizations to ensure that the crisis does not spread to other larger European countries such as Italy and Spain.



Developed Markets

The outlook for developed markets largely rests upon the outlook in Europe. The situation in Europe is rapidly changing which makes forecasting difficult. Some developed countries started the year with expanding economies only to see them slow and possibly contract by year-end. Given the magnitude of the global economic slowdown it appears that Europe is headed for another recession.

Germany, whose economy was growing at 4.6% in the first quarter of this year, could end the year with a contracting economy. Germany's GDP has grown generously since recovering from the global financial crisis but has slowed because of the European debt crisis, declining consumer sentiment and weakening industrial production.

Japan has continued on the road of recovery after the March Tohoku earthquake and tsunami. Manufacturing orders are on the rise and auto producers and exporters have remedied the supply chain disruptions caused by the earthquake. In April, passenger car production in Japan was down 60% from the previous year. By July, production was only down by 8% over the previous year which shows significant progress. Two major

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LifeNeeds™ wealth management accounts feature optimized asset allocations, robust security screening and Idaho Trust's unique TacticLogic™ investment process. All of which are tailored to our client's unique financial needs.

factors continue to weigh on the economy which already had its fair share of struggles before the earthquake. First, the nuclear disaster at the Fukushima Daiichi power plant has caused rolling power outages to the Tokyo area. These energy shortages continue to hinder the economy. Second, the Japanese yen has risen in relation to the euro and US dollar, adversely affecting the competitiveness of struggling Japanese exporters. The Bank of Japan, Japan's central bank, has taken measures to lower the yen's exchange rate three times in the past year with little lasting effect.

The United Kingdom, as with most of Europe, appears to be close to another recession. Declining quarterly GDP figures are getting dangerously close to zero and contraction. The Bank of England, The United Kingdom's central bank, is preparing for the resumption of their quantitative easing program. The Bank of England conducted a successful first round of quantitative easing and the hope is for similar results to keep borrowing costs for businesses low and spur the flagging economy. However, additional quantitative easing measures may put additional inflationary pressures on the UK's already above-target level of inflation.

Emerging Markets

Emerging countries are still attempting to slow their overheated economies since the global financial crisis. The majority of emerging economies continue to slow themselves by contracting their monetary policy. Now, faced with a global slowdown these economies may be better served by loosening their monetary policy to proactively spur growth. Only Israel, Brazil and Thailand have been observed taking moves to stimulate their economies given the slowdown.

China, which has had extraordinary growth coming out of the global financial crisis, is now faced with an economic slowdown. The slowdown, inflationary pressures and a possible real estate bubble are currently weighing heavily on investors' minds. To complicate matters, the United States Congress is now considering a bill that would label China as a currency manipulator and subject it to countervailing duties that could spark a trade war with China at a time of economic frailty. Congress has accused China of keeping its currency undervalued. Looking at the exchange rates, we see that the yuan has actually appreciated against the US dollar. Congress believes that the yuan, at its current level, is still undervalued given its underlying fundamentals.

Conclusion

European leaders are now putting together viable solutions to deal with the European debt crisis and pushing for more fiscal reform. This has been a welcomed development from the market's perspective which has been waiting for European leaders to develop a contingency plan for Greece, to stem the threat of contagion and make progress to expand the size and scope of the EFSF. Meanwhile other countries remain vulnerable, namely, Italy and Spain. As German Chancellor, Angela Merkel, alluded any conclusion to the deleveraging of Europe is sure to be a long and difficult process.

S&P 500 Index

3 Month	-2.48%
Year-to-Date	1.28%
1 Year	8.07%
3 Year	11.41%
5 Year	0.25%

Int'l Developed Markets

3 Month	-9.68%
Year-to-Date	-6.36%
1 Year	-3.58%
3 Year	10.50%
5 Year	-1.86%

Int'l Emerging Markets

3 Month	-11.91%
Year-to-Date	-11.54%
1 Year	-7.71%
3 Year	23.36%
5 Year	6.61%

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