



## Gimme shelter

*That's the battle cry as investors get rocked by one debt crisis after the next*

July 29, 2011 – Two weeks ago Italy and its sovereign debt woes were the sauce that coated over all other investment issues, and gold was the main beneficiary. Ultimately, though, the Italian job was accomplished, and last week the Greece fire and its sovereign debt problems burned out all other investor concerns, and gold hit another new all-time high.

By the end of last week, however, a Greek tragedy was averted, and that left the field clear for this week's main focus, the U.S. and its debt dilemma. Amid the turmoil, gold hit yet another record.

On the face of it, the problem is a simple one. The U.S. federal government is prohibited by legislation of borrowing more than \$14.3 trillion. That debt ceiling will be hit by Tuesday August 2. If the Congress and the Senate don't agree to raise the limit by that time, a number of dire consequences may result.

For one, social security cheques to millions of seniors won't be sent out, immediately affecting some of the most vulnerable members of its society, and an age demographic that is known for high voter turnout at the polls come election time.

For another, Moody's Investor Services would most certainly lower the Fed's coveted Aaa credit rating, an endorsement it has enjoyed since 1917. That would result in more than just billions in higher interest costs on federal debt. It would affect many other rates, such as mortgages and corporate borrowing costs, that are keyed off the federal benchmark.

Moody's already has the rating under review, and has telegraphed that it may drop the rating to Aa even in absence of a technical default, citing the mere obstinacy of lawmakers leading up to the deadline. The agency has also hinted that if the rating is lowered in the event of a real default, it may not raise it back to Aaa any time soon after the default is papered over with new money. (Moody's recently cut Greece's debt rating by three notches.)

The roadblock to a deal is similarly straight forward. Republicans want any increase in the ceiling to be matched dollar for dollar with spending cuts. Democrats agree that some cost cutting is in order, but insist on tax increases as part of the solution. Republicans are dead set against the latter.

The consequences of not raising the ceiling on time – and its credit status is already being repriced in the bond markets – are so extreme that it's difficult to conceive that some kind of compromise won't be reached in time.

But that hasn't stopped the markets for preparing for that scenario just in case. The S&P 500 is heading for its third straight monthly loss, the longest since 2008. Crude oil has fallen to \$95.70 this week from \$99.87 last week as traders anticipate lower demand, not just by more-impooverished family drivers, but also by factories and airlines as the economy adjusts to suddenly higher interest costs.

Canadian banks raised three times as much cash this month as the normally do, positioning themselves to potentially capitalize on loan demands that the U.S. banks would not be able to satisfy. The greenback posted its third consecutive weekly loss this week; it's likely to fall regardless of the outcome of the debt talks.

And gold, the epitome of a safe haven in troubled times – it's mobile, sensitive, scarce, tangible and universally recognized – hit another record, with gold futures touching \$1,637.50 for gold's biggest monthly gain since November 2009, as the U.S. government played chicken with itself. The yellow metal was also assisted by a late-week report that U.S. GDP underperformed a previous forecast for the second quarter. Gold is up 15% this year, and on track for an eleventh consecutive annual gain.

Investors with 'gimme shelter' on their minds continued to flock like geese to Canada as well. The Canadian dollar slipped by 0.66% this week to \$1.047 from \$1.054, ending four previous weeks of gains, but the Loonie remains one of the best among the 16 most-traded currencies this month, as expectations mount here for interest rate increases. Thirty-year Canada bond yields fell to 3.291% this week from 3.393% last week on rising demand.

Canadian equities, however, fared about as poorly as their American counterparts this week, especially after Canada's GDP was shown to have shrunk 0.3% in May, the largest drop in two years. The S&P/TSX Composite Index fell 4.07% on the week, with all 13 of its sector indexes closing in the red, while the Dow Jones Industrial Average declined 4.24%. The S&P 500 slipped by 3.92%, and the Nasdaq Composite fell 3.58% on the week.

In July, the TSX fell a net 2.67%; it's now down 3.70% so far this year, while the Dow is up 4.89%; the S&P by 2.75% and the Nasdaq by 3.90%. A Canadian investor would subtract 4.18% from those latter three numbers – the amount the Loonie has risen this year – to calculate those returns in domestic terms.

Looking around the rest of the world this week, or at least the 21 most developed equity markets on the planet, investors fared about the same as in North America. Only two of those markets – Mexico's Bolsa and Singapore's STI – showed gains, of 0.68% and 0.20% respectively; the other 19 all lost money. The worst-performing was Paris' CAC 40, down 4.24% on the week.<sup>n</sup>

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