

Pacific Asset Management Group



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**Greece and the Financial Markets**

Despite persistent signs of improvement in the U.S. economy and a flurry of recent better-than-expected corporate earnings reports, stocks have retraced three months of gains as fears over Greece's debt woes have cast a shadow over the financial markets. From a 10,000 foot view, a general economic recovery appears to be underway with growth waxing not waning across many parts of the globe. The chart below illustrates this point with nine of the top twelve world economies posting positive percentage gains over the same period last year.

Country	GDP/\$	GDP % +/-	Country	GDP/\$	GDP%+/-
Greece	342.2 Billion	-2.3%	United States	14.43 Trillion	+2.5%
Portugal	222.4 Billion	+1.7%	Japan	5.10 Trillion	+1.2%
Spain	1.466 Trillion	-1.3%	China	4.81 Trillion	+11.9%
Italy	2.11 Trillion	+6%	Canada	1.33 Trillion	-1.2%
France	2.66 Trillion	+1.2%	Russia	1.23 Trillion	+4.5%
Germany	3.27 Trillion	+1.7%	Brazil	1.4 Trillion	+4.3%
U.K.	2.22 Trillion	-3%	India	1.09 Trillion	+6.0%
European Union	16.18 Trillion		World Est.	58.07 Trillion	

(Source 5/15/09 Economist Magazine and CIA 2009 World Fact Book)

The situation in Europe is unsettling for two reasons; it comes on the heels of the 2008 meltdown in the economy and seemingly has once again caught the markets by surprise. The fact is, the crisis has been brewing for years and like rubbish or rocks that can only be seen when the tide goes out, has become apparent after the last recession and exposes some serious flaws in the Federalist system that cobbles together the European Union (EU). Here's the Cliff Note version of what we're facing. Since joining the EU, many countries, especially those in the less economically competitive Mediterranean region (Portugal, Greece, Spain and Italy) have amassed an increasingly uncomfortable amount of government debt. In Greece's case, foreign borrowing was used to fund excessive amounts of military expenditures to counter threats from Turkey and a civil employment system that due to the country's lack of industry, natural resources and a small agricultural base employs around one out of every three working people. After a series of violent protests, holders of Greek debt have become increasingly concerned that the country's government won't have the stomach to confront the problem and would instead default on its IOUs and leave investors holding the bag as Russia did in 1998 and Argentina in 2001. Facing another "to big to fail" situation and in an effort to prevent the crisis from spreading, the European Central Bank and the International Monetary Fund, last week took a play out of the Federal

**About:**

**Pacific Asset Management Group**

*We are registered investment advisors headquartered in the San Francisco-Silicon Valley, Bay Area. Pacific Asset Management Group develops and manages portfolios for individuals, trusts, estates, and retirement funds. Each portfolio is positioned to take into consideration our clients current needs, long-term goals, risk profile and other more personal issues including economic and social values. Our ongoing reviews and personal meetings help us to make adjustments and take advantage of trends in the financial markets while at the same time striving to keep our clients on a steady, long-term course towards their goals.*

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Reserve’s 2008 playbook and among other measures offered Greece about three years worth of funding in return for harsh budget cuts. It’s hoped these actions will buy enough time to bring the debt situation to manageable levels and allow emerging recoveries across Europe to improve to the point they can absorb the shock if Greece does in fact default in the future.

Assuming the intervention by the EU leaders to lend close to \$1 Trillion stabilizes the crisis and prevents it from spreading we believe the Euro zone could experience a slight reduction in economic activity due primarily to contractive effects of reduced government spending and widespread austerity measures. Investors should not expect an immediate end to the uncertainty. The EU is a federation of countries without strong leadership and any bailout will take time to become fully operational. If member countries are going to underwrite each other’s debts they will want more say in each other’s fiscal affairs and the task of creating a set of sanctions for misbehavior and rewards for good behavior will be messy and likely keep the markets on edge.

We believe there two aspects of this crisis that are being under reported. First, if Greece does re-enter a recession it’s unlikely to derail the burgeoning global recovery. The simple reason, Greece’s economy as measured by gross national product (GDP) is only slightly less than Massachusetts and makes up about 2% of the overall European Union’s economy. (see chart on page 1). Second, market growth during a recovery period is often tentative in the early years and gains momentum as economic signals become less mixed. For example after the last six recessions stocks often surged from near panic levels in year one then paused to a degree in year two. Few markets are ever one sided. During the five year bull market from 10/9/02 through 10/9/07 the Standard and Poors 500 Index more than doubled in value but also suffered through eight tumbles of at least 5%. We realize the long term ramifications of the housing bust, accompanying bailouts and upgraded regulations will likely set this recovery apart from past rebounds, but let’s not lose sight of where we are in the overall healing process.

***S&P 500 Index Annual Returns After Last Six Recessions***

<b>Recession Market Low</b>	<b>1 Yr</b>	<b>2 Yr</b>	<b>3 Yr</b>	<b>4 Yr</b>	<b>5 Yr</b>
5/26/1970	43.73%	11.12%	-2.85%	-17.80%	1.52%
10/3/1974	38.01%	21.04%	-7.69%	7.32%	6.90%
3/27/1980	37.09%	-16.60%	34.99%	5.23%	13.25%
8/12/1982	58.33%	2.02%	13.22%	31.16%	36.22%
10/11/1990	29.10%	6.81%	13.17%	.94%	25.27%
10/9/2002	33.73%	8.25%	5.38%	13.93%	15.15%
<b>Average</b>	<b>40%</b>	<b>5.44%</b>	<b>9.37%</b>	<b>6.80%</b>	<b>16.39%</b>

Past performance does not guarantee future results. (S&P 500) Is a standard measure of the U.S. Stock market. Indices are unmanaged and returns do not include reinvestment of dividends, also does not reflect any fees or expenses  
(Newsletter based on information as of 5/24/10)

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