



SPECIAL EUROPE

EDITORIAL

The third quarter ended in September as it started: in a state of extreme instability. Indexes around the world ended down during the month and concerns focused on French banks and their exposure to the mounting national debt. Ironically, the U.S. debt benefited greatly from this, as Uncle Sam's bonds as well as the U.S. currency rose sharply, serving once again as a safe haven.

Our global strategy remains unchanged. We remain cautious and have not increased our equity exposure. We still do not believe the storm has blown over, so we will remain patient. Actually, the probability of a recession may have increased in the course of the month. Should this materialize, this latest recovery will have been the shortest in history.

Is this a double-dip scenario; are we heading back into recession or a mid-cycle pause or is the economy simply growing very slowly? Each of those scenarios probably has the same probability. In any case, it is wise to remain cautious and increase the level of exposure to risk once a recovery is confirmed rather than try to guess when the market will bottom out.

Currently, these points cannot be confirmed; caution is therefore the recommendation.

Minh Nguyen, CFA
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FEATURE ARTICLE



The future of Europe

Europe remains in the center of the storm. Given my European roots, this is not something I enjoy writing about or discussing, for I would prefer to see a well-governed and forward looking Europe. In the euphoria over the fall of the Berlin Wall, the borders and defenses came down and few could foresee the profound changes this would bring. 20 years later Christopher Caldwell would say that "Western Europe became a multi-ethnic society in a fit of absence of mind."

Has Europe lost its ways? Was the integration of Europe into a single unit nothing more than a dream of the intellectual class with no application in the real world? Was this the best way to contain Germany? Did Europe not for 30 years discuss the coming demographic time bomb and do little about it? Was it right to put European nations into a straightjacket called the Euro?

The problems Europe struggles with today were mostly predictable, but the tendency is always and everywhere the same: We do not deal with problems when they are small and containable; we deal with them when they threaten to crush us. Europe was no exception and it is now struggling to find solutions. Nations used to have an option when dealing with financial crises. They could devalue, or inflate, or default or deflate. Within the Eurozone, the only two remaining options are default and deflation. Unilateral devaluation and inflation are no longer possible since individual countries are no longer masters of their exchange rates, and much to their chagrin they no longer control the printing press.

The current problems are a golden opportunity for China who presents itself as Europe's friend. Needless to say that altruism and self-interest

coincide. For China to bail out Greece and countries on the periphery would hardly make a dent in China's reserves, yet it would still help to diversify its reserves. More importantly though, being shut out to the US market for aerospace and defense-related companies/technology, China could purchase such assets from Europe, at very advantageous prices. True, Europe bans weapons and weapons technology exports to China, but the EU laws are subject to national enforcement, and in time of crisis, when money is scarce, many a nation has put its moral scruples aside.

Europe's problems and inevitable decline work in favor of China. The economic and political powers have shifted to Asia. Europe will survive, one day it might prosper again, but its economic and political powers are on the wane. We are witnesses to history!

This is my 100th consecutive Blue Bridge newsletter. I thank you for having given me the opportunity to share with you my experiences, hopes and fears. It was and is a privilege to write to you every month and your feedback was always greatly appreciated. I extend my gratitude to you and hope to have the opportunity to continue sharing my thoughts with you.

**Rolf Spielmann, CFA
Senior Vice President
& Chief Strategist
BLUE BRIDGE**





ECONOMY

The “new sub-prime” rates?

As Valérie Segond wrote in a recent article published in *La Tribune*, we wonder if the national debts of European states are the new sub-prime rates corrupting finances and thereby creating a new systemic risk.

Banks that are rushing to the ECB for refinancing would rather invest their liquid assets in safe havens rather than lend to their peers ... does this remind you of anything? The U.S. corporate bank Lehman Brothers went bankrupt and set the world of finance on fire on September 15, 2008; three years on, there is an air of déjà-vu hovering over the world of finance. The 2011 crisis, however, could potentially be even worse than that of 2008.

There are similarities, even though the U.S. mortgage loans repackaged, transformed and then concealed in hybrid securities, the bad assets that corrupted the system, have been replaced by the national debts of European states – securities whose intrinsic qualities are, in principle, known to everyone.

“In a world where trust is everything, this transparency could potentially change everything. Although the quality of the securities has not been concealed this time round, like in 2008 the risk has been spread within the banks, insurance companies and, generally, all global savings that blindly invested in assets deemed to be solid,” said Maurice de Boissésion of Octo Finances. “As a result, the 2011 disaster, as was the case in 2008, could be triggered by the fall of a non-banking player such as a major insurance company that is unable to secure refinancing from a central bank. We cannot even identify where the securities are or how they are accounted for on bank balance sheets as the accounting methods used by bankers have become completely undecipherable. As was the case in 2008, this would explain the brutal change in the markets’ stance on the threat that national debts pose to the entire system,” he continued.

So, will 2011 be a repeat of 2008? It would appear so! As in 2008, the central banks are on the bridge, pumping in the cash that the economy needs. Three years ago, the ECB was still able to demand that the states do their part by recapitalizing, and in some cases even nationalizing their banks. This time round, the debt level will not allow them to swoop in as last-minute saviours. This excludes those, like the United States or England, who have used their central bank to

monetize their debt by churning out bank notes and deem that, in the long term, we’ll all be dead anyway. Europe may not be far behind but it is not there yet: it’s up to the ECB to finance the banks, purchase sovereign issues that no one wants and struggle to maintain a single monetary zone in spite of the constant breaches of its operating rules!

As in 2008, we are therefore going to support the banking systems and secure liquidity. The financial system will once again be patched up with a few Band Aid solutions.



“However, as was the case in 2008, this will only be a cosmetic solution aimed at hiding the key issue: the fundamental problems that triggered the crisis have not been resolved and have

become so large that any actions taken by the central banks will not suffice,” added Maurice de Boissésion. “Although the banks were saved in 2008, neither the U.S. state nor the Federal Reserve were able to resolve the U.S. property crisis, which triggered the crisis and continues to impact on the economy. In 2011, no one is able to resolve the problems of national debts, which have now become too considerable to be absorbed by any means other than generalized impoverishment.”

Right now, there is one question: what exactly has been done in three years? Transferred from the U.S. real estate industry to European states, the scope of the crisis has expanded and become economic, social and now political. So will 2011 be a repeat of 2008? No, it will be much more serious. We’ll tally the costs in 2014...



Alain E. Roch
President & CEO
BLUE BRIDGE



BOOK REVIEW

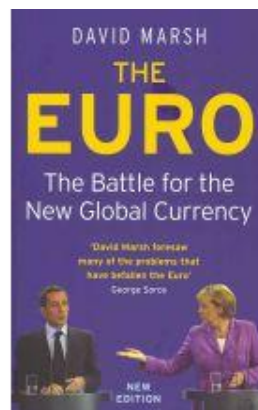
The Euro: The Battle for the New Global Currency

Chosen as an Outstanding Academic Title for 2009 by *Choice Magazine*, this book is the first comprehensive political and economic account of the birth and development of the Euro. Today the Euro is the supranational currency for sixteen European countries and the world's second-largest reserve currency. David Marsh tells the story of the rivalries, intrigues, and deal making that brought about a currency for Europe, and he analyzes the achievements and shortcomings of its first decade of existence.

While the Euro represents a remarkable triumph of political will, great pressures are building on the single currency. Drawing on more than 100 interviews with leading figures associated with the Euro, and scores of secret documents from international archives, Marsh underscores the Euro's importance for the global economy, in particular for U.S. and British economic and political agendas.

Hidden facts and fresh insights from *The Euro*:

- How the legacy of France and Germany's tortuous relations affects the Euro
- Why the United Kingdom is unlikely to accept the Euro before 2025
- The impact on the Euro of the U.S. credit crisis
- How the Euro has rebounded against the aspirations of its founders
- How Italy and Spain have massively lost competitiveness
- Why radical changes must be adopted to prevent a European upheaval.



In his new, fully revised and updated edition, Marsh tells how complacency and recklessness have holed the Euro below the waterline, with Greece, Ireland and Portugal rescued from ruin via hastily assembled bail-out packages, amid rising resentment among countries and electorates bearing the cost. With the aid of copious interviews and previously untold stories, Marsh chronicles the monetary union's rise and fall, and records how it is fragmenting into opposing blocks of creditor and debtor nations. He explains how politicians ignored years of financial imbalances heralding growing problems for the Euro, why the Euro has increased rather than lowered Germany's economic dominance and why Greece and other hard-pressed Euro states will be forced to restructure their debts.

David Marsh is chairman of SCCO International and co-chairman of Official Monetary and Financial Institutions Forum. He is a frequent contributor to German and British publications, and he lectures widely on political, economic, and business issues. He lives in London.

The Euro: The Battle for the New Global Currency
By David Marsh
Yale University Press | August 23, 2011 | Trade
Paperback



MARKET WATCH

Selection of Financial & Economic Indicators

Index	DJ Ind	DJ Transp.	Nasdaq	S&P500	S&P/TSX	MSCI World
September 30th	10913,38	4189,37	2415,40	1131,42	11623,80	10913,38
Monthly var.	-6,03%	-10,23%	-6,36%	-7,18%	-8,97%	-6,03%
Year-to-date	-5,74%	-17,96%	-8,95%	-10,04%	-13,53%	-5,74%
Year-over-year	1,16%	-7,36%	1,97%	-0,86%	-6,02%	1,16%

Index	FTSE	DAX.	CAC40	SMI	NIKKEI	EURO50
September 30th	5128,48	5502,02	2981,96	5531,74	8700,29	2179,66
Monthly var.	-4,93%	-4,89%	-8,44%	0,06%	-2,85%	-5,32%
Year-to-date	-13,08%	-20,42%	-21,63%	-14,05%	-14,94%	-21,95%
Year-over-year	-7,57%	-11,67%	-19,74%	-12,14%	-7,90%	-20,68%

Commodities	GOLD	COPPER	CRUDE	WHEAT	LUMBER	CRB
September 30th	1622,30	315,20	79,20	609,25	211,10	298,15
Monthly var.	-11,11%	-24,95%	-10,96%	-23,03%	-15,05%	-12,98%
Year-to-date	14,17%	-29,69%	-13,66%	-24,71%	-30,10%	-10,41%
Year-over-year	23,84%	-14,35%	-1,47%	-9,64%	-7,00%	3,94%

Currencies	\$CA	¥	€	£	\$AU
September 30th	1,0503	77,0625	1,3388	1,5584	0,9662
Monthly var.	-7,28%	-0,60%	-6,83%	-4,01%	-9,66%
Year-to-date	-5,91%	5,18%	0,68%	0,24%	-5,30%
Year-over-year	-1,89%	7,67%	-1,88%	-0,87%	-0,01%

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