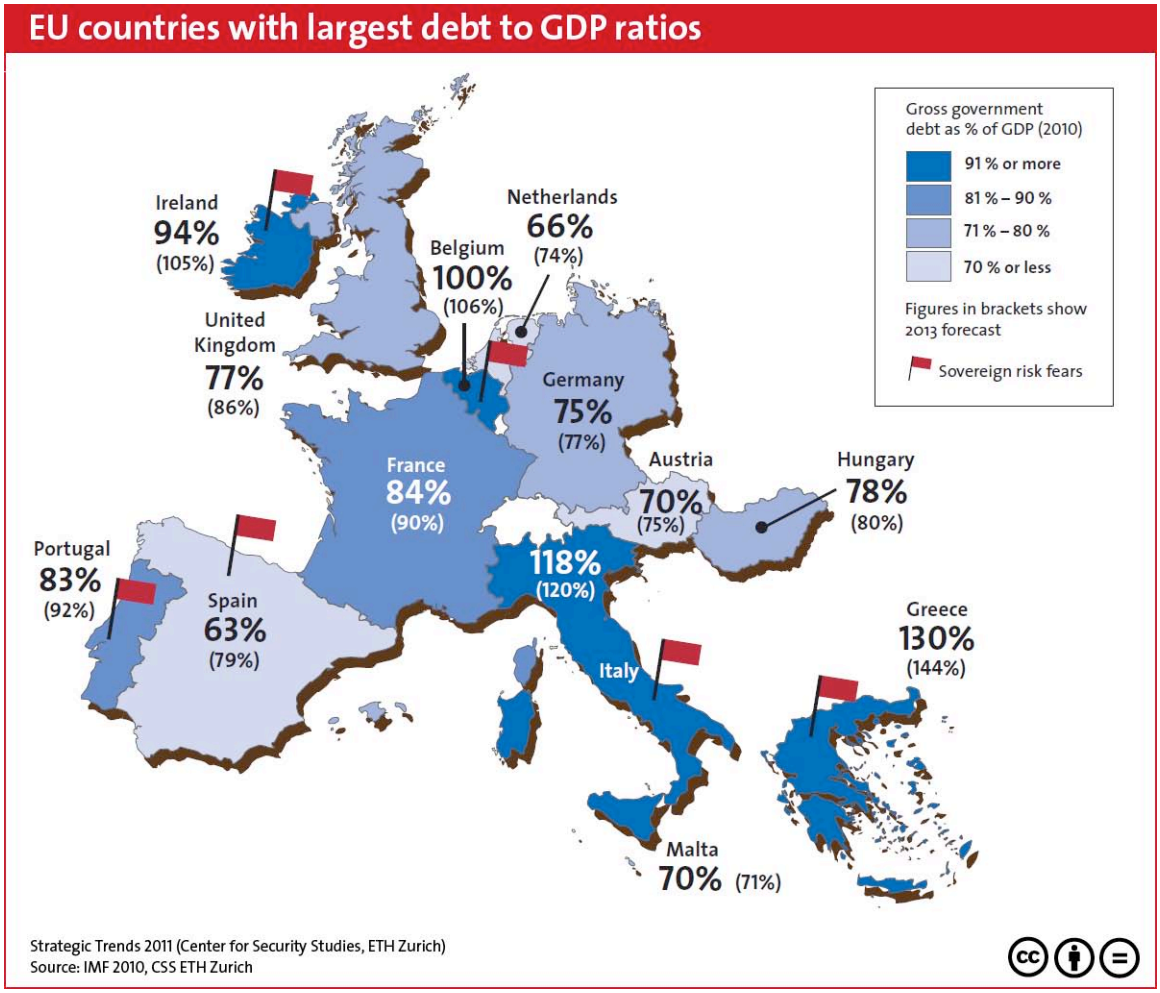
What Europe's Crisis Means For You and Your Savings

Europe is heading into a full-scale disaster.

You see, the debt problems in Europe are not simply related to Greece. They are SYSTEMIC. The below chart shows the official Debt to GDP ratios for the major players in Europe.



As you can see, even the more "solvent" countries like Germany and France are sporting Debt to GDP ratios of 75% and 84% respectively.

These numbers, while bad, don't account for unfunded liabilities. And Europe is nothing if not steeped in unfunded liabilities.

Let's consider Germany. According to Axel Weber, **the head of Germany's Central Bank,** Germany is in fact sitting on a **REAL Debt to GDP ratio of over 200%.** This is Germany… with unfunded liabilities equal to over TWO times its current GDP.

To put the insanity of this into perspective, Weber's claim is akin to Ben Bernanke going on national TV and saying that the US actually owes more than $30 trillion and that the debt ceiling is in fact a joke.

What's truly frightening about this is that Weber is most likely being *conservative* here. **Jagadeesh Gokhale of the Cato Institute published a paper for EuroStat in 2009 claiming Germany's unfunded liabilities are in fact closer to 418%.**

And of course, Germany has yet to recapitalize its banks.

Indeed, by the German Institute for Economic Research's OWN admission, German banks need 147 billion Euros' worth of new capital.

To put this number into perspective TOTAL EQUITY at the top three banks in Germany is less than 100 billion Euros.

And this is GERMANY we're talking about: the supposed rock-solid balance sheet of Europe. How bad do you think the other, less fiscally conservative EU members are?

Think BAD. As in **systemic collapse** bad.

Indeed, let's consider TOTAL debt sitting on Financial Institutions' balance sheets in Europe. The below chart shows this number for financial institutions in several major EU members relative to their country's 2010 GDP.

Country	Financial Institutions' Gross Debt as a % of GDP
Portugal	65%
Italy	99%
Ireland	664%
Greece	21%
Spain	113%
UK	735%
France	148%
Germany	95%
EU as a whole	**148%**

Source: IMF

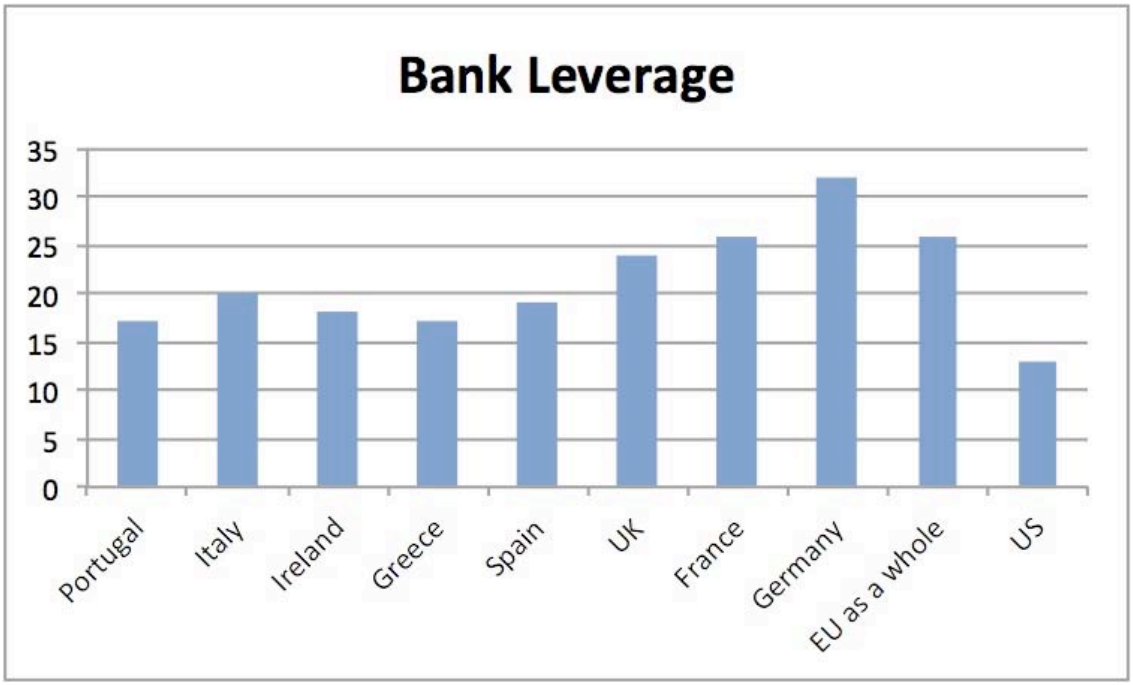
As you can see, financial institutions in Germany, France, Italy, Spain, the UK, and Ireland are all ticking time bombs.

Indeed, taken as a whole, European financial institutions have more debt than Europe's ENTIRE GDP. Let's compare the situation there to that in the US banking system.

Taken as a whole, the US banking system is leveraged at 13 to 1. Leverage levels at the TBTFs are much much higher… but when you add them in with the 8,100+ other banks in the US, total US bank leverage is 13 to 1.

The European banking system as a whole is leveraged at nearly twice this at over 26 to 1. That's the ENTIRE European Banking system leveraged at near Lehman levels (Lehman was 30 to 1 when it collapsed).

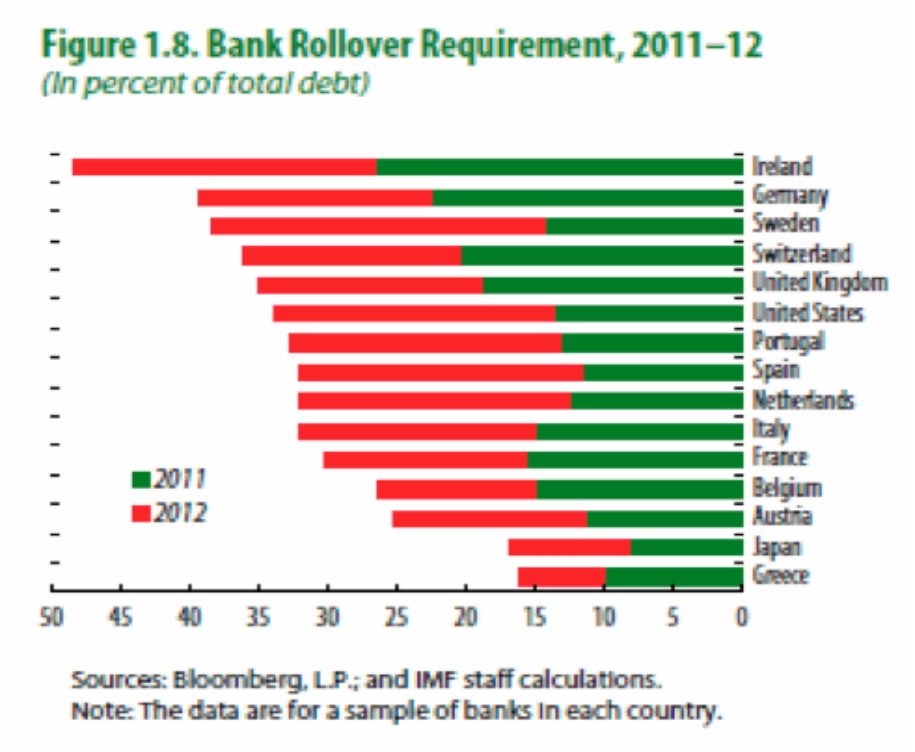
To put this into perspective, with a leverage level of 26 to 1, you only need a 4% drop in asset prices to wipe out ALL capital. What are the odds that European bank assets fall 4% in value in the near future as the PIIGS continue to collapse?



These leverage levels alone position Europe for a full-scale banking collapse on par with Lehman Brothers. **Again, I'm talking about Europe's ENTIRE banking system collapsing.**

This is not a question of "if," it is a question of "when." And it will very likely happen within the next 10-12 months if not sooner.

The reason that this is guaranteed to happen before the end of 2012 is that a HUGE percentage of European bank debt needs to be rolled over by the end of 2012.



I trust at this point you are beginning to see why any expansion of the EFSF or additional European bailouts is ultimately pointless: Europe's ENTIRE BANKING SYSTEM as a whole is insolvent. Even a 4-10% drop in asset prices would wipe out ALL equity at many European banks.

The situation is not much better at non-Financial European corporations. Indeed, the debt situation is so endemic to Europe as a whole that corporate Debt to Equity ratios for ALL of the PIIGS as well as the supposedly fiscally conservative countries of France and Germany are TERRIBLE.

Country	Corporate Debt to Equity Ratios
Portugal	145%
Italy	135%
Ireland	113%
Greece	218%
Spain	152%
UK	89%
France	76%
Germany	105%

What I'm trying to point out here is that Europe's debt problems extend well beyond the PIIGS. Indeed, the entire European banking and corporate system is over-burdened with debt.

Jagadeesh Gokhale puts the situation as the following, "***The average EU country would need to have more than four times (434 percent) its current annual gross domestic product (GDP) in the bank today, earning interest at the government's borrowing rate, in order to fund current policies indefinitely."***

As I said before, Europe is finished. The region's entire banking system is insolvent (with few exceptions). European non-financial corporations are running massive debt to equity ratios. And even EU sovereign states require intervention from the ECB *just* to meet current debt issuance, to say nothing of the huge amount of sovereign debt roll over that is due over the next 14 months.

Again… Europe. Is. Finished.

Moreover, the argument that the ECB or Federal Reserve could stop this from happening is misguided. True, the Central Banks have managed to prop up the markets for several years now.

So what makes this time different?

Several items:

1) The Crisis coming from Europe will be far, far larger in scope than anything the Fed or Central Banks have dealt with before.
2) The Fed is now politically toxic and cannot engage in aggressive monetary policy without experiencing severe political backlash (this *is* an election year).
3) The Fed's resources are spent to the point that the only thing the Fed *could* do would be to announce an ENORMOUS monetary program, which would cause another Crisis in of itself.

Let me walk through each of these one at a time.

Regarding #1, we have several facts that we need to remember. They are:

1) The European Banking system is over $46 trillion in size (nearly 3X total EU GDP).

2) The European Central Bank's (ECB) balance sheet is now nearly $4 trillion in size (larger than Germany's economy and roughly 1/3 the size of the ENTIRE EU's GDP). Aside from the inflationary and systemic risks this poses (the ECB is now leveraged at over 36 to 1).

3) Over a quarter of the ECB's balance sheet is PIIGS debt which the ECB will dump any and all losses from onto national Central Banks (read: Germany)

So we're talking about a banking system that is nearly four times that of the US ($46 trillion vs. $12 trillion) with at least twice the amount of leverage (26 to 1 for the EU vs. 13 to 1 for the US), and a Central Bank that has stuffed its balance sheet with loads of garbage debts, giving it a leverage level of 36 to 1.

And all of this is occurring in a region of 17 different countries none of which have a great history of getting along… at a time when old political tensions are rapidly heating up.

As bad as the above points may be, they don't even come close to describing the REAL situation in Europe. Case in point, regarding leverage levels, PIMCO's Co-CIO Mohammad El-Erian (one of the most connected insiders in the financial elite) recently noted that *French banks* (not Greece or Spain) currently have 1-1.5% capital relative to their assets, putting them at leverage levels of nearly 100-to-1.

http://www.marketwatch.com/story/sovereign-debt-spiral-seen-imperiling-europe-2011-09-23?pagenumber=2

And that's *France* we're talking about: one of the alleged key backstops for the EU as a whole.

To be clear, the Fed, indeed, Global Central Banks in general, have never had to deal with a problem the size of the coming EU's Banking Crisis. There are already signs that bank runs are in progress in the PIIGS and now spreading to France (see El-Erian's comments in the article above).

Thus, the World's Central Banks cannot possibly hope to contain the coming disaster. They literally have one of two choices:

1) Monetize everything (hyperinflation)
2) Allow the defaults and collapse to happen (mega-deflation)

If they opt for #1, Germany *will* leave the Euro. End of story. They've already experienced Weimar and will not tolerate aggressive monetization.

So even the initial impact of a massive coordinated effort to monetize debt would be rendered moot as the Euro currency would enter a free-fall, forcing the US dollar sharply higher which in turn would trigger a 2008 type event at the minimum.

Moreover, we need to consider that the Fed is now so politically toxic that Ben Bernanke is literally going on the campaign trail to attempt to convince the American people that the Fed is an honest and helpful organization. Put another

way, there is NO CHANCE the Fed can announce a large-scale monetary policy unless a massive Crisis hits and stocks fall *at least 15%.*

Finally, regarding my third point… if the Fed *were* to announce a new policy it would have to be MASSIVE, as in more than $2 trillion in scope. Remember, the $600 billion spent during QE 2 barely bought three months of improved economic data in the US and that was a pre-emptive move by the Fed (the system wasn't collapsing at the time).

So given that the Fed will only be able to announce a large scale program in *reaction* to a Crisis, whatever it *did* announce would have to be ENORMOUS, a kind of shock and awe, attempt to rein in the markets.

Moreover, it would literally be THE LAST QE the Fed could hope to ever announce as political outrage from the ensuing Dollar collapse and inflationary pressures would likely see the open riots and/or the Fed dismantled (this has happened twice before in the US's history).

In simple terms, the Fed's hands are tied until a huge Crisis hits. And then, *if* the Fed acts it's going to have to go "all in" with a massive program. If it does, we will *still* experience a Crisis, as the Dollar would collapse pushing inflation through the roof as well as interest rates (which in turn would destroy the banks as well as the US economy).

In simple terms, this time around, when Europe goes down (and it will) it's going to be bigger than anything we've seen in our lifetimes. And this time around, the world Central Banks are already leveraged to the hilt having spent virtually all of their dry powder propping up the markets for the last four years.

Again, this time it *is* different. I realize most people believe the Fed can just hit "print" and solve everything, but they're wrong. The last time the Fed hit "print" food prices hit records and revolutions began spreading in emerging markets. If the Fed does it again, especially in a more aggressive manner as it would have to, we would indeed enter a dark period in the world and the capital markets.

Country	**GDP**
European Union	**$16 trillion**
United States of America	$14.5 trillion
China	$5.8 trillion
Japan	$5.4 trillion
European Central Bank	**$3.8 trillion**
Germany	$3.2 trillion
US Federal Reserve	**$2.8 trillion**
France	$2.5 trillion

United Kingdom		$2.2 trillion	
Banking System	**Total Assets**	**Total Assets Relative to GDP**	**Total Assets Relative to Central Bank Balance Sheet**
Europe	$46 trillion	287%	1,210%
US	$12 trillion	82%	428%

This is not Doom and Gloom, this is *reality*.

With that in mind, the Great debt Implosion will hit Europe within the next 10-12 months and likely much, much sooner. When it dues, we will see numerous debt defaults and restructuring on both the corporate and sovereign levels. We're also very likely going to see significant portions of the European banking system collapse "Lehman-style" along with subsequent HUGE losses of capital.

The impact of this will be global in nature. The EU, taken as a whole, is:

1) The single largest economy in the world ($16.28 trillion)
2) Is China's largest trade partner
3) Accounts for 21% of US exports
4) Accounts for $121 billion worth of exports for South America

So if the EU banking system/ economy collapses, the global economy could enter a recession just based on that one issue alone (ignoring the other issues in China, Japan, and the US).

So how does one profit from this?

For one thing, the short-selling ban on European banks has lifted, so if you have an international brokerage account, you can short any European bank you like.

Among some of the more troubled banks to consider:

Bank Name	Country	Requires International Brokerage Account	Short-able by US-based investors
BNP Paribas	France	Not necessarily	Via pink-sheets
Societe General	France	Not necessarily	Via pink-sheets
Credit Agricole	France	Not necessarily	Via pink-sheets
Banco Sabadell	Spain	Yes	No
Banco Santander	Spain	No	Yes via NYSE
Nat'l Bank of Greece	Greece	No	Yes via NYSE

Deutsche Bank	Germany	No	Yes via NASDAQ
HSBCS	UK	No	Yes via NYSE
Barclays	UK	No	Yes via NASDAQ

We cannot advise you when specifically to short these investments in this report. However, if you would like specific buy and sell alerts in real time on when to trade the above investments, we suggest taking a look at our ***Private Wealth Advisory*** newsletter. You can learn more about it on our website: www.gainspainscapital.com

For those investors wary of shorting individual investments, more generalized means of profiting from Europe's collapse include the following ETFs:

Name	**Symbol**
European Financials ETF	EUFN
Italy ishares ETF	EWI
Spanish ishares ETF	EWP

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This concludes this Special Report. From all of us at Phoenix Capital Research, thank you for your interest.

Sincerely,

Graham Summers
Chief Market Strategist
Phoenix Capital Research

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