NAVELLIER
Calculated Investing

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Navellier MarketMail: Special Update
By Louis Navellier

The euro-zone crisis is now taking its toll on political leaders. Greek Prime Minister George Papandreou agreed to step down in conjunction with forming a new coalition government. The same thing is now happening it Italy, where Italian Prime Minister Silvio Berlusconi fell short of getting a majority of the Italian Chamber of Deputies (its lower house) to back a routine budget item. This was a humiliating setback for Prime Minister Berlusconi, since it represented a revolt by eight key votes from the Northern League, which is the most powerful political party in Italy. The head of the Northern League, Umberto Bossi, said Berlusconi should be replaced by Angelino Alfano, who heads the PDL party. Essentially, the Northern League and the PDL Party are in the process of forming a new center-right coalition government. On Tuesday, Prime Minister Berlusconi said he would resign as soon as the Italian Parliament passes urgent budget reforms that other European leaders (i.e., German Chancellor Merkel, French President Sarkozy, etal.) have been demanding.

What is essentially happening is Berlusconi is asking Italy to bend over and have him kick all his opponents in the rear by agreeing to austerity cuts and major tax increases! This is the equivalent of President Obama agreeing to resign if Congress passes a balanced budget by taxing everyone in America earning above $75,000 per year at 100%! The Wall Street Journal, in an editorial a while back, said 100% taxation above $75,000 is now necessary to eliminate the annual U.S. budget deficit. The net result in Italy is a panic whether the proposed austerity cuts and tax increases will be enough to shore up its finances. The answer is clearly no, since Italian bond yields have already risen over 7%, and Italy's rising interest burden is expected to threaten even more austerity cuts or even a possible default just like Greece is enduring.

Since the Italian bond market is the third largest in the world after the U.S. and Japan, European banks are loaded with Italian bond debt that is eroding in value as Italian yields soar. Unlike Japan and the U.S., which have their own central banks that buy back government debt and keep interest rates low, Italy cannot get the European Central Bank (ECB) to buy Italian debt until it passes the austerity reforms and tax increases it agreed to in August when the ECB stepped in and bought Italian debt. Ironically, the new head of the ECB is an Italian, Mario Draghi, who was Italy's top central banker! Yet Draghi will not help Italy until it agrees to pass necessary austerity reforms. Furthermore, Draghi is trying to get the European Financial Stability Facility (EFSF) to buy Italian bonds, so in the meantime, Italy's bond yields continue to soar and put the country in a precarious predicament. Essentially, while politicians, bureaucrats, and central bankers argue, Italy and Greece are allowed to burn, just like Rome burned when Emperor Nero was playing his fiddle!

At Navellier, we have consciously tried to avoid any financial stocks that are exposed to the euro-zone crisis. As an ex-banking analyst, I have to say that I have not liked financial stocks in general for quite some time. I also want to assure investors that the U.S. will not follow Greece and Italy into a financial abyss despite the fact that the U.S. budget deficit is actually larger than either Greece or Italy relative to GDP. What is killing Greece and Italy is that their cumulative budget deficits are larger than the U.S. relative to GDP. When interest rates were low, both Greece and Italy could manage their interest burdens, but now that both countries are characterized by soaring interest rates, they have hit their respective breaking points.

This is why interest rates will not be rising in the U.S., which the Fed has already confirmed, for the next two years. The Fed knows that if key interest rates rise, the U.S. would also reach a breaking point, so I am firmly convinced the Fed will adapt an ultra-low interest rate policy, just like Japan has since the early 1990s. An ultra-low interest rate environment is incredibly bullish for stocks. For example, Coca-Cola* has strong sales, earnings, a 41% return on equity (ROE), and yet has a dividend yield of 2.8%, which is higher than its recent sale of 10-year bonds yielding 2.375%. Historically speaking, when stock dividends yield more than companies' underlying bonds, it has indicated that the stock market is likely oversold and undervalued.

I realize investors are scared, especially when they watch CNBC and all the coverage is on the euro-zone crisis. However, when stocks have strong forecasted sales and earnings, high ROE, and are aggressively buying back their outstanding stock, then there is likely to be a strong foundation underneath these types of quality stocks. We especially find Blue Chip stocks with high-dividend yields very attractive in this environment. As a result, investors with longer term objectives who hold quality stocks should try not to panic and possibly even consider buying high-dividend yielding stocks that rank

well in our stock grading system. For investors looking for dividend yields, Navellier offers a Concentrated High Dividend Portfolio that can can offer significant capital appreciation potential.

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