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Financial troubles in Europe will leave a mark in the U.S.

European crisis is likely to slow world's economic recovery

The U.S. economy does not operate in a vacuum. The crisis in Europe and its ongoing effects will reverberate through the U.S. economy and credit markets for some time. These reverberations are already bringing a sense of risk aversion back to the global capital markets. The short-term effect will be to alter investor perceptions of the desirability and the value of U.S. fixed-income instruments and markets.

All the impacts of the current dislocation in Europe and the equity markets will not be negative. What is happening in Europe will continue to fuel a developing flight-to-quality trend.

Advanced non-Euro economies like the U.S. should become safe harbors for capital. The high-end housing market in London already has benefited from this capital outflow. This flight to quality also has been seen recently in the U.S. bond market.

The upshot of this is that we probably will see an ongoing credit crisis in Europe that will slow the rest of the world's economic recovery, but not halt it. On the plus side, these events will continue to create cheap credit as investors continue to pile money into safe, yield-driven instruments like bonds. This will also go

CREDIT MARKETS

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a long way in helping the Fed maintain its current accommodative low-interest-rate policy.

In the short term, a more important question to ask is whether the deficit in U.S. states like California will take on the same tenor as the crisis in the Eurozone, and hurt rates. That's probably unlikely, however. Unlike Portugal, Italy, Greece and Spain, the U.S. states burdened with large deficits also have well-educated and extremely productive labor forces. Ultimately, this should help those states grow out of their budget problems.

The Fed's easy money policies haven't kept the global economy from turmoil. There are still too many credit market uncertainties abroad and at home, suggesting that global economic growth in the second half may be slower than anticipated. Therefore, get ready for more volatility.

The European financial crisis, coupled with domestic deficits and the most anti-business/anti-Wall Street climate in memory, will negatively impact capital markets. This will ensure that investors continue dumping money in safe, fixed-income investments, keeping interest rates low for now. This positively shaped yield curve offers much profit potential for high yield income investments in 2010.

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Many high-income investments are still returning historically above-average dividend yields. In the last month, due to the financial crisis, they got even cheaper. Take advantage of these high-income investments while they are on sale. They sure beat three-month T-bills at 0.17 percent.

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