

THE ECONOMIC OUTLOOK GROUP



475 WALL STREET
PRINCETON, NEW JERSEY 08540 TEL: 609 - 529 - 1300
WWW.ECONOMICOUTLOOKGROUP.COM

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

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The Dubai World Scare Will be Short-Lived

Let's begin with the most critical questions.

Q. Does the \$60 billion default by Dubai World pose a systemic risk to the global financial system?

A. No. It should be viewed as a momentary setback in the on-going recovery of global capital markets.

Q. Will the latest problems in Dubai require a material change in our model asset allocation portfolio?

A. We have decided to sell some gold shares as well as Brazil's Petrobras to lock up capital gains. In addition we have sought to raise our U.S. dollar exposure through the purchase of UUP, an ETF that moves in support of the greenback. We took these as defensive steps because Friday is an abbreviated trading day and there is always the risk of additional negative news from Dubai over the weekend.

Q. How will Dubai's financial crisis be resolved?

A. We're expecting oil-rich Abu Dhabi to help bail out its cash-strapped sister emirate, Dubai, by early next week. That should calm international investors. What drove our decision to make portfolio changes today was simply prudence and a desire to capture gains achieved this year. Our plan is to become fully invested again next week and take advantage of cheaper equity prices from the Dubai fallout. ***In other words, we***

view this as an opportunity to buy more shares, rather than a crisis that will abruptly end the stock market's rise.

Background:

Dubai is one of seven emirates that make up the United Arab Emirates. However, unlike most other emirates, Dubai depleted its oil reserves and had to rely to on other sources of revenues. It's principal engine of growth came from Dubai World, a massive conglomerate that operates real estate, ports, entertainment and leisure entities. Though Dubai World is classified as "private company," it is 100% owned by the Dubai government. Given the emirate's lack of revenues from oil, all these ventures were financed by domestic and international creditors.

But the longest global recession in modern history slashed Dubai World's cash flow so severely, it could no longer service its \$60 billion debt. That default, in turn, led nervous investors to question the creditworthiness of the Dubai government itself. Indeed, Standard & Poor's and Moody's both downgraded the emirate's sovereign debt.

Dubai World's financial problems have actually been building for months. The surprise this time came when the Dubai government was unwilling to step in at the last minute and prevent the company from defaulting on its debt. That startled foreign investors, who are still nursing wounds from the last global economic downturn.

What happens now? While some regional and international creditors of Dubai World will take a hit on their loans, we expect some of the wealthier emirates, led by Abu Dhabi, to announce plans to bail out Dubai World in the days ahead. Their motivation is clear. Failure to do would undermine the creditworthiness of other emirates and nations in the Persian Gulf, a situation that would throw fear into foreign investors again, hurt economic recovery efforts around the world, and lead to lower oil prices.

And that scenario is in no one's interest.

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