Market Perspectives

A Glance At How The World Affects You!

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Greece; Throw Them Out

The Greek debt crisis blind-sided U.S. investors who spent most of 2011 trying to avoid the affects of a potentially bankrupt country. Rather than allowing shameless spending and reckless management derail a rising U.S. market, investors vowed to turn away from the constant vacillations of what seems like a never-ending drama (by the way, Drama is the eponymous city in Northeastern Greece).

Ostensibly, it appears that a solution is forthcoming. Greece has about 14.5 billion Euros ($19 billion U.S.) in maturing debt on March 20. Greece is also due a second bail-out payment, and the EU has stated that disbursement of any bail-out funds is conditional on Greek lawmakers crafting a more sustainable government spending plan and economic policy. The quandary has worsened and Greek lawmakers subsequently shocked the world by actually enacting stringency measures. In my opinion, pledging austerity and actually living by the new rules may be easier said than done.

Here at home, we too are living on debt; the Obama Administration's budget proposal for 2013, which includes higher taxes for the wealthy, still assumes the government will spend $2.5 billion more per day than it takes in. In spite of this, investors are mainly focused on economic recovery prospects as though a balanced budget is little more than a trivial detail.

For now, economic indicators are outweighing the political conundrum. With 4Q11 earnings season now in the rear view mirror, stocks will need to depend on continuing (good) economic data to keep the near five

month rally intact. Working in favor of the continuing rally, retail sales in January improved mainly due to the auto component. Durable goods advanced 1.8% and the latest regional Fed surveys on manufacturing point to healthy momentum in the short term. Business inventories remain lean and well managed which could lead to restocking; that is good news for production and the employment picture.

As Europe works to restore solvency, they must also balance what could be a mild to moderate downturn in economic output. Estimates for global economic growth have once again been revised lower; in Europe, the GDP outlook calls for a decline of 0.5% in 2012 due to the sovereign debt crisis. Greece's economy is set to contract another 7%. In simple terms, Northern nations will need to more than pull their weight as the deficit spending-dependent economies in the South attempt to enforce austerity without restraining growth. The difficulty, in a nation such as Greece, is that its industrial output is already modest and could be further reduced if domestic consumers tied to government entitlements continue to see a reduction in their weekly or monthly checks.

The global economy has been watching Greece for several years and their brazen recklessness has caused significant damage. The idea that markets continue trading higher on "hope" that Greece will finally concede to measurable austerity is ludicrous. If the "history rich tourist magnet" Greece had its own currency, a rescue effort from Europe would no longer be needed. Furthermore, their currency would be inevitably low; drawing droves of bargain-hunting tourists. This would subsequently drive up revenues and jobs growth. My conclusion is don't let Greece leave the euro currency; throw them out fast. Leaving things in their current state does nothing more than intensify the diminishing spending power in Greece as the Euro gains strength. The rising Euro, based purely on "hope", is no lure for fellow euro zone denizens to visit Greece anytime soon.

I don't expect Greece to leave the Euro currency zone anytime soon. However, the debt laden country would stand a better chance at recovery and eventual growth if they weren't tied to the rising value of the euro/dollar. In the meantime, we don't anticipate much out of Europe this year in terms of growth or recession. The Northern countries will be expected to do the heavy lifting and the South will have to hang on and hope for the best. But at least they have pledged austerity, even if it is only a tactic to get much needed bailout money before the dreaded default date arrives; March 20, 2012. The sight of union workers and students rioting in the streets of Athens has raised the level of skepticism on the latest austerity agreement. Will the terms of the deal ever be met?

Even if Greece begins to scratch away at its enormous problems, other debtor nations make this a multi-decade problem.

A Recap of Last Week: Equities posted moderate gains for the week on net positive economic news, some positive news on resolution of Greek debt, and extension of payroll tax cuts. The first trading day was up notably after the Greek parliament early Monday (local time) approved a package of financial reforms that are needed to obtain its bailout. The package still awaited approval by EU partners.

Stocks were mostly lower Tuesday as retail sales were less robust than expected with some believing that discounting of autos softened the January gain. Also, Europe was risk off for the day on uncertainty over Greek debt.

Equities were the softest at mid-week as European Union sources said finance officials were examining ways of delaying parts or even all of a second bailout for Greece, while still avoiding a disorderly default. This was offset in part China's pledge to step up its participation in a Euro zone bailout of Greece. Disappointing U.S. markets in the afternoon were Fed minutes of the latest FOMC meeting that showed Fed officials being divided on buying more assets—meaning lower likelihood for QE3. A healthy Empire State report was positive but was largely lost in the other news.

Stocks surged Thursday on an unexpectedly sharp decline in initial jobless claims, improved housing starts, and a positive Philly Fed report. For once, positive economic news outweighed the water torture from off-and-on Greek debt progress. For the day, there was essentially no progress on resolving Greek debt. At week's end, stocks were mixed ahead of a three day weekend. A favorable leading indicators report on Friday provided some support for equities as did passage of an extension of payroll tax cuts with President Barack Obama promising to sign the legislation promptly. Inflation is heating up but remains moderate according to the Fed; keep in mind, however, they remove food and energy cost from their number.

The Bottom Line: Perceived progress on Greek sovereign debt has dominated the news for too long. However, it is back in the spotlight again as earnings season for fourth quarter 2011 has run its course. Economic data has been improving but the data remains mixed; special factors must be taken into account to make the data look as good as the media makes it sound. On closer examination, the headlines could be construed in a not so positive way. Starting with industrials, much of the increase is due to auto sales and manufacturing. Housing is said to be getting better but most of the increases are due to multi-family starts; this supports that notion that more consumers are renting rather than buying.

Consumers are still spending and credit card debt is rising. Oil prices are on the move; our reserves are lower and Iran is suspending supply to Europe. Gas prices will soon follow the trend. We expect gas prices to eventually reach the $5 to $7 per gallon range.

With the exception of Brazil, United States and Japan, global growth has been revised lower and Europe is ignoring reality; Greece needs to leave the euro currency and perhaps others should follow suit. Actually, why not expunge the euro program and avoid a repeat performance; or agree that all participants must take the bad along with the good.

So where are markets headed? Although stocks continue to show signs of shaking off its two week consolidation period, the age of this rally coupled with technical indicators tell us we've had a good rally but the downside risk is growing higher than upside potential. While no one knows how long this rally may last, now may not be the best time to bet the farm due to manifold challenges around the globe. We remain invested but not without excess cash to take advantage of a pullback or consolidation.

A Look at This Week: This week won't offer much economic data which likely puts the spotlight back on Europe. So far, the "new" austerity plan from the Greek's remains unresolved. Focus is on the housing sector, starting with existing home sales Wednesday, FHFA home prices Thursday, and new home sales Friday. Consumer sentiment also will garner trader attention at week's end.

Best Regards,

Phillip L. Clark, RFC

President/CEO