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The Greek Drama Continues

The origin of drama can be traced to Greece, where it was used in competitions as early as the 5th century BC. Drama, which comes from a Greek word meaning "action", is a composition intended to tell a story involving conflicts and emotions through action and dialogue. The two masks we commonly see when watching plays represent the two sides in any drama – comedy and tragedy. From first being used in plays, it has spilled over to movies and television. Telenovelas and soap operas have taken advantage of our enjoyment of drama and have monopolized the airwaves in local channels. Similarly, the European debt crisis has gripped the investments world. Investors and traders alike bore witness to high drama in the financial world, courtesy of the Greeks yet again.

Fear and Contagion

Through August and September, with the spectre of sovereign default hanging over Greece, investors started looking at banks in Europe that may be holding large amounts of Greek debt. With the market clearly pricing in an eventual Greek default, banks had to mark-to-market their bonds, which would directly hit their capital. There were fears that another bank failure of Lehman-like proportions would not only increase counterparty risk but also cause a freezing of credit, just like in 2008. After taking a big hit in 2008, banks were once again in the hot seat, with many traders shorting European banks with significant Greek exposure. Fear spread and the debt of other countries, such as Italy and Spain, were likewise hammered over concerns that they were on the same road as Greece (see table in *Role Reversal*, 25 July 2011). Stock markets around the world experienced massive drops and investors were once again sent reeling.

Europe and the G-20 to the Rescue

Now that it was painfully clear that world markets were held captive by the drama being played out by the Greeks, Europe led by French President Nicolas Sarkozy and German Chancellor Angela Merkel headed the charge to craft a united European plan to solve the crisis. From bank recapitalization to an increase in firepower of the EFSF rescue fund to a 50% private investor haircut on Greek bonds, European leaders addressed wave after wave of issues. With the 17 Eurozone members united, markets were electrified on optimism that the worst is over. With the view that the contagion was successfully contained, markets rallied double-digit percentages from their lows.

Halloween Scare

On Halloween, just as the roadmap for a solution to the European crisis was being laid out, the Greeks shocked the world yet again. In an act of desperation to save his political career and appease the citizenry, Greek Prime Minister George Papandreou announced that he would declare a referendum to ratify the austerity program being imposed on Greece. Markets got spooked by Papandreou's decision to put the rescue package to a vote. Investors were so mortified that the Dow Jones dropped nearly 600 points in two days. Even copper fell 5% in two days as a result of this. European markets tumbled as much as 6% in one day as traders realized that they were in for a trick and not a treat. The surprise referendum announcement triggered the biggest 2-day slide in three years for the MSCI World index.

Trick, not Treat

Papandreou's irresponsible act not only put the success of the European plan in jeopardy, but it also brought Greece much closer to default. European leaders did everything to prevent the Greek debt crisis from escalating, but these efforts were nearly wasted by the Greek "trick". This not only surprised other Europeans, but it also infuriated them. Incurring their ire, they declared that Greece would not get any bailout funds until they got their political affairs in order.

Too Much Democracy

The Greeks not only gave us drama but democracy as well. An example of this is what they recently tried to do. Just when hope shined brightest, the Greeks bequeathed to the world their second legacy. In a move that shocked the world, the Greeks proposed a referendum. Getting the opinion of the majority is one of the hallmarks of democracy, and conducting a referendum was one of the ways of accomplishing this. However, Washington Sycip, founder of SGV and one of our directors, has argued against too much democracy in a developing country. According to Mr. Sycip, a strong government and economic development must come before democracy, else it may serve to hamper a country in its path to economic prosperity. While democracy itself is a form of government that should be aspired for, too much democracy tends to be detrimental to a country's progress, especially in a developing country like Greece.

Saved By the Bell

Fortunately for the Philippine stock market, the 2-day holiday last week saved us from the Halloween scare. However, by Thursday last week, the PSEi had fallen 123 points as a result of the uncertainty in Europe. Even in our own country, traders still had their eyes on Europe. As BSP Governor Amado Tetangco, Jr. explained, "the global economy is interconnected. Emerging market economies can be insulated, but we are not immune. It is, therefore, quite important that the Eurozone economies cooperate toward a speedier and credible resolution to their problems." Despite all this, the Philippine market showed its resiliency by remaining in the green. Still up 1.6% year-to-date, the Philippines, along with Indonesia, are the only Asian stock markets that are up for the year.

Another Twist in the Greek Saga - The Ultimatum

As markets collapsed, Papandreou and other Greek politicians brought upon themselves the collective anger of investors worldwide. With the world on the brink of yet another financial crisis, European leaders declared an ultimatum - if the referendum resulted in a "No" vote, Greece would be thrown out of the Eurozone. As a result, Papandreou blinked and dropped the idea of the referendum. Still, investors were at the edge of their seats since a confidence vote was to be held last Friday. If Papandreou were to lose that vote, then any vote on the bailout package would be delayed, increasing the probability of a Greek default. Fortunately for markets, Papandreou survived the confidence vote last Friday.

Comedy or Tragedy?

Investors will continue to encounter pitfalls and experience shocks along the way that can cause the market to fall. Conversely, good news will serve to propel the market upwards. Much like the plot twists in our local telenovelas and soap operas, the twists and turns in the European crisis will ensure that the volatile conditions we are experiencing now will continue. However, with the firm resolve of the central bankers and G-20 leaders, we are cautiously optimistic that a solution to the European crisis will eventually be worked out. On the bright side, central banks around the world have started to implement their own stimulus packages. For instance, Russia, Turkey, Indonesia, Brazil, Australia and, most recently, the European Central Bank itself, have cut interest rates. China has also signalled that its tightening cycle is coming to an end. However, Italy and Spain have to be monitored closely since issues in these countries may increase downside risks.

The Greeks confined the word "comedy" to stage plays with a happy ending. As the Greek drama continues to grip the attention of the world, only time will tell whether this drama will be a comedy or a tragedy. With all this drama continuing, we recommend that investors focus on fundamentally sound companies with a strong growth potential. The near term prospects will be quite nebulous and the stock market will still be volatile because of all the uncertainty surrounding the European crisis. Despite all the high drama and volatility, we believe that with an investment time horizon of 1-3 years, the risk-reward balance is skewed to the upside. In the meantime, though, the Greek drama continues.

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