

NOVEMBER 2011

11/11

Countdown to Midnight

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Some of you will remember the Cold War symbol of the clock face where as the closer we seemed to get to Mutually Assured Destruction ("MAD") the nearer the time was to 12 o'clock. I wonder if there is a similar clock face in the office of Angela Merkel and the rest of the Eurozone "leaders" at the

moment. If there is, they should be watching it very closely as we are fast approaching 11:55, and no one seems to be remotely capable of proposing a solution that will take us away from MAD. We thought they had a solution a few weeks ago, but astonishingly the Germans and French proceeded to have a very public spat about the role of the European Central Bank (ECB) in any long term rescue plan. What were they thinking of! Markets require firm leadership and someone to demonstrate that they know what they are doing and that there is a plan. If this does not occur, the uncertainty will cause investors

to act totally rationally and sell Europe. These, contrary to what the politicians think, are not evil speculators, but totally rational investors trying to preserve their capital in the face of massive uncertainty.

Think about the choices for a moment. You are a bond investor, either private, managing your own reserves and pen-

sion, or a professional, managing the reserves and pensions of many millions of savers. Confronted with the laughable display of European leadership, do you, a). Buy bonds from Eurozone countries because you can see that the yields have risen and that you hope they will resolve their problems without incurring a default, or b). Buy anything else that is not a Eurozone bond, because at least you know that you will have protected your capital?



To protect capital: the answer is obvious. Maybe, just maybe this crisis will pass and those Italian government bonds being offered at tasty 7% yields or more will be repaid. Well done, you will have earned a 7% yield to maturity for the next 10 years. But, what if the crisis does not pass and Italy is forced to ask for a haircut, payment delay, lower coupon, new currency or any of the above, the price of your bond will fall from its current 100 to 50 or 60 percent... and you have just lost almost half of your hard saved retirement pot. The payoff, or the risk/reward to the investor is asymmetric and investors will continue to shun ALL Eurozone

bonds until a credible, defensible agreed plan is put into action.

The worry for all of us is that the German stance on letting the ECB act more like the US Federal Reserve or the UK's Bank of England will not change until the clock is at 11:59, and by then the damage inflicted on countries, their banks, their industrial sectors and their populations will be beyond repair.

Electorates are already voting out their incumbent governments more rapidly than Chelsea football club changes Manager, and the next two to go could well be Angela Merkel and Nicolas Sarkozy. If you let history guide you, look no further than Argentina after 2001. Debt default and currency devaluation lead to a populist government, nationalisation, tariffs on imports and on exports, government intervention in all aspects of economic life and graft. However, Argentina had one big advantage in 2001. They were major exporters of raw materials at a time when Chinese and Indian demand was really beginning to accelerate... can the same be said for olive oil, rape seed and whatever is produced in some of the smaller nations in the Eurozone?

The prognosis is bleak. The decision in both Italy and Greece to have a so-called technocratic government is galling for many reasons. In Italy not one elected member of Parliament has agreed to serve in the Cabinet of Mario Monti, who has ended up with a Government accountable to no one and with all the current political parties sitting on the sidelines waiting for him to fail. How disappointing for the electorate that politicians in Italy are not prepared to participate,

because they do not want to be associated with the tough decisions that Italy needs to make. No doubt come the next elections, the electorate will vote for a wholesale change in Parliament in exchange for people ready to take decisions and to lead. They say that Turkey's don't vote for Christmas, but it would appear that this is what has happened in Spain. The right of centre People's Party was elected with a landslide majority on the understanding that they were going to have to cut spending, increase the tax collection and make tough decisions. In the end, the electorate are like investors. Both want clarity, honesty and a plan. If you are unable to provide these, you won't be elected and you will not be financed.

It is very rare that as an investor we should let our emotions get in the way of the rational decision, but strange though it might seem, I really want the Eurozone crisis to be solved. I want it to be solved because the pain of failure will cut deep and affect millions of people who had only really wanted two simple things from their political leaders: courage and leadership. Sadly few in Europe are getting what they deserve, its time for the rest of the Turkey's to vote!