



Below is the latest Market Comment from Ian Williams: (26/02/2015)

GREEK PROBLEMS

The much vaunted Greek deal is nothing but a bit of sticking plaster that papers over the cracks for a few months, but the problem is pretty much insurmountable in that Greece wants to reach a deal on its debts that it can afford and also stay in the Euro and this cannot be achieved without other EU countries writing off a huge amount of what is owed.

Greece (population 11 million) owes 300 billion Euros; 50BN to Germany & 40BN to France (this is now inter-government debt and unlike 3 years ago there is no domino-style Lehman threat to the banking system). In addition, there are other debts to the ECB etc.

The Greek idea of a deal is that its rich German uncle takes a say 90% haircut (similar to precedents in Argentina) so the debt becomes 5BN not 50BN - 5BN is a level that Greece can afford and 45BN is a figure that Germany could afford (Germany could issue 5 year Bunds on negative nominal yields & could borrow 45BN in about ten minutes). France could also borrow 35BN but that is a bit more tricky.

So what is the problem? Greece could then stay in The Euro, Greek crisis is solved and the great Euro dream lives on. Well it is not as simple as that for the following reasons - namely:

- Germany is not prepared to take such a hit
- The Greek offer is quite simple - take 5BN (or an affordable figure) or take nothing and we default - no different to any creditor /debtor negotiations between a bankrupt debtor and his creditors on either a personal level (IVA) or Corporate Entity
- The biggest problem for Germany is that this would set a precedent; if Greece is allowed to stay in the Euro and default on say 90% of its debts then Italy may want a similar deal

- Germany could afford (however reluctantly) to bail out Greece but no way could it afford a similar deal with Italy (and any others that decide to join the "can't pay - won't pay" brigade)
- Italy's debt to GDP ratio is 135% and growing exponentially as the old debt compounds up and the economy does not grow at all (it may not for another decade). The figure for France is 105% and growing likewise; this French number jumps up if it has to take a hit on its loans to Greece.
- If Germany does not agree a huge haircut - Greece has no option but to default - it simply cannot afford to pay back this money. Greek option 2 kicks in and it then goes back to the Drachma and gets on with life debt free - not their 1st choice as they would prefer to stay in the Euro but a million % better than taking responsibility for its 300BN debt. Also Greece would still be in the EU, just not in the Eurozone like the UK.
- Germany's trump card is that if Greece defaults Greece loses access to foreign funding as it would become a debt pariah and unable to fund itself. - WRONG - Russia has offered Greece money if they have a problem with cash flow - in return for:
 - a) A NATO veto on attacks on Russia; Under NATO rules all NATO members including Greece would have sign off to attack Russia - Greece therefore has a veto on US & EU attacks on Russia using NATO - something very useful given events in Ukraine
 - b) The Russian Gas pipeline currently being built through Turkey has to enter Europe - Greece seems the obvious choice
 - c) Much closer ties between Greece & Russia - Russia has offered to open up its food market to Greek exports
 - d) Warm water berthing facilities for Russian Ships - exactly what sort of ships (Military or Civilian) would be open to question.

So the consensus view is that Germany holds all the Aces and the Greeks have a poor hand is completely wrong - It is the Greeks who hold the aces (and the odd trump card as well). The idea that this will be solved by constantly kicking the can down the road is unlikely to be the case as matters are now reaching the point of no return. This could very easily lead to the Euro busting apart at the seams as the whole edifice comes crashing down. This would then lead to European Central Banks trying to unscramble their cross holdings of each other's Bonds causing mayhem in the EU Government Bond markets.

Why with this outlook why on earth would, say the Dutch Central Bank sit there as a passive holder of Government Bonds issued by Italy, France, Spain, Portugal etc. when it is looking at possible defaults and the base currency (the Euro) that might cease to exist in its current form. It could potentially end up involuntarily swapping a 100 US Dollars' worth of an Italy Euro Bond for 30 US Dollars' worth (or less) of a newly constituted Italian Lira Bond (the haircut) and then lose another 50% odd as the Lira plummets against the remnants of the Euro or whatever base currency the Dutch adopt if the Euro breaks up. This is especially so given that these Bonds currently yield next to nothing anyway.

In addition to EU Central Banks the Swiss National Bank is rumoured to have acquired around half a trillion in Euro Government Bonds as part of its adventures in the Foreign Exchange market where it was printing Swiss Francs (to the tune of 65% of Swiss GDP) and exchanging them for Euros in its futile attempt to peg the Swiss Franc to the Euro at a rate of 1.20. The peg may have been abandoned but the Bond holdings remain. These holdings are already on a huge loss for the Swiss Bank due to the currency move when the peg was removed - any default/huge losses on the underlying Bonds as well would be a disaster for the SNB which unlike most EU Central Banks has outside shareholders and is expected to trade at a profit.

For these Central Banks to switch their entire holdings of these vulnerable EU Bonds (i.e. Non German, Dutch etc.) into Gold is potentially the no brainer trade of the decade. See above a chart of Gold priced in Euros which is not far off its all-time high unlike the Gold Price in US Dollars. If the Euro was to weaken further, there is a very high probability that the Euro price of Gold will move higher

If you would like any more information on any of the newly launched or existing funds, please contact myself or the team.

Warm regards,
Ian Williams, Charteris CEO and the team.

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