Realm Market Update – Greek Update

23rd May 2012

Last weekend I was visiting my in-laws only to be pulled into a vigorous debate with my father in law around everything from the structure of European funding mechanisms to spreads and the difference between Greek bonds issued under Greek law versus British common law. All of that may not be such a surprise to anyone given the parlous state of the Greek economy, but for one thing. My father in law drove trucks for thirty years, has a grade four education and his financial literacy pre-crisis was limited to stand alone dwellings in the 3166 post code in land lots above 750sqm.

More interestingly this is not an isolated case it's a phenomenon. The Greek media is saturated with commentary which goes into the crisis in astonishing detail. Why is any of this relevant? The Greek electorate is informed, they have made their own mind up and while the politicians of the two major parties lacked the courage to call the Eurozone, the Greek public have decided otherwise.

As I was following the polls going into the election it was clear that 1. The Greeks wanted to stay in Europe, 2. The Greeks wanted the bailout terms renegotiated. 3. The Greeks did not want to hand a mandate to govern to any one party.

The first two are known, but the third is what took my interest. By far most Greeks preferred that no political party get given the right to act unilaterally. The Greeks do not trust the major parties, the technocrat government that was installed by them seemed to act in the interests of bankers and foreign sovereigns. This was seen as something almost approaching treason. The consequences have been predictable with the Greek people voting for their own good and be damned the court of European public opinion.

Which brings us to Alex Tsipras. A left sided radical. Some go so far as to call his SYRIZA party the political arm of the hooded anarchists. However even the reasonable people among the Greeks believe that now is his time. Sometimes the right type of tool is a scalpel and other times it's a chainsaw, meet the chainsaw. Small on subtlety, Tsipras position is that the Europeans cannot afford to kick Greece out.

Members of the Bundesbank and German political elite retort through the media, that an exit will be bad for everyone but worst of all for Greece. The Greeks however have not said no to the Euro, which means they have to be ejected, this allows Tsipras to out flank and occupy the high ground in the Greek political landscape by announcing that in such a case the bailout terms are null and void and that Greece, given insolvency will default on their debts.

The Greek people understand the binary nature of the outcome here. On one side you have the traditional voices of reason beseeching the Greeks to choose Europe, telling them to do the right thing and stay the course, on the other side you have a leftist radical telling them to call what he is convinced is a bluff.

This is a problem for Germany, and for the so-called core nations, the man on the streets in Greece trusts the leftist radical as much if not more than he trusts the pro bailout parties. They are not voting against Europe they are instead voting to gamble with the country's future on the assumption that the Germans are bluffing. More to the point while a politician could not make such a decision unilaterally without a referendum (the referendum that poor old George Papandreou asked for almost a year ago), the people can and seemingly have.

In the meantime, Greek citizens continue to withdraw their fresh minted Euros from their ELA (ECB) funded Greek bank accounts and stick them in the mattress. The wealthier individuals were off course well ahead of the curve and withdrew their funds to other European jurisdictions long ago, this money is unlikely to return until the coast is clear.

The other angle that isn't often covered is geopolitical. Greeks tend to look Eastward for assistance during the worst of times, the largest of the pro Russia parties collected close to 11% of the vote. Given the effort that has gone into purging Russian influence in the middle East, the NATO drive into the caucuses through Georgia and the attempt to Westernize the Ukraine, it is hard to imagine that NATO and Europe would be in a rush to invite significant instability across Europe's Southern flank. The Russians are already actively intervening in a number of domestic Greek disputes regarding the powerful Greek Orthodox church, meanwhile 1 million Russian tourists will plug a hole vacated by Germans during this European summer. A Euro exit could easily be a pre-cursor to a number of un-savoury scenarios.

All of this points to us coming one step closer to the endgame, which is the same today as it was a couple of years ago when the debacle started to develop. Ultimately there needs to be a convergence towards greater unification, political, fiscal and monetary. For the core, the problem has been injecting energy and capital into a union that they do not unilaterally control. The Germans have insisted that a monetary union could only follow a political and fiscal union, one that preferably recognised relative contributions as opposed to the one state one vote approach, however their contributions to common European mechanism might have already dragged them in too deep. So, with the doomsday device now ticking, it is as we suggested almost a month ago now Germanys turn to decide. For the Germans, austerity allowed them to be involved without being committed, however now that austerity has failed, the time has come for Germany to go guarantor.

This provides a difficult decision for investors, a Greek exit will off course almost certainly lead us down another leg on our recent risk off journey (perhaps a rather substantial one), however the shorts have made their money with current prices across the risk off trade providing a good harvesting point.

The large risk for the shorts is the potential for some kind of convincing common issuance which acts as a form of cross collateralization which the market finds convincing enough to allay their fears, at least in the short term. A form of common issuance would be a vote against the Bundesbank and the pathway of austerity. If this were to materialise the prospect of risk rallying strongly rises substantially. Meanwhile the potential downside provides a perilous set of circumstances for a risk on trade. The month to date performance of risk off combined with the spectre of uncertainty makes this an ideal opportunity to harvest profitable positions and consider what to do next from the sidelines

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