May 24, 2010

Note

RE: Greek Debt Crisis

Despite the market's response, the Greek debt crisis will not lead to the end of the world as we know it, though there's a strong possibility Greece will ultimately default on its sovereign debt and that could in turn put the EU concept in jeopardy. Two countries so disparate as Greece and Germany sharing a common currency in the end probably can't work. Germany is ultra-competitive internationally and fiscally very conservative. Greece by contrast is much less trade competitive and their social programs were wildly unaffordable. Without the ability for currencies to adjust relative to one another, Greece is doomed to the really nasty period of economic and social adjustment they now face.

While Greece is a moderately important economy to Europe, it's economically much less important to the rest of the world. Greece's deep recession will negatively impact European economic growth and to a lesser extent the growth of the rest of the world, though the falling Euro will help mitigate this, as it makes European exports more competitive. But this economic fact is not the real problem troubling the market. Rather, it's the high degree of uncertainty surrounding how this will play out, and uncertainty is the one thing the market just can't abide, hence the market correction we're experiencing.

On the flip side is the fact US GDP this quarter will surpass the high-water mark set before the recession. Further, GDP revisions have persistently been adjusted higher as have projected corporate earnings, yet the market is now about 40% cheaper than it was at the lower GDP level of a couple years ago. An important sign of the market's improved stability is that VIX (The Investor Fear Gauge) hit 48 last week, yet the market remains 3,000 points higher than the last time such a high reading (it was just 20 a couple weeks ago) was posted, at the trough of the market panic. Translated, both the market's fundamental and psychological states are stronger than they were a year ago, and this episode will likely prove little more than a routine market correction when all is said and done.

We're not near the end of the world and the second stage of the market's post-recession rally lies ahead. As investors, we must recognize that corrections are normal occurrences and be mentally and financially prepared to weather these storms as they occur. The reward for doing so is the capture of the market's superior long-term return opportunity, with persistence the critical ingredient to success.

Keep the faith!

Lowell