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The saga about Greece keeping the euro goes on and on, and round and round...

For weeks on end, we were inundated with daily media updates on the latest in this ongoing crisis: Banks in Greece had been closed for three weeks, with queues forming outside to get what little they could (€60 per day, or just over £40) from the cash machines. Many businesses had to stop as they were lacking the raw materials to continue operating. A five-man (!) team at the Greek Treasury decided what money could flow out of the country to pay for imports. Even tavernas had to close as they could not source the necessary food ingredients.

Average, i.e. poorer, Greeks were distraught and near breaking point, and it is worth remembering that the average Greek had nothing whatsoever to do with the reasons for the country's malaise. Yes, they were happy to retire unreasonably early on big pensions (55 for men and 50 for women if they carried out what were termed "arduous and unhealthy" jobs, such as musicians playing wind instruments, hairdressers, bakers, masseurs and, believe it or not, radio and TV presenters!). The state employees were equally happy to receive a thirteenth salary at Christmas time and a fourteenth (!) salary (half paid in spring for "Easter goods" and half in summer to help with holiday costs).

However, the real culprits, in the opinion of many historians and political commentators, were the three political dynasties Papandreou, Karamanlis and Mitsotakis who, over many decades, headed Greek governments and created a bloated and self-serving system of cronyism.

Ever since coming to power in January, Prime Minister Tsipras and his Syriza-led government have tested the patience of their paymasters in the shape of the ECB, European Commission and IMF. When Tsipras and his Finance Minister Varoufakis did not succeed in obtaining the wished-for debt relief and when time and room for negotiations finally had run out, Tsipras announced that he wanted the Greek electorate to decide what was best for the nation.

The hastily arranged referendum, which by the way posed a question that few voters could fully understand, appeared to be a triumph for the Greek government. Actually, we have it on good authority that the result was a shock for both Tsipras and Varoufakis. Apparently, they both had expected a "yes" vote, allowing them to call for an "emergency" national unity government and leave the stage with their heads held high.

In the event, Varoufakis resigned, evidently in an effort to appease the creditors who called him intransigent and rude and found it difficult to engage in any sort of negotiations with him.

Negotiations started afresh, and just when it looked that Greece would have to leave the eurozone's currency, a "solution" was finally found and agreed between the EU and Greece. Or was it? A "Grexit" would have been an ending with horror, whilst another bailout is a horror without ending.

The “agreement” in reality is a capitulation by Greece. Ironically, the terms are now much tougher for the Greeks than what had been required of them previously. Needless to say, it will take several weeks of further negotiations between Greece and the technical teams of the ECB and IMF, as well as eurozone finance ministers and heads of state, to iron out all the wrinkles of the deal.

The Eurogroup (the collective noun for the finance ministers of the eurozone states, i.e. the countries who use the euro as their currency) decided to help Greece with bridging finance of €7billion to meet its upcoming commitments, which means Greece can pay back the money it received from the IMF and the ECB. In a nutshell: Greece’s creditors have loaned Greece more money so Greece can repay its... creditors!

A third Greece bailout of €86billion over the next three years is to follow, and several nations’ parliaments will have to ratify the proposals.

Eurogroup President Dijsselbloem expressed his hope that the agreement would put Greece on the path to a sustainable recovery. That, frankly, is laughable. The economics make no sense at all. Greece is in deep recession, and the Eurogroup’s diktat is the very last thing Greece needs. When an economy suffers already, a hike in VAT rates and reducing pensions is virtually guaranteed to further damage that economy. There is a whole raft of other measures the Troika insists on, and it is difficult to see how these measures will improve the economic performance of Greece at all. It is almost as if the creditors wanted to teach Greece a lesson and, at the same time, demonstrate to other eurozone countries who may flirt with the idea of an anti-austerity approach that the outcome of such a policy would be painful for those nations.

Clearly, the political leaders of the eurozone, led by Germany’s Angela Merkel and France’s François Hollande, are absolutely determined to keep the euro dream going at all costs. All these bailouts over the last five years or so have achieved very little, and they have certainly exacerbated the problems in Greece. These bailouts have now acquired the soubriquet “extend-and-pretend” loans. Politicians have a nasty habit of not wanting to see things go wrong on their watch, and they seem to be sticking to that rule, even though few would argue that the whole euro idea was ill-conceived and likely to end in tears. The vision of a single currency encompassing such disparate economies was always politically driven but, unfortunately, not properly thought through. The single currency dream has turned into a nightmare.

There will be political fallout as well. Chancellor Merkel now has to deal with serious opposition within her own party, and the German *Bild Zeitung*, the tabloid newspaper of the Springer press concern, said in its headline that Merkel had rescued the Greeks “with our money”. Germany has parliamentary elections in 2017, and it is highly unlikely that “Mutti” Merkel, having enjoyed excellent approval ratings for a long time, will stand for re-election. Here in the UK, George Osborne avoided having to contribute to the bridging finance, but the whole Greek saga may well have influenced the thinking of people when considering the upcoming in-out EU referendum in Britain.

With all the focus on Greece, it was easy to miss other happenings in financial markets. We have often commented in our Newsletter about recurrent fears that China was heading for an economic slowdown. It is unrealistic to expect any nation to achieve double-digit GDP growth indefinitely. As an economy grows, those double-digit gains become harder to achieve. At around 7%, China's much proclaimed slowdown remains healthy by most standards but it would be wrong to ignore the very real policy challenges the Chinese government faces as it tries to deal with the rising tide of urbanisation, an ageing population and growing consumer demands. China is a significant global player and it can throw up very pertinent indications of the likely direction of global growth which it would be wrong to simply brush aside.

That said, the performance of stock markets do not necessarily offer that same insight. The rollercoaster performance of Chinese markets recently has drawn the attention of many commentators for understandable reasons, particularly the spectacular fall from the June 12th high. The market fell by nearly a third in a month, wiping approximately US$3.5trillion from the total market capitalisation. Interestingly, few saw fit to calculate how much had been added to the market capitalisation in the twelve months prior to the June peak. Over that period, the Shanghai Composite index had risen by over 150%! Even after the recent “bloodbath”, the market remains some 70% higher than a year ago.

Chinese stock markets are still at a developing stage and exhibit a number of features that explain some of the recent excesses. Shanghai, in particular, has been described as a “casino” with trading volumes dominated by domestic retail investors who account for some 80% of daily trades. That said, only about 15% of household financial assets are held in equities and the “free float” of tradable shares is roughly a third of GDP rather than being in excess of 100% which is typical in developed economies. So whilst the recent market upheaval will have enriched some and made many poorer, it has not had a significant impact on general levels of consumption or the broader economy.

There also was speculation that China's market was to be included in the Morgan Stanley World Index (MSCI) which drove speculators to invest, often funded with margin debt, in expectation of an upsurge in foreign investment as index tracking funds would have to buy Chinese stocks to reflect the new index. Price/earnings ratios for start-up companies on the ChiNext market (a NASDAQ-style part of the Shenzhen Stock Exchange) reached an incredible 147 (compared to the FTSE 100’s long-term average of 15) as firms struggled to get a listing ahead of the anticipated demand for stocks. Valuations were clearly very stretched, akin to the “TMT bubble” in the US during 2000.

In the end, China's inclusion in the MSCI was postponed and, alarmed by the increasingly frothy market, many foreign institutional investors led the rush for the exit. At the worst point on 8th July, trades in nearly 70% of Chinese stocks were suspended as daily volume limits were breached. The government regulator stepped in to ban share sales by state-owned enterprises in an attempt to halt the panic and may yet take further measures which could have a negative impact globally. Given the furore and levels of “noise” surrounding market moves, a policy overreaction is a distinct possibility.

The headlines were correct: there was a lot of panic as investors sought to cover margin calls by selling whatever they could. For a few days, investors could be forgiven for thinking that Armageddon was at hand but, since 8th July, the Shanghai market has climbed again by some 17.6% to today as bargain hunters returned.

China, as can be seen, is a very volatile market that is certainly not for everyone and for this reason it currently does not feature in the majority of our client portfolios. For investors with a sufficiently long timeframe to tolerate short term volatility, however, it has much to commend it, particularly after such a sharp sell-off.

Talking of volatility, the gold price took a hit earlier this week when "short-trading" speculators, in the form of anonymous funds, sold a staggering 57 tonnes in New York (24 tonnes) and Shanghai (33 tonnes), probably timed for maximum effect after China's announcement that it held far less bullion reserves than generally had been assumed. The price now languishes at US$1088, at a five-year low, not helped by a stronger dollar and the expectation of fiscal tightening before long.

If you want more in terms of volatility, just look what happened to Apple shares this week. In one day, the consumer electronics giant's share price dropped by nearly 9%, purely on worries that the popularity of some of its products might be on the wane. Their iconic iPhones are still selling well, but not as well as analysts had expected, and their iPads sales have been in steady decline for the last six quarters.

Overall, the American S&P 500 has risen by nearly 7% over the last year. That looks quite healthy in the current climate, but we are a bit concerned over the heavy buy-back of shares by major US companies. Of course, that helps in pushing the share price higher, and it also usually translates into the higher earnings of the top executives who, of course, are the very people who make the decision to buy back their own company's shares...

Returning home, the FTSE 100 has not moved much over the last twelve months, down just under 2%. In our April Newsletter, we assumed – as did everyone else! – that we would be dealing with a hung parliament following the General Election. The result surprised us, and it removed the uncertainty that financial markets hate. The Chancellor's budget had mixed reviews, and it is interesting to note that the polls concerning the Labour leadership contest suggest that the UK population also has a strong anti-austerity element, just like Syriza in Greece and Podemos in Spain. The outcome will be fascinating, particularly as our nation still has a mountain to climb to deal with our own indebtedness problems!

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