Commentary

July 6, 2015

The Markets

It's been a wild, wild quarter.

In early April, stock markets were doing so well (14 of 47 national benchmark indices hit all-time highs) that global market capitalization — the value of stocks trading on exchanges throughout the world — pushed past $70 trillion, according to *Bloomberg Business*. The publication attributed the climb to stimulus programs. About two-dozen countries' central banks were either engaged in quantitative easing or had committed to lower interest rates.

Rate hike speculation
Since the start of the year, analysts have been avidly seeking clues about when the Federal Reserve may begin to tighten monetary policy. Would it happen in June? In September? In December? In 2016?

After a mid-June policy meeting, *The Wall Street Journal* reported that Fed officials expect to raise rates during 2015. However, the latest turn of events in Greece, turmoil in Chinese markets, a strong dollar (which could slow U.S. growth), and other factors may cause that signal to change.

China's bull market ends
By late May, China's Shanghai and Shenzhen Stock Exchanges were valued at about $10.3 trillion dollars. The Shanghai Composite Index was up about 60 percent from the start of the year, and the Shenzhen was up about 120 percent for the same period. Markets were pushed higher by enthusiastic Chinese investors. In April, the *Financial Times* described it like this:

"After years of poor performance, confidence in the stock market has returned in China with a vengeance. Savers have switched hundreds of billions of dollars out of property, deposits, and wealth management products in the hope of making a fast buck in stocks."

Those hopes may have been dashed when Chinese markets headed south late in the quarter. During the last three weeks, Chinese markets have lost about $2.8 trillion in value, bringing the longest bull market in that nation's history to a rather abrupt end.

Angst in the European Union
The European Central Bank's 2015 quantitative easing (QE) program was a shot in the arm for Europe. Expectations that QE would spur economic growth and help the region conquer deflation helped push some stock markets to all-time highs.

Late in second quarter, however, the high gloss of QE was dulled by Greek gamesmanship. After a stellar first quarter, the Stoxx 600 Index, which includes stocks of companies in 18 European countries, saw its first-half gains fall to 11 percent, according to *Bloomberg Business*.

Crowdfunding for Greece?
You may be familiar with crowd funding. If not, boiled down, it comes to this: Someone has an idea, sets up an online campaign, and raises money to fund the concept. Often perks are offered for contributions.

Late in the second quarter, a 29-year-old shoe salesman in York, England, set up the Greek Bailout Fund. He wrote, "All this dithering over Greece is getting boring…The European Union (EU) is home to 503 million people, if we all just chip in a few Euro then we can get Greece sorted and hopefully get them back on track soon. Easy."

You've got to admire his audacity. The goal? Raise €1.6 billion. As of July 5, 2015, €1.8 million had been pledged.

A no vote in Greece
We may be in for more excitement during third quarter, which began with the

Greek voters rejecting the EU's bailout offer.

THE EUROPEAN CENTRAL BANK IS NO U.S. FEDERAL RESERVE OR PEOPLE'S BANK OF CHINA OR BANK OF ENGLAND… Recent matters in Greece have highlighted some of the problems with the European Union. One of the most important is the EU does not have a single government pursuing a coherent fiscal policy. Nope. As *The Economist* suggests, it's a conglomeration of countries with disparate economic goals and circumstances.

A writer at *Forbes* captured the essence of the problem in a Tweet: "No currency-issuing national central bank would freeze the money supply in a depression. But that's what the [European Central Bank] ECB has done to Greece."

The lesson about money supply was learned during the Great Depression. The Federal Reserve began tightening monetary policy in 1928. It allowed money supply in the United States to shrink by about one-third from 1929 to 1933, and that had a disastrous effect on the American economy. It's hard to grow when you have less and less money. In 2002, then-Fed Chairman Ben Bernanke fessed up, "…the Great Depression can reasonably be described as having been caused by monetary forces."

But the heart of the *Forbes* Tweet is the observation that no national central bank would freeze money supply. *The Economist* pointed out that the ECB is not a national central bank. It is an international central bank, and that is problematic.

"The ECB, of course, doesn't derive its mandate from the Greek government, but from all euro zone member governments. And here there is a clear conflict of interest; Greece owes money, not just to the rest of the EU, but to the ECB itself. When the ECB provides liquidity to Greek banks, it increases the bank's exposure to a government that may not repay it. This works both ways; neither the British nor the American government would want the credibility of their central banks to be undermined. But the Greeks don't have any interest in maintaining the reputation of the ECB."

If the interests of the various countries in the EU don't align, how does the region pursue a coherent fiscal policy? How does the ECB implement effective monetary policy? Should one country's pension or healthcare system be more generous than another's? How does the United States do it?

Eurozone countries have a complex relationship. We're likely to learn a lot about its long-term sustainability in coming weeks.

Weekly Focus – Think About It

"It's not what happens to you, but how you react to it that matters.
-- *Epictetus, Greek Philosopher*

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* The Dow Jones Global ex-U.S. Index covers approximately 95% of the market capitalization of the 45 developed and emerging countries included in the Index.
* The 10-year Treasury Note represents debt owed by the United States Treasury to the public. Since the U.S. Government is seen as a risk-free borrower, investors use the 10-year Treasury Note as a benchmark for the long-term bond market.
* Gold represents the afternoon gold price as reported by the London Bullion Market Association. The gold price is set twice daily by the London Gold Fixing Company at 10:30 and 15:00 and is expressed in U.S. dollars per fine troy ounce.
* The Bloomberg Commodity Index is designed to be a highly liquid and diversified benchmark for the commodity futures market. The Index is composed of futures contracts on 19 physical commodities and was launched on July 14, 1998.
* The DJ Equity All REIT Total Return Index measures the total return performance of the equity subcategory of the Real Estate Investment Trust (REIT) industry as calculated by Dow Jones.
* Yahoo! Finance is the source for any reference to the performance of an index between two

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