ECOGNOSIS ADVISORY LTD

From the Greek: ΟΙΚΟΝΟΜΙΚΗ ΓΝΩΣΙΣ (Ekonomiki Gnosis, Knowledge of Economics). Ecognosis is a global financial, economic advisory and information service, covering economic and financial developments, equities, fixed income, forex, commodities and other assets. Econotes is a research publication available free on our internet site and to the public in Hong Kong. It is not a solicitation for business and neither does it contain investment suggestions on specific and named securities including any buy, sell or hold advice. It is written by Dr. Andrew F. Freris based on 47 years of market experience which includes senior positions with GT Capital, Salomon Brothers, Bank of America and BNP Paribas as well as senior academic posts with universities in London and in Hong Kong

8/F, 2 Exchange Square, 8 Connaught Place, Central, Hong Kong. Tel: 852 3167 4591, Mob 852 9738 0944
Email: afreris@ecognosisadvisory.com Website: www.ecognosisadvisory.com

ECONOTE No. 38 **20/7/2015**

Asia: Greece and China: Postmortem and investment suggestions

Summary	Investment Conclusions
The final stage of the Greek crisis coincided with the collapse of the SHCOMP which peaked at around 12/6 and bottomed in 8/7, with the Greek crisis accelerating during 29/6 to 5/7 (the last day being the referendum) and the negotiations with the EU during 6-12/7. The two crises, of course, could not have been less connected. The Greek crisis is not over with the certainty of a default and political crisis. China could not have a financial crisis even if it tried, but the mishandling of the stock crash gets top grades for trying. Chinese stocks will fall more as the market is artificially supported with no macro or valuation basis justifying current levels.	Greece might be cheap but for a reason: yet another year of recession followed by a minimum of three years of hard adjustment, assuming that the political and social system will decide that the exit from the EUR would inflict much harsher realities than sticking with the EU rescue. Risk- takers may consider government bonds for a brief spell, about 4 months, before default fears set in. (see Fig. 1) As for China, all the liquidity injections of the authorities will not suffice to avoid yet another "correction". Keep clear from Chinese equities till this happens, as it will by yearend.

Greece: By no means the end

The Tsipras' administration has now written the book on "How not to negotiate with your creditors". From continuous changes of plans, all the way to the bluff that the Germans would not consider a Grexit, which they most clearly did. The cherry on the cake was the referendum, utterly misleading in what it asked the voters to do. The overwhelming "No" result, interpreted by Tsipras as "brave little Greece thrusting its proud chest out to fight for democracy in Europe" failed to bring tears of emotion and goose pimples of pride to the average Belgian.Instead, it hardened Germany's determination to show Greece that it could not vote for more money from the German tax payers. Tsipras' cowardly total U-turn to the Greek voters, who foolishly and irresponsibly trusted him, left the country in moral tatters to face an extremely tough set of conditions for more money which will be used mostly to pay off debt. This has happened with all the previous rescues, as the data in the Factbox clearly indicate. The loans were used to repay debt, as nearly 50% of what was received went to pay interest and debt repayments. Greece will need a huge extension of debt maturity in order to allow it to use the new loans for productive investment. If this is done, plus a true liberalisation of the economy, recovery will ensue.But the Tsipras administration is totally ill-suited ideologically to do this, and it has lost the moral support of the voters.Who would trust any of its promises ? New elections will be needed for a chastised Greek public to elect, hopefully, a technocratically- led administration to sort out the Tsipras mess .

Chart 1:EUR/USD (red) Greek bonds 10y (blue),2014-2015

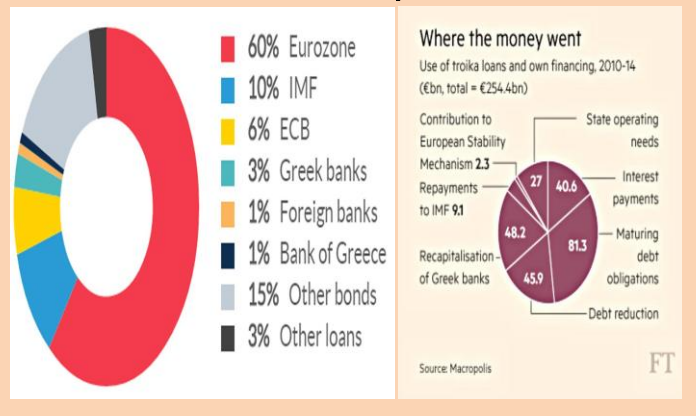
Source: Bloomberg

ECONOTE No.37

What's next for Greece, and for China

As Fig.1 shows the EUR/USD rate hardly indicated a crisis, as it actually appreciated to date from March 2015, well before the Greek crisis accelerated.But the SHCOMP did peak in mid June and its 30% crash led the Chinese authorities in a panic of ill-advised measures to reassure the 90ml of retail and margin-financed investors that stock markets only go up, and that truly speculative and non-earnings or macrodata based investment always pays. As Figure 2 shows the index is now in more reasonably- priced territory, with the P/E 12M forward down, but still expensive, the RSI in mildly oversold territory and the index below its moving average. But pouring trillions of RMB into additional margin loans, restricting trade by large shareholders, allowing hundreds of firms not to trade their shares as well as at the same time pursue "speculators" do not make

FACTBOX Greek debt data for yearend 2014



Source: Wikipedia, FT.

market sense. The agreed interpretation is that authorities did not want the stock losses to reflect badly on the popularity of the communist party, nor to besmirch the reputation of the stock market at the time that the authorities were pursuing financial reforms. The little detail was that the looser monetary policy followed since the start of the year helped create the boom, as well as the absence of the stabilizing influence of deep-pocketed institutional investors, the absence of which is partially due to the existence of capital controls. A QE addressed to the stock market only, is a fairly unique policy and has little chance of succeeding as its aim is to cover the losses of foolish and greedy retail investors and not to address a systemic or cyclical event.

Chart 2: China,SHCOPM (red,green) P/E 12M (blue) RSI, 2014-2015

Source : Bloomberg

Making sense of the mess

Greece's travails are the result of a combination of feckless politicians leading an irresponsible electorate for over a 40 year period during which external loans and fiscal laxity resulted, finally, in a bone- crunching disaster that can be remedied only by extreme measures.There is no reason whatsover why Greece can not emerge with a dynamic and export-oriented economy, IF all the years of restrictions and of special interests keeping competition down are lifted, and lifted quickly, BUT combined with less extreme and punitive austerity policies and a debt restructure.Societies, just like families and people, can go through periods of sickness and can recover.As for **China,** consider the simple fact that a country with a persistent current account surplus, with long term net capital inflows, as witnessed by USD 3.7 tr forex reserves, with a fiscal deficit of about 3.0% of GDP, and all of it financed domestically, and with a banking system which is effectively owned by the government, plus capital controls, can not have an "external" crisis.A domestic banking crisis can be easily dealt with by turning it into an off-balance sheet fiscal item, which China can massively afford. So the current stock market crash and the artificiall way in which it has been stopped, can be considered as a poorly managed event which will have domestic macro consequences, such as less investment and consumption, albeit temporary.

Andrew Freris (writing completed on 19/7/15)