MARKET PERSPECTIVE

BY RICHARD SKEPPSTROM

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> "Some grouse that our markets are rigged but you have to take your hat off to the Chinese. They aren't shy at all when they want to rig something."

Confused situation, imperfect advice

One of my closest friends reached out to me on Father's Day to say he thinks I am a better father than stock-picker. I was touched. And then more recently, another very dear friend said he enjoyed my writing but wished I'd say something. Lovely friends. Most folks just don't care enough to give you such thinly veiled criticisms.

Honestly though, the predictions business, if it can be called that, is more pricks than petals these days. Take the Greek situation. They'll never be able to pay their debts (creditors and debtors alike are to blame, as they always are); the economy is crippled; and the banks are hopelessly insolvent. Most everyone (without savings in Greek banks) agrees Greece needs at least a few semesters off from the euro. The banks would need support and so would the new drachma but experience suggests that they would regain competitiveness in a couple of years. They would default on their debt but that's inevitable no matter what they do. By the way, that IS the International Monetary Fund's (IMF) playbook but the Germans won't agree to any concessions for fear of political consequences at home and follow-on contagion in other overly indebted countries. The Greeks even elected and recently overwhelmingly reaffirmed, through referendum, a government that promised Greek sovereignty, reduced austerity and debt relief. And what did everyone just agree to (most reluctantly)? No relief, more austerity and a loss of sovereignty. For some in Greece, this is the easy way out but for many, I fear, it will eventually lead to rage. In my mind, the situation is now less stable and perhaps even combustible but the markets actually seemed to like it for a few days. Gun-to-the-head diplomacy with a sister nation is ominous. If the citizens of other member nations weren't already anxious about a loss of sovereignty, they likely are now. This frustrating episode is far from over. All I can do is shrug.

And the Chinese "situation" is much more important to global growth but no less confusing. Some grouse that our markets are rigged – 0 percent interest rates forcing folks into riskier assets – but you have to take your hat off to the Chinese. They aren't shy at all when they want to rig something. This all started last year when the long-dormant Chinese stock market came to life. Their markets had been depressed since the spectacular collapse of their last bubble in 2008. But in July of last year, the Shanghai Composite began to move and by June of this year it had risen 150 percent. This curious move was not confirmed by an improvement in their economy. It seems average Chinese got the notion that the government wanted higher stock prices and would, if necessary, support higher prices. Mix in a generous helping of margin lending and things quickly got out of hand. The inevitable crash began June 12 and in three weeks the market had lost a third of its value. This predictable outcome was met with unexpected force as the government outlawed selling by large investors, forced state-owned enterprises to buy their own shares and suspended trading in hundreds of companies. That worked … for a couple of weeks. One minute I was certain they had lost control and the next morning I was convinced they could manage to any price they wanted. I marvel at their brazen disregard for free-market rules. But I have no idea what a market is if it's not free to discover prices. And just last night (July 27), the collapse resumed with the biggest one-day loss since 2007. They are in a tight spot. If the underlying economy were actually recovering (a bull market can be an early sign), this would be a self-correcting situation. However, it looks to me like the Chinese economy is still slowing and the bubble in equities was a blunder by authorities grasping for anything that might soften the landing. I can only speculate on what they'll do next but confidence in Chinese markets is somewhere between depleted and exhausted.

And now for the imperfect advice: The forces shaping the curve of global growth (China, Europe) aren't on solid footing. The United States is OK. Developed markets have recovered from the crisis and are now mostly dependent on earnings growth, which is unspectacular. The U.S. Federal Reserve wants to normalize (raise) interest rates. Let's hope it can. U.S. stocks are more attractive than U.S. bonds. Bonds are unattractive. I expect low returns from here. We can wish for more but I'd rather not see another bubble.

Thank you for taking the time to read this month's Market Perspective. I hope you found it helpful.

Strategic Return Portfolio	
Equities	66%
Bonds	13%
Gold	2%
Cash & similar	19%
Total	**100%**

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Richard, an investment professional with more than two decades of experience, manages Eagle's Strategic Return Portfolio. His views are his own and may not reflect those of other Eagle portfolio managers.

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