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ASSET MANAGEMENT, L L C

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### **Clear Harbor Flash: Markets Await Word on Patient Status in Eurozone**

Watching negotiations unfold between political leaders in Greece and the European Central Bank (ECB) is like monitoring the progress of someone's high-risk medical procedure from afar. Credible information is scarce, and we're left to scrutinize the tone of the hopeful comments offered by officials involved that are probably overly optimistic. Over the last several days and weeks, rumors and some statements that have the ring of truth have escaped the closed negotiations and have led some observers to hope that a solution to the Greek debt restructuring is imminent while others have concluded that at this final hour, many fundamental challenges remain in order to achieve a favorable outcome.

We have written about this crisis on several occasions, and the main challenge facing the Eurozone remains: there is no official mechanism by which the European Union can effectively tax and collect revenues from member nations. There also remains a significant lack of coordination between the initiatives of the ECB and the European Banking Authority (EBA). The ECB is attempting to stabilize the banking system by providing banks with cheap three-year funding while the EBA has mandated that these same banks raise large amounts of capital by June of this year (banks must have a Tier 1 capital ratio of 9%). There is also little coordination between Eurozone countries. Austerity measures in the periphery of the Eurozone (Italy, Greece, Portugal, and Spain for example) remain a significant challenge for Brussels as they attempt to enforce debt or deficit targets.

The bond market does not like what it sees either. Ten-year sovereign debt issued by Greece and Portugal is currently trading at yields of 29% and 12.5% respectively. Other Eurozone bonds have trended into a more favorable direction since ECB president Mario Draghi initiated the 3-year bank loan program.

I continue to believe that we will see the exit of one or more Eurozone members in the shorter term—and this could be a disorderly process. Unfortunately, I suspect that Greece, the patient on the operating table, is now losing a pulse as the ECB and political leaders of the Eurozone rush to provide her with morphine. The lack of information and direction over the last few days from either Athens or Germany suggests that officials may have realized that Greece is no longer in a state where resuscitation is possible and that quick action is required to convey this unfortunate news to the public.

Have authorities properly insulated Greek banks from the broader European and global financial system? Will they still have access—albeit temporary-- to the ECB lending window in the event that Greece leaves the Eurozone? Have Greek authorities determined whether they can or should restart their physical currency printing presses? If so, when? There are many key questions that remain unanswered. It is my view that the political class in Greece (and possibly even Portugal and Italy) has very little equity left with their electorate. Populist sentiment is raging and nationalism is on the rise across the Eurozone. The politically expedient path for Greece is to leave the Eurozone, print drachmas, inflate, and institute an enforcement mechanism for the majority of wage earners who tuck their wages into offshore accounts.

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