MV CAPITAL MANAGEMENT

Weekly Market Flash

Yet Another Week of Crises Deferred

July 10, 2015

The more things change, the more they stay the same. A week that started off with a surprising and spine-tingling "OXI" – No – from Greece's citizens, amidst much animated chatter among the punditry about the inconvenience of the democratic process to orderly asset markets, ended with yet another application of aloe balm and Band-Aids to defer the hard decisions to a later date. From Athens to Shanghai to the great chamber of transactional irrelevance that is the physical floor of the New York Stock Exchange, this week demonstrated once again that the signature characteristic of capitalism in the 21st century is the ability to defer to tomorrow those issues that are too daunting to take on today. Call it the "Mañana Doctrine". Tomorrow is always a day away.

Athens: From "OXI" to "Oh, Okay"

"…there's only so long you can ask people to vote for impoverishment today based on promises of a better tomorrow that never arrives" -- Mark Blyth and Cornel Ban, "Austerity vs. Democracy in Greece", Foreign Affairs *January 29, 2015.*

Apparently, "only so long" is long enough for yet another round of bailouts for an economy that appears to have no prospects of recovery whatsoever. Greek citizens voted "No" on Sunday and by the middle of this week the consensus among those following the unfolding events was: no bailout, no emergency funding, let Greece deal with the consequences while the ECB and the European Commission figure out how to contain any collateral damage. But late Thursday, in a matter of hours, the framework of yet another bailout deal emerged – yet another Phoenix from the ashes of Eurozone unity. There is not yet a done deal, though investors are certainly acting as if the icing has already been applied to the cake and little EU and Greece flags inserted atop thereof.

In the end it was the Hellenes who blinked first, dropping their demand for concrete language about reducing the unsustainable debt load. Now they will accept virtually all the austerity measures roundly rejected last weekend, as a "good faith effort" to start a discussion about debt reduction. Otherwise, nothing has changed. Germany still insists that the Greeks channel their inner House of Lannister and promise that all debts will be paid. Greece still can't function as a viable stand-alone economy, within or without the Eurozone. European Commission and ECB functionaries still can't conceive of a world without endless summits, conceptual frameworks and plenary sessions. And the single currency zone looks ever more like the wobbling gold standard of the late 1920s.

Shanghai and Shenzhen: What's Mandarin for "Kabuki"?

Once upon a time, in a capital marketplace far, far away, common share prices were thought to reflect the future cash flow-generating potential of a company's installed asset base. How quaint. Consider China's domestic A share market, where likely fewer than 20 percent of the enthusiastic retail investors showing up at local exchanges (Humans! Physical exchange buildings!) to bid up shares earlier this year had any notion of the relationship between cash flows and share prices. Spurred on by explicit government support, popular delusions and the madness of crowds (to paraphrase Charles Mackay) these domestic investors bid up the Shenzhen Composite index by 122 percent from January 1 to June 12 of this year. Then it all came tumbling down, to a low point 40 percent below the 6/12 high water this past Wednesday. Think about that for a moment: after losing more than the S&P 500 lost in that *annus horribilis* of 2008, the Shenzhen Composite was still up in mid-double digits for the year to date.

But 40 percent reversals aren't supposed to happen in the everyone-gets-a-trophy world of postmodern asset markets. The authorities in Beijing went into overdrive to prove that Communist policymakers can tame the wild stock market beast, shutting off as many escape valves as possible. This was not only to keep people from selling more shares, but to actually mandate brokerage firms to "get out there and Buy…Buy…Buy!" in their best imitation of the characters Randolph and Mortimer Duke from "Trading Places". Well, it worked…to a point. Back-to-back

rallies have produced an 8% gain for Shenzhen and 11% for Shanghai – the two main domestic exchanges – since Wednesday's low point. Investors the globe over are predictably thrilled. Meanwhile, more than 1,400 stocks, or about half the total number of listed companies, are suspended from trading (lest anyone actually want to sell out of them). A flurry of restrictions from Beijing has made selling shares in any major way practically impossible. The notion of "natural floor" obviously has no resonance in the lexicon of China's financial mandarins. Of course, a buyer's market with no sellers is also a fairly implausible concept. We do not count ourselves among the choir of the credulous – much as we are often fans of "buy the dip", China is in our opinion an exposure to avoid while the OK Corral stand-off between mandarins and market forces plays out.

The Incredible Shrinking NYSE

With all the kerfuffle going on elsewhere in the world, the fact that the New York Stock Exchange shut down for four hours on Wednesday seems almost un-newsworthy. Time was, of course, that turning the lights off on America's Stock Exchange would have been a riveting event. But – contrary to all those stock photos of sad traders with face in hands framed by a sea of red numbers – nothing much really happens on the floor of the NYSE any more. On the same day that technology problems brought down the servers at United Airlines and the Wall Street Journal, the NYSE went dark and…nobody cared. Trades were routed through NASDAQ or another exchange with nary a disruption to the day's proceedings. Problem solved! say the Pollyannas, noting that our multiple advanced technology platforms act as back-up to ensure that what once would have been a genuine crisis is no more thus.

That's true, as far as it goes. Having alternative channels through which to route orders was definitely helpful, particularly given that the day the NYSE went down was the same as the high point of fear over Greece and China – a day when a real system failure in US equities could have been devastating. But any technology failure like this reminds us of what is perhaps the most high-probability, as yet-unrealized threat lurking in the market; namely, the potential for a system failure brought on by cyberterrorism. As both private sector and government systems around the globe fall victim to the techniques of highly sophisticated hackers, this risk demands continual vigilance and recovery preparations.

We are pleased the week is ending on a positive note, with most US share indexes more or less close to where they started the week and Europe's bourses substantially higher. But at the same time we believe the problems which begat a volatility spike this week will continue to loom large. As we have noted in recent commentaries, we see the risks as being higher outside the US, and in the intermediate term this should work to the benefit of US shares relative to those of non-US developed or emerging markets. For the next few weeks, though, it may be a bumpy ride in all markets.

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