THE DANA VIEWPOINT

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Reality Sandwich

So the Greeks voted a resounding "No" to accepting the EU's austerity proposals and yet an apparent new and potentially tougher deal has now been struck. It's not easy to accept a salary cut, a cut in your pension or any other entitlement benefits. However, when your government's debt is 280% bigger than its GDP, eventually there is no money in the coffers. Not only that, but you owe billions of dollars (Euros) and your creditors are getting a little testy. Who are these creditors? Most of Greece's debt is held by the IMF (International Monetary Fund), the ECB (European Central Bank) and the World Bank - there is very little exposure to financial institutions in Europe or the U.S. They all can take the hit if Greece defaults. Greece's GDP is small, about 2% of the European Union members. This will have little impact on the overall economy of the EU.

So why the concern if Greece drops out of the EU? Contagion. The other members of the EU are concerned about Italy, Spain or Portugal (who have similar debt/GDP issues) dropping out and thereby collapsing the EU. So who gets hurt if Greece defaults on its debt and drops out of the EU? The Greek citizens of course. Barring some last minute magic, Greece is about to take a big bite out of the reality sandwich. Without payment up front, who will supply them with food products, oil or other necessities of life? Putin maybe. He has oil, he has money and he may even have some extra food. He would certainly like to have a port on the Mediterranean and perhaps even a missile site.

Socialism always sounds great in theory, but it never works in reality. Margaret Thatcher once said about socialists, "The problem with socialism is that you eventually run out of other people's money." Too many entitlement programs resulting in higher borrowing and higher taxes to pay for it resulting in defaults and bankruptcy. It's an old story with the same ending but there is always a greater fool coming along to try it again. Detroit recently took a bite of the reality sandwich and was forced into bankruptcy where they were able to restructure wages and pension benefits and there are already signs that they are coming out of their debt problems. Chicago may be the next one to bite on that reality sandwich.

While everyone has been watching the antics of Greece and the EU, China has been quietly trying to manipulate their stock market. They are not the first ones to do that. At least they are being up front about it. In just a month's time, the Shanghai stock market has dropped almost 30%. This equates to a loss of $2.5 trillion (of course, it's not a loss until you sell). The Chinese government's first line of defense is to stop all short selling and cancel all IPO's. Their second line of defense is to hand money to those who want to buy

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stocks. Why not add a little fuel to the fire. Thirdly, China encouraged their largest brokerage firm to start a fund with $19 billion to purchase large blue chip stocks. You can't make this stuff up.

Then there is China's increasing debt. According to McKinsey & Co., China's debt now exceeds $28 trillion. That's 282% of GDP. We are looking better all the time. China's double digit economic growth over the past decade is now history. The government is projecting 7% growth this year but you can bet this is an exaggeration. In addition to its debt, China is looking at hundreds and maybe thousands of empty residential and commercial buildings. Construction jobs will be hard to find for some time. Consumer spending will also decline with all the stock market losses. Have a bite of the reality sandwich.

We are trying to do our part over here. The government just saw fit to give the new CEO's of Fannie Mae and Freddie Mac each a $600,000 bonus (for a job well done we suppose). Not only that, but the government is encouraging them to start writing sub-prime loans again. They are also encouraging banks to join in and write more loans to individuals with weaker credit. If they don't, there will be penalties. Well, we all know how that turned out the last time.

Then there is Puerto Rico. They can't pay off their debts either. Who will bail them out? This will affect some individual and institutional American investors.

Our stock and bond markets will suffer some collateral damage, but will escape any direct hits. After all, we are still the best and safest place to invest. Gee, and we thought it was going to be a quiet summer.

Random Thought for July 2015 Only two people signed the Declaration of Independence on July 4th, John Hancock and Charles Thomson. Most of the rest signed on August 2nd, but the last signature wasn't added until 5 years later.

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