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EU Policymakers Act Too Slowly

Following news of Operational Twist from the Federal Reserve, the market sold off aggressively. Concerns over the potential impact of a Greek default and worries over a U.S. economic slowdown had been weighing on world stocks. The MSCI All-Country World Index of 45 nations has lost more than 20% since peaking on May 2, meeting the common definition of a bear market.

However, a huge rebound came suddenly on hopes that the European Central Bank might cut interest rates and the policymakers might increase the size of EFSF, a vehicle designed to provide assistance to euro zone states suffering economic difficulty, to help the economy counteract concern over the euro zone debt crisis.

CNBC reported that European Union officials were considering providing seed money for a special-purpose vehicle that would be able to issue bonds and buy up euro zone sovereign debt. CNBC has heard talk of as much as an eight-to-one leverage ratio, depending on how much capital comes from the European Financial Stability Facility, EFSF.

Meanwhile, Greek lawmakers approved an unpopular property tax law on Sep 27 that is crucial to a new austerity campaign the government has proposed so it can meet the terms of its international bailout and continue receiving aid funds.

Stocks are looking cheap and good news is coming, so should we take this opportunity to increase the equity holdings?

Our answer is NO. We believe that governments' actions are too late and bear market has begun after the major indexes around the world have dropped below the critical points. The recent rally should be treated as short-term rebound rather than a sustainable uptrend.

After meeting at the IMF/World Bank and G20 meetings in Washington D.C. by the end of September, European policymakers said on Sep 26 that they are working on ways to shore up the euro zone financial system. However, their mixed messages on the size of a rescue fund and the role of ECB underscored the difficulties for 17 euro-zone nations in reaching consensus.

ECB Executive Board member Lorenzo Bini Smaghi said that officials are examining how to leverage the money out of the EFSF in a more innovative and efficient way. But, Germany's Finance Minister Wolfgang, Central Banker Jens Weidmann & the Finance Ministry spokesman Martin Kotthaus had ruled out such possibility.

ECB Governing Council member Ewald Nowotny said an increase to the EFSF is likely but might not be as large as some have speculated. Markets chatter has suggested the fund could be increased to as much as 2 trillion euros from the current 440 billion euros.

Besides, credit ratings agency Standard & Poor's warned that leveraging the EFSF could potentially trigger rating downgrades for leading euro zone countries – Germany and France.

On the other hand, we think the Greek property tax is a short-term measure only, which would do nothing to address the fundamental economic problem. Greek debt default is just a matter of time.

EU policymakers act too slowly and the policy effect seems deteriorating. Investors are reluctant to wait anymore.



MSCI World Index (Sources: MSCI)

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