

## **Manning & Napier: A Response to the Markets & Greece**

Given recent market activity and concern regarding Greece and other European economies, Manning & Napier Advisors, Inc. (“Manning & Napier”) has prepared this brief overview about the current events. On Thursday, May 6th, the Dow Jones Industrial Average dropped nearly 1,000 points before recovering some of its steep losses and closing down 3.2% for the day. As of Monday, May 10th, no one seems to know what caused the unsettling plunge, but there has been speculation that a trading error or glitch could have occurred. Major exchanges have said they will cancel any erroneous trades that were made in the sudden sell-off. Without any confirmation, however, it remains unclear what actually happened last Thursday afternoon. Apart from that particular period of market unrest, global stocks have been volatile and down lately, likely in reaction to the Greek debt crisis and the possibility it could spread to countries such as Spain and Portugal. That situation remains fluid as the International Monetary Fund (IMF) and Euro-zone leaders have approved aid to Greece and subsequently announced a major €750 billion Euro-area bailout plan in an attempt to halt an escalating sovereign debt crisis. Our outlook on some of the main points is below.

### ***Greece***

Fellow Euro-zone countries and the IMF have agreed to give Greece an unprecedented three-year rescue package worth €10 billion (\$145 billion USD). That bailout plan was contingent on approval from each European country’s government, as well as passage of strict austerity measures in Greece. Amid riots and social backlash, the Greek parliament passed its package of severe budget cuts last week, and Germany’s parliament also overcame political opposition to approve its contribution to the bailout, clearing the way for Euro-zone leaders to officially pass the Greek loan package on Friday. The loans from the European Union (EU) and IMF should give Greece some breathing room for the next few years before they would need to access the capital markets again. However, there are certainly risks that Greece does not adhere to their forced fiscal discipline, as their economic growth could be poor in the coming years, making conditions even harder. If Greece cannot meet the tough requirements for reducing its budget deficit, they may still have to default and restructure their debts. That would be similar to a California default in the context of the U.S. Regardless, it remains a risk that needs to be closely tracked. Some have questioned whether Greece would choose to exit the EU to have the ability to drive growth by devaluing their currency, but we believe fiscally weak countries receive many benefits from belonging to the EU.

### ***Fear of contagion***

While there is some threat the Greek debt crisis could spread, the significant EU rescue plan unveiled over the weekend was an assertive attempt to prevent the troubles in Greece from affecting other Euro-zone countries. From an economic and fiscal standpoint, other European countries such as Portugal, Spain, and Italy have their own debt and deficit problems, but they are not on the same level as Greece’s. Nonetheless, contagion is often a function of market psychology rather than fundamentals, making it difficult to predict. The earlier downgrades of Spain and Portugal’s credit ratings seemed to spark fears that a contagion effect could be starting if Greece’s problems weren’t properly addressed, and the build-up of such factors likely led the IMF and EU to strive to create a Euro-area support plan impressive enough to halt mounting concern. The

unexpected aid agreement seems to have bought European governments more time to implement tough debt and deficit reduction measures, but it has not solved all of their problems. Overall, while immediate panic fears seem to have subsided, many risks remain and we are monitoring the situation closely.

### ***The EU and the European Central Bank (ECB)***

On May 9th, the EU and IMF agreed on an extraordinary €750 billion (\$995 billion USD) bailout plan that would provide money to rescue Euro-zone economies if needed. The plan includes €440 billion of loans from Euro-zone governments, €60 billion from an EU emergency fund that could be available quickly, and €250 billion from the IMF. Immediately following that announcement, the ECB revealed it is prepared to buy Euro-zone government and private bonds “to ensure depth and liquidity” in the markets. Meanwhile, the U.S. Federal Reserve has also reopened swap lines with other central banks to facilitate access to dollars. The European Central Bank’s (ECB) decision to purchase Euro-area bonds, a form of quantitative easing, comes just a few days after the central bank did not take new steps to fight the spreading fiscal and liquidity crisis and apparently did not contemplate buying Euro-zone national debt at its scheduled meeting. At that time, the ECB had not gone as far as the Federal Reserve or the Bank of England in monetizing debt problems, and their inaction likely added to the uncertainty in the markets leading up to the coordinated rescue plan. As for currency, the Euro rebounded initially on the news of the Euro-zone bailout agreement, but in general the common-currency remains lower against the U.S. Dollar than it was earlier this year. While the Euro could be pressured lower, it has already had a big drop and doesn’t seem strongly misaligned with other currencies.

Greece’s predicament and the potential for contagion have implications for the broader EU, which has never bailed out a member country before and has previously maintained each nation’s fiscal independence. This has been somewhat of a shock to healthier European economies that now seem more closely tied to government debt problems in weaker member countries. While the plan to fend off a Euro-zone debt crisis may ease some concerns for now, the EU will likely need to develop a clear mechanism for handling these types of government issues in the future. To put together the current rescue plan, the EU used an “exceptional occurrences” clause in its treaty to work around the section that prohibits any bailouts, suggesting that if more coordination over fiscal policy occurs down the road, the treaty could be amended. Ultimately, while the situation raises credibility questions for the EU, we believe the current structure and the common Euro currency should be able to survive. The risk of the Euro disbanding as a result of these problems is important to track, although we do not expect that to happen at this time.

### ***Investment Implications***

In response to general stock market gains over the past few months, Manning & Napier has taken advantage of higher prices by reducing our exposure to economically sensitive stocks, positioning our clients’ accounts to better handle this market volatility. While we do not believe the markets have reached a panic over Greek debt, often these types of environments can provide an opportunity to buy compelling long-term investments knocked down due to fears of contagion. We are monitoring closely for such opportunities. Given the uneven economic and market conditions, we believe it remains important to be selective and to focus on industry and company specifics when making investment decisions.