

Putting the Greek crisis into perspective

Despite the continued and occasionally frenzied media attention, Greece's fiscal problems aren't necessarily a forerunner of a second Global Financial Crisis. Rather the Greek crisis confirms that Europe hasn't yet come to terms with the fallout from the first financial crisis. While it has undoubtedly unsettled financial markets, the real impact of the Greek problems is likely to be confined to Europe. The rest of the world has largely emerged from the GFC and continues to pursue growth, providing a range of opportunities for patient investors seeking value over the long term.

In this *Investment Update*, we review the Greek financial crisis against the global backdrop and examine the underlying reasons for the ongoing financial difficulties in the region.

The Greek crisis in perspective

Tens of thousands of companies participate in global investment markets. By comparison, on the world stage Greece is a small, relatively insignificant country with a population of just 12 million and an economy smaller than of the state of Victoria.

However, the fortunes of the world's share markets over the past six months have been dominated by economic news from Greece rather than coverage of successful companies, which have been mostly unaffected by the crisis. The key concern has been whether Greece would be able to pay back its massive foreign debt.

When seen in broader context of the global markets, the persisting focus on the current Greek crisis, which has come about as a result of very poor economic management in that country, is unjustified and difficult to understand. It is hard to believe that such a small country can have such an impact on the world's share markets. Nevertheless the effect on global investment returns is clearly evident.

While it is not possible to pinpoint exactly what the investment performance of the NGS Super Diversified Option may have been had the Greek crisis not occurred, midyear indications were that the annual return for this option may have been close to 15%. However, the uncertainty and fear created by the situation in Greece have contributed to a final return of just over 10%.

A symptom of a bigger problem

The real problem is that Greece is just a small part of a more deeply rooted problem in Europe. Whereas most countries dealt with the Global Financial Crisis quickly and returned to economic growth, Europe has attempted to delay its day of reckoning with a raft of half measures that temporarily addressed symptoms of the crisis rather than successfully resolving the underlying causes, which points to this being a European problem, rather than a global one.

The Greece crisis is important because it exposes Europe's need to confront the effects of the GFC head on.



Underlying issues

There are three key dimensions to the persisting crisis problems:

- 1) unsustainable levels of government debt
- 2) unsustainable welfare entitlement regimes
- 3) banking systems that have lent far too much to insolvent governments.

Firstly, there's real concern that Greece is not the only country with such a high level of government debt that it can't repay. Ireland and Portugal, two even smaller economies, are in the same boat. Spain and Italy, which are much bigger economies, also have high levels of debt.

European authorities' key concern is that if Greece is allowed to go into some form of sovereign bankruptcy, banks and other lenders will stop lending to other countries with high debt levels. The reality is that this has already happened with neither Ireland nor Portugal being able to borrow from the markets without guarantees from the European Rescue Fund.

The second issue surrounds welfare entitlements. In Greece, many workers were able to retire at age 50 on a pension of up to 80% of their pre-retirement income. No economy can sustain this scale of welfare payments, let alone one where tax avoidance is rife.

Finally we have the European banking system where banks have sought to take the "safer" option of lending to governments rather than a focus on lending to households and the corporate sector. This means that if Greece, Portugal or Ireland default on their loans, many major banks in Germany and France will be close to insolvency and require rescue in an environment where many are clamoring for limited resources.

Europe's problems do not herald another GFC but rather reflect the ongoing effects of the first crisis being drawn out year after year because they weren't properly addressed in the first place.

By contrast, other countries such as the United States faced up to these issues in the year after the GFC and whilst they haven't escaped unscathed, they've moved through recovery and into growth mode.

Eventually Greece will almost certainly default on its debt and Europe will be forced to properly deal with the GFC. The outcome won't be pleasant, however, it will be a European problem, not a global one.

Global markets performance

In the meantime companies around most of the world are making record profits, have paid down their debt and have increased dividends paid to share holders and the real world economy is doing very well.

Disappointingly, companies' current success has not yet resulted in higher share prices. However, if financial history teaches us anything, it is that good value is eventually recognised over the long term.

The returns that we missed out on in the past financial year due to the Greek crisis are not lost; rather they have been deferred to future periods and will reward investors who have patience and a long term focus.

How to contact us

Visit our website www.ngssuper.com.au, or contact our Customer Service Team or your local relationship manager at any time. We're here to help you.

NGS Super Administration
Telephone: 1300 133 177

Phone number for callers outside Australia
+61 3 8687 1818

Fax: (03) 8640 0813

Email: administration@ngssuper.com.au

Web: www.ngssuper.com.au

Postal address

GPO Box 4303

Melbourne VIC 3001

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