BPM Berlin Portfolio Management

Market Commentary, June 2012

"When insanity begins to pile up they becomes invisible."

Bert Brecht

There's much agitation in national parliaments, in bank trading rooms and amongst the families of wealthy investors. No matter where one looks, the effects of a Greek exit from the Euro are discussed feverishly, sometimes even fuelled by sheer panic. There's already a catchy term for it - GREXIT! Analysts, fund managers and those other people that are obliged to act rationally by virtue of their profession are now trying to calculate the likelihood of the Greek fever spreading to other Eurozone countries, such as Spain, Portugal, Cyprus and Italy. Even France is now the subject of much debate!

Europe before fundamental changes

Meanwhile, though, one thing seems clear to the doubter or optimist: the Eurozone faces a decisive and, possibly, irreversible period of change. One or more countries will be forced to abandon the Euro. Above all, this will happen in order to protect these countries from themselves. The inflexible monetary corset that is worn by all members of the Eurozone has hindered, and continues to hinder, the ability of a country to adjust to true national economic performance by devaluing its own currency. As a consequence of harmonised interest rates, there has been, and continues to be, an epic misallocation of capital by borrowings that far exceed a country's own means. To put it bluntly, one can say that the market is fighting back. Political decisions and wishes can only deny the truth of basic economic interrelationships for a limited period.

In our view, it is crucial when faced with such a situation to quell the irrational fears of a quasi-politically-motivated total loss of Euro assets in the event that the Euro were to cease existing as a means of payment. Unfortunately, and for obvious reasons, politicians have hitherto concealed the technical means currently available for achieving this.

At this point, please allow us clear up one of the least qualified, tactical statements made by the German Federal Chancellor, for whom we otherwise have a great deal of respect: `If the Euro fails, so does Europe!´ This message is not just false, it also suggests the absence of an alternative course of action within a community resigned to its fate, hidden behind a sham currency union. Europe is older, stronger and more successful than a single currency could ever be.

Are there alternatives?

Before we turn our attentions to the impact of the situation on fund allocations, that is to say, your invested wealth, we would just like to set out a few plausible alternatives and the means of achieving them.

The alternative to the Euro would be for countries to return to their national currencies. That is logistically possible without further ado. The Euro coins and notes in circulation could be stamped for a brief transition period and used as national currency until the new money was available. The main thing is to ensure that these plans remain secret in order to prevent panic and bank runs. Such activities generally tend to occur over long weekends.

In order to minimise the risk of a capital flight across national borders, currency conversion can be linked to the creation of a currency basket modelled on the European Currency Unit (ECU). Do you remember? The precursor to the Euro as a real accounting unit without the characteristics of a method of payment whose value was determined by the strength of the bilateral exchange rates? A strong Deutschmark within the currency basket would limit the depreciation considerably. In this instance, experts predict that the Deutschmark would also appreciate strongly. Just like the former ECU in the European currency system, the new ECU (perhaps it might be called the New Euro, the Neuro or even the Newro?) would represent a currency basket of weighted national currencies of the countries involved.

Existing contracts, accounts receivable and Euro bank balances would be immediately converted into ECU. There would be no need for investors to worry that their outstanding Euro receivables would be converted into weaker currencies or depreciate to nothing. New bonds, contracts or loans would then be taken out in the new national currencies. The Deutschmark, guilder or franc would live again. To keep things simple, it would be best to use an exchange rate of 1:1 when converting from Euros.

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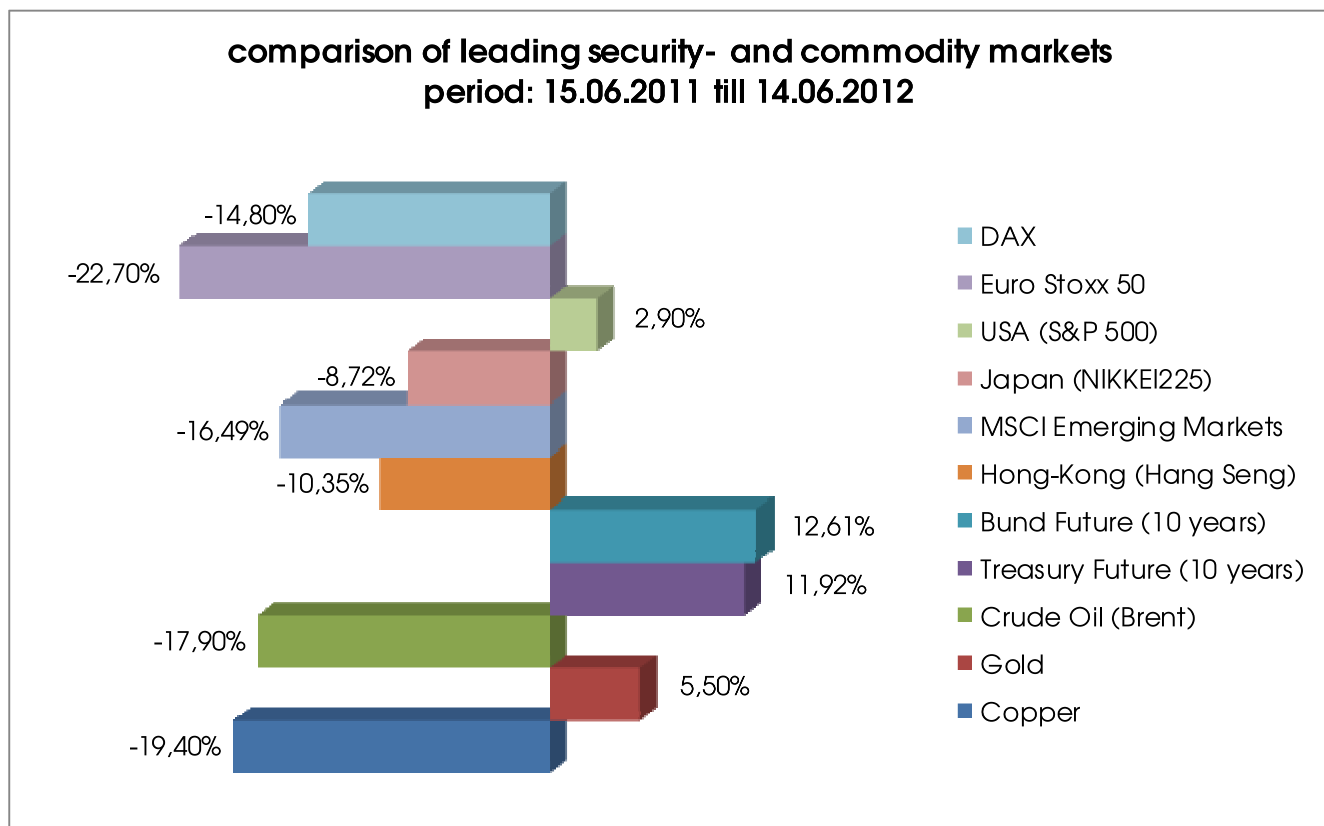
Interim conclusion

An exit by one or more countries, right up to a total abandonment of the Euro as a method of payment, would create massive turbulence within the world markets. However, the economic advantages would be huge. The countries would regain a great deal of the flexibility that they had lost; they would be practically forced to accept structural reform, and could compensate for economic differences by means of their exchange rates. At present we see at the capital markets a further rising risk version. Out of our point of view a substantial part of this is already included in the currently reduced asset price levels. The following graph should give you a compact overview about the Return of major assset-classes within the last twelve months.



Source: Bloomberg

Consequences for your wealth

Specifically, for the allocation of funds and investment decisions relating to fund assets, this would mean:

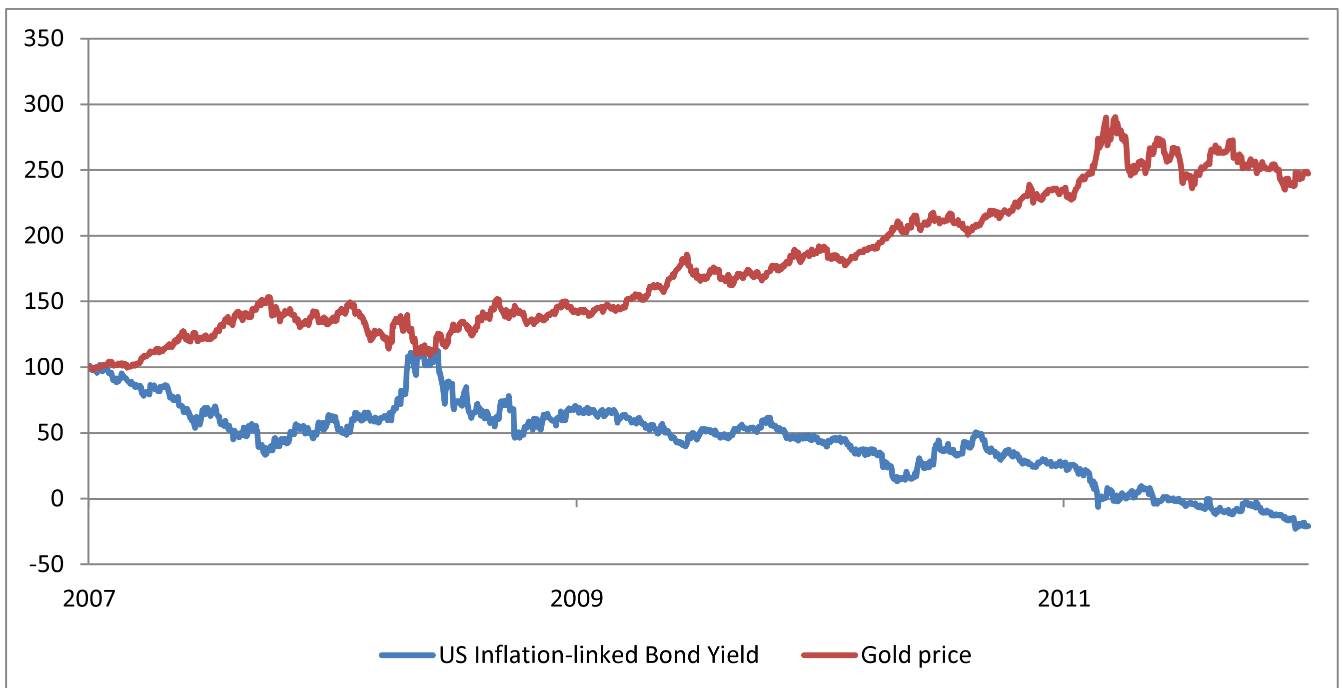
1.) Strict underweighting and/or divestments of assets in potentially weak currencies.

2.) Retention of precious metals and specific commodities (and purchases if prices fall) Provocative spoken: "Gold has not got more expensive – you just have to fork out more banknotes to obtain it".

3.) Maintaining portfolio building blocks linked to the equity and property markets. These are "real assets" and their volatility is the price for substantial advantages.

4.) The opportunism of governments and central banks will continue to be seen as a ´safe bank´. We shall stick to our guns: if there is any doubt, they will print money and inflation will rise. We have to prepare our self in time.

5.) US-treasuries and German Bunds are not the right too to preserve purchase power in the mid-term. Their yield is already negative! Fear for money devaluation has pushed the prices of gold as well as the prices of inflation linked bonds (see the graph below). You know the difference: precious metals are "real", Bonds are just promises on paper.

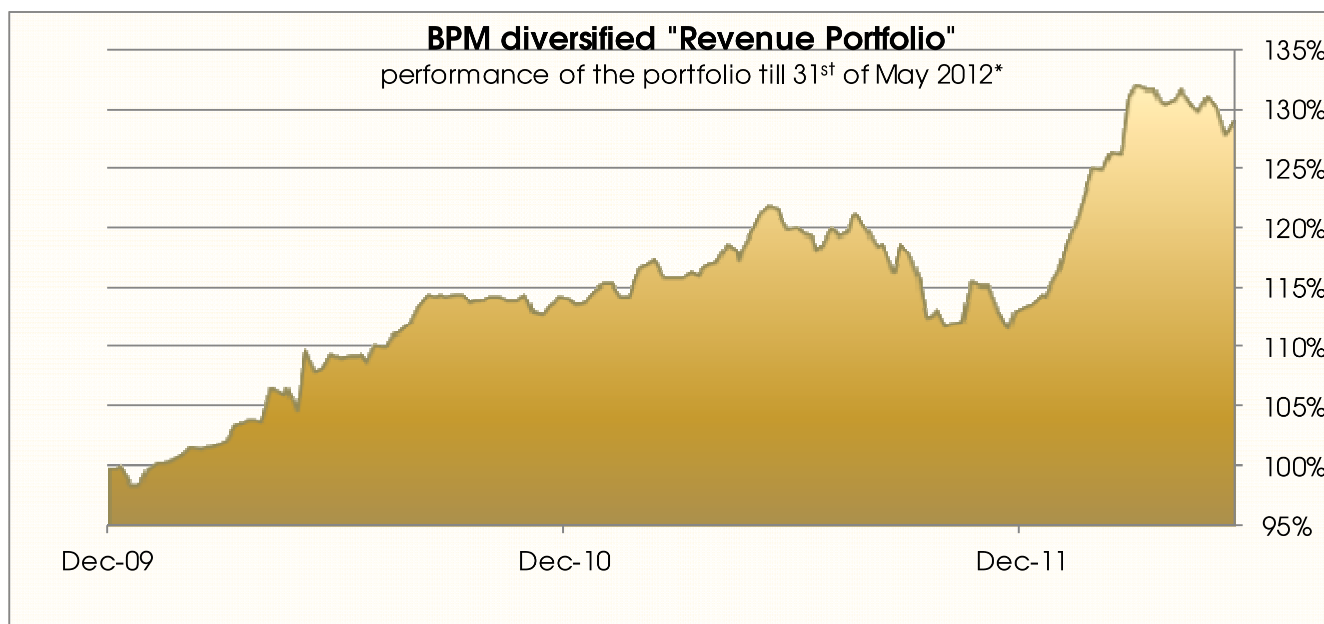


Source: Bloomberg

We would like to reassure you that we shall continue to stay true to our quality-focused and income-driven approach over the nail-biting months and quarters ahead. It should, therefore, be possible to weather a fall in the market price in the interim below the intrinsic value of the fund assets. The coming months are bound to be very turbulent and, consequently, difficult to predict. Nevertheless, we continue to believe that this is not a doomsday situation and that your wealth can still be protected with our help.

The BPM-Team would like to send warm regards for a fantastic summer-time!

Uwe Günther Sven Marzahn



Performance since inception : 29.07 % Max. drawdown (1 week) : -2.87 %
Performance YTD : 12.69 % HVaR 52 weeks (95%) : -1.85 %

*Institutional Asset Management Mandate, Hong Kong, 15.17m USD

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