

Martone Capital Management: Weekly Investment Commentary (5/22/2012)

Although US economic data was generally good last week, stocks sank sharply as investor fears over Europe's debt problems intensified.

Currently, the focus of the European debt crisis is on Greece, particularly on next month's elections. The upcoming elections look to be turning into a referendum on whether or not Greece will remain part of the eurozone. Should the more extreme parties in Greece gain popularity, the greater the likelihood that the country exits the eurozone. The more traditional Greek political parties, as well as the powers that be in Europe as a whole, are pushing for Greece to remain part of the euro, but the outcome is far from clear and the uncertainty has rattled global financial markets.

Of course, Greece is capturing most of the headlines, but perhaps more worrisome is the debt contagion that appears to be spreading to other countries such as Spain and Italy. It is important to note, however, that contagion is not spreading as widely or as deeply as it did last year. This resilience reflects the sounder position of both the global financial system and global economic indicators, although it is difficult to take too much comfort in this fact since a broader resolution of the eurozone crisis is not yet in sight.

In some sense, the only hope for the eurozone is to lower monetary policy further, which would also push the value of the euro lower. Additionally, we believe the European Central Bank would have to engage in larger-scale bond purchases to improve financial market liquidity. The alternative could be the disintegration of the euro over time.

While it is true that US stocks have taken a turn for the worse over the last month, other markets (particularly European stocks) have been hurt even more. On a year-to-date basis, European stocks are down roughly 3%, while US stocks are still up close to 6%.

So what is the likely outcome for US stocks given the prevailing backdrop? In the near term, it appears stocks will continue to face crosscurrents that have solid corporate earnings and economic growth pushing prices higher and uncertainty and fear over macro risks pushing them lower. Until these crosscurrents diminish, we expect the volatile trading pattern we have seen over the last several weeks to continue.