

Headline Fatigue

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“Headline fatigue” is how we would describe the market reaction to what was a series of negative headlines in March. In the past two months we highlighted pieces that addressed the rising costs of food and energy, the political ramifications that ensued from those costs and more recently, the potential for governments to offset inflationary pressures with stronger currencies. During March, these themes continued and were followed by a series of negative events which, for a short time, caused some weakness in global markets. However, those events ultimately had a limited impact on global markets and almost no impact on emerging markets (“EM”) debt. There were three main events which occurred during the month that caused the greatest amount of concern.

The first event was twofold: the horrific earthquake and the more damaging tsunami that engulfed the shores of Japan on March 11th. These circumstances culminated in serious concerns over the Fukushima nuclear power plant that houses six nuclear reactors and risked a possible meltdown if left uncontrolled. The Japanese stock market plunged over 20% in the ensuing days, resulting in its worst performance since October 1987. Thereafter, the central bank of Japan pledged significant liquidity to ensure smooth functioning markets and the Nikkei eventually recovered to lose only 7%.

The next headline to raise investor anxiety was the escalation of the Libyan conflict that began in February. A resolute Gaddafi declared his intent to remain in power, vowing that he would show “no mercy, no pity” on rebel opposition forces. On March 17th, the U.N. passed a resolution to impose a no-fly zone in Libyan airspace which was followed shortly thereafter by an intervention of coalition forces (including the UK, U.S.

and France) in support of the Libyan rebels. Despite the combat escalation, the conflict did little to deter markets.

Finally, the month finished with renewed concerns about the periphery governments in Europe and the European Union as a whole. Beginning on March 24th, the rating agencies initiated this concern by downgrading Portugal, Greece and Ireland as a result of clarification on the European Stability Mechanism (“ESM”) facility to support sovereign nations. Specifically, Europe clarified that support from the ESM facility would “enjoy preferred creditor status in a similar fashion to the IMF” – in essence subordinating bondholders if international support is required. This caused bond yields to rise further in the periphery countries, with Portugal breaching 9%, Ireland 10% and Greece close to 13%. Clearly, the markets are discounting an eventual restructuring for these countries, given the clarity around international support. This is the theme that Gramercy has focused on. Last fall, we published several opinions in the *Wall Street Journal* concerning this very issue.

Developed markets were able to shrug off these concerns as demand for riskier assets appeared to be overwhelming the negative headlines. As we move closer to year-end and the policy of easy money is removed globally, “headline fatigue” could become “headline concern”. EM are benefitting from the better credit quality supporting valuations; however, the removal of monetary stimulus will also produce a field of winners and losers. We continue to focus on assets which have better credit quality than market prices would indicate and therefore, will likely perform in this current environment. However, as we move closer to the end-game and headlines become a concern, we are cognizant that risk premiums could reverse in reaction to the spate of negative events.

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