Thoughts on Four Financial Hot Spots

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When it rains it pours, as the saying goes. If you've been following the financial news this summer, it probably seems like a torrential storm has been churning all around the world. Every week, people ask me about the headlines they hear on TV. "What's going on with China?" they want to know. "Is the Greece situation over?" "Why do I keep hearing more about Puerto Rico?" "What about Canada?" You may have already seen our thoughts on some of these issues, but for the sake of convenience, we thought you might enjoy a quick round-up about what's happening in the world and what it means for us. Let's start in the Old World before returning to the New.

Greece Continues Its Odyssey with Austerity

Quick recap: for years now, Greece has struggled to pay down its massive debt, frequently turning to its European neighbors for help. The European Union (EU) has responded with bailouts, but this generosity comes at a cost: Greece has been forced to impose severe austerity measures on itself, mainly in the form of budget cuts and tax increases, in order to bring its debt under control. That has made life very difficult for Greece's citizens, leaving thousands without jobs and no access to healthcare.

In June, Alexis Tsipras, the Greek prime minister, said "No more." Despite the fact Greece could not make a scheduled debt payment to one of its creditors, Tsipras rejected the idea of accepting another bailout if it meant more austerity. A referendum was held in early July, asking Greek citizens whether to accept more austerity measures or not. Tsipras advocated the "Not" option, and over 60% of the country agreed with him.[1] Tsipras, it seemed, had stared the EU in the eye and refused to blink.

Barely a week later, he blinked.

On July 13, Greece announced it had reached an agreement with its creditors: another bailout and more austerity.[2] As of this writing, negotiations remain ongoing as to how much Greece must reduce their debt, and by when. Meanwhile, the economy continues to plunge even deeper into recession. For the Greeks, their national nightmare is far from over.

What does this mean for us? Well, the big worry was that Greece would be forced—or would choose—to leave the European Union. The concern was that a so-called "Grexit" would destabilize the entire continent, thereby upsetting the world economy at large. That seems less likely now. As a result, most observers have settled into "watch-and-wait" mode.

China's Stock Market Hits a Great Wall

Now we travel east. After climbing 150% last year, the Chinese stock market came crashing down in June, falling over 30% between June 12 and July 8.[3] It all started when millions of people—mostly working class families who previously had little to do with the markets—started pouring their money into stocks. This trend was driven largely by government-created hype. For months, state-owned media had been urging people to buy stocks, loudly proclaiming that the markets were the place to put their money.

As the demand for stocks increased, so too did stock prices. But that didn't deter investors, who kept buying as long as stocks looked like they were going up. Many even borrowed money to keep buying. To make a long story short, stock prices rose too high, too fast.

Meanwhile, the overall Chinese economy had actually been slowing down, and, despite its size, was thought by some analysts to be relatively weak in terms of growth.

The end result? A bubble. And as every little child knows, bubbles pop.

In June, investors finally woke to the fact that their nation's economy wasn't an effective prop for their nation's markets ... and that their own over-borrowing was a problem. Once again, investors acted emotionally—but this time, out of fear instead of greed. Their sudden loss in confidence led to a sharp sell-off in the stock market.

To stop the crisis, the Chinese government has thrown the book, sink, and even the bathtub against the wall to see what sticks. They essentially ordered Chinese brokerages to keep buying stocks, and even gave them money to do so. They instructed the rich and powerful not to sell. They prevented new companies from going public. They've even cut interest rates. For a time these measures seemed to work, and the country enjoyed a brief period of calm. But on July 27, the market dropped a whopping 8.5%, the largest fall since 2007.[4] The government continues to do everything it can think of to stop this financial hemorrhage, but the outcome is still very much in doubt.

What does this mean for us? Like Greece, China's stock market woes don't affect the United States directly. It's estimated that only 1.5% of Chinese shares are owned by foreigners, so most people won't notice a thing as far as their portfolios are concerned.[4] But, like Greece, the worry is that if China's collapse continues, it could damage their overall economy. Because China is such a huge country, with such a large role in world affairs, their pain could potentially spread to other parts of the world. That's especially true for those countries and industries that conduct a lot of business with China.

Stress and Struggle in San Juan

Puerto Rico, the U.S. island territory, is a Caribbean jewel … but there's trouble in paradise. The island has long been a popular tourist destination for its beauty and beaches, but a closer look reveals a territory mired in economic problems. Take their recession, for example, which began in 2006 and is still ongoing. In addition, a significant percentage of the population lives below the poverty line, and the government's public debt is enormous.

How enormous? Try over $72 billion.[5]

In some respects, the situation is a little similar to Greece. In Puerto Rico's case, the island defaulted on a $58 million bond payment on August 3rd .[5] It's their first default since becoming a U.S. territory in 1898. But while the U.S. government has certainly granted significant financial assistance to Puerto Rico over the years, it has officially nixed any suggestion of a Greece style bailout. One line of thinking is that a Puerto Rican bailout would set a bad precedent, encouraging other territories, cities, and even states to plead with Washington for emergency loans.

What does this mean for us? Well, some investors on the mainland are likely to be affected. That's because a large part of Puerto Rico's debt lies in the form of municipal bonds, which the local government issued so it could raise funds to pay for public infrastructure, like road and sewer maintenance, electricity … basic services that most of us take for granted.

One estimate says that over 20% American bond funds own bonds issued by Puerto Rico.[6] That means regular investors who have invested in these funds also own bonds issued by Puerto Rico, at least indirectly. If the value of Puerto Rico's bonds drop in value (they are already rated as junk status, meaning they are at a high risk of default), then those investors will feel the effects … or at least, their portfolios will. [3]

And Finally … Canada

Stay with us, because we're almost through. While the story here isn't nearly as dramatic, the world's second largest country hasn't been able to entirely escape the news. On July 31, Statistics Canada, the government agency in charge of keeping official stats, announced that the economy shrank by 0.2% in May.[7] That doesn't sound so bad, right? Unfortunately, it's the fifth month in a row. In fact, the numbers for all of 2015 suggest that Canada is nearing the edge of a recession.

Technically, a recession is two straight quarters of falling GDP growth. Canada hasn't quite reached that point, but it's still a worrisome sign. The problem here is oil. Oil prices have continued to fall, sliding 20% in the month of July.[8] While that's good news for motorists, it's bad news for the many Canadian companies that produce the stuff. Many of these companies have been forced to reduce spending and halt new business. If you remember the rule that one person's spending is another person's income, you'll find it easy to understand why this could seriously harm Canada's national economy.

What does this mean for us? At the moment, it's unclear. But if there's a prevailing theme to this message, it's that we live in a global, interconnected world, with a global, interconnected economy. Stress in one region can potentially lead to tremors in another … and that is the reason for all the headlines.

That said, let's remember something the media too often forgets: this sort of thing happens every month of every season of every year. Sure, things may seem out of the ordinary when you see a lot of headlines involving a lot of different countries all at once. But there are almost 200 countries on the planet. Some of them will always be at war, always be in a recession, and always be struggling with some issue or another.

To put it another way, it's always raining somewhere.

So while we hope you found this quick trip around the globe informative, remember: we never make financial decisions based on the headlines. Our team is always staying up-to-date, so if something ever happens that could affect your personal economy, you'll be the first to know.

In the meantime, keep on enjoying your summer! Have some fun with the people you like best. And remember that we'll always be here to hold down the fort.

If you have any questions about Greece, China, Puerto Rico, Canada, the markets, or anything else, please give us a call at 518-499-4565. We'd love to hear from you.

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