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More Acts to Come in Greek Debt Drama

By VITO J. RACANELLI | MORE ARTICLES BY AUTHOR

Investors should realize that the country's second bailout solves its problems for a few mo resolution.

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With a second bailout of Greece preliminarily agreed to last week by the European Union, the world is once again safe for investors—not.

The EU's proposal to throw Greece another 90 billion to 120 billion euros means the financial threat has eased temporarily, say to Defcon 2 from Defcon 1. First, the new money still must get the final OK in coming months. Regardless, when Greece's books have to be examined again to see whether it has achieved its ruinously difficult austerity plans, stock-market fretting and volatility will begin anew.

"The situation is solved for some months," says Asoka Woehrmann, the Frankfurt-based chief investment officer of DWS Investments, but it's not resolved. Government officials should use the time to come up with a long-term plan that will reduce Greece's debt level. Some kind of "soft restructuring" is inevitable, he adds.

This second bailout—which follows the €110 billion life preserver of May 2010—was arranged after the Greek Parliament passed additional spending cuts and tax hikes, totaling €28 billion over five years, on Thursday. That cleared the way for release of a delayed €12 billion installment from the first bailout by the EU and the International Monetary Fund.

Presto. Greece narrowly avoids default again. Welcome to the 90-day world. Greece's unsustainable debt level will be back on the front burner by fall. Enjoy the summer and possible relief rally while you can. The volatility will return.

WITH MARKETS FOCUSED ON A SMALL COUNTRY living beyond its means, many investors might not have noticed a string of corporate-profit misses last week, unhappy surprises that, should they continue, bear watching.

To say these disappointments confirm a global economic slowdown would be an overstatement. Still, it's worth taking note that a disparate group, including retailer **Carrefour** (ticker: CRRFY), **Philips Electronics** (PHGFF), chemical company **Akzo Nobel** (AKZOF) and retailer **Colruyt** (CUYTF), came up short of expectations with a common chorus of higher costs and diminished pricing power.

Recently, Société Générale strategist Andrew Lapthorne wrote that global earnings momentum, or the ratio of earnings-estimate increases to total earnings-per-share changes, has weakened to around 40%, a level that is "normally associated with equity markets declining on a six-month basis." While stock prices and earnings momentum are coincident indicators, a deceleration shouldn't be ignored.

Danny Van Quathem, a money manager at SG's Private Banking division, gets paid to worry about corporate earnings. "I haven't made up my mind whether these companies are canaries in a coal mine or not," he says. "But I'm worried."

The consensus remains that global economic conditions will improve in the second half of this year and in 2012. Adds a somewhat skeptical Andrew Lapthorne: "Everyone is expecting profit margins and sales to grow at pretty healthy rates."

SHARES OF BOTH THE Nasdaq OMX Group (NDAQ) and the **London Stock Exchange Group** (LSE.UK) rose about 10% last week, on rekindled speculation about a combination of the two exchanges.

While that deal would be logical, it won't likely offer much, if any, of a premium from current levels. Any such union would likely be pushed as a stock-swap merger of equals.

First, the back story. Both have been frustrated in their pursuits of other exchanges —Nasdaq gave up chasing **NYSE-Euronext** (NYX) earlier this year, losing out to **Deutsche Boerse** (DBOEF). Last week, the LSE and **TMX Group** (TMXGF), which runs the Toronto Stock Exchange, terminated their proposed $3.7 billion merger.

Given Nasdaq's fervent but ultimately failed attempts to corral the LSE in 2006 and 2007, and the fact that the Deutsche Boerse-NYSE proposed deal is moving ahead, a Nasdaq-LSE hookup seems a strong possibility. The exchange environment has changed for the worse since 2006, with stock trading in particular not the profitable business it was.

There will be more exchange mergers, notes Jean Francois Comte, co-president of Lutetia Capital, a Paris-based fund specializing in picking merger targets. Lutetia remains long in TMX but has no position in LSE because there is more upside in TMX, which has another suitor, Maple Group Acquisition. In any LSE-Nasdaq combo, "I'm not sure there is going to be a significant premium," he adds.

Both Nasdaq and LSE are coming from weak positions now, and there is a rationale for a deal that creates value, says Diego Perfumo, an analyst with Connecticut-based Equity Research Desk. An all-stock deal with a small premium could be about 14% accretive to earnings of the combined entity, assuming about $150 million in annual synergies, he avers.

If there's a wedding, don't expect much of a party.

FOR THE WEEK, THE STOXX EUROPE 600 index jumped 4%, to 274.92, and is flat for the first half of 2011. Next Thursday, the European Central Bank is expected to raise its benchmark refinancing rate by 25 basis points, to 1.50%.

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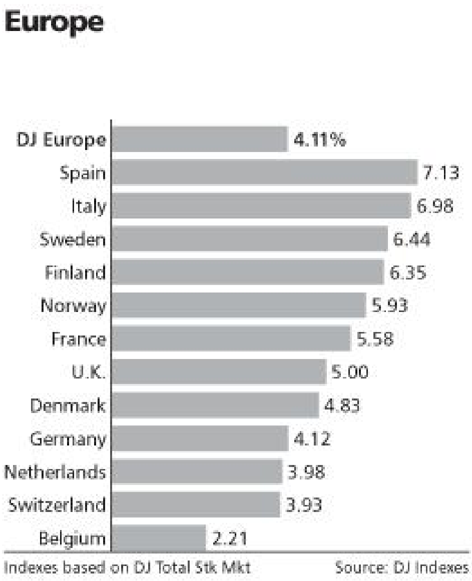

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