Russell's view: Surprisingly, Europe delivers

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A message to financial advisors and their clients

This message discusses Russell's perspectives on this week's European summit.

As events continue to unfold about the global markets, Russell Investments' experts will continue to share their insights with you.

Blueprints for the three-legged stool

Going into this week's European summit, market expectations for substantive moves by politicians and policy makers were actually quite high. In the last 18 months, every time the market had expectations like these, policy makers had responded with the bare minimum to "kick the can down the road." This time, arguably when more was on the line than ever, they actually delivered a response that met the relatively high expectations.

The European leaders—namely Merkel and Sarkozy—gave themselves the effectively self-imposed deadline of this week's meetings to craft a plan. It would appear that the deadline created enough leverage for the leaders of the 17-nation Euro to form a response that actually has a chance of addressing the issues lying before them.

What did they agree to do? In so many words, they actually showed the blueprints for the three-legged stool that we have said will form the outline of the solution to the sovereign debt crisis:

1. They recommended expanding the EFSF (European Financial Security Fund) to up to one trillion euros, principally through the use of leverage (details to come later) of the current 450 billion euro fund.

    a. This expanded pool of money will allow the EFSF to provide subsidized financing for Greece and the other peripheral countries for some time to come.
    b. They also outlined the deadline and approach to the recapitalization of the European banking system, at a cost of roughly 110 billion euros.

2. They reached agreement with banks that hold Greek debt on the size of the haircut (decrease in the face value of bonds) they will be taking, which is approximately 50%.

3. They continue to demand that peripheral countries plan and implement austerity measures, as evidenced by the incremental commitments that Italy approved this week.

Although the only thing that we have seen is the plan—and in some areas only the broad outline at that—the commitment shown this week by European leaders has done a great deal to make a worst-case outcome even more unlikely. Earnings are solid and the outlook for risk assets is more positive than it was yesterday.

That said, this is not over.

The devil is in the European details. And because 17 different countries are involved, there will be ups and downs; but perhaps the *crisis* is over and maybe we've entered the beginning of the end. Angela Merkel deserves some credit, as she has shown strong leadership in the last two weeks and, as the market response has evidenced, that has been a very good thing.

If you have any questions about this article, please contact your Russell representative or financial advisor.

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