Real Money: How to best benefit from the breakup of the euro?

Rob Rikoon | Posted: Monday, June 3, 2013 10:00 pm

Once in a while, an investment theme emerges which makes good sense, is not widely held and allows ample time to take advantage of an as-yet-unrecognized inevitable trend. Having recently traveled to Germany, it was clear to me that the animal spirits of German industrialism and entrepreneurialism are alive and well. The work ethic is intact and German consumers, abounding with optimism about their future and infused with a green sensibility, will propel their economy steadily upward for the foreseeable future. Crossing the border into the Czech Republic, economic conditions were markedly different, exciting in their own way. The Czechs, though they are not affluent like the Germans, are full of vitality, working and playing hard, exhibiting all the hallmarks of an entrepreneurial culture. In contrast, the French, Spanish and southern Italian economies are blatantly unproductive.

The central theme here is that while the European Union provides political and military stability, the European currency, the euro, is a noose around the necks of the flailing economies of those nations mired in a deep recession or depression. The weak economic countries in Europe — Greece, Spain, Portugal, Italy, France, Ireland and several former portions of the communist bloc — are facing a prolonged period of suffering. Because Europe's leaders are unable to publicly admit that the euro is a disaster, these moribund economies are unlikely to emerge from their deeply disadvantaged positions. A radical reorientation of their economic policies can be implemented most efficiently by de-linking the financial policies of the strong nations from the weak. This means the end of the euro as a common currency.

The reason the Czech Republic is fairly dynamic is that it has its own currency. The Czech never accepted or wanted to be part of the euro, but they still enjoy the benefits of being part of the European Union. Domestic forces control local interest rates, currency values, government spending and the regulatory environment. This stands in stark contrast to Italy, Spain and France (and others who use the euro), where local decisions must be approved by centralized bureaucrats who run the various European Bank mechanisms. These people in Brussels must balance the competing interests of all 18 members and often end up deciding what amount and form of local government activity is to be supported or curtailed.

As a result of this "coordinated" economic policy, no one country gets quite what they need. Consumer demand, employment opportunities and construction activity therefore continue to contract when they most desperately need growth to stave off domestic political unrest. Currency devaluation and aggressive government spending is the typical recipe to pull a country mired in recession out of the doldrums. This is what is happening in United States and Japan, but the European countries whose growth is stymied and who are entering their third year of recession cannot take such actions.

France is the good example of a country with flawed spending, taxation and regulatory policies which will eventually sink its economy unless it de-links from the euro. The markets have not acknowledged this eventuality, but one day they will! Portugal, Spain and Italy are on financial life-support systems, with transfers from Germany and the northern European countries needed to keep their big banks afloat and their economies running. Resentment is rising in the northern donor countries as well as in the recipient populations, not a good recipe for furthering the cause of unity.

The euro was created by bureaucrats with the understanding that it was an experiment. The time will come when those mired in depressions will recognize that they can recover only by having their own currency to devalue. The euro experiment, at least its first reiteration, will most likely come to a close. Devaluing one's currency results in factories operating at higher capacity utilization levels, it allows goods and services to be sold cheaper on an international scale, and it narrows the disparity in employment opportunities between countries, reducing the need for emergency and ongoing transfer payments.

The current political situation, which revolves around saving the euro, makes de-linking and then devaluation impossible. This means that countries with chronic deficits and moribund growth prospects will remain ill, and that European Central Bank-imposed austerity programs will continue to constrict domestic demand, choking off the possibility of growth and continuing the cycle of dependence.

The inevitable endgame has to include abandoning blind allegiance to the euro. I see no other way out and, if this is true, it provides investors with the opportunity to make money. If the euro in its current form is going to fail, who will suffer and who will gain becomes a key investment question. Hedge funds are generally the first ones to pounce on currencies that are going to implode, and then most investors will probably abandon those nations' stock markets that look like they're going to capsize.

The challenge to investors is to develop both a short- and long-term strategy that takes into account this seemingly improbable but likely change. It may be portrayed in the media as the end of the world, but in fact, it would serve as an eventual contributor to the long-term stability of various economies that today have no hope of re-energizing themselves. I invite readers to email me if they have ideas of how to take advantage of this possible change and will compile a list of these suggestions and circulate them back to anyone who participates in this process.

Anticipating investment trends is a tricky business, and game-changing events do not happen often. The removal of the U.S. dollar from the gold standard and the emergence of OPEC as a force in energy markets were two such examples. The eventual breakup of a single European currency would be a stimulating and exciting development, one worth thinking about well before its ripple effects spread across the great pond.

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