KIM: Is new Greek bond deal "Déjà vu all over again?"

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In August 2015, I wrote about Greece's ***third*** trip to the brink of default since 2010, the crisis *du jour* for world financial markets. Its lenders demanded Greece be held accountable and pay for its spendthrift ways by suffering the consequences of a draconian "austerity program."

I said while Greece was to blame for this "crime," it had a *most* willing accomplice; the lenders themselves. Fast forward to last month and investors were once again clamoring to buy bonds from Greece. As Mark Twain said, "history doesn't repeat itself, but it rhymes."

Governments and corporations borrow by issuing bonds, which are a contract between the borrower and lender detailing the timing and amount of interest to be paid (i.e. the "coupon") and when the principal amount borrowed is to be repaid (i.e. the "maturity"). Because the amount and timing of the cash flows are contractually set, bonds are referred to as "fixed income" investments.

Although the cash flows are fixed by contract, the price of a bond will fluctuate between the date of issuance and maturity based on ***interest rate risk*** (bond prices fall as interest rates rise) and ***credit risk*** (the risk the issuer defaults).

Unlike stocks, there is ***no upside*** beyond receiving the contracted payments. The key to investing in bonds is determining if you're being paid enough to compensate you for the risk the issuer defaults. The higher the credit risk, the higher the interest rate or yield you should demand.

The two primary credit rating agencies are Standard & Poor's (S&P) and Moody's. S&P rates bonds on a scale of AAA (strongest) to D (weakest), while Moody's scale runs from Aaa down to C. Bonds rated BBB- (S&P)/Baa3 (Moody's) and above are considered "investment grade," while lower rated bonds are "high yield" or "junk."

In April 2014, Greece had been in exile from the world financial markets since March 2010, when it issued bonds just weeks before the markets lost confidence in Greece, forcing its first bailout by the European Union and IMF. Then, as now, investors tend to 1) have short memories and 2) over-reach for yield, particularly in this era of ultra-low interest rates.

Greece decided to test the waters by marketing a 2.5 billion Euro ($3.5 billion) bond issue maturing in 5-years with a mid-5% interest rate. The results were astounding, as 550 institutional investors placed orders for more than *20 billion* Euros of bonds ***(eight times more than Greece wanted to sell)***. This enabled Greece to both *upsize* the deal to 3 billion Euros and *reduce* the interest rate to 4.75%.

Alas, the honeymoon proved short-lived. By the end of 2014 the bonds were trading below 80 cents on the dollar and bottomed at 40 cents in early July 2015.

The Greek economy was devastated by the harsh austerity measures, but is showing signs of recovery. Both S&P (B-) and Moody's (Caa2) consider Greek bonds "highly speculative," but investors clearly believe the third bailout will prove to be the charm and eagerly snapped-up 3 billion Euros of new 5-year bonds.

Time will tell if the 4.625% yield on the new bonds is sufficient compensation for Greece's credit risk, but with bailout support ***and*** shackles both expiring next August, I'm afraid we've seen this movie before.
