

“1914 is the New Black”

Man in Black: All right. Where is the poison? The battle of wits has begun. It ends when you decide and we both drink, and find out who is right ... and who is dead.

– ***“The Princess Bride” (1987)***

Time is a game played beautifully by children.

– ***Heraclitus of Ephesus (535 – 475 BC)***

How can you hide from what never goes away?

– ***Heraclitus of Ephesus (535 – 475 BC)***

Whoever cannot seek the unforeseen sees nothing, for the known way is an impasse.

– ***Heraclitus of Ephesus (535 – 475 BC)***

Let me just say that I am very negatively surprised by today’s decisions by the Greek government. That is a sad decision for Greece because it has closed the door on further talks, where the door was still open in my mind.

– ***Jeroen Dijsselbloem, head of Eurogroup finance ministers***

The judge smiled. Men are born for games. Nothing else. Every child knows that play is nobler than work. He knows too that the worth or merit of a game is not inherent in the game itself but rather in the value of that which is put at hazard. Games of chance require a wager to have meaning at all. Games of sport involve the skill and strength of the opponents and the humiliation of defeat and the pride of victory are in themselves sufficient stake because they inhere in the worth of the principals and define them. But trial of chance or trial of worth all games aspire to the condition of war for here that which is wagered swallows up game, player, all.

– ***Cormac McCarthy, “Blood Meridian, or The Evening Redness in the West” (1985)***

I have always thought that in revolutions, especially democratic revolutions, madmen, not those so called by courtesy, but genuine madmen, have played a very considerable political part. One thing is certain, and that is that a condition of semi-madness is not unbecoming at such times, and often even leads to success.

– ***Alexis de Tocqueville (1805 – 1859)***

Children and lunatics cut the Gordian knot which the poet spends his life patiently trying to untie.

– ***Jean Cocteau (1889 – 1963)***

If you don’t like how the table is set, turn over the table.

– ***Frank Underwood, “House of Cards” (2013)***



Nothing like a good Friday-after-the-close blockbuster to set the stage for an interesting week.

At 1am Saturday morning Athens time, the Greek government called for a nationwide referendum to vote the Eurogroup's reform + bailout proposal up or down. The vote will happen on Sunday, July 5th, but Greece will default on its IMF debt this Wednesday, and as a result the slow motion run on Greek banks is about to get a lot more fast motion unless capital controls are imposed. If you want to get into the weeds, Deutsche Bank put out a note, [available here](#), that I think is both a well-written and comprehensive take on the facts at hand. As for the big picture, I've attached last week's Epsilon Theory note ("[Inherent Vice](#)"), as **this referendum is EXACTLY the sort of self-binding, "rip your brakes and steering wheel out of the car" strategy I wrote about as a highly effective way to play the game of Chicken.**

Look, I have no idea whether or not Tsipras will be successful with this gambit. But I admire it. It's a really smart move. It's a wonderful display of what de Tocqueville praised as the "condition of semi-madness" that was so politically effective in 1848, and I suspect will be today. Plus, you can't deny the sheer entertainment value of hearing Dijsselbloem splutter about how he was open to a revised, revised, Plan X from Greece all along, if only Tsipras would continue with this interminable charade. "The door was still open, in my mind." Priceless.

So long as Tsipras can avoid market anarchy and TV coverage of violent ATM mobs this week, I think the NO vote is likely to win. The referendum is worded and timed in a way that allows very little room for Antonio Samaras and other Syriza opponents to turn the vote into a referendum on the Euro itself, which has proven to be a successful approach in the past. Particularly as the Eurogroup rather ham-handedly denied the request for a one-week extension in the default deadline, the referendum is being framed by Syriza as what Cormac McCarthy called a "condition of war", an over-arching game where "that which is wagered swallows up game, player, all." **It may well be a close vote, but it's hard to vote YES for a public humiliation of your own country under any circumstances, much less when that YES vote is being portrayed as giving aid and comfort to the enemy.**

Here's how I see the game playing out after the vote.

If Greece votes to accept the Eurogroup reform proposal after all, then the game of Chicken resolves itself within the stable Nash equilibrium of a shamed Greece and a triumphant Euro status quo. I would expect an enormous risk-on rally in equities and credit, particularly in Euro-area financials. Hard

to say about rates ... peripheral Euro debt (Italy, Spain) should rally, and German Bunds might, too, as the Narrative will be that Germany "won". But reduction of systemic risk is a negative for any flight-to-safety trade, so this outcome is probably not good for Bunds in the long term, or US Treasuries over any term.

If Greece votes to reject the proposal, then either the game resolves itself within the stable Nash equilibrium of a shamed Euro status quo and a triumphant Greece (if the ECB and EU decide to cave to some form of the original Greek proposal), or we enter the death spiral phase of a game of Chicken, as all parties start to talk about how they "have no choice" but to crash their cars. That latter course is the far more likely path, I think, given how the various Euro Powers That Be are already positioning themselves. It's all so very 1914-ish. **Draghi's cap on bank-supporting Emergency Liquidity Assistance (ELA) is the modern day equivalent of Czar Nicholas II's troop mobilization. Good luck walking that back.**

If we go down the death spiral path and some form of Greek exit from the Euro-system, I expect the dominant market Narrative to be that Greece committed economic suicide and that the rest of Europe will be just fine, thank you very much. That should prevent a big risk-off market move down, or at least keep it short-lived (although you should expect Bunds and USTs to do their risk-off thing here). [Unless you're a hedge fund trying to make a killing on those really cheap Greek bonds you bought two years ago](#), there's no reason to panic even if we're on the death spiral.

Over time, however, I expect that dominant Narrative to be flipped on its head. Greece will quickly do some sort of deal with Russia (hard currency for port access?), and then the IMF will strike a deal because that's what the IMF does. More and more people will start to say, "Hey, this isn't so bad", which is actually the worst possible outcome for Draghi and Merkel. At that point, you'll start to see the Narrative focus on the ECB balance sheet and credibility, and as Italian and Spanish rates start to creep up and as the spread to Bunds starts to widen, people will recall that ECB QE only has national banks buying their own debt ... the Bundesbank ain't propping up Italian sovereign debt. **I suspect it will be a slow motion contagion, all taking place in the Narrative and expressed in Italian, Spanish, and French politics over the next 12 months or so.** [The Red King will start to wake.](#)

One last point on how the market Narrative will shift if we go down the death spiral path, and that's the dog that will stop barking. [The incessant and often silly focus on Fed "lift-off" is about to go on summer hiatus, which can't happen soon enough for me.](#)

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