Euro zone stocks at 3-month lows on Italian vote stalemate

Wednesday, 27 February 2013 03:36
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LONDON: Euro zone shares sank to three-month lows on Tuesday after an Italian election stalemate renewed concerns about the future of the euro zone and sent investors in search of insurance against a deeper sell-off.

No group managed to secure a majority in the Italian parliament, heralding weeks of political uncertainty and raising the prospect of a government of sworn enemies - the centre right led by former prime minister Silvio Berlusconi and the centre left under Pier Luigi Bersani.

"In the medium term we think that Italy is unlikely to abandon reforms or leave the euro, but the politics before then could turn into a game of chicken. And equity markets really hate games of chicken," said Derry Pickford, macro analyst at investment manager Ashburton.

Italy's benchmark FTSE MIB index sank 4.9 percent to 15,552.20 points, posting its biggest daily fall in nearly a year and with all but two of its 40 companies in the red.

The EuroSTOXX 50 index closed down 3.1 percent at 2,570.52 points, its lowest finish since Nov. 28. The move extends the euro zone blue chip index's retreat from an 18-month high of 2,754.80 points hit at the end of January.

The broader, pan-European FTSEurofirst 300 fell 1.4 percent to 1,150.25 points.

"It introduces a whole range of uncertainty at a time when the markets were quite toppy anyway and were probably ready for some sort of correction," said Paul Jackson, strategist at Societe Generale.

Worries about a new flare-up in the euro zone's debt crisis fed through to the bank sector, whose lenders could be hit with new writedowns and bad debts if the region's economy weakens as a result of debt problems in countries such as Italy and Spain.

The STOXX Europe 600 Banking Index was the worst-performing sector, falling 3.1 percent with Italian banks such as Intesa and nicredit - which own large amounts of Italian government debt - tumbling 9.1 and 8.5 percent, respectively.

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Spooked by the steepness of the fall, investors rushed out to buy put options - which give the right to sell the index at a pre-set price in the future, thus protecting against or simply betting on a fall in the market.

Implied volatility on the euro zone index - a crude barometer of investor risk aversion, based on how much people are willing to pay for options - surged 21.5 percent to new 2013 highs, though at 25.90 points it was still some way below last year's peak of 38.31 points.

Investors also sought refuge in sectors which earn most of their profits outside the euro zone and should thus be less affected by any crisis there.

Within those, Simon Maughan, strategist at Olivetree Securities, recommended focusing on stocks which have underperformed so far this year and those which pay dividends.

"If you look at the relative performance of Energy, Basic esources and some Industrials, they are outperforming markedly," he said. "iding out in these sectors, as well as utilities and some telcos, is the way to lose as little money as possible in this latest storm, which has its eye on Italy, but with cross winds throughout Europe and in France in particular."

The STOXX 600 Basic esources index fell only 0.2 percent, making it one of the best performing sectors.

Analysts said that in the longer term the current sell off could offer an attractive opportunity to snap up cheap European stocks, but cautioned that it may be soon to start buying in - a view that was also backed by technical analysis charts.

"The Italian index has not yet reached an obvious support, it is too early to step back into equities," alerie Gastaldy, analyst at Day By Day, said in a note.

"The weekly chart of the FTSE MIB shows that the index is back into its large trading range, between 12,320 and 17,000. When an index breaks out and then reintegrates such a pattern, we can expect it to move back to the middle of the range. This level would be around 14,715."