Greece: No Widespread Panic After Painful Weeks

Our View After the Weekend's News

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INVESTMENT TALKS

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In some ways, recent events could lead to an improved future for the Eurozone: with clearer positions and support by democratic legitimacy.

We believe that there is no reason to panic: Eurozone is much more prepared than four years ago to a bad event, direct exposure versus Greek assets is low.

The Greek Saga Escalated During The Weekend, With Premier Tsipras Calling For A Snap Referendum. What's Next?

Next Sunday, the Greek people will technically be voting on the terms offered by the trio of institutions (European Commission, European Central Bank and the International Monetary Fund) – although it is unclear as of this writing exactly what will still be "on offer" come this weekend. However, we emphasize that the vote is ultimately about whether Greece is to remain in the common currency (yes) or to pursue "Grexit" (no). As such, at the end of the day, whether Greece remains in or out of the Eurozone would be in the hands of the Greeks themselves. We see a positive in this: a clear democratic mandate could help all stakeholders move forward without the political stalemates that have continually stalled the process.

We have many times highlighted that Europe's fragility results from a Monetary Union crossed with the lack of political integration; the strenuous negotiations of recent days are a clear symptom of it. However, the concrete possibility (even if not the most likely outcome at this stage, in my view) that a country leaves the Eurozone can act as a further stimulus to accelerate the integration. We believe this is a test for the future of the Eurozone, and has far broader implications than for the Hellenic Republic itself.

Recently, S. Fischer, the vice chairman of the Fed's Board of Governors, said that the relative tightness of the Eurozone's integration is periodically challenged through a series of crisis episodes. He argues that in the end, a more cohesive Europe could emerge along the lines suggested by the recently released "Five Presidents'" report, which charts a course for strengthening the Economic and Monetary Union. Moreover, the threat of centrifugal forces that, from left to right, are visible in the political debate in Europe could lose some of their popular appeal and impact, given how the European media have depicted the current Greek drama's impact on the Greek people themselves.
It will be a turbulent week for the Greek people because of the limitations imposed on currency and the closure of banks. This will likely add to the desire to remain part of Eurozone – both for Greece and for other peripheral members.

Markets Opened Today Experiencing A Bout Of Volatility And Weak Equity Market, How Long It Will Last?

The result of a Greek referendum is currently unknown, therefore the situation remains binary, with Greece either remaining part of, or chaotically exiting, the Eurozone. Therefore, volatility will no doubt last for a while in financial markets. However, **we believe that there is no reason to panic**: the Eurozone is much better prepared than four years ago for a crisis event even of this magnitude, with direct exposure to Greek assets being relatively low internationally. Moreover, European institutions – the ECB first and foremost – will smooth as much as possible excessive volatility. The current Quantitative Easing (QE) programme and all the

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instruments that the ECB added to its toolkit, up to and including OMT (Outright Monetary Transactions), should avoid a widespread contagion impact.

We are convinced that the most likely result of the referendum is a "Yes" vote to Europe.

Which Are The Main Uncertain Issues Now And Which Is The Most Likely Scenario?

There are many uncertainties and we are closely monitoring the situation. The main uncertainty, before the upcoming referendum, is still related to what will happen on June 30th, the expiry date for the €1.5 billion that Greece owes the IMF. In the meantime, the ECB may well suspend the ELA facility (Emerging Liquidity Assistance), although the impact of having done so would be mitigated by the current forced "bank holiday". It's extremely difficult to base investment strategies on political events such as a referendum, which are by definition binary, as we said above.

However, we believe that the most likely result of the referendum is a "Yes" vote to the Eurozone.

In that case, with a possible change in Greek political leadership, we could see an acceptance of EU conditions, new funding and an implementation of structural reforms reinforced and endorsed by Greece. Capital controls will likely be mantained for a long time. In the meantime, the role of the ECB to support the Greek banking system will be crucial. It will help to smooth the eventual transition to normality.
Even in this scenario, there remains the risk that a prolonged period of uncertainty could negatively impact the confidence in the Eurozone, weakening the current positive momentum.

We are entering in the current market phase with a defensive approach, as we were expecting a rise in market volatility.

What Investment Approach Might Be Appropriate to Deal With A Rise Of Volatility Due to The Greek Situation?

We are entering in the current market phase with a largely defensive approach, as we were expecting a rise in market volatility.

Our Multi-Asset team takes the view that it is worth strongly considering keeping (and increasing) some form of protection on risk assets, despite an improvement of macro-economic conditions. They are still constructive on risky assets, especially equities, and we maintain a positive view on US dollar, but with geopolitical risks on the rise on different fronts (Greece, but also Middle East, IS, Russia) they suggest keeping some protection in place through hedging strategies.

Our European Fixed Income team was also expecting an increase in stress spreading from Greece to other peripheral countries and in credit markets, where valuations have become stretched after a long bull market. For this reason, they have suggested caution with exposure to Spanish and Italian government bonds which could suffer in the short term. However, we believe that both countries have made real progress in term of structural reforms that make them more resilient that in the past. Moreover, as highlighted above, the contagion should be limited also by the strong will of the ECB to do *"whatever it takes"* to preserve financial stability in the Eurozone.

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