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Greece: A Big Fat "NO" Vote

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Greek voters went to the polls on Sunday (July 5) to vote on a referendum as to whether to accept the bailout proposal by the troika of creditors (IMF, ECB & EU). The results were a "no" vote by a wide margin (61% voting "no"). However, based on various polls, 74% of Greeks want to stay in the Euro.

On the surface, Sunday's vote would seem to empower Prime Minister's Alexis Tspiras's position to negotiate more favorable bailout terms for Greece. Either aiding or compounding the situation, Greek Finance Minister, Yanis Varoufakis, has resigned. This move suggested that an impediment is being removed from the negotiating table, so to speak, as it was apparent that Varoufakis and his approach were not making headway with the troika.

The likelihood that the outcome of the Greek referendum changes the deal is less than clear. In that regard, German Chancellor Angela Merkel, traveled to Paris yesterday (Monday) to meet with French President Francois Hollande to discuss the latest developments. Within the EU, there is a split in terms of "leanings," with the Germans representing the "hawks" and France representing the "doves." A neutral stance as noted on Bloomberg comes from Austria: "It's now up to the Greek government to make proposals about how to proceed," Austrian Chancellor Werner Faymann said in a statement on Monday.

The direction and result of negotiations over the next week or so will have important implications for, not only Greece, but the integrity of the Eurozone longer term. If the troika makes significant concessions as a result of the referendum, it would likely empower other anti-austerity movements. The Economist notes the following as it relates to the entire process and the referendum results: "many believed they had launched an anti-austerity revolution that would soon sweep the rest of Europe."

The next move now has to come from Tsipras. Capital controls are having a very negative effect on the economy in Greece and the availability of cash (Euros) at Greek banks is quickly waning. The likelihood of exporters or other business entities depositing cash in Greek banks is very unlikely. We believe that the following is a key issue when considering the broader ramifications or contagion risk in the context of recent history: unlike 2008, where financial institutions, money market, equity and fixed income mutual funds held the paper from Lehman and other fallen angels, approximately 85% of Greek paper is not held by private institutions, creating a lower level of contagion.

Yesterday, European bourses were active with the major indices off on the day, while Asia was off more. As to Asia, a good deal of the dislocation in that region is attributed to the bear market sell-off in China following a period of significant and unsustainable gains. In the U.S., equity markets were off on the day, with the major indices closing down fractionally and well off their lows of the day. The ten year U.S. Treasury bond is trading under 2.25% this morning, an obvious beneficiary of the flight to quality. Sovereign and U.S. high yield debt are not rising significantly on a yield basis and credit default swap spreads at EU banks are not widening in any significant way.

This morning, European equity markets were off fractionally, while China closed down over 1% (well off their intraday lows) and equity markets in Japan were up over 1%. In the U.S., equity market futures were up marginally on a pre-market basis.

There was little new in the way of news after yesterday's events. The EU finance ministers meet today in Brussels at 6:30PM (12:30PM EDT) to discuss the situation. It is clear that the so called Eurogroup is waiting on a creditable proposal by Tspiras.

This latter point is underscored by the following comment made by German finance minister, Wolfgang Schaeuble, "Of course the EU has every obligation to help Greece, but it will all depend on the decision of the Greek government. We are waiting for that with excitement."

Updating the saga through noon (EDT) today, reports coming out of Brussels indicate that Greek officials have arrived without a new set of specific proposals. The expectations are that Greece will be submitting a new set of reform proposals either tonight or tomorrow. As a result, equity markets are trading lower today in another day of "risk-off" trading.

In our opinion, the contagion from these events appears limited, given the size of the Greek economy and the ownership of their paper, as previously noted. However, we see volatility continuing over the near term. In these environments, higher quality assets will fare better, which is consistent with our investment philosophy and process.

On an intermediate and longer term basis, the U.S. markets will react more to and be priced based on corporate profitability and the upcoming second quarter earnings reporting season, as well as Fed policy. As to the latter, the events in Greece will no doubt be considered in the timing of the first Fed rate increase and could possibly affect the timing (September or December) but not the eventual outcome.

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