Greece sparks a major sell-off

- June was a difficult month for markets. The uncertainties around the further developments in Greece weighed on market sentiment. The Greek government was not able to agree with the EU on a reform package and was thus left without further financial support. Furthermore, the Greek government did not repay its IMF loan of EUR 1.55 bn. Prime Minister Alexis Tsipras called for a referendum and asked the Greek population to vote against austerity policy measures. The Greeks supported this request with a clear 61% majority. Although finance minister Yanis Varoufakis resigned on 6 June to facilitate further negotiations with the EU, the outcome of the referendum makes a compromise any time soon highly unlikely.
- In June most equity markets sold off; the EuroStoxx50 index lost 3.9%, the German Dax 4.1% and the Swiss SMI 4.9%. Also the S&P500 index lost 1.9%, the Hang Seng index 4.3% and the Nikkei index 1.6%. This was followed by further losses in early July.
- Bond markets also lost ground. 10-year benchmark yields rose 28 basis points in Europe and 24 basis points in the US. Credit spreads widened across the board. Gold did not benefit from the uncertainties, falling 1.7% in June with increased losses in the first week of July. Industrial metals fell 4.8% and oil also dropped 4.8%. The Euro appreciated in June by 1.6% but lost value after the Greek referendum.
- While markets were hit hard by the worsening Greek crisis, economic growth data improved, especially in the US and Europe, and suggest that economic recovery is progressing well.
- We think that the Greek drama will have little impact on the economic development of the rest of Europe and regard contagion risks as rather muted. While the recent market correction for European equities has been quite severe, we remain positive on European equities and rather see current weakness as a buying opportunity. European growth data continue to improve and valuations look more attractive, both in relative and absolute terms. A word of caution, though, since it is always hard to call the trough of a market move and we think the sell-off could possibly intensify in the coming weeks. We remain positive for Japanese equities and believe that the USD is likely to strengthen further. We remain cautious on bonds and bearish on US bonds.

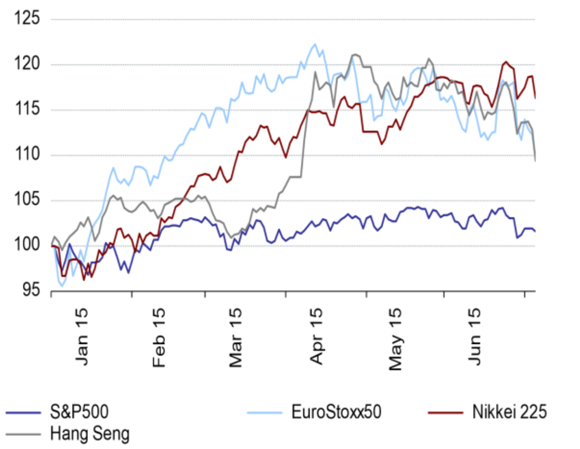
Macroeconomics and financial markets

By and large we saw stronger economic data in June. The US ISM index rose to 53.5 from 52.8 in May, which was a strong reading and suggests that the economy is recovering from a very weak first quarter. Also, US consumer sentiment improved markedly in June. The University of Michigan consumer confidence index climbed to a five-month high of 96.1, exceeding expectations. The US economy has again created more jobs, albeit at a slower pace. The non-farm payrolls rose 223,000 in June after 254,000 in May. The unemployment rate fell to a seven-year low of 5.3%. This, however, is partly attributable to people leaving the workforce. Average hourly earnings at private employers rose only slightly by 2% YoY, which suggests that wage inflation remains moderate for now.

The Markit Eurozone PMI Composite Output Index rose to 54.2 in June, up from 53.6 in May, thus, reaching a four-year high. Growth accelerated both in the manufacturing and the service sector. New business as well as employment indices expanded at solid rates. Economic growth was broad based and improved in Germany, Italy and France.

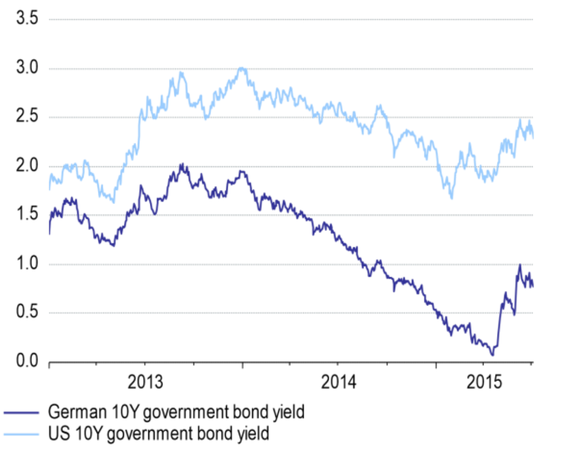
However, business conditions in China remained difficult. The HSBC Manufacturing PMI index rose slightly to 49.4 in June from 49.2 in the prior month and thus remained in contraction territory (below a level of 50). Chinese manufacturers further reduced production and cut jobs in June. Meanwhile, there has been an increase in new orders, driven by both higher domestic and export demand. As a result, stocks of finished goods have declined somewhat.

Fig. 1: Major equity indices in 2015



Source: Thomson Reuters Datastream / Blue Horizon Wealth Partner AG

Fig 2: 10Y bond yields



Source: Thomson Reuters Datastream / Blue Horizon Wealth Partner AG

Outlook

The result of the referendum on 5 July has made a short-term negotiated solution more unlikely. In fact, it has become even harder to re-start negotiations at all. In our view, restructuring of Greek debt has become inevitable. Whether the country's banks will be able to avoid insolvency is still not clear. A bank run already started and the banks had to be closed. It remains to be seen whether the ECB will do whatever it takes to keep Greek banks afloat, given the non-cooperative stance of the Greek government. That government may at some point even decide to exit the European Union. However, we do not regard the Grexit as absolutely inevitable, even in the case of an uncoordinated debt restructuring.

In any case, we believe that neither a Greek debt default, whether coupled with a Greek exit or not, would necessarily prove to be catastrophic for Europe. More than 80% of Greek debt has been transferred to official institutions, with the ECB holding the lion's share of it. In addition, other EMU periphery countries have undertaken significant economic reforms in recent years and look much healthier than four years ago. As a result, we consider contagion risks to be rather muted.

While the recent market correction for European equities has been quiet severe, we remain positive on European equities and rather see current weakness as a buying opportunity. European growth data continue to improve and valuations look more attractive, both in relative and absolute terms. A word of caution, though, since it is always hard to call the trough of a market move and we think the sell-off could possibly intensify in the coming weeks.

We remain positive for Japanese equities and believe that the USD is likely to strengthen further. We remain cautious on bonds and bearish on US bonds.

Besides Greece, the risk to watch is the timing of the first Fed rate-hike, which has the potential to induce a market correction. We still expect a Fed rate-hike for September, most likely accompanied by rather dovish rhetoric. Market expectations with regard to a Fed rate-hike have been volatile. Mid-June, money market futures suggested a 25 basis points rate-hike in September, while in early July expectations came down to about a 50% probability of a rate-hike.

Blue Horizon Wealth Partner AG
Sihlhaldenstrasse 10
CH-8803 Rüschlikon / Zürich
info@bluehorizon-wp.com
www.bluehorizon-wp.com

Important Legal Notice