July 6th, 2015

July 4th, 1775 – 240 years ago, a fledgling land mass was deeply entrenched with the world's preeminent super power in a 10 year war later to be known as the American Revolution.

One year later on July 4th, 1776, after two days of strong debate amongst the Second Continental Congress, The United States of America declared their independence from Great Britain's rule.

History can be fascinating and a great insight into what the future may hold.

What is particularly interesting this year is potential Greek independence, and the difference a year makes.

At time of writing, the Greek 10 year bond yield traded at 18.25%[1].

One year ago today, the same Greek 10 year bond traded at a yield of 5.29%.

To help put these numbers in perspective, we look at other world players below (all are 10 year government bond yields)[1]:

COUNTRY	**July 4, 2015**	**July 4, 2014**	**YoY change**
United States	2.33%	2.66%	-0.33%
Canada	1.65%	2.32%	-0.67%
Germany	0.73%	1.27%	-0.54%
U.K.	2.01%	2.79%	-0.78%
Greece	14.82%	5.29%	9.53%
Switzerland	0.06%	0.61%	-0.55%
Japan	0.46%	0.55%	-0.09%
Australia	2.90%	3.58%	-0.68%
New Zealand	3.52%	4.47%	-0.95%
India	7.78%	8.66%	-0.88%

The chart above illustrates that the risk of default, indicated by required interest rate, for every listed major government's debt has been reduced over the last year, except for Greece, which has essentially tripled.

Why?

Greece recently missed its required payment to the IMF, International Monetary Fund, of €1.6 billion on June 30th.

While €1.6 billion is certainly significant, the act of being unable to make the actual payment was probably more significant.

To put €1.6 billion into perspective, let's look at some other Greek facts and figures:

- Greece's uncollected tax receipts as a percent of total receipts in 2010 was 89.5% compared to Germany's 2.3% uncollected rate[2]
- Greece's Gross Domestic Product is around €215 billion
- Compared to the Eurozone, a monetary union of 19 member states, Greece represents about 2% of total, €12 trillion[3]
- The largest GDPs in the EU are:
    - Germany accounting for nearly 30%
    - France 21%
    - Italy 16%
    - Spain 11%
- The EU's GDP is roughly equal to 128% of China's GDP but only 76% of the United States' GDP[4] and comprising about 18% of the world's GDP[5]
- Greece's primary growth sectors are agriculture and fishery, with the highest level of cotton and pistachio production throughout the European Union[6]
- Maybe the most *easily digestible* stat is of Greek yogurt, which is expected to be in negative growth territory as a whole, previously accounting for a significant portion of the > $7 billion U.S. yogurt market annually[7]

As Krishna Memani, Chief Investment Officer for OppenheimerFunds, a global investment manager of nearly $250 billion in assets noted:

> *"in a surprise to the financial markets, the results from Sunday's Greek referendum showed voters overwhelmingly rejected the terms of an international bailout. A "no" vote was not our base-case outlook, although it became more probable as the week progressed and no true Greek statesmen emerged to fight for the "yes" vote. In the end, Greek Prime Minister Alexis Tsipras convinced a voting public, who have supported continued membership in the Eurozone, that the referendum was an up or down vote on continued austerity and not on whether or not to remain in the Eurozone."*[8]

The comments above give us the "why" for the dramatic increase in rates for Greece over the last year, as things went from improving to worse.

Now the question becomes, "what do we do next?"

For Greece, the answer is complex and will have long-lasting consequences for itself, its citizens and its future.

For most of us, investors based in the United States, the implications of a "Grexit" may be much less significant.

To the question of "How will the financial markets respond?", Memani remarks:

"In European markets, we would expect to see a near-term flight to quality complete with lower interest rates in core European countries, declines in European equities, modestly wider interest rate spreads in peripheral Europe, and a stable to modestly weaker euro.

The U.S. dollar and U.S. Treasuries are likely to be near-term beneficiaries. The stronger dollar will probably act, as it did in early 2015, as a drag on U.S. growth and corporate profits, and that may put U.S. equities under pressure for the near term. Emerging market equities will likely decline and emerging market credit spreads may widen as money flows towards higher quality, U.S.-dollar-denominated assets.

Once the dust settles and further policy actions are enacted (including an expansion of the ECB's quantitative easing program and an extension of the U.S. Federal Reserve's zero interest rate policy), we believe the market response is likely to be favorable."

These above comments match with our sentiments for clients and their investment portfolios. The actions and their consequences probably present volatility in the near term but that transitions to opportunity when markets rebound, especially for active managers, which we have had a long-term bias towards in many asset classes we invest in.

Things happen, but by being appropriately diversified amongst stocks, bonds, real estate and commodities, domestic and international, dollar-denominated and foreign-denominated investments, our clients can expect to be buffered when strong shocks to systems occur. The opportunity now presents itself for investment management teams to find "babies thrown out with the bathwater" – great, quality companies that are sold in moments of panic, representing attractive entry points to otherwise appropriately-valued names and sectors.

In closing, I would suggest that headline risks will continue to be a prevalent concern as the interconnectedness and access to information continues to increase. However, a prudent investment thesis, partnering with well tenured, best of breed managers, and having portfolios structured to a client's individual plan and needs will continue to be the best path to success for clients, their families, and their wealth.

Situations like these are when an investment portfolio's time horizon and diversification amongst asset classes really comes in to play.

Now is likely a good time to add to accounts that are structured for long-term growth. It makes sense to buy when attractive assets are temporarily on sale.

If you have questions or concerns, or would like to review, update, or initiate your own financial plan, please call us – as always, we are here to help.

Davin Carey
Lead Financial Advisor
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Citations

1 – http://www.bloomberg.com/markets/rates-bonds
2 – http://www.washingtonpost.com/blogs/wonkblog/wp/2015/07/05/as-greece-votes-heres-everything-you-need-to-know-about-the-nations-crisis/
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8 - https://www.oppenheimerfunds.com/investors/article/greece-votes-no-is-grexit-next

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