



**BROMPTON**  
ASSET MANAGEMENT

## Grexit comment

29 June 2015



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### A potential buying opportunity but it will pay to be highly selective

Grexit, the term coined to denote a Greek default and departure from the euro, dominated the weekend headlines. The concepts of democracy and chaos, two much older words borrowed from the Greeks, were also in evidence as events unfolded in Brussels. First, the Greek prime minister, Alexis Tsipras, said the latest bailout proposals would be the subject of a referendum on Sunday, July 5. Then Christine Lagarde, head of the International Monetary Fund, warned that if Greece did not make tomorrow's scheduled repayment, the bailout proposal would be void and Greece would be cut off from further funding until its outstanding debts were cleared. This could leave nothing for the Greeks to vote on next weekend. Finally, the European Central Bank (ECB) president, Mario Draghi, confirmed there would be no additional financial support for Greek banks although current financing limits would be maintained. The Greek central bank has now imposed capital controls to protect the banking system.

What do these events mean for Brompton client portfolios? First of all, clients have no direct investment in Greek bonds or equities, the assets most obviously affected. Greece has shut its stockmarket but Greek bonds traded internationally fell sharply today. In the coming weeks, I would expect announcements from banks, financial institutions and hedge funds that may have suffered losses as a result. As was seen when Switzerland surprised investors earlier this year and announced the end of the link between the Swiss franc and the euro, it is almost impossible to predict the casualties of these events. I do not, however, expect private sector losses to be widespread given the long period of time investors have had to prepare for a potential Greek default and the fact that a substantial proportion of Greek bonds are held by the ECB and the eurozone's central banks. There will be an impact on the financial system as a whole but years of refinancing and tougher regulation since the credit crisis have increased its ability to withstand a shock of this nature.

Global markets did, however, fall as the crisis developed and fell further today, affecting

the value of clients investments in equity funds. I have already significantly reduced the level of risk in client portfolios in recent weeks through sales of equity funds. This has resulted in an increase in the level of cash in the portfolios. I have reduced the equity investments in Europe excluding the UK, emerging markets and Japan, in particular. I have also reduced investment in property equity funds although I remain positive on the outlook for UK direct property funds. These changes should have significantly reduced the overall impact of today's market falls on client portfolios.

Our clients, however, still have a significant, albeit reduced, investments in Europe ex-UK equity funds. For those invested in balanced, income and higher-risk strategies, a proportion of this is invested in sterling or dollar-hedged share classes of our preferred Europe ex-UK equity funds to protect against further weakness in the euro. The region's stockmarkets continue to be supported by the ECB's €1.1 trillion programme of asset purchases, the weak euro and lower oil and energy costs. Today's falls in equity markets may provide a buying opportunity if investor



## Grexit comment continued

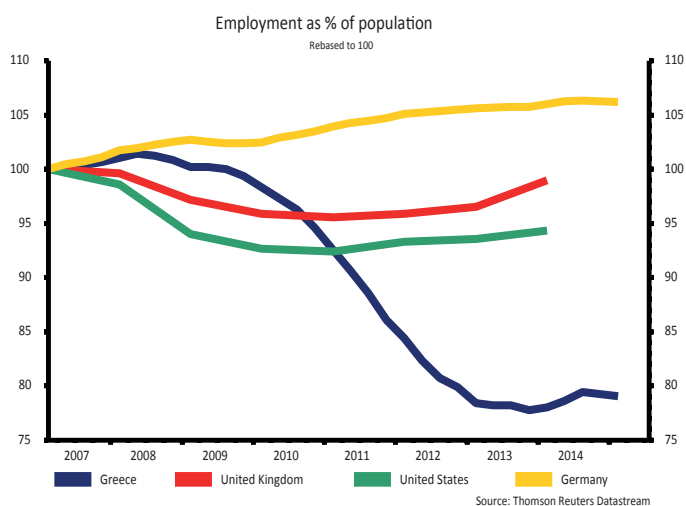
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fear results in the indiscriminate selling of equities. I did, for example, modestly increase clients' investments in UK equity funds following the election of a majority government in May as sterling strengthened and the UK economic data improved, and there may be further opportunities to add to these investments.

The unpredictability of events such as this highlights the benefit of investing through funds in a multi-asset portfolio diversified across different asset classes and numerous underlying individual investments. Client portfolios should, for example, benefit from holding dollar-denominated assets such as treasury bonds or dollar-hedged share classes of equity funds as well as from the capital protection afforded by the increased level of sterling cash.

Tragedy is another Greek word for the long sequence of events that culminated in last weekend's scenes of queues forming outside the nation's banks. A Greek default may not automatically foreshadow the country's departure from the euro but membership of the single currency has prevented a currency devaluation that could potentially lead to economic resurgence. As the chart shows, the social costs of a unified currency combined with policies of austerity are apparent in the sharp falls in Greek employment since 2007 compared to other nations. If Greece does leave the euro and recover, this could provide

a blueprint for other highly-indebted peripheral eurozone countries and prove that the single currency is not irreversible. Sovereign bonds issued by Italy, Spain and Portugal also fell sharply today as investors responded to this risk. Client portfolios have minimal exposure to these bond markets.



Although the weekend's events may give rise to selective buying opportunities, I remain focused on the prospect of the first US rate rise since the credit crisis, a development expected later this year. Although the Federal Reserve is unlikely to raise rates if inflation and employment data are insufficiently robust and even then the pace of subsequent rate rises may be slow, I am unlikely to increase risk in client portfolios significantly until there is more clarity on the impact of this change in monetary policy particularly on bond markets, where valuations appear most stretched.

### Important information

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