Does Greece Need Adult Supervision?

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Events on Saturday in Europe, regarding the “final” proposal by the ECB, IMF and Germany, roiled the global markets on Monday, June 29.

The Greek leadership team and the Eurogroup negotiating team have traded proposals for the past ten days. But the ECB and IMF negotiators finally set Saturday as the deadline for their final offer – and Greece whiffed.

Greek Prime Minister Alexis Tsipras was elected five months ago on a promise to “tear up” the bailout terms that the IMF and ECB had imposed as conditions to financial aid. A young and inexperienced leader at 40, Tsipras made a surprise move on Saturday: Instead of accepting or rejecting the Eurogroup proposal, he stated that he wanted to refer the matter to a national referendum next Sunday. In response, senior European leaders are making it clear that a no vote will mean that Greece will be forced out of the euro.

The situation is problematic, since Greece has a 1.6 billion loan payment due on June 30 to the IMF. The loans under the European Financial Stability Facility (ESFS) to Greece terminated on June 30 and will not be renewed.

As a result of the impasse, the Greek banks and stock exchange were closed on Monday and will likely remain closed all week. And the government imposed currency controls.

However, an ETF on Greek stocks does trade in the U.S., and it plummeted 20% on Monday. The American Depository Receipts (ADRs) on the National Bank of Greece fell 24%.

The stock indices in Germany and France fell over 3.6%, and stocks in their major banks fell over 5%. The global rout has been estimated at 1.5 trillion – so far.

Even the most thoughtful analysts familiar with the details of the situation in Greece have for the past two months remained uncertain as to the impact of a Greek default (or the departure of Greece from the euro) on other economies in Europe, and beyond. But on Monday, the stock markets in Spain and Italy both fell over 5% in reaction to the surprise news of the weekend – as some investors fear that they may follow Greece into a spiral out of the euro.

In our view, the impact on the U.S. economy or the U.S. stock market is very likely to be trivial to none. Nevertheless, the U.S. stock market indices were down significantly on Monday, with 95% of trading volume on the NYSE to the downside, the strongest measure in over three years, and over 90% of issues traded were negative, the most in two years. But the global markets appear to be recovering in early trading on Tuesday.

It is possible that for other reasons the U.S. stock market may finally be completing a cyclical top in May and June. Stock markets do not always need a catalyst to start a downturn, but clearly the situation in Europe has caused at least a temporary fear episode in much of the developed world. Only time will tell.

As always happens during a global fear episode, the U.S. Treasury market (and correlated bond markets including municipals) surged on Monday. Somewhat surprisingly, the dollar index did not – and the Euro rallied against it.

It is early days in what is likely to be months of turmoil in Greece, but we expect the dip in U.S. stocks relating to this situation to be temporary and modest, although for other reasons Monday's decline may be a part of the early phase of a more significant multi-quarter decline.

What does all this mean for our portfolios? Importantly, our exposure to U.S. and global common stocks is very low, and our current allocations to high-grade bonds, including municipals, is higher than usual. Some holdings, such as Vanguard Wellesley Income, have dipped enough to hit our trailing stops and we are selling. But we are looking to place cash into asset classes that may rise during periods of fear and uncertainty.

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