Market Commentary

CI Investment Consulting

The Greek referendum and its impact on financial markets

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On July 5, a majority of Greek citizens voted "no" to the debt proposals offered by its creditors, including the European Central Bank (ECB) and eurozone countries. This raised at least three questions: 1) Will the ECB still provide emergency support to the Greek banking system? 2) Will Greece be forced to exit the monetary union? 3) Will the sovereign debt be restructured and, if so, how?

On the global scale, Greece is an insignificant player with its economy representing only 0.3% of the world economy as measured by gross domestic product. However, because of its ties to the eurozone, it has received much attention from investors. The Greek government's debt totals 323 billion euros. Following two "bailouts" in 2010 and 2012, approximately three-quarters of its debt is now owed to the non-private players, including eurozone countries, the ECB and the International Monetary Fund (IMF). These lenders have a realistic expectation that some form of write-down and restructuring will happen. In addition, they also have the balance sheets to absorb losses.

The best scenario for Greek citizens is for Greece to stay in the eurozone with its banking system backed by the ECB, and for its government to reach agreement with the creditors to restructure the debt. If this does not happen, it is almost certain there will be further long-term damage to the Greek economy. On the other hand, we expect limited impact on European growth regardless of the outcome, as Greece represents only 2% of the eurozone economy. In addition, the ECB has a lot of firepower to contain spillover and stimulate growth through its bond purchase program.

The capital markets in general have behaved on the first business day after the Greek referendum. Stocks in Europe were down by approximately 2%, while the impact on North American markets was modest. "Safe haven" assets such as the U.S. dollar and sovereign bonds gained value. We expect volatility to linger and may even heighten until the ECB and the eurozone reach a "verdict" on Greece.

Inside our portfolios, we do not expect any longer-term losses as we do not have direct exposure to the Greek stock and sovereign bond markets. Uncertainty is creating volatility in all stock markets but our holdings in the U.S. dollar and top-tier global sovereign bonds have gained and are offsetting some of the volatility. We have also been benefiting from our portfolios' larger emphasis on North America. It is unlikely that we will be investing in either the Greek stock or bond markets in the near future. Our team and CI's various portfolio management teams are monitoring the Greek situation and market valuations closely. We expect opportunities may arise to allow us to

add to our existing holdings at potentially discounted prices or to sell some of our holdings of safe haven assets, as value is being unlocked faster than anticipated. As in previous times of uncertainty, we expect volatility to eventually subside and investors to focus on quality investments.