News & views

BNY MELLON

For Professional Clients only and, in Switzerland, qualified investors

Five possible portfolio ramifications from Greece

By Kira Nickerson, BNY Mellon Investment Management

Greece, and any looming banking collapse, has been the focus of attention this week in Europe. But the Greek banking system shut down and a possible 'Grexit' are not the only areas investors should watch with respect to the ramifications of the situation.[i]

1. European Copycats

Newton Global Income strategy manager Nick Clay says: "If Greece goes into a short, sharp economic recession followed by a quick recovery, other countries in the eurozone might start to think twice about continuing down the austerity path. They could wonder 'Why are we bothering to go through this structural pain? Perhaps we should go for a short, sharp drop and rebound instead'."

Paul Brain, manager of the Newton Global Dynamic Bond strategy, adds: "The government can't afford to pay pensions and salaries and could soon need to resort to 'IOUs' which effectively become the start of a new currency. 'Grexit' would happen rapidly after that. The initial economic disorder may undermine support for other European anti-austerity parties (such as Podemos in Spain) which, given the proximity of upcoming elections, is important. Longer term, if Greece can come back post-Grexit with a vibrant and recovering economy with less debt (owing to default), the next country to run into difficulty may see debt default as an easy option."

2. Rate rise delays?

There is a potential positive side to the situation, Brain notes. "A worsening Greek situation (to which the 'no' vote will lead) could bring about more support from the European Central Bank (ECB) and delay a rate hike by the US Federal Reserve, thereby keeping liquidity flows in place." The fall in the Chinese stock market has given this particular theme further ammunition over the last couple of weeks, he adds.

BNY Mellon boutique Standish* agrees the Greek situation is adding more uncertainty to the timing of a US rate rise. While Standish's chief economist Thomas Higgins believes a September rate rise is still largely on the cards, he acknowledges the probability of a delay has increased. He believes the market is now pricing in a rate rise for February 2016. "The idea that the central bank will wait until early 2016 to raise interest rates seems too dovish given that the domestic fundamentals of the US economy are sound and exposure to the Greek economy is minimal," he says.

Higgins highlights that at the end of June, the Greek economy accounts for less than 3% of euro area GDP and US exports to Greece amount to less than US$775m while he feels the likelihood of contagion through the banking system is low given that US banks have lent less than US$13bn to Greece.

3. Sectors to watch

Utilities look to have benefited from the uncertainty and volatility created by the Greek dilemma while sectors like manufacturing could be adversely impacted, according to Paul Stephany, Newton UK equity manager.

"Longer term, were the euro to be considered a 'club' that countries can leave at will, we do believe this would increase the risk premium associated with eurozone equities and therefore depress valuations. Were European underlying economic growth to suffer from a Greece-related blow to confidence, then certainly stocks in my

portfolio with high eurozone exposure, like Reckitt Benckiser and Wolseley, may see slower growth. One particularly high risk area (which I do not own) would be UK based manufacturers exporting to the eurozone."

Paul Flood, multi-asset income manager at Newton, echoes this sentiment. He believes that unless a compromise between Greece and the European creditors can be made within the next week there will be further volatility in asset markets. This, he notes, is likely to lead to further weakness in more economically sensitive sectors/asset classes such as financials, industrials and European high yield bonds, while he believes healthcare and utilities will hold up better. "Within alternatives we expect renewables to perform well as the attraction of their perceived high stable revenue streams remain appealing in an uncertain backdrop."

4. Global upsets

Recent headlines, which pointed to Greece being the first 'developed world' economy to default on a payment to the International Monetary Fund, illustrate why the country's plight matters, according to Newton's Real Return team. "The concern is that it might indicate where other first world economies with large welfare states, huge debts and a dependency on imports might be going- headlong towards a process of deleveraging that becomes contagious. For this reason, markets, which seem almost dangerously complacent, may well be right to expect a last-minute fudge. The risks of a financial accident are rising, however, as the stalemate continues."

Greece's debt has been unsupportable, the team notes but it may not be the only economy in such shape. The Real Return team comments: "At current growth rates, the debt loads of most western economies (broadly the highest ever seen in peace time) are similarly unsustainable, just less extreme."

The Mellon Capital*team behind the BNY Mellon Dynamic Total Return strategy also note Greece's relationship with Russia and what this may mean in the weeks and months ahead. "The possibility that Russia may extend some emergency financing to Greece should not be ruled out and may further worsen relations between Greece and the rest of the Eurozone member states."

5. Debt doldrums?

Insight's fixed income team says it expects the benign default environment to persist despite what has been happening in Greece but believe increased market volatility is likely.

"We are forecasting higher German government bund yields over the next 12 months. However, while we believe we will see a 'flight to quality' continue, yields are likely to be volatile and could decline from current levels."

With respect to peripheral European bond holdings, Newton's Brain believes they could initially be in the firing line. However, he also thinks there are a number of support tools including the ECB's QE program that will help stop yields rising in the way they did in 2011. "Also the peripheral economies are in much better shape economically and their legacy problems (bad property loans and fragile banking systems) are less of an issue. Our recent reduction in peripheral European government recognises there could be an initial sell-off but also that given low yields we wouldn't miss much if the market were to rally. Once the short-term market reaction is played out we would expect the peripheral bond market to stabilise.

Past Performance is not a guide to future performance The value of investments and the income from them is not guaranteed and can fall as well as rise due to stock market and currency movements. When investments are sold, investors may get back less than they originally invested.

This is a financial promotion for Professional Clients only and, in Switzerland, for Qualified Investors only. This is not investment advice. For marketing purposes only. Any views and opinions are those of the Interviewees, unless otherwise noted. This material may not be used for the purpose of an offer or solicitation in any jurisdiction or in any circumstances in which such offer or solicitation is unlawful or not authorised. Portfolio holdings are subject to change, for information only and are not investment recommendation. For marketing purposes only

BNY Mellon Investment Management EMEA Limited (BNYMIM EMEA), and any other BNY Mellon entity mentioned are all ultimately owned by The Bank of New York Mellon Corporation. Issued in the UK and Europe (ex Switzerland) by BNY Mellon Investment Management EMEA Limited, BNY Mellon Centre, 160 Queen Victoria Street, London EC4V 4LA. Registered in England No. 1118580. Authorised and regulated by the Financial Conduct Authority. Issued in Switzerland by BNY Mellon Investments Switzerland GmbH, Talacker 29, CH-8001 Zürich, Switzerland. Authorised and regulated by the FINMA. Issued as at 08-07-2015. CP15521-08-01-2016(6M).

---

[i] BNY Mellon Investment Management EMEA Limited is the distributor of the capabilities of its investment managers in Europe (excluding funds in Germany), Middle East, Africa and Latin America. Investment managers are appointed by BNY Mellon Investment Management EMEA Limited or affiliated fund operating companies to undertake portfolio management services in respect of the products and services provided by BNY Mellon Investment Management EMEA Limited or the fund operating companies. These products and services are governed by bilateral contracts entered into by BNY Mellon Investment Management EMEA Limited and its clients or by the Prospectus and associated documents related to the funds.