MV CAPITAL MANAGEMENT

Technical Market Comment

Greece, Europe and Global Asset Markets

July 6, 2015

Yesterday, Greece's citizens resoundingly rejected the most recent proposal by the country's creditors to implement new austerity measures in exchange for continued financial assistance. The size of the "no" vote was a surprise to observers of the situation and leaves Greece's economic future, and its continued participation in the single currency union, very much in doubt. We continue to follow the unfolding events closely, and are using this Technical Market Comment to share our views and outlook with you.

The Situation As It Now Stands

The most pressing question in the next several days will be whether the European Central Bank (ECB) will continue to provide emergency financing to Greece's beleaguered banking system. Greek banks closed last week after the ECB's Governing Council put a cap of €89 billion on its emergency credit line. The ECB is expected to announce sometime after it meets today whether it will increase the amount of emergency funding it provides to Greece. Yesterday's vote is expected to move sentiment among Governing Council members closer to the hard line position of Germany. The bottom line, though, is that without some form of continued support the Greek banking system could very well be insolvent by the end of this week. This would further extend the pain of the worst economic collapse not related to war that any country in Europe has suffered in the last 125 years.

The ECB will also be a key player in what many EU policymakers see as a more important concern than Greece's economic future; namely, how to prevent the situation from being a Continent-wide contagion that poses a deeper threat to global asset markets. To help calm nerves the central bank could accelerate the pace of the bond-buying program announced earlier this year. One fact that may temper panic among investors is the relatively low level of exposure to Greece held by other European financial institutions. In a briefing note last Friday, Barclays Bank estimated that the total exposure of all Eurozone countries to Greece amounts to less than 3.5% of the region's total GDP, and that only a fraction of that amount is held directly by its financial institutions.

Finally, while Greeks voted "no" in the referendum, it remains unclear what exactly they voted for. The majority of polls continue to indicate most Greeks want to remain in the Eurozone. And their support for Prime Minster Tsipras and the ruling Syriza party, whose credibility was enhanced by the referendum, would not be likely to last if the country faces bankruptcy. Early indications are that Tsipras and his team are returning to the negotiating table with renewed seriousness – a position underscored by the resignation this morning of controversial finance minister Yanis Varoufakis. Greece is expected to propose new bailout terms at an EU summit meeting on Tuesday.

Our View and Outlook

We expect short-term asset movements will be largely event-driven and influenced by how alternative scenarios play out. One can never rule out a worst-case scenario, but we do not see such a scenario – involving a viral collapse of peripheral Eurozone debt markets and an ensuing sharp reversal in global equities – as the most likely outcome. The market response in the immediate aftermath of Sunday's vote has been relatively muted, with most European bourses down by less than 1%, the S&P 500 trading more or less flat, and peripheral Eurozone bond yields up a bit but nowhere near danger-zone levels. Most observers, ourselves included, expect to see negotiations muddle along even as the probability increases of an eventual Greek exit from the single currency.

We do see elevated risks, but we also believe the risks are more prevalent outside the US – not only in Europe, but also in China where monetary authorities are trying to stabilize a sharp pullback on domestic stock exchanges. International sentiment could certainly spill over into US equities, but we would expect any such pullback to be relatively brief and within the 5-10 percent range of a technical correction as opposed to a more sustained

structural reversal. Economic data continue to reflect growth, with good consumer activity indicators, a decent (if not barnstorming) June jobs report and expectations for 2Q real GDP growth above 3 percent.

We believe the Fed remains on track to begin gradually raising interest rates as early as September. However, the Fed will not be forced into a rate hike if developments between now and September suggest otherwise. The economy is not overheating, inflation remains somewhat below the 2 percent long term target, and this gives the FOMC plenty of leeway to defer action on rates if need be, while adhering to its dual mandate of stable prices and full employment.

If we do experience a pullback in US equities sometime in the coming weeks, we would be inclined to view it more as an attractive buying opportunity than a signal to take on a more defensive strategic position. In any event, our current action plan is simply to stay disciplined and closely attentive to the situation as it continues to unfold.

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