

# Greece Referendum. Analysis and Investment Opportunities.

Greece will conduct a referendum on July 5 regarding a creditor plan of reorganization. The referendum is framed as a Yes/No vote to either accept or reject the creditors' proposals.

1. The vote as it is framed is strictly about accepting or rejecting the creditor proposal. However, the consequences of either a Yes or a No go beyond the creditor proposal, they go to whether Greece intends to be a part of Europe, or not.

2. There are a number of scenarios:

a) Yes. Tsipras government resigns. A new government will have to be formed which is happy to comply with the referendums implications. Financial and liquidity support will resume and details of a bailout will be finalized and implemented.

b) Yes. Tsipras government does not resign. Syriza has campaigned for anti-austerity and recommend the people vote No so a Yes vote would destabilize the government. It is unclear how the creditors will proceed in negotiations with Syriza. Syriza would have to honour the implications of the Yes vote and negotiate accordingly. The ECB may not be as quick to lift the suspension of ELA and negotiations would have to continue to finalize details. These negotiations could be problematic if represented by Syriza.

c) No. Tsipras government will have a strengthened mandate. The ECB would certainly ringfence the Greek financial system and maintain suspension of the ELA. Greece may be explicitly removed from TARGET2 which would isolate its financial system. There are many possibilities under a No vote since it would imply chaos and a likely exit of Greece from the currency union and perhaps from the European Union as well.

3. Short term effects: Equity markets will likely react well to a) above. The

uncertainty of b) above means that any upside is likely to be fragile. Volatility could persist until a clear deal could be reached. In c) above the immediate impact will likely be a sharp sell-off as investors seek to de-risk and avoid any potential Black Swan events. "We know how bad it is and it ain't so bad, but we don't know what else we could have missed..." would be the likely thinking. European markets are still on average about 10% in the money year to date and investors will want to protect that.

4. European equities will correlate closely with BTP and BONOS spreads versus Bunds in each of the above scenarios. For 30 year BTPs, spreads could tighten below 100 under a) or languish in a 100 – 150 range under b). Under scenario c) the immediate impact could be big. Spreads were over 400 in 2011 but with the ECB's OMT, QE and LTRO operations a widening to 200 would be extraordinary and would be a trigger to buy the spread. A similar analysis applies to 30 year Spanish spreads.

5. Longer term positioning.

a) Scenario a) provides Greece a lifeline. Depending on the final nature of the bailout the outcome could be long term negative for Europe, if for example, the creditor plan was unrealistic, draconian and would cause Greece to require another bailout in a few years' time. A realistic deal would see some form of debt write-down with conditions to rehabilitate the Greek economy. Such a scenario would be long term positive.

b) Scenario b) could not realistically play out over the long term since the *raison d'être* of Syriza was anti-austerity.

c) Scenario c) presents the most interesting long term investment opportunities.

I) The Greeks might soften their demands but the probability of this after a No vote is small. The probability that the Eurozone would soften their demands following a no vote is similarly remote given the contagion risk of moral hazard to Spain, Italy, Portugal.

II) Greece is already *de facto* in default and a No vote would formalize this. Negotiations would begin, or in this case, resume, with creditors. In this case, creditors would be quite powerless to negotiate for anything except to eject Greece

from the union and suspend all aid. Keeping Greece in the greater union but not the Euro would provide a template for subsequent member exits and is therefore unlikely to be supported by Germany or France.

III) Greece would have to mint its own currency, which would probably depreciate some 40%-50% instantaneously. Some form of capital controls will be needed to ensure the success of the new currency.

IV) At this point but not before, Greek assets and legacy debt might present value.