THOMAS MILLER INVESTMENT

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A brief outline of the crisis in Greece and the implications for asset allocation

Summary of Issues

- The seeds of the current turmoil were sown in late January 2015 when Greek voters ushered in anti-austerity Syriza party and thus put the country on an inevitable collision course with its group of lenders over the conditions of the bailout package agreed by the previous government. It is hoped that the ongoing negotiations will result in an end to the five-month standoff and help Greece avoid imminent default.

- While many have found the Greek government's apparent intransigence frustrating, it is worth noting that Greek voters elected Syriza precisely to oppose the existing terms of the bailout. The fact that any deal agreed would need to be ratified by the Greek parliament [and parliaments of other member states, particularly Germany] suggests that there will be no easy (or quick) resolution.

- The contentious issues relate to the structural reforms that Greece's creditors want the Syriza government to implement. In particular, the so-called "red lines" relate to pension cuts and VAT rises.

- Bloomberg reported that after the Greek Prime Minister, Alexis Tsipras, appeared willing to compromise on most of the contentious issues, the creditor institutions (the International Monetary Fund, European Commission and European Central Bank) put forward a revised proposal "apparently steering the government more toward spending cuts over tax increases, considering Greece's abysmal record in collecting taxes." The creditors were also concerned about the damage that higher business taxes might do to growth prospects.

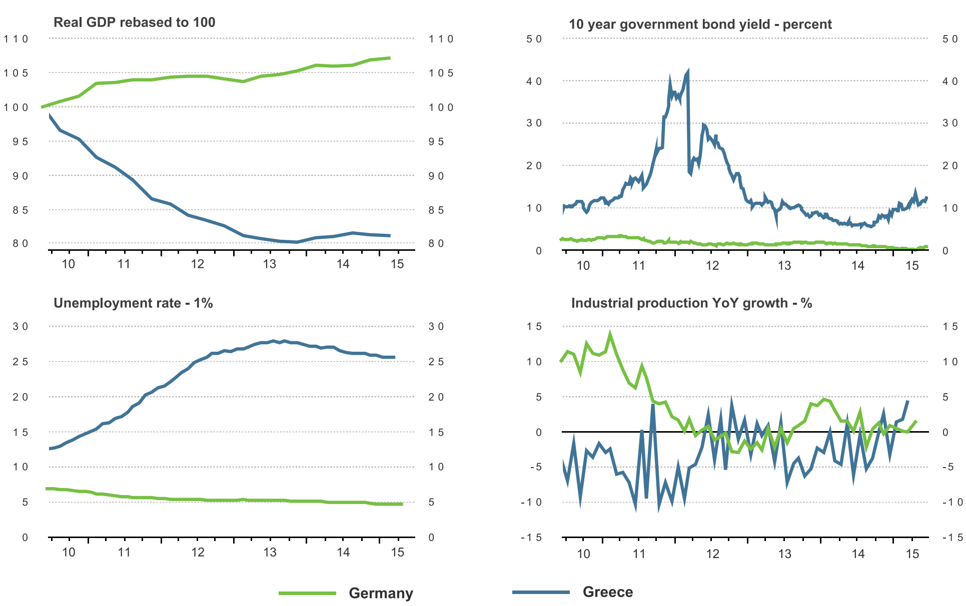
Some comments

- After several years of pretensions to the contrary by its institutional creditors, it now seems apparent that Greece is unlikely to ever grow out of its debt. While a political solution may be hard to design, an economic one seems more straight-forward. Greece needs a combination of significant debt relief and deep structural reforms. As things stand, the creditors balk at the idea of much debt relief while the Greek government refuses to commit to meaningful structural reform.

- Of course, a write-down of a significant portion of Greece's debt is not politically palatable to its creditors but at some point the penny has to drop. Greece has suffered a 25% cumulative decline in its gross domestic product over the last five years and the economy remains moribund. Greece cannot pay. Perhaps it's time to come to terms with the reality that Greece will not pay!

- The outcome of the latest round of negotiations remain to be seen, but clearly the lenders will need to be more generous, bail-out conditions less onerous and Greece more respectful of its commitments.

Selected economic indicators: Greece and Germany



Source: Thomson Reuters Datastream

Implications for asset allocation

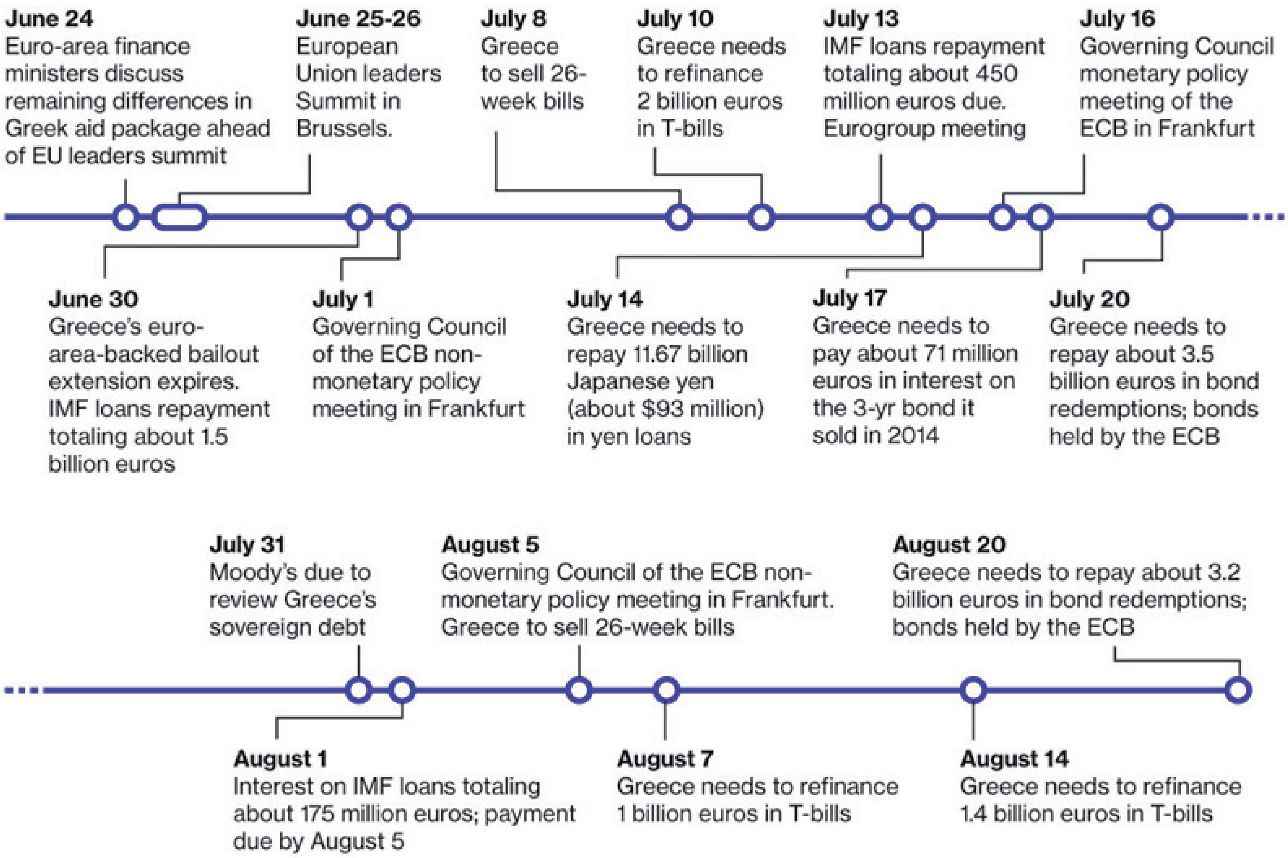
- The crisis in Greece adds to the level of uncertainty that investors have to contend with. However, one could argue that given that this has been a slow motion train crash, investors have had sufficient time to adjust both their expectations and asset allocation as appropriate/required.

- Therefore investors might be tempted to ignore the whole episode. Indeed, while markets have been somewhat volatile over the past few months, the vix, a major gauge of fear among investors remains at low levels.

- Overall, there is relatively little exposure to the Euro-zone periphery across TMI

What's next for Greece?

Here are the key hurdles the country faces before its euro-area-backed bailout expires.



Note: Sums cited on payments due to the IMF are only approximate, as they depend on the exchange rate between the Fund's Special Drawing Rights and the euro; list of debt repayments is indicative as some small bond redemptions are not included.

Source: Bloomberg

portfolios. Nevertheless, it is worth noting that markets abhor uncertainty and the longer the crisis goes unresolved, the greater the likelihood of broader deterioration in investor sentiment, which could result in a sell-off in risk assets across the board.

- More broadly, the appropriate asset allocation response to this (as with any other crisis) depends on the type of investor.

- For more conservative investors, the key is to avoid direct exposure to the Euro-zone periphery while also limiting exposure to broader Euro-zone assets (in order to avoid any contagion effects).

- More risk-tolerant investors may want to heed the words of Baron Rothschild that the best time to buy is "when there is blood in the streets."

- To the extent that consensus expectation is that there would be another eleventh hour deal that prevents a Grexit—at least in the near term—more risk-tolerant investors may see any short term volatility as an opportunity to increase exposure to Euro-zone equities. Afterall, the region is currently enjoying a rebound in growth, leading indicators suggest that the economic outlook remains robust and monetary policy remains very accommodative.

- However, the risks relating to a disorderly Grexit scenario should not be underestimated. For all the column inches that have been devoted to this possibility in the financial media, the precise ramifications of that scenario remain largely unknown. What is clear is that it would unleash a period of economic, social and political uncertainty. We err on the side of caution.

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