



Economic and Market Insights

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What's Next for Greece and the Markets?

Commerce Chief Economist Scott Colbert, CFA, offers some insight on why the current Greek economic drama does have real impact on your investment portfolio, and how the European Union (EU) and its euro currency could affect world economies.

The unfolding Greek financial drama may seem just like the latest episode in a never-ending TV series, but investors need to realize the outcome of the Greek default this week could affect their portfolios in the short term.

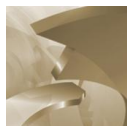
Considerable stock market volatility is expected amid all the uncertainty leading up to this Sunday's Greek financial referendum. Greece will have to decide whether to accept forced austerity measures that accompany a European Central Bank (ECB) loan bailout offer or whether to potentially be forced to exit the European currency.

A Greek exit – or “Grexit,” as it is being called in the press -- has already and will certainly continue to roil economic markets, including U.S. markets. Equities are the most exposed to the volatility because they are not directly shielded by the ECB policy protections. In the bond market there already has been a modest flight to quality and safety with U.S. and German 10-year yields falling slightly on the increased volume.

The Greek impact looks localized for the moment, but the danger of contagion to other regions is always present. News reports reminded us of the economic teeter-totter of debt that Puerto Rico still contends with. What other countries might come out of the woodwork?



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For now, the initial reaction of the eurozone's currency affords us the most confidence. Within the European sphere, earnings are rising, equity valuations are not stretched and the region will benefit from the weaker euro and cheaper energy costs. Also, while the dollar has rallied a bit earlier this week, the euro has actually gained as well.

Even though European common currency is only 16 years old, the euro represents 22% of all central bank reserve currencies and is the second most used currency for daily transactions on the planet behind the dollar. We certainly don't see this Greek drama as being significant enough to break the common currency.

Ironically, if Greece chooses to leave the EU, the remainder of the countries using the euro should be stronger, and the euro should be correspondingly higher. While we thought that would probably take some time to occur, it appears that markets simply want certainty. With Greece in or Greece out, the markets in the eurozone just seem to want to get the ultimate resolution of this crisis. Recent developments simply pulled this forward.

Unfortunately for Greece, most of the pain of a vote to leave the EU would be borne by Greek citizens, mostly with a devalued currency in the form of a new drachma and painful inflation. For the moment, we believe the situation is likely to be contained and present the patient investor with another near-term buying opportunity. But don't expect a smooth equity markets ride along the way.

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