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With my best regards

Andrew Freris

4 July 2015

IMPROPTU ECONOTE FROM ATHENS: The Greek crisis-the consequences for Asian investors

Introduction

These notes are written in Athens on Saturday 4 July, the eve of the referendum in Greece. This was done on purpose in order to avoid the temptation to offer advice once the result of the referendum was known. This also removes "scenarios advice" and allows me to stick my neck out, something which, I think, am essential for any self-respecting adviser!

Summary of investment suggestions going forward from July 5th onwards

1. Asian investors are overwhelmingly USD based, and the events in Greece will impact primarily the EUR and EUR-denominated assets. The truth is that the on-going crisis had little impact on the EUR. After bottoming in March 2015 at 1.05, the EUR trended up (with bumps and grinds) to a current 1.11, hardly a sign of crisis. The Eurostoxx index fell from a recent 3,800 to a current 3,440.The German 10Y bunds rose from 0.08 % in April 2015 to a current 0.80%, rightly reflecting the concerns of investors on sovereigns, but not forgetting that a year ago these bunds were yielding 1.20 %!

2. Crisis, what EU crisis? (At any rate resulting directly from the Greek crisis). Asian investors are most unlikely to be holding either Greek bonds or stocks so there is nothing to worry about, and, even more importantly, any of their EUR exposure has improved since April 2015!

3. Buy Greece now? Not unless you held it a few months back, in which case you stand to make a killing if Greece votes Yes.

4. Buy EUR now? Yes, because a Grexit will ultimately mean little to the EU, and notions of the EU and EUR falling apart if Greece leaves, are so nonsensical as to bear little analysis or serious consideration.

5. Contagion effect? Honestly, contagion effect from Greece to EMKs? Greece was never in the EMK universe, and is such a special and unique case that anyone selling, say, Thailand or, for that matter, Mongolia, because of Greece is not a serious or well-informed investor. China collapsed because it was a train crash about to happen in slow-motion. Myself, and 1,000,000 other commentators, had said months ago that China was an absurd liquidity-retail-margin funded-closed market boom and was doomed to collapse, and it finally did, but NOT because of Greece! Surely the Greek crisis spooks EU investors because of its novelty, and one has also to allow for the hype over Greece leaving or not leaving the EU and the EUR.

6. What to buy in the next 6 months will not be predicated by Greece, see the imperturbable EUR, but by the incessant will-they-won't- they Fed decision. We believe that the Greek crisis is bullish for US shares as the longer the crisis lasts the more the Fed will be impeded into hiking rates, not because they love Greece and the EU, but because the hike could blow back in their faces. If Greece was totally settled tomorrow, I would issue a bear note on US shares, despite the fact that I have called for the Fed not hiking in 2015!

7. Bottom line: Greece's Yes or No will be, ultimately, of little consequence for the EUR, except knee-jerk reaction on Monday. Share markets are spooked with China (which, to repeat, has nothing to do with Greece) and a Greek No will spook them further, but short term as well. Keep your US shares powder dry for a Greek No,(never mind the immediate bearish impact) as this will keep US rates low for longer and will be bullish for US equities. Keep out of Chinese shares despite all the measures taken by the authorities to keep the market steady. The liquidity will need to be dried off.

8. We continue to like S.Korea, Taiwan and Philippines in Asia, limited choices, but decent earners in the middle of this perceived mess.

Grexit and the rest of the hype

The notion that Greece leaving the EUR and returning to the drachma will be the end of the EUR bears little serious examinations. Consider:

- Leaving the EUR must mean leaving the EU, but there are legal doubts about this. The case of the "outs" (UK, Sweden and Denmark) is not a valid comparison as they never joined the EUR but did join the EU. Greece did both. However Greece could leave the EUR and still stay in the EU in a perverse, and reverse UK-Denmark-Sweden type of agreement.

- Leaving the EUR will not set a bad example for Italy, Portugal and Spain, as they are all doing (relatively speaking) very well, thank you, and have no intention of leaving the EUR! As for the aspiring minor candidates (Turkey, Croatia etc) and the ones not using the EUR, such as Poland and Czech, Greece will be a salutary example as how not to do it. Why one economy failing to meet the condition of a single currency means that all other economies who have met the conditions see their union fall apart is never explained.

- Even if Greece was to leave the EU and the EUR, why this would lead to the collapse of the EU is never explained. Being nasty, one can say "good riddance" to Greece which could not or would not play by the rules, and life goes on for the rest of the members. Why failure of one member mean failure for all is not explained.

- Setting a bad example for the UK (and its referendum, equally as absurd as the Greek one, in my opinion) is also irrelevant, unless the Brits (oops, sorry, the English) decide to compare themselves to the bankrupt Greeks, except for the Scots, who of course, think otherwise.

Can Greece stay out of the EUR while sorting things out?

In terms of the rules of the ECB, no, because all government and bank funding ceases, as it already has. But Greece can go on its own by issuing "EU-EUR-illegal" temporary government IOUs, which will be made legal tender, and keeping strict capital controls. Imports of medicines and of oil could be funded by Greece's limited export earnings (tourism) and the absence of imported Argentine lemons and Belgian tomatoes (yes honestly, this is true) will need to be endured. Banks could be used only as means of transacting payments with whatever EUR are left in circulation, plus government IOUs, while deposits are subject to that wonderful Argentinean invention the "corallito", that is you can't withdraw them ! This is a nightmarish scenario which could only last for 2-3 months at best and will do a lot of damage, while Greece returns to the negotiation table. But yes, Greece can notionally leave some parts of the EUR while common sense prevails.

A note of probability

Please, please pay no attention to statements, by people and investment banks who should know better, that "Greece has a 85 % chance of leaving the EUR" and " A No vote will imply a 75% exit from the EU" as these probabilities are not incorrect, they are actually meaningless.

A probability is established by observing the percent of a certain event occurring in a number of events. For example the number of heads in the spinning of a coin, the number of sixes coming out in repeated throws of dice etc. As Greece has not left the EU in repeated occasions in the past, there is no way of calculating the likelihood of doing so now! These are meaningless probabilities expressing the "gut feelings" of whoever declares them and have no scientific or mathematical basis whatsoever. And that is 100 % true!

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