BALANCING CAUTION WITH OPPORTUNISM

> *Should the draft agreement submitted by the European Commission, the European Central Bank and the International Monetary Fund on 25.06.2015 that consists of two parts be accepted?*
> *Answer boxes: Not approved/NO - Approved/YES*
> SOURCE: Bloomberg

Over the past few weeks, many have asked us how our Investment Committee has positioned the portfolios to take advantage of the unfolding Greek sovereign solvency crisis. As a quantitative asset manager, we heavily rely on econometric models to inform our investment decisions. In terms of the framework's view specific to Greece, while scoring neutral-to-negative in the aggregate, deteriorating risk, fundamental dynamic and technical metrics have kept us from gaining exposure to that market. These trends came as no surprise, really, as austerity-induced retrenchment in all corners of the economy resulted in a collapse in growth.

Outside of the framework, as it becomes ever more a function of brinkmanship, the evolving situation in Greece begs for, but defies sound modeling. Given our role as a risk manager, we remain firm in our belief that it is not prudent at the present time to invest in Greece.

But the Greece story isn't solely about Greece. Rather, Greece is a symptom of a global macroeconomic dynamic that has been dominated, in our view, by decades of overly generous monetary policy that emphasizes risk taking over prudence. On the contrary, we believe our investments should reflect a balance of caution with opportunism, with a heavier focus on the former.

The situation in Greece provides context for the approach. The Investment Team acknowledged early on the potential for just such a crisis in Greece, while navigating various mini crises in the interim. Against a backdrop of regionally weak to declining macroeconomic growth, we have sought to bolster the portfolio against the impact of a range of potential geopolitical, financial and economic crises. The "Grexit," the potential for the country's exit from the euro area, is just one such example.

As noted, global central bank policies undoubtedly have influenced our portfolio positioning. As we discussed in last month's commentary, accommodative monetary policy, in our view, generally is supportive of equity investments. However, in the early days of Quantitative Easing, capital markets seemed to have become dependent on the stimulus. Central banks, in turn, took a 'hair-of-the-dog' approach to countering QE hangovers. The final open-ended round led to heightened uncertainty in regard to its end, with the 2013 Taper Tantrum symptomatic of that fixation.

Nonetheless, through the past half-decade, the team has remained cognizant of the opportunity costs to extremely cautious positioning. This, even within an environment of minimal capital market yields, in which expected returns-for-risk tradeoffs both in fixed income and equity have left rare room for error. In the end, the Investment Team has sought to balance caution

with opportunism via strategic fixed income exposures variously chosen for their favorable yield/duration characteristics and liquidity, via a process that seeks strong overall portfolio diversification.

As for tactical equity decisions, given that our framework is firmly grounded in quantitative analyses of the financial fundamentals relevant to the tactical equity opportunity set, we have remained skeptical of value in many developed equity markets, even as risk metrics have remained relatively tame while the indices have soared in the updraft provided by monetary policy. Even so, our tactical decisions have contributed meaningfully to portfolio total return, with individual contributions to return mostly outpacing respective contributions to relative risk.

THE NEXT CHAPTER

The Greek saga undoubtedly will see many more twists and turns. New information will hit the markets and the expectations of market participants will adjust accordingly. The referendum this weekend is a fork in the journey. Its outcome will shape the future of Greece and the euro area. The two main roads leading out are steep climbs with no turnouts or guard rails. Both, arguably, lead to some manner of better fortune for Greece and Europe. And both, arguably, lead to some manner of worse fortune for Greece and Europe. We believe that we will see neither the best, nor the worst outcome, only a slog to an eventually suboptimal outcome for all parties involved.

What we do believe is that the Greek debt burden is insurmountable, no matter the conclusion of this weekend's vote. The debt eventually will have to be reduced, by default or other mechanism. Meantime, the macroeconomic repercussions of the negotiations having reached this juncture are dire, to say the least. So, again, for the time being the Greek story remains an uninvestable one, and may well remain so for a very long time.

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