Update

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Beware Greeks bearing 'No' votes in a referendum

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What was the referendum about?

Eligible Greek voters took part in a referendum initiated by the Greek government last Sunday (5 July) in response to a proposal put to the Greek government by the so-called 'troika' of the European Union (EU), the International Monetary Fund (IMF) and the European Central Bank (ECB) immediately after their meeting on 25 June.

This proposal offered to extend debt financing for some months in return for reforms by the Greek government that included:

- some tax increases
- some expenditure and pension cuts
- more privatisations of government entities (including electricity)
- expanded and more complete tax collection.

More broadly, however, the referendum was about whether the Greeks would be willing to endure further 'austerity' in return for achieving a 'restructuring' of the debt owed by Greece to international creditors (mainly in Europe), which currently totals around 170% of GDP, according to the IMF.

The aim of this 'austerity' is to put Greece into a more competitive position so that growth can return and the government can meet its accumulated debt payment obligations.

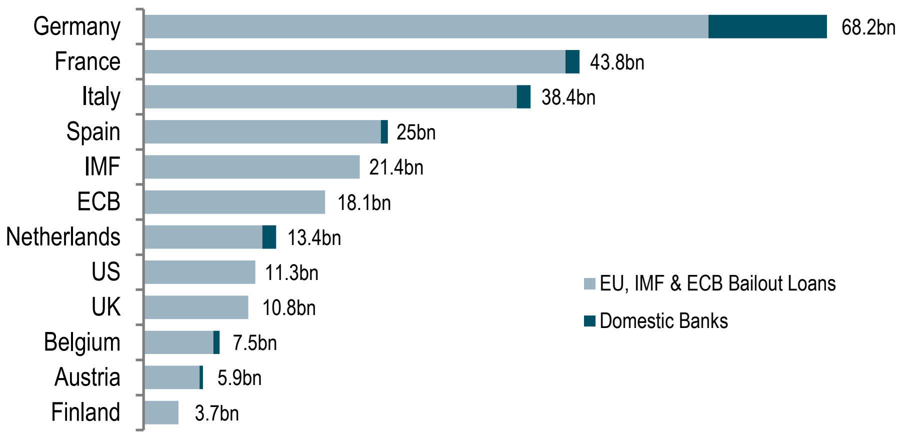
How are the share markets likely to react?

On Monday, 6 July, the Australian share market (ASX200 index) fell by around 1% but then on the next day the market recouped all of this decline and more. Further market volatility over coming days and weeks though can also be expected.

However, it is important to note, most debt currently owed by Greece is to either other European national governments or to international institutions, including the ECB and the IMF (as opposed European Domestic Banks) and these institutions certainly have the resources to cope with any default or 'haircut' (write-down) that may occur in a worst-case outcome for this crisis.

Much of the rhetoric about this crisis appears to be overblown. In relative terms this is a small-scale issue as the Greek economy is tiny

Who Owns Greece's Debt?
Leading Creditors (in euros)



Source: Open Europe, BIS, IMF, ECB

Therefore, much of the rhetoric about this crisis appears to be overblown. In relative terms this is a small-scale issue as the Greek economy is tiny and even the total Greek debt burden is minuscule in relation to total outstanding government debt for the whole of Europe, as we have detailed previously.

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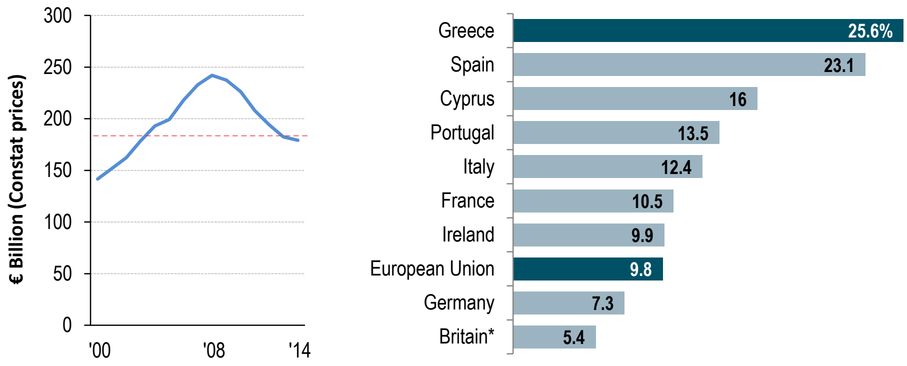
Why did the Greeks vote against the proposal and what is next?

The Greek people have clearly had a gutful of an economy in a state of severe depression. Despite years of experiencing a contracting economy (down 24% in real terms since 2007, according to the IMF), unemployment is at 25%, falling wages and deteriorating services, the debt burden has continued to rise until recently and in net terms remains at around 170% of GDP.

Greece's G.D.P. and Unemployment Rates in Europe

First quarter 2015 average; *Britain is the three-month average through February.



Source: Eurostat

We currently do not intend to make any major portfolio changes at this time. Fiducian's multi-manager diversified funds in particular are constructed to weather this type of market stress

Given all this, the Greeks appear to have decided that continued 'austerity' is too painful and that a default could be a preferable way out of their crisis. However, the 'No' vote by the Greeks does not mean the end of the story.

In fact, in some ways this is only the beginning. Negotiations between the Greek government and the 'troika' have already been protracted but there is more to go. The immediate reaction by European authorities to the 'No' vote was to arrange a summit of all the heads of the Euro zone governments to take place today, Tuesday 7 July. Essentially Europe is still looking for a way to keep Greece within the single currency and to avoid a default by Greece (at least on paper) of its loan obligations.

Another option for Greece, as we have discussed previously, would be for it to return to its own currency (which would drop by perhaps 50% relative to the Euro) and thereby give the country an immediate competitive lift, particularly for its major industry, tourism. However, for the rest of the Euro zone and even for Greece itself, this option we believe is still less likely than a negotiated settlement, at least for the time being.

The important point to stress is that whichever way Greece decides to go, this issue is a relatively minor one for everyone involved, except for the Greeks themselves. The risk of 'contagion', or a domino effect on other members of the single currency union, is minimal today because of the somewhat improved economic position of other Euro zone states at risk, such as Portugal, Spain and Italy in particular.

These countries have managed to stabilise their debt positions and (with the help of the ECB) are managing to fund this debt at relatively low yields (interest rates). These countries have also now emerged from recession and are experiencing some degree of economic growth.

What does this all mean for my investments?

We currently do not intend to make any major portfolio changes at this time. Fiducian's multi-manager diversified funds in particular are constructed to weather this type of market stress. Our asset allocation is currently moderately tilted towards overseas shares to take advantage of any downward shift in the domestic currency, while exposure to domestic shares and listed property securities is being maintained at close to benchmark.