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Weekly Market Update

All eyes on Greece after a turbulent, holiday-shortened week

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- Markets are volatile amid unexpected twists in the Greek debt crisis.
- Puerto Rico meets July 1 debt obligations, avoiding default.
- June's disappointing employment report casts doubt on a September Fed rate hike.
- We continue to monitor events in Greece closely, maintaining a long-term perspective.

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Equities

U.S. and European equity markets started the past week with sharp losses following news that debt negotiations between Greece and its international creditors had broken down, and that Greek Prime Minister Alexis Tsipras had scheduled a July 5 referendum for voters to approve or reject the terms of the creditors' last offer. Appealing to the anti-austerity sentiment that brought his Syriza party to power, Tsipras urged Greek citizens to vote "no."

The failed talks meant Greece did not receive a final €7.2 billion ($8.2 billion) installment of bailout funds, thus assuring that it would not meet the June 30 deadline to repay a €1.6 billion ($1.8 billion) debt to the International Monetary Fund (IMF). Meanwhile, the Greek stock market remained closed and banks were shuttered to prevent further depletion of funds by anxious depositors.

At midweek, Tsipras made some conciliatory overtures to his negotiating counterparts, but his messaging was mixed, and a firm stand by Eurozone officials made it clear that no further talks would occur until after the referendum. European equities, which had fallen nearly 4% in the first two days of the week, began to recoup some of those losses as markets appeared to be betting on a "yes" vote. The S&P 500 Index also began to recover amid some strong U.S. economic releases, including improved manufacturing and housing data and a jump in consumer confidence.

Fixed income

Vying for the spotlight with Greece early in the week was Puerto Rico, which faced a July 1 deadline to make more than $1.4 billion in debt service payments. Puerto Rico, whose credit rating is below investment-grade, has struggled

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economically for nearly a decade, and its government has borrowed heavily to cover shortfalls. Despite a warning from Governor Alejandro García Padilla that the Commonwealth would need concessions from creditors in order to manage its heavy debt load, Puerto Rico avoided a default on July 1, easing concerns among investors who feared broader repercussions in the municipal bond market.

Meanwhile, U.S. Treasuries benefited from a flight to safety as the week began, with Greece driving market sentiment. The yield on the bellwether 10-year Treasury note, which moves in the opposite direction of its price, fell from 2.49% on June 26 to 2.33% on June 29, then crept higher at midweek on solid economic releases and increased optimism about Greece.

Returns for "spread" products (higher-yielding, non-Treasury securities) were modestly negative for the week through July 1. Overall, however, spreads were significantly less volatile during the past week than in previous Greece-related bouts of market volatility. Volumes were generally low, with investors awaiting the results of the Greek referendum, and issuance was lighter across sectors given the holiday-shortened week.

Current market headlines are available here.

June's disappointing employment report casts doubt on a September Fed hike

The U.S. economy created 223,000 jobs in June, somewhat below forecasts. Meanwhile, payrolls for April and May were revised downward by a combined 60,000. And while the headline unemployment rate fell to 5.3%, a seven-year low, the drop reflected an unwelcome decrease in the labor force participation rate. Of greater concern, though, was that wages were flat in June, while gains for the past two months were adjusted downward—taking the wind out of the sails of expected stronger wage growth, after what had appeared to be positive momentum in the spring. Because the Fed will want evidence of employment growth along with several months of wage gains before raising interest rates, we believe this report significantly reduces the odds of a September move.

Outlook

Markets remain somewhat volatile heading into the Fourth of July weekend, although the initial knee-jerk reaction to the past week's unexpected developments has moderated. That said, as of this writing the outcome of the Greek referendum is far from certain, so continued volatility is likely in the near term. Amid the uncertainty, there are a number of factors that may help mitigate potentially negative fallout in the coming days:

- Although Greece missed its June 30 repayment deadline, the IMF has yet to declare an official default. This could provide a window for another round of negotiations after the referendum is held.
- A "no" vote on the referendum does not automatically mean that Greece will exit the Eurozone, although it does increase the odds.
- A "yes" vote, which European officials are actively pushing for, would not only signal Greek citizens' desire to stay in the Eurozone, but could also

lead to a potential change in the Greek government—one that is more moderate than the current Tsipras coalition and thus more credible in the eyes of its creditors. Finance Minister Yanis Varoufakis has already stated that he would resign if referendum voters approve the terms of the bailout.

- The Eurozone is in a stronger financial position than it was in 2012, with a recovering economy and a healthier banking sector that has eliminated most of its Greek debt exposure. Additionally, the European Central Bank (ECB) has expressed its determination to “use all the instruments available” in its arsenal to address any fallout from Greece, including expanded quantitative easing (QE) asset purchases to support financial market liquidity.
- However the Greek crisis unfolds, it should not have a major global economic impact. Greece’s GDP makes up just 1.3% and 0.3% of EU and global GDP, respectively.

The situation in Greece remains very fluid and still subject to unexpected twists. On balance, however, while the chances of a Greek exit from the Eurozone have increased, the odds remain in favor of a resolution. We will continue to monitor developments closely, maintaining our long-term investment perspective.