

# Separating sentiment from fundamentals: Eurozone's recovery, not 'Grexit', is the bond market's real pressure point

Published 30 June 2015

As Greece is on the verge of exiting the EMU ("Grexit"), Greece's continued existence in the EMU matters only to the extent to which a Greek default on debt will be orderly or chaotic. In either case, bond markets have already priced-in Greece's unsustainable debt load, with yields of long-term Greek government debt having entered default territory long before the ECB announced its QE intentions.

The heightened probability of Grexit over the past few days has driven investors to sell off Italian, Spanish and Portuguese bonds whilst piling into safe havens like the German 10Y Bund. However, these moves are likely to be sentiment driven, with the fear of the unknown weighing on the minds of investors over the near term. In reality, the stronger fundamentals in the Eurozone make it highly unlikely that the Eurozone recovery will be derailed by the potential untethering of Greece long term.

In fact, the euro, perhaps the best gauge of sustainable growth within the Eurozone, has remained stable, suggesting that confidence in the Eurozone as a whole has remained unscathed. As also highlighted in the chart below, the euro has hovered around 1.11 to the dollar since February with implied volatility at 13%, unchanged since the start of the year, even with a lack of progress in Greece. As Greece fades from the picture, the strengthening of the Eurozone recovery is likely to be the real pressure point for Eurozone bond markets.

Following the previous two macro alerts (links can be found [here](#) and [here](#)), the bullets below reiterate the view of why both short and long term sentiment in Eurozone's bond markets is likely to remain downbeat and why bearish positioning may be warranted:

Peripheral European bonds have succumbed to heightened volatility with the imposition of capital controls on Greek banks and no extra funding from the ECB raising the prospect of 'Grexit'. Sunday's upcoming referendum is fuelling uncertainty.

- The souring sentiment in Eurozone bonds is driving a wedge between the yields of the safest safe haven bonds and the Eurozone's peripheral bonds. Investors are seeking cover in the crowded German Bund while shunning Italian, Spanish and Portuguese government bond
- Eurozone's bond market volatility is likely to persist, regardless of the outcome in Greece, with improving economic fundamentals in the rest of the Eurozone economies. The resilient euro serves as the best indicator that confidence in the Eurozone remains intact and contagion risk is limited

- The banking sector is healthier now than it was a year ago. Bank recapitalization and restructuring, coupled with cheap ECB funding, is encouraging Eurozone banks to depart from government debt hoarding and return to more risk-taking behavior through extending bank credit to households and businesses. This will put the Eurozone's domestic demand-led recovery on a more solid footing
- Bearish positioning in Eurozone fixed income may be warranted. Leveraged short ETPs tracking German Bunds and Italian BTPs are efficient investments to play the theme.
- **Boost BTP 10Y 3x Short Daily ETP (3BTS)**
- **Boost Bund 10Y 3x Short Daily ETP (3BUS)**

*All data is sourced from WisdomTree Europe and Bloomberg, unless otherwise stated.*

## Important Risks Related to this Article

### Important Information

**Marketing communications issued in the European Economic Area (“EEA”):** This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

**Marketing communications issued in jurisdictions outside of the EEA:** This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

**For professional clients only. The information contained in this document is for your general information only and is neither an offer for sale nor a solicitation of an offer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.**

The application of regulations and tax laws can often lead to a number of different interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and after seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public offering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any affiliate, nor any of their respective officers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.