

Reflections on Greece and Global Macro

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Last week I spoke with Alex Gurevich, the former head of global macro trading at JPMorgan Chase. We chatted about his views on trading in the global macro landscape, in particular Europe, Japan, emerging markets and the United States. He labels his investment style as one that is long term in nature and regards patience as a virtue when considering investment opportunities. Note: Our conversation occurred before Greece, which still had not come to terms with its creditors, closed its banking system for a week, causing a sell-off in European stocks on Monday and putting more pressure on sentiment. I checked back with him to update his views following the weekend's major news.

Economy vs. Market Impact of Greece? From an economic standpoint, the Greek economy represents only about 2% of the eurozone GDP, so Gurevich believes whether Greece muddles through or exits, the long-term economic impact should be moderate. The more important question now is whether this will lead to a market panic. **Gurevich wrote the following this weekend:** *Paradoxically, it is easier to describe what would happen to the markets in the aftermath of a completely unanticipated and destructive event such as 9/11. We would expect a sharp equities sell-off, a flight to U.S. Treasuries and to defensive currencies such as the dollar, Swiss franc and yen. The reason is that if market players are not positioned for this particular event, it is easy to guess what they would do. But when an event was in the making for five years, the prediction is much harder. If we assume that most speculative money was already positioned defensively with respect to Greece, any resolution may come as a relief. But let's go to the next level. If the speculators anticipate the post-resolution relief rally in Greek bonds and stocks, they may actually not be positioned defensively.*

Global Monetary Policy Implications Gurevich believes that global monetary policy is a critical component of currency (FX) valuations. While the euro depreciated strongly in 2014 (approximately -12%) and started to do so again in early 2015, it has more recently corrected and has appreciated from its low. Gurevich believes that the longer-term trend for euro weakness is very much intact, although he believes the brief correction could continue for several more months without harming the long-term trend for more weakness. The weakness in the euro and yen is primarily becoming a strong U.S. dollar story. Gurevich foresees the euro's strength today as temporary and believes it can resume weakness when short-term interest rates start to rise in the U.S. The crux of FX valuation is interest rate differentials. With the European Central Bank on track to continue quantitative easing (QE), pushing local European rates lower, a Federal Reserve (Fed) liftoff as early as September this year could push rates in the U.S. higher, leading to simultaneous U.S. dollar strength and euro weakness. The Japanese yen has retained its depreciating trend over the past 2.5 years. Its currency direction today is also a function of currencies in the Asia bloc, namely China and South Korea. In the event of more yen weakness, it would be interesting to watch the reaction functions of the People's Bank of China and the Bank of Korea. Currency valuations play a large role in export-oriented economies.

U.S. Interest Rate Outlook Gurevich is bullish on bonds in the U.S. Thus far, he views the steepening sell-off

as temporary and expects that it will correct once the Fed starts tightening its policy. Without tightening, investors are able to reap a 2.5% yield in the long end, while paying close to 0% to fund their costs in the short term—an unbalanced risk/reward profile. The curve may eventually flatten, with a big rally in long-end bonds. **U.S. Equity Outlook** While the U.S. market has outlived its historical six-year average bull markets, Gurevich does not think that valuations look egregious. He follows both the Information Technology and Financial sectors closely and has favored Financials for the last several years given that the litigation and regulation risk premiums have been abnormally high. Technology is one he watches closely for its growth potential in an environment of rising rates. In assessing the turning point for equities as rates rise, the Utilities sector has tended to lead the pack. In other words, the more bond-like sectors have tended to lead the markets, and Gurevich is cautious with these particular sectors as rising rates gain momentum. **China Outlook** Gurevich finds it difficult to relate to staunch China bulls and is skeptical about the capability of any government to successfully engineer reforms in a manner that is not disruptive to markets. Chinese financials, despite low valuations, are difficult to fully assess given the potential for accounting manipulations and the Chinese government's ability to transfer infinite wealth from its citizens to corporations via the state-owned enterprise structure. Additionally, credit growth in China is in uncharted territory, with total volume of credit growth 3x that of 2007 at \$28 trillion; for perspective, that is larger than total credit in the U.S. After this weekend's additional monetary actions—a fourth cut in interest rates as well as a drop in the required reserves of banks to inject more money into the system—Gurevich believes there might be more problems in China than it looks like from the outside. Gurevich believes positioning for yuan currency weakness is a worthwhile trade, as its risk/reward is disproportionately positive. However, it is not a certainty given that China is looking to be included in the International Monetary Fund's special drawing rights (SDR) this November, and political forces globally, namely the U.S., do not favor Chinese currency devaluation. *Read the Conversations with Professor Siegel Series [here](#).*

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