INVESTMENT COMMENTARY

Euripides would have been very proud! In typical Greek tragedy fashion, a referendum was called in Greece. The result of which turned out to be not so much about the terms of any new agreement, or about staying or exiting the euro currency, but on whether member nations of the European Union (EU) have the right to view the citizens of other EU members as second class citizens and bluntly interfere in their domestic affairs. Economic targets are one thing, but when the European cacophony of no less than fifty statements a day from every known and unknown, elected and non-elected official ranging from stating the obvious to "the end of the world is near" reaches such a climax, one then has to feel sorry about of the state of affairs of the so called "European Union". The concept of a Union is based on the premise that all parties are equal, and while some might have different views as to how the world works, or have better economies than others, or might be more spendthrift than others, in the end there should be an underlying respect and dignity towards all members of a Union.

With elections coming up in Spain and the euro skepticism generally gaining ground, the EU does not want to set a precedent that a change in government or a referendum can lead to an easy solution out of debt and economic restructuring obligations. The European dream sounds more and more like a teacher's nightmare in dealing with a bunch of rowdy kids. And how did Germany and its satellites come to play the teacher role? Yes, it is the economy stupid. But let us not forget that it was the massive debt forgiveness and growth loans of the past that made Germany what it is today. Or for that matter that while the nations of the European south were spending like the nouveau riche, it was Germany that was reaping the economic benefits of low interest rates and exports to these same countries.

Waiting in the wings for another round of European high drama is David Cameron's almost ignored presentation to the European leaders about its need for the EU to be less involved in British domestic affairs or the British people will vote in 2017 to leave or not leave the EU. Whatever damage to the EU caused by Greece's leaving the Euro currency, it would pale next to the effects of a British exit of the EU. Right now, the odds favor Scotland wanting to stay and England wanting to leave.

At the other end of the globe, the Chinese economic bubble appears to have begun the process of bursting, despite the frantic efforts of the government to reflate it. With the slowdown in the Chinese economy coupled with the events in Greece and renewed declines in oil prices, most risky assets underperformed during the second quarter. Fears about the imminent hike in interest rates by the Federal Reserve caused the yield curve to steepen, only for that trend to be recently reversed by the events in Europe.

All this uncertainty is likely to provide support for US assets in general and interest rates specifically. The uncertainty surrounding Europe along with the weakening euro should give the Fed another reason to either delay the hike in rates or limit the pace of the hikes. We still believe a rate hike is not likely before year-end. This uncertainty should also impact financials, as their small spread widening is not commensurate with their increase in risk. Even the unlikely, but ultimate worst case scenario of a "Grexit" (Greek Exit) should not create an immediate systemic risk (mostly due to the ECB asset buying), but the flight to quality, along with a further increase in volatility and potential speculative attacks on the debt of the countries of the European south should all provide support for US fixed income assets.

For the third quarter of 2015 our strategy is more defensive, electing to add value to our portfolios by selectively investing in high quality corporate bonds, while maintaining the risk of our portfolios at acceptable levels.

The duration of our portfolios remains close to their respective benchmarks, and our yield curve positioning has a more barbelled structure. Global uncertainties about the ability of economies to grow should provide support to the long end of the yield curve. Valuations relative to other foreign government bonds now favor longer maturity US treasuries.

Very selective credit overweight continues to be the primary theme of adding value during the 3rd quarter. We maintain our overweight in industrial bonds, which has provided our portfolios with additional yield. We also have a neutral allocation to financials, as we believe that the historically high spreads offered by the sector only fairly compensate for the sector volatility, especially after the recent events in Europe. We maintain our allocation to agency Mortgage Backed Securities, as sector valuations remain in a fairly valued range.

In spite of potential oil weakness, we are comfortable holding our energy sector selections over the longer term. We believe that they: (1) can withstand years of reduced oil prices, (2) have shown the commitment to maintain their investment grade ratings and (3) have a willingness to reduce leverage.

Evangelos Karagiannis
Senior Vice President,
Senior Portfolio Manager

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EU - The European Union is a politico-economic union of 28 member states that are located primarily in Europe. The EU operates through a system of supranational institutions and intergovernmental-negotiated decisions by the member states.

ECB - The central bank responsible for the monetary system of the European Union (EU) and the euro currency.

Barbell - An investment strategy primarily applicable to fixed-income investing, in which half the portfolio is made up of long-term bonds and the other half comprises very short-term bonds.

Duration - A commonly used measure of the potential volatility of the price of a debt security, or the aggregate market value of a portfolio of debt securities, prior to maturity. Securities with a longer duration generally have more volatile prices than securities of comparable quality with a shorter duration.

Past performance is not a guarantee of future results.

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