Trustmark Investment Advisors, Inc.

SPECIAL TIAI COMMENTARY

July 8, 2015

Greece and China

Media attention is currently devoted to the fluid situation surrounding Greece and the debt restructuring negotiations with the rest of the European Union. Of equal interest, but garnering fewer headlines has been the bear market in Chinese equities and the Chinese authorities' attempt to help prop up their financial markets.

Greece

At the time of this writing, the situation in Greece is at a virtual stalemate. Over the July 4th holiday weekend, the Greek people overwhelmingly voted "no" in a referendum to reject terms laid forth by the European Union (EU). In this referendum, finance authorities would have layered levels of austerity and restructured Greek debt in an attempt to keep the country a part of the European Union as well as attempt to somehow make the ongoing servicing of debt tenable and manageable for Greek authorities.

The referendum did not explicitly do anything other than give Greek Prime Minister Tsipras an arrow in his quiver at the negotiating table to uphold the will of his people.

The main player on the side of the EU is Germany – they are the largest and most economically powerful country in the union. They have led the negotiations up to this point, and will continue to do so. They have a keen interest in keeping Greece as an EU member – lest other profligate nations follow Greece out the door - Portugal, Spain and Italy.

Next Steps

At this point, it is increasingly likely Greece will officially default on their debt. Upcoming debt payments include one on Tuesday, July 14, for 86.5 million euros and growing (as the debt is denominated in Yen) and on July 20, they have a scheduled payment to the ECB for 3.5 billion euros.

Sunday, July 12, marks the self-imposed deadline European leaders have set in order to reach a deal with Greece on a rescue in exchange for austerity measures. Greece has until then to accept the terms of the deal or risk expulsion from the EU.

Catch-22

However this situation plays out, other profligate nations could follow in Greece's foot-steps. Either their debt gets renegotiated, and others look for similar terms on their debt, or Greece leaves the EU and defaults on their debt, and others could follow suit. Either way European Central Bank authorities are caught in a tense and uneasy situation. On the other hand, Germany could be making this entire situation as painful as possible for the Greek populace and the Greek banking system so much so that other overly-leveraged countries are discouraged to make the same choices as Greece.

Market Expectations

The U.S. dollar continues to rally as the situation deteriorates, and the longer it messily plays out the more likely a continuation of the dollar rally. A flight to safety trade has helped push down U.S. interest rates, with the 10-year Treasury rallying to 2.22% at the time of this writing, down from a recent high of 2.47% on June 26.

The other secondary issue coming out of this is what it may mean for Federal Reserve interest rate policy. Before the Greek situation escalated, the consensus expectation was for a Fed rate hike at their September meeting. With the volatility introduced to the fixed income market and the global economy, a lift off might get pushed back to December. Keep in mind the EU is our largest trading partner.

China

Over the past three weeks, China's main stock market index has lost about 25% of its value. Bloomberg added some perspective to the situation, noting that the dollar value of the decline, $2.5 trillion is "about ten times Greece's gross domestic product."[1]

Recently the China Securities Regulatory Commission moved to weaken rules on margin trading, vowed to crack down on short sellers in what they viewed as market manipulation, and lowered transaction costs, all to no avail. None of these measures slowed down the pace of selling, so a new plan was unveiled over the holiday weekend.

Plans for a stabilization fund were announced which amounted to 21 of the leading Chinese brokerage funds pledging 120 billion yuan ($19 billion) for a stock-purchasing fund to help provide stability and liquidity to their equity markets. The Chinese central bank said it may help provide liquidity for the brokerages in order to act as a backstop. Alongside the brokerage firms, 25 of China's largest mutual funds pledged to buy stocks and hold them for at least one year. In addition, many of China's largest publicly traded companies have pledged enormous share buy-back programs to begin immediately. For example, China's largest property developer, China Vanke Co. announced plans on July 6, to buy back as much as 10 billion yuan of its shares.[2]

Lastly, on July 8, Bloomberg reported that by their calculations the total number of suspended companies unavailable for trading was 365 on the Shanghai Composite, equal to 33% of all listings on that exchange and another 992 on the Shenzhen Stock Exchange about 56% of the total listings.[3] The

[1] http://www.bloomberg.com/news/articles/2015-07-03/what-is-to-be-done-possible-steps-to-stem-china-s-stocks-rout
[2] http://www.bloomberg.com/news/articles/2015-07-06/timeline-china-s-efforts-to-stem-3-2-trillion-stock-rout
[3] http://www.bloomberg.com/news/articles/2015-07-08/china-stock-futures-plunge-amid-trading-halts-margin-debt-drop

suspensions have frozen investor assets to the tune of $2.6 trillion of shares, or about 40% of the country's total market value.[4]

It is important to remember that the majority of the pain is largely contained to mainland China as the country's domestic indexes house A-Shares, which are only available for purchase by Chinese nationals and to a lesser extent through tightly controlled and regulated Qualified Foreign Institutional Investors (QFII). The rest of the world generally gains access to Chinese markets through B-Shares which trade in Hong Kong and have not experienced declines in the magnitude of A-Shares.

Going Forward

It remains to be seen whether any of these measures will have the desired results. Interestingly, there is a significant transfer underway of risk from the individual investor to the balance sheets of Chinese corporations, brokerage and mutual fund firms, and the Chinese government through the purchase of overvalued equity securities. This risk transfer along with the more immediate market declines are worth keeping an eye on as it relates to our equity markets here at home.

[4] http://www.bloomberg.com/news/articles/2015-07-08/this-is-why-so-many-chinese-companies-are-suspended