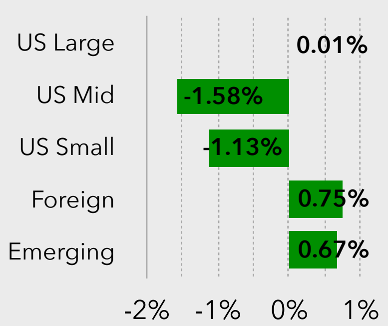
Economic Data

- 1Q GDP declined at -0.2% annualized rate
- Year over Year Inflation (CPI) was flat for May
- Retail Sales were up 1.2% in May
- 698,000 jobs were added during the quarter and the unemployment rate dropped to 5.3%

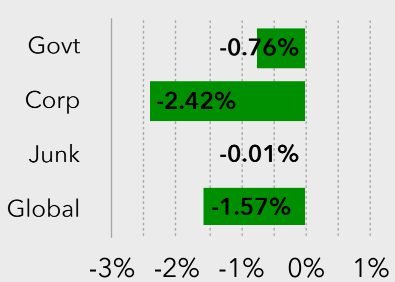
Stocks

2Q15 Returns



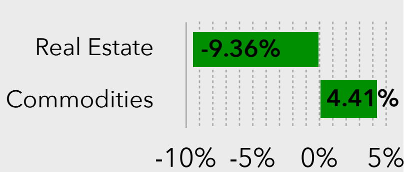
Bonds

2Q15 Returns



Alternatives

2Q15 Returns



Above index data provided by Morningstar.

Gyro Zone

Greece Watch: Day 2,086!!! Seriously, it has really been going on that long. This whole Greece debacle seems to finally be coming to a head, though. With no deal between them and the rest of the eurozone Greece missed a $1.7 billion payment to the International Monetary Fund on June 30, making it the first developed country ever to do so.

Prime Minister Alexis Tsipras called for a July 5 referendum vote, putting the decision in the hands of the Greek people. They could have voted ‘yes’ and accepted a deal offered by the country’s creditors that demanded more austerity measures. Instead, they overwhelmingly voted ‘no’ with 61.31% of the vote. Many who voted ‘no’ had the impression that it was not a vote to leave the eurozone, but rather just another step in the bargaining process. They may find the rest of Europe has grown weary of them, however, and the bridges for further negotiation have now been burned. This would leave Greece facing default and expulsion from the eurozone; perhaps even the EU. Banks will be cut off from the ECB, hoarding of cash and goods will intensify, shortages will be prevalent, and an economy that has already shrunk by 25% over the past five years will simply collapse.

The fallout from all of this should be relatively contained. Much has been done over the past few years to put a ring fence around the crisis with most of the debt in the hands of various governments. Contagion should be limited and, in the long run, the world will be better off once the headline risk that Greece has been posing has been removed. European markets are down about 7.5% over the past two weeks, but US markets only took about a 3% hit in the final week of June and have reacted very little since.

Greece is desperate, and desperate people make poor choices about whom to go to bed with. On the geopolitical stage I see Greece shifting away from Western alliances and snuggling up to allies of lesser repute. According to one report, they have already made a deal with Russia to build a new gas pipeline that will bypass Ukraine. Russia will pay for construction with the understanding that Greece will repay the debt later. Good luck with that, comrades.

The Chavez Legacy

Speaking of sovereign defaults, Venezuela is poised to have their own soon. The country’s currency, the bolivar, has been dropping in value. That’s nothing new in and of itself, but the rate of decline has rapidly increased lately as lower oil prices have wreaked havoc on their economy which is largely dependent on oil. Don’t bother looking at the official exchange rate of 6.35, because nobody will pay that much for bolivars — not even close. Similar to Argentina, there is a black market to get around currency controls. The current black market exchange rate? 482 bolivars per dollar — 76 times as weak as what the government says! That’s Zimbabwe level inflation.

A number of companies with operations in Venezuela are taking it on the chin due to the difficulty of converting bolivars into dollars. Ford lost $800 million last year as a result, and GM said it will be taking a $600 million dollar hit in the second quarter because of it.

Venezuela may have the largest proven oil reserves in the world, but there doesn’t seem to be much hard currency lying around to pay the bills. With the state of the bolivar as it is they have been reduced to bartering with other countries. Uruguay pays for its Venezuelan oil with beef, and Trinidad and Tobago has offered to pay for it with — I kid you not — toilet paper. The government has about $5 billion in debt payments due in October, so don’t be surprised if we see another sovereign default then.

Puerto Rico, My Heart's Devotion, Let it Sink Back in the Ocean

Yes, that’s from the song *America* in the musical *West Side Story*, but please pay no mind to my knowledge of show tunes and instead focus on the fact that Puerto Rico is indeed sinking. Puerto Rico has seen a quadrupling of emigration off of the island to the mainland US in the past few years as people seek out better job opportunities. This has shrunk the tax base, forcing the commonwealth to rely more heavily on debt to keep the lights on. Puerto Rico now owes $73 billion it can't reasonably pay, and the US has zero interest in providing them with a bailout.

The Governor of Puerto Rico has been lobbying Washington to make it legal for them to declare Chapter 9 bankruptcy, like Detroit did in 2013. Without the legal avenue of bankruptcy, Puerto Rico will be required to settle its debts with creditors on its own, which would take years. Regardless of which route they have to travel, the bottom line is that anyone holding Puerto Rican debt likely won’t be getting paid back in full.

Dusting Off a Playbook From 1929

October 24, 1929 — Black Thursday — alarmed by rapidly falling stock prices a group of five of America’s most powerful financiers met at the offices of J.P. Morgan to devise a solution. They pooled some of their financial resources and put it in the hands of Richard Whitney, then vice-president of the exchange. As he walked on the trading floor, silence fell over the crowd. They expected him to close the exchange, but instead he asked what the current price for US Steel was. “195,” someone shouted. He then announced he would buy 10,000 shares at 205. He continued to buy shares of other stocks amongst cheers from the crowd. The tactic was successful in stopping the slide that day, but failed overall as the selloff resumed the following week with Black Tuesday. Incidentally, Richard Whitney was found guilty of embezzlement nine years later.

Why do I mention this? Well, China’s stock market had been red hot over the past year but has fallen roughly 25% in the past three weeks alone. 21 of China’s largest brokerage houses are pooling $19.3 billion in money and using it to buy stocks in hopes of stabilizing the market. That’s only enough money to cover about 20 minutes of the normal trading volume in China. It didn’t work for us in 1929, and I don’t think it will have much impact this time, either

In a further effort to stem the bleeding, 28 IPO's (new stock listings) have been put on hold to prevent these new offerings from drawing money away from other areas of the stock market. The Chinese government is also easing restrictions on margin investing and providing capital to fund it. This means that mom and pop types will be able to borrow more money to invest in the market, giving them more leverage. This practice amplifies gains, but can quickly wipe someone out if markets fall dramatically. Yeah, this won't end badly. It's China that's the real problem, not Greece.

Three-Time Champs

I've filled most of this newsletter with a lot of negatives around the globe, but the truth is things are pretty good here in the home of the 2015 Women's World Cup Champions! Sure, GDP didn't look too good as cold weather, a strong dollar, and the West Coast port strike all contributed to a no-growth first quarter. But that is old news, and there are plenty of leading indicators that point to a strengthening economy.

Low oil prices typically lead to improved economic data about six months after bottoming, which happened at the end of January. There is a lot of strength in the housing market right now, which is helping to offset any economic weakness tied to export manufacturing. Existing homes sales in May were up 9.2% year-over-year and prices were up 7.9%. Home supply is pretty tight right now at only 5.1 months, making it a seller's market and boosting demand for new construction. The consumer looks financially healthy and retail sales have been picking up. Most importantly, we've seen healthy job growth over the quarter which is a very encouraging sign.

The dollar is still strong, but at least it stopped marching upward this quarter. If we can put this whole Greek mess behind us I think US stocks will respond favorably to better economic news in the second half. The stronger economic data will make it difficult for the Fed not to raise rates soon, and the bond market has been moving downward in anticipation. Things abroad are a bit murkier right now. We remain overweight in stocks with an emphasis on the US and other developed countries, and underweight in bonds overall.

Stay rational and time will always smooth things out.

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