



GREEK DEBT CRISIS



BASIC BACKGROUND

On June 28, the European Central Bank chose to stop providing emergency loans to Greece that provided vital support to its banking system. Greece has been receiving these emergency loans for the past five years.

In response, the Greek government ordered its banks to close their doors for six days, beginning June 29, to prevent a “run” on the banks’ limited currency reserves.

The Greek government has also scheduled a July 5 national referendum on the conditions for future loans by Greece’s creditors (the ECB, the International Monetary Fund and the European Commission, collectively known as “the troika”).

On June 29, Greece said it would not pay a \$1.7 billion loan repayment to the IMF due June 30

The result of the July 5 referendum could lead to Greece’s eventual exit from the eurozone. If it occurs, it would be the first time that a eurozone country has left the shared currency.



KEY POINTS FROM THE USAA INVESTMENT TEAM

We have no exposure to Greek debt. Our exposure to Greek equities is small and indirect via an emerging markets ETF.

As investors, we believe in global diversification. We are currently overweight to Europe due to attractive fundamental valuations, prospects for strong earnings growth and the beneficial impacts of the European Central Bank’s loose monetary policy. The situation in Greece does nothing to change our overall positive view on European equities. The financial sector in Europe has scant direct exposure, as virtually all of Greece’s sovereign debt has been shifted out of private banks and into public hands.

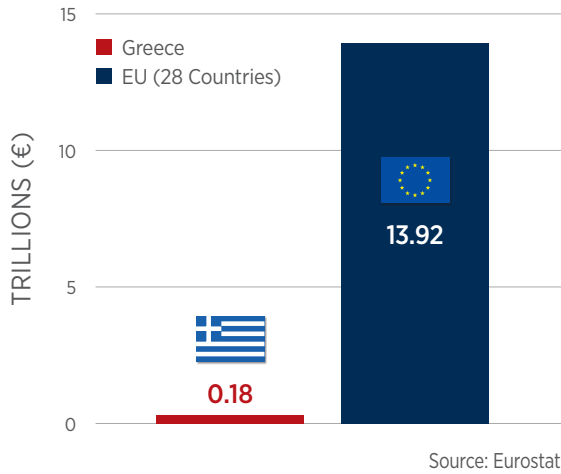
Volatility is likely to increase due to the wide range of possible outcomes.

Uncertainty tends to drive market volatility, so we expect an upswing in short-term volatility heading into the Greek referendum on July 5. Global equity and bond markets sold off on the first day of trading after the Greek debt crisis came to a head. Longer term, we do not think the current situation will exert a lasting impact on global capital markets because of Greece’s troubles have been largely walled off from the rest of Europe. We are closely monitoring Greece during this fluid period, and are prepared to add to our Europe overweight if short-term volatility creates good buying opportunities.

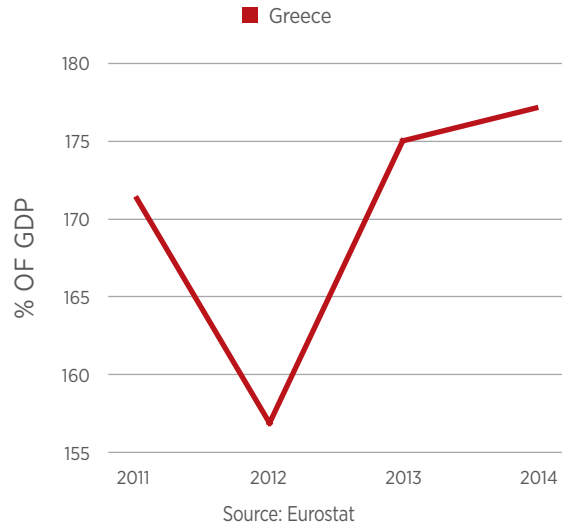
In our view, the risk of contagion from the Greek debt crisis is negligible.

Greece represents roughly 1.3% of the European Union’s economy. Its GDP is just a little bigger than the state of Iowa. So from the beginning, the risks surrounding Greece have been less about Greece itself and more about the possibility that its woes could affect the euro and other countries in the EU. We believe other peripheral EU countries – including Ireland, Portugal and Spain – face little risk because they have accepted austerity, stabilized their debt burdens and are participating in Europe’s economic gains. Greece, by comparison, has resisted austerity and its public debt (170% of GDP as of the end of 2014) has continued to grow. Refer to Figure 1 and 2 on the next page.

GROSS DOMESTIC PRODUCT (GDP) AT MARKET PRICES AT CURRENT PRICES



GENERAL GOVERNMENT GROSS DEBT ANNUAL DATA



The European Central Bank stands ready to help fend off negative impacts.

Just a few months ago, the European economy was close to falling into a deflationary spiral. Now it is in the early phase of finally recovering from the Great Recession. Just as the Federal Reserve has supported the U.S. recovery, the ECB seems committed to ensuring that Europe does not slide backward as a result of Greek fallout. It has a number of tools at its disposal, including direct loans to member states and expansion of its current quantitative-easing program.

Greece doesn't want to leave the EU, but it may have no choice.

Even with all of the drama, public opinion polls have consistently indicated that Greeks want to stay in the eurozone. The results of their July 5 referendum, however, may ultimately force them out of the common currency. In our view, there are no easy choices for Greece at this point. If it returns to the drachma, Greece will suffer an immediate economic shock that will take years to normalize. If it keeps the euro, the austerity terms likely to be imposed by its creditors (led by Germany) will also lead to a prolonged period of pain.



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Our disciplined approach is built on a tradition of military values and helping our members achieve their financial goals.

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