Greek Debt Resolution: What a Difference a Weekend Makes

Summary

- Our view is that the Greek situation is contained and is not an Armageddon move.
- The US structured credit markets we target have continued to reap the benefits of a post-crisis reflationary recovery in the US, and the US data continues to improve.
- We believe US banks at this stage in the post-crisis period are more stable, due to higher capital requirements, stress tests, increased regulatory oversight and scrutiny, enhanced underwriting standards, and limited direct exposure to Greece.

Brad Friedlander
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Angel Oak Capital Advisors

In the News: June 29th, 2015
Brad joined CNBC Power Lunch to discuss the Greek debt crisis and rising interest rates contributing to market volatility.

Overview

What a difference a weekend makes. Last Friday evening, headlines were optimistic toward a Greek resolution, and US macro data continued to paint an improving picture, sending US treasury yields higher by 10-20 basis points (bps) on the week. Existing home sales were up 8.9% year-over-year (YoY) in May, and new home sales were up 19% YoY. Q1 GDP data was revised higher to -0.2%, better than the -0.7% previously reported. Consumer spending showed some welcomed signs of improvement in Q2. Real spending was up 3.0% at an annual rate from the Q2 average, and jobless claims data continued to be robust. Continuing claims remained at a 15-year low. Inflation data was the one sore spot with core personal consumption expendatures (PCE) rising a meager 1.2% YoY.[1]

However, everything changed over the weekend after the Greek storm, which has been brewing for years, finally made landfall. On Saturday, the Greek government shut down all negotiations to release the last €7 billion ($7.77 billion) of the economic adjustment program. Greek Prime Minister Tsipras rejected the recent bailout terms offered by the European Monetary Union (EMU) and asked the Greek Parliament to approve a national referendum on whether to accept or reject the terms. Tsipras and his government are recommending voters reject the EMU and International Monetary Fund (IMF) terms. Voters head to the polls on July 5th, but until then, all Greek banks are closed. Capital controls are in place, and all cross-border transactions have been halted. Even worse, citizens are restricted to €60 ($67) per day at the ATM. Greece missed today's emergency $1.7 billion bank aid payment to the IMF, which technically may result in a formal default if the IMF declares Greece "in arrears." The situation in Greece is bleak even if the voters choose to stay in the European Union. The European Central Bank (ECB) could possibly declare all Greek banks insolvent triggering the single resolution mechanism (SRM) even if the voters decide to accept the terms of the EMU.[2] Sadly, the economy is in shambles. With unemployment at approximately 25%, an overwhelming amount of debt, and a cultural reluctance to pay or even collect taxes, Greek exit (Grexit)/default appears imminent. This has all markets nervous as the first half of the year winds down. US Treasury yields have fallen 2-14 bps, global equity markets have fallen 2-5%, peripheral sovereign spreads have widened 20-30 bps, US investment-grade corporates were approximately 4 bps wider, and high-yield spreads widened by approximately 25 bps.[3]

As if the Greek news weren't enough, concerns of an impending Puerto Rican default rose over the weekend after Governor Alejandro Garcia Padilla spooked investors by warning they should prepare to sacrifice. Moreover, Chinese equities, after an absolutely remarkable run year-to-date (YTD), have fallen under pressure. The Shenzhen composite is off 25% from the highs but is still up 74% on the year. Interestingly, the US market appears relatively resilient in light of the Grexit, Puerto Rico, and China news. Despite the reemergence of sovereign risk, we would like to remind our investors that this is another storm resulting from the post-credit crisis fallout. The Greek and Puerto Rican debt burdens are certainly not new. They have been brewing for some time and are the result of too much debt with too little productivity. When leveraged bubbles burst, like during the 2008 crisis, they take years to heal, and this summer's storm is not unusual.

[1]Bloomberg and HFE [2]Jefferies [3]Goldman Sachs

Conclusion

Structured credit is not immune to mark-to-market fluctuations due to these macro events, and while global markets and structured credit may experience jitters, we view this as a buying opportunity and will be bargain-hunting for the following reasons:

1. The US structured credit markets we target have continued to reap the benefits of a post-crisis reflationary recovery in the US, and the US data continues to improve. Fundamentally the macro picture is brighter:
   a. Consumer – Household net worth as a percentage of disposable income is back to pre-crisis levels, and consumer delinquencies are at all-time lows. Also, the consumer confidence index is back to pre-crisis highs, and the unemployment rate continues to improve.
   b. Housing and real estate – The real estate recovery has been slow, but there are signs that things are beginning to pick up. New home purchases hit a 7-year high in May, and existing home purchases continue to increase. Also, limited new construction in commercial real estate bodes well for continued strength.
   c. Corporate – The improving consumer picture is finally leading to an increase in consumer spending on durable goods. More consumer spending can lead to better corporate profits, offsetting any negative effects of increased costs if the Fed were to raise short-term rates.
2. Our view is that the Greek situation is contained and is not an Armageddon move. This is a difficult and unfortunate situation for Greece and the Greek people, but we do not expect contagion when it comes to the broader impact on global developed markets.
3. The amount of liquidity in the system through the ultra-accommodative monetary policies in the US, Japan, England, and the EMU in the post-crisis period will continue to soften the blow and support market stability in post-crisis storms.
4. We believe US banks at this stage in the post-crisis period are more stable, due to higher capital requirements, stress tests, increased regulatory oversight and scrutiny, enhanced underwriting standards, and limited direct exposure to Greece.
5. Finally, there are post-crisis mechanisms in Europe that were not in place in the summer of 2011, like the SRM, designed for situations like Greece.

ABOUT ANGEL OAK CAPITAL ADVISORS

Angel Oak Capital Advisors is an investment management firm focused on providing compelling fixed-income investment solutions for its clients. Backed by a value-driven approach, Angel Oak Capital seeks to deliver attractive risk-adjusted returns through a combination of stable current income and price appreciation. Our experienced investment team seeks the best opportunities in fixed-income with a specialization in mortgage-backed securities and other areas of structured credit. As of 6/30/15, Angel Oak Capital has over $5 billion in assets under management through a combination of mutual funds, private funds, and separately managed accounts.

Sreeni Prabhu
Managing Partner
Co-CEO, Chief Investment Officer

Mr. Prabhu is a Managing Partner, co-founder and Chief Investment Officer at Angel Oak Capital and is ultimately responsible for the overall investment strategy of the firm.

Prior to Angel Oak, Mr. Prabhu was the Chief Investment Officer of the investment portfolio at Washington Mutual Bank in Seattle for three years managing a $25 billion portfolio. He was also part of the macro asset strategy team at the bank. Mr. Prabhu worked for six years at SunTrust Bank in Atlanta, where he was responsible for investment strategies and served as head portfolio manager for the $3 billion commercial mortgage backed securities (CMBS) portfolio. He began his career at SunTrust in 1998 as a bank analyst focused on asset/liability management and liquidity strategies. Mr. Prabhu holds a B.B.A. in Economics from Georgia College and State University and an M.B.A. in Finance from Georgia State University.

Brad Friedlander
Managing Partner
Head Portfolio Manager

Mr. Friedlander is a Managing Partner, co- founder and Head Portfolio Manager of Angel Oak Capital's family of funds. Since 1999, Mr. Friedlander has been involved in the capital markets and asset management across the fixed income product spectrum. Prior to Angel Oak, he spent five years as a Portfolio Manager with Washington Mutual Bank in Seattle, WA where he managed over $8 billion in RMBS, ABS, and US Government and Agency portfolios. Mr. Friedlander's previous experience includes four years on the trading desks at JP Morgan in New York.

Fund Industry Intelligence named Mr. Friedlander one of the 2013 Rising Stars of Mutual Funds. He was featured in Barron's and has been quoted in The Wall Street Journal, Bloomberg and Reuters. Mr. Friedlander has also appeared numerous times as a guest on CNBC and Fox Business. He has also been a visiting Lecturer at Emory University Goizueta Business School. Mr. Friedlander earned his bachelor's degree in economics from the University of Rochester.

→ Learn about Angel Oak Capital's innovative approach to structured credit investing: AngelOakCapital.com

Must be preceded or accompanied by a prospectus. To obtain an electronic copy of the prospectus, please visit www.angeloakcapital.com.

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