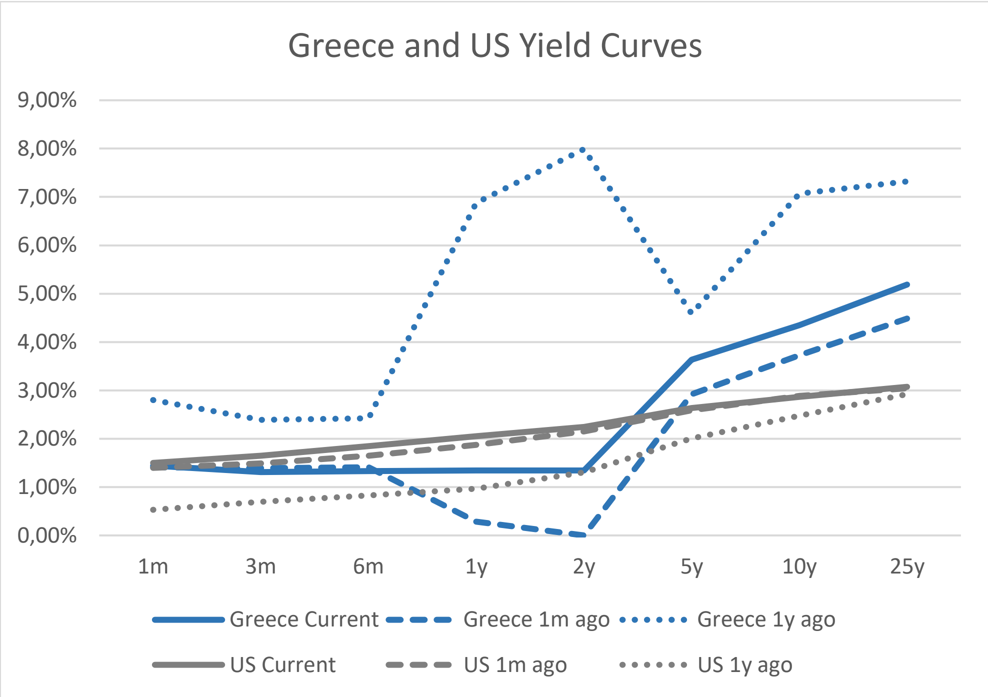
Greek Banks are Back (in THE Game)

Macro Environment

2018 is bound to be the point of inflection for the Greek economy. The Bank of Greece reports that GDP will grow 2.5% over the next two years, while the European Commission expects a 1.6% growth in 2017 - the economy's best performance in a decade. Greece's 10-year bond yield fell below 4% for the first time since 2006 after a successful bond swap agreement between the country and its creditors in a Eurogroup meeting on December 2, 2017. Currently, Greece's 2-year sovereign bond yield is significantly below that of the United States (1.344% vs 2.246% as of March 2, 2018). These lower yields signify that investors are significantly more optimistic on the future of Greece. However, this more constructive view that we see with fixed income has not yet translated to higher stock market valuations - the Global X FTSE Greece 20 (GREK) ETF remains far below historical averages and has changed relatively little over the past two years. Theoretically, as sovereign yields become lower, stock valuations should increase since the discount rate used in valuation models also decreases.



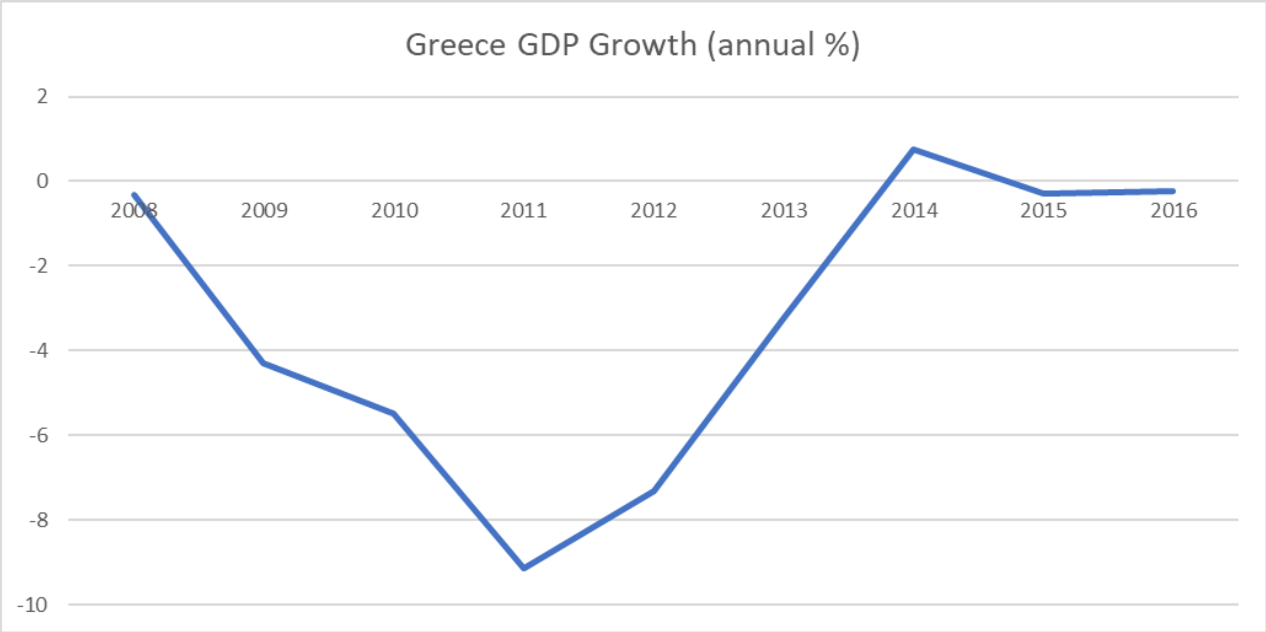
Source: Investing

Furthermore, the European Commission, considered to have been "tough" on the Greek government in the past, has issued the following statement: "The recovery is expected to strengthen in the coming years providing further support for employment growth. Sustained commitment to structural reforms remains vital to the continued expansion."

In addition, on January 19, 2018, the ratings agency Standard & Poor's raised Greece's foreign and local currency long-term sovereign credit ratings to "B", citing improvements in the macroeconomic and fiscal outlooks.

Moreover, the government plans to return to the international capital markets with two or three bonds issues, with seven, three, and ten year maturities, in the first semester of 2018. Finally, Greece is expected to exit its current bailout programme by August of this year.

The improvement of the macroeconomic scenario has led to a return of investor interest in the country. For instance, Brevan Howard has revealed plans for the inception of two funds, totalling over USD 500m, to invest in Greek property and publicly traded stocks.



Source: Tradingecomonics

Greece's banking stocks have been severely hit by the crisis. The country's four main, publicly listed banks now trade at fractions of their tangible book values, and should recover dramatically as the economy starts to grow again and as investor confidence returns. They are:

- National Bank of Greece (ETE)
- Alpha Bank (ALPHA)
- Piraeus Bank (TPEIR)
- Eurobank Ergasias (EUROB)

Traditionally the two major challenges of the Greek's banking system have been liquidity and non-performing loans. The overall liquidity situation in Greece has improved again in the Q3-2017. With the exception of Alpha Bank, Greek banks are getting close to a loan/deposit ratio in the range of 90%-110% what is normal in the sector, given the fact that the average L/D in the whole Eurozone was 118% in Q2-2017. With respect to non-performing loans, there has not been any significant progress in the NPL ratios during the Q3-2017 and remain quite high with respect to the average NPL ratio for the Eurozone which was roughly 5.5% in Q2-2017. Therefore, NPL ratios are flat, but volumes are going down marginally. Moreover, all the Greek banks have been shrinking their balance sheets in recent years and improving their profitability.

Recently, all four banks have experienced similar trend in these last months. Initially, the share price of the major Greek banks started to increase and peaked in late December and early January. However, this trend did not last and in early February has mean reversed to the original prices of November. On 2 March 2018 Greek banks were trading in a range from 0.16x-0.39x P/TBV [0,16x, 0,29x, 0,31x, 0,39x].

On top of that, we have to take into account the fact that biannual EBA stress tests started on 31 January 2018 and the results will be delivered in the autumn. According to EBA, the four Greek banks directly supervised by the European Central Bank (ECB) will undergo the same stress test under the EBA scenario and methodology. However, in order to complete the test before the end of the third European Stability Mechanism stability support program for Greece, the timetable will be accelerated and the results are expected to be published in May instead of November.

Strategies:

We could consider a simple Long Only strategy by buying either at the money calls or small out of the money calls. Moreover, we could consider a second strategy: Long-Short in between Greek Banks and Beta hedging, i.e. long few Greek banks and Beta hedge with respect to the European financial sector benchmark. By picking stocks and building with the confidence that such portfolio should outperform the rest of European financials' stocks in 2018.

In order to be both cost effective and have an exposure to the European and Financial Industry, a suitable ETF benchmark that might be used for this strategy is the iShares MSCI Europe Financials ETF. Among the different options, this specific ETF provides a good exposure to some the main Southern European and French banks (e.g. Banco Santander SA (SAN:SIBE) 5.39%, BNP Paribas SA (BNP:PAR) 4.30%, Banco Bilbao Vizcaya Argentaria S.A. (BBVA:SIBE) 2.70%, Intesa Sanpaolo SpA (ISP:MIL) 2.47%, Societe Generale SA (GLE:PAR) 2.11%).

By shorting the iShares MSCI Europe Financials ETF, this would protect our strategy from any unexpected shock within the financial industry in Europe that could potentially harm a Long Only strategy with respect to these Greek financial stocks. Indeed, the aim of this strategy is to lock in the benefits. To do so, one way of implementing such Long-Short strategy could be through the use of futures. We would need to pick futures on the stocks of the abovementioned banks and short a proportionate amount of futures of the MSCI Europe Financials ETF. In fact, we would need to short a number of futures in the ETF equal to the product of the Beta of our portfolio of future stock with respect to the holding stocks inside the ETF and the division of the current value of the Greek banks portfolio and the current value of the ETF's futures.

Practically, we would need to estimate the amount beta to hedge by performing a linear regression of the returns of our portfolio with respect to the chosen index

$$R_{pft} - r_f = \alpha + \beta\left(R_{index} - r_f\right) + \epsilon$$

Finally, given the disparity on the publications of the stress tests in between the Greek banks and the banks supervised by the EBA, the former in May and the latter in November. In order to be avoid different treatments with different available information, our strategy should last until the EBA stress tests' publication in November.