



global weekly

Investment
Communication
17 June 2016**Brexit uncertainty intensifies**

The question to remain in or leave the EU looms over the UK and causes jitters among investors worldwide. Volatility is expected to remain high until the referendum.

Macro update

Over the past few days, risk aversion has increased in anticipation of rising uncertainty related to the UK referendum regarding its EU membership. Volatility has increased, as polls regarding the outcome of referendum have narrowed and the results flip between remain and leave. The vote will take place on Thursday, 23 June.

If there were to be a vote to leave, uncertainty would likely continue for some time. Much would also depend on the nature of the exit, for example if it were to become messy or go smoothly.

Given the decline in market sentiment that has been recently seen, a vote to remain could result in a post-referendum rally. We continue to believe that Britain will vote to remain in the EU, although it is a close call.

Political risks are rising, as the UK's referendum vote approaches, Spanish elections are in the offing, the US presidential campaign begins in earnest and, next year, there are general elections in Germany and France.

Equity update

Market volatility was high last week, with large losses as a result. Europe performed the worst, closely followed by developed markets in Asia. The losses in the US and China were less extensive.

Sentiment was dominated by Brexit fears. The US Federal Reserve leaving its interest rates unchanged and the acquisition of LinkedIn by Microsoft hardly had any impact.

We expect the UK to vote for staying in the EU, but if that were not the case, we expect equity markets worldwide to drop, with Europe and the UK underperforming the most.

Equity index performance in local currency

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	392.1	-2.3	-1.8
S&P 500	2078.0	-1.8	1.7
AEX Index	422.7	-3.0	-4.3
EuroStoxx 50	2819.3	-1.7	-12.4
DAX Index	9550.5	-1.6	-9.9
Nikkei 225	15599.7	-6.0	-18.0
Hang Seng Index	20143.0	-4.3	-8.1

Important rating changes

Company	From	To
Münich Re	Hold	Buy
Twitter	Buy	Hold
LVMH	Hold	Buy
Prudential	Hold	Buy
Allianz	Hold	Buy

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.695	-3.4	4.4
German Bunds 2-year	-0.598	-5.1	-40.1
Japan 2-year	-0.254	2.0	-24.9
US Treasuries 10-year	1.604	-3.8	-71.4
German Bunds 10-year	-0.004	-2.3	-81.1
Japan 10-year	-0.166	-1.1	-64.1

Spreads

Index	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	82.72	4.87	12.28
iTraxx Euro 5-year	86.83	8.98	10.72
JPM EMBI+	407.67	23.35	3.37

Performance data as of Friday, 17 June

Source: Bloomberg

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A sector that would be negatively impacted is the financials sector. Not only because London is a financial centre, but also because risks in the financial system would increase.

Another risk is contagion risk, which could increase if other EU countries could investigate leaving the union as well. For other countries, however, leaving the EU will be much more difficult due to regulation and existing treaties.

All in all, we expect next week to be a nervous trading week with, in the end, a vote from the UK to stay. The unrest will not be over by then, however, as Spanish elections will follow three days later.

The regional equity allocation is neutral regarding the US and Europe, with a tilt toward emerging markets Asia. Within Asia, China has been moved to neutral from overweight, in light of weak earnings-growth momentum. South Korea, which is attractively valued and the only Asian market with positive earnings revisions since the beginning of 2016, was moved from neutral to overweight.

Bond markets update

Indicators on the outcome of the UK referendum are showing a close call. During the week, spreads widened across European peripheral markets, including Italy and Spain. These bonds are likely to suffer if the vote is to leave the EU and if the outcome of the Spanish elections on Sunday, June 26, signals a large change. In that case, those yields may continue to experience upward pressure for months.

We have therefore advised to further reduce the bond allocation to Spain, before the EU referendum and the Spanish elections, while spreads are still relatively tight. We advise reinvesting the proceeds into European corporate bonds, which are supported by the purchases by the European Central Bank (ECB) and show robust fundamentals and decent valuation. We expect the ECB to buy around EUR 5 to 10 billion per month.

The ECB is expected to increase its government bond purchases after the summer from EUR 80 to 100 billion a month, as inflation expectations keep falling. We do not expect the ECB to extend corporate bond purchases, as the bank is already pushing this market to its limits. Any setback, however, due to financial stress or abundant bond issuance would be a reason to further step up its support. All in all, the ECB is also providing protection against losses.

Currency update

The US Federal Reserve left interest rates on hold on 15 June and scaled back its forecasts for future rate hikes. This resulted in weakness of the US dollar, lower US Treasury yields but higher gold prices and emerging market currencies. Financial markets have further priced out the possibility of even one rate hike this year. With our base case of the Fed being on hold this year, the US dollar will likely remain under pressure. Nervousness surrounding Brexit should, however, keep the US dollar and the yen supported in the near-term.

As financial markets became seriously nervous about the Brexit referendum, stress in the foreign-exchange options market increased. Since the end of May, the pound sterling has fallen by more than 3.5% versus a basket of currencies. As long as the Brexit polls remain close, uncertainty will likely continue to trigger weakness for the British pound sterling.

Asset allocation

In the run-up to the British vote on staying in the EU next week, the Global Investment Committee left the asset allocation unchanged at its meeting on Thursday 16 June. It continues to reflect a modest overweight in equities, an underweight in bonds and a significant overweight in cash. Commodities are overweight, with neutral allocations to real estate and hedge funds.

Reporting calendar

Company	Date
FedEx, Adobe Systems, Colruyt, Lennar	21 June
H&M	22 June
Accenture, Blackberry	23 June

Investment Strategy & Portfolio Expertise

Group Economics



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