



global weekly

Investment
Communication
24 June 2016**Brexit: the path out of the EU**

In a historic referendum, Britain has voted to leave the European Union (EU), affecting economy, politics and financial markets.

Equity update

Friday, European investors woke up with the news that Britain voted to leave the EU. While first exit polls indicated a vote to remain in the EU, the final result was a 52% vote to leave the EU and a 48% to remain. The turnout was 72%. This is an outcome with seismic consequences for the UK, Europe and beyond.

Since last Friday equity markets were increasingly convinced that Britain would most likely vote to remain at Thursday's referendum. Equity markets rallied, led by cyclical sectors such as materials and energy, but foremost the financials sector. Today, this trend was reversed. The US dollar and Swiss franc acted as a safe haven.

The coming weeks are expected to be volatile as equity markets, corporate CEOs and politicians need to digest this event. Furthermore, Spain will hold its national election on Sunday, which could indicate the political mood within Europe.

Bond markets update

Fixed income markets reacted to Brexit as expected. Yields on safe haven government bonds of the US and Germany moved lower while the more risky fixed income categories did less so. The yield difference between peripheral and corporate bonds widened in an orderly fashion. European high yield bonds, the most risky bonds, widened the most.

Recently, we have reduced our exposure within the eurozone peripherals by selling our Spanish position, as the polls into the UK referendum were 50/50.

As a consequence of the UK referendum, it is expected that credit rating agency Standard & Poor's will revise its UK credit rating down to AA+ from AAA, bringing it at the same level as other rating agencies. Moody's rates the UK at Aa1 and Fitch at AA+.

Equity index performance in local currency

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	407.7	3.4%	2.1% *
S&P 500	2113.3	2.0%	3.4% *
AEX Index	418.8	-0.7%	-5.2%
EuroStoxx 50	2784.1	-2.3%	-14.8%
DAX Index	9555.8	-0.8%	-11.1%
Nikkei 225	14952.0	-4.2%	-21.4%
Hang Seng Index	20259.1	0.2%	-7.8%
* Before Brexit			

Important rating changes

Company	From	To
Tesla Motors	Hold	Buy
Societe General	Buy	Hold
Kinder Morgan	Buy	Hold
LafargeHolcim	Buy	Hold
Apache	Hold	Sell

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.580	-11.5	-10.2
German Bunds 2-year	-0.669	-6.0	-46.9
Japan 2-year	-0.281	-2.3	-27.7
US Treasuries 10-year	1.499	-10.9	-86.9
German Bunds 10-year	-0.111	-12.9	-95.4
Japan 10-year	-0.195	-4.0	-65.3

Spreads

Index	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	76.25	-6.54	10.17
iTraxx Euro 5-year	94.38	9.56	26.03
JPM EMBI+	371.14	-36.53	-4.15

Performance data as of Friday, 24 June

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Currency update

Sterling fell by around 12% against the dollar to the lowest level since 1985. Although sterling has already fallen significantly, we would expect further sharp falls going forward, as the British currency remains vulnerable. The UK has a large current account deficit, trending at around 5% of the GDP. That means it has to attract that flow of capital annually to finance the deficit. Yet, the vote to leave will be a headwind to portfolio inflows and foreign direct investments.

Macro update

The UK referendum outcome has led to violent reactions in financial markets. If these trends are sustained, the tightening of financial conditions and heightened uncertainty could undermine global economic growth. This is especially the case given the weak starting point for the global economy, financial vulnerabilities in emerging markets, and the lack of easy options for central banks to provide further support.

We think the vote to leave the EU will most likely trigger a downturn in the UK. Although the UK's relationship with the EU will not change for two years following the vote, the uncertainty could lead to corporate retrenchment, with companies pulling back investment and hiring. This would be particularly the case for companies – both UK-based and foreign – whose business could be hurt by a change in UK's access to EU markets.

Asset allocation

Over the past few months, the Global Investment Committee has taken several steps to insulate the portfolio from the risks of a decision by Britain to leave the EU. These steps included reducing equities, creating a cash buffer, neutralising the regional equity allocation between the US and Europe and reducing the peripheral government bond allocation. A core (US, Germany and Japan) government bond active duration strategy was also put in place.

In an environment of increasing uncertainty, the committee recommends waiting for markets to stabilise before re-entering. Volatility across all markets, including 'safe havens' is expected. The period of market adjustment will likely abate in the coming days. The Global Investment Committee will wait for this stabilisation in volatility to occur before re-entering assets that may represent attractive opportunities over the medium-term.

The asset allocation 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
Nike	28 June
Monsanto	29 June

Investment Strategy & Portfolio Expertise Group Economics



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