



global weekly

Investment
Communication
1 July 2016**Brexit vote: the aftermath**

After a market-rattling Brexit vote, equity indices recouped some of their losses this week. Safe-haven demand remained high, pushing down yields on German Bunds and US Treasuries.

Macro update

Following the UK's vote to leave the EU, we have lowered our forecasts for economic growth, interest rates, sterling and the euro. In our new base scenario, we make a number of key assumptions. First, the UK will trigger Article 50 of the Lisbon treaty by the end of the year and negotiations will begin. The talks will be difficult and the period of uncertainty will be prolonged. This will make the corporate sector cautious – especially in the UK – and will curtail investment and hiring. However, uncertainty should gradually ease during the course of next year.

Second, financial conditions will not tighten too much further as markets should start to stabilise. Third, although we expect political risk to remain elevated across Europe, we do not expect perceived EU/euro break-up risk to rise very sharply. Finally, we think central banks and other authorities will do what they can, but do not have the tools readily available to be game changers.

We expect lower economic growth, especially in the UK. In our new base case, UK GDP is around 2% lower in 2017 at 0.5%, eurozone 0.6% lower at 1% and the US 0.3% lower at 1.8%. This is all compared to our pre-Brexit scenario. We will likely see easier monetary policy compared with our pre-Brexit scenario. We expect the Bank of England to cut the bank rate by 25 basis points to 0.25%. More importantly, we think it will launch a new asset purchasing programme.

We already expected the ECB to step up its asset purchasing programme in September and to extend the programme. We now expect the ECB to extend the programme through the end of next year. We have kept our base case for Federal Reserve policy unchanged. However, we already expected the Fed to delay rate hikes until 2017. The risks to our Fed view are for an even longer delay.

Equity index performance in local currency

| | Value | One week change (%) | Year-to-date (%) |
|-----------------|----------|---------------------|------------------|
| MSCI ACWI | 399.3 | 2.8 | 0.0 |
| S&P 500 | 2,098.9 | 3.0 | 2.7 |
| AEX Index | 437.6 | 3.2 | -1.0 |
| EuroStoxx 50 | 2,884.9 | 3.9 | -11.7 |
| DAX Index | 9,740.0 | 1.9 | -9.3 |
| Nikkei 225 | 15,682.5 | 4.9 | -17.6 |
| Hang Seng Index | 20,794.4 | 2.6 | -5.1 |

Important rating changes

| Company | From | To |
|---------------|------|------|
| Wereldhave | Hold | Buy |
| Apache | Hold | Sell |
| The Mosaic Co | Hold | Buy |
| Fedex | Hold | Buy |
| BP | Hold | Sell |

Government bond yields

| | Yield (%) | One week (bp) | One year (bp) |
|-----------------------|-----------|---------------|---------------|
| US Treasuries 2-year | 0.580 | -4.9 | -11.0 |
| German Bunds 2-year | -0.640 | 0.9 | -39.8 |
| Japan 2-year | -0.333 | -5.5 | -32.8 |
| US Treasuries 10-year | 1.420 | -14.1 | -100.3 |
| German Bunds 10-year | -0.105 | -5.6 | -91.7 |
| Japan 10-year | -0.260 | -8.2 | -73.8 |

Spreads

| Index | Spread (bp) | One week (bp) | One year (bp) |
|--------------------|-------------|---------------|---------------|
| CDX NA IG | 76.98 | -9.49 | 7.83 |
| iTraxx Euro 5-year | 81.86 | -11.84 | 8.56 |
| JPM EMBI+ | 376.52 | 5.38 | -17.16 |

Performance data as of Friday, 01 July

Source: Bloomberg

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Currency outlook

In our new base case scenario, we expect sterling – and to a lesser extent the euro – to be weaker than in our pre-Brexit scenario. In particular, sterling looks likely to fall further – to a low of 1.20 against the dollar – given the risks related to the UK's huge current account deficit and the capital flows necessary to fund it, as well as the cushion the UK economy will need.

Equity markets update

This week, equity markets took a bit of a breather after last Friday's Brexit turmoil. The start of the week was negative, but equity markets started to recover as of Tuesday. The strongest rebound was seen in parts of the market that are considered safe havens. US stocks were in demand for their domestic exposure. Investors also bought into sectors such as consumer staples, because consumer demand is considered relatively stable, and health care. European markets lagged the US in the slight recovery this week, due to European companies' revenue exposure to the UK. As for the UK FTSE 250 Index, since last Friday it is 6.9% lower in GBP terms and 14.5% in EUR terms due to a lower pound.

Financial stocks continue to suffer from Brexit-related fears, with investors worrying over increased risks to the financial system, UK revenue losses for banks and potential costs if banks were to relocate to mainland Europe. Volatility in equity markets continues to be higher than before the outcome of the Brexit vote, but is not at extreme levels. Volatility in Europe is currently higher than in the US.

The negative impact of Brexit on economic growth and company earnings is still being assessed. In about three weeks from now, the earnings season will kick off in the US, followed by Europe. We expect company statements to provide more details about the impact that Brexit might have on earnings. We continue to recommend diversified positions across equity regions (US, Europe, emerging markets) and prefer defensive growth (health care, IT) and stocks with higher dividend yields.

Bond markets update

The outcome of the British referendum stunned everybody, including bond investors. A flight to safety drove down Bund and US Treasury yields (yields move inversely to bond prices). Credit spreads widened and inflation expectations fell to historic lows. Brexit did not inspire Spanish voters and even seemed to have scared them. Based on the outcome of last Sunday's general elections, the Spanish people appear to be inclined to maintain the status quo, which was rewarded

with spreads falling below Italian levels. In Italy, concerns over the banking system were raised as the government is contemplating a new capital injection. Furthermore, an adverse outcome of the Italian referendum in October could have devastating consequences for the existing government. We therefore continue to be cautious regarding the periphery.

Markets and policymakers are still dealing with confusion and uncertainty. We have significantly reduced our forecasts for yields, as central banks are ready to act and the impact of Brexit on confidence and growth must certainly be negative. To counter panic reactions in financial markets and to soften Brexit's impact on growth and inflation, central banks are likely to increase their accommodative measures. How riskier bond market segments will react going forward, still depends much on future developments. We monitor events to see if and how we should adjust to this sudden change in circumstances.

Asset allocation

The ABN AMRO Global Investment Committee left the asset allocation unchanged at its meeting on Thursday 30 June. It continues to consist of a preference for cash, equities and commodities over bonds. Real estate and hedge funds are viewed neutrally.

Published this week

Investment Strategy Update – 30 June 2016

The negative impact of the decision by Britain to leave the EU is expected to primarily impact economic growth in the UK, with a more mild effect on eurozone and global growth. We continue to recommend waiting for stabilisation of market volatility before considering re-entering assets that may represent attractive opportunities over the medium term.

Bond thematic update – more risk for senior bank bonds

Traditional senior unsecured bonds issued by large banks will not be as secure anymore under new TLAC regulation. Five things you need to know about the Total Loss Absorbing Capacity (TLAC).

Reporting calendar

| Company | Date |
|---|--------|
| Walgreen Company | 6 July |
| Samsung Electronics, Seven & I, Pepsico | 7 July |

Investment Strategy & Portfolio Expertise Group Economics

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