

# EVENT COMMENTARY: “BREXIT”

27 June 2016

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## EVENT

With a 51.9%<sup>1</sup> majority, Britain voted to leave the European Union on the 24th of June 2016.

## MARKET REACTION

Following this unexpected outcome, volatility spiked and global assets were routed. In Asia, the Nikkei 225 fell the most by some 8%, the Sterling fell 7% against the USD and nearly 2% against the Euro. Both Brent and WTI prices dropped some 4%, the 10-year U.S. Treasury bond yield fell 12% while the Dow Jones closed over 610 points in the red last Friday<sup>2</sup>.

Despite a build up in uncertainty over the weekend, Asian markets exhibited an unexpected resilience today<sup>3</sup>. The Nikkei 225 index surged 2.4% after Friday's sharp fall as Japanese policymakers announced willingness to step in and prevent an unhealthy rise in the Yen. Other Asia Pacific ex-Japan markets were mostly flat.

At the time of writing<sup>3</sup>, the Sterling was trading at 1.3440 to the USD, a decline of just 1.8% from Friday's close. The FTSE-100 recovered from a shaky start to trade just 0.2% lower, with the Sterling's decline putting a floor on companies with significant foreign currency earnings.

## ASIAN FIXED INCOME TEAM VIEW

"Brexit" vote has injected considerable uncertainty in global financial markets. Till greater clarity on UK's political and economic direction vis-a-vis the EU, and the economic implication of this development is obtained, volatility in the Asian currency and bond markets is likely to be high in the near term. As such, we will adopt a more cautious stance in our portfolio positioning. However, we see further sell-offs in Asian currencies and credit markets as potential buying opportunities for our portfolios.

While global growth could take a hit this year, we think the economic fallout globally and more so in Asia should be manageable. Growth will slow but we are not about to have a Lehman-like event. The dependence of Asia on the developed markets has reduced significantly over the past decade. Major central banks are also likely to turn more dovish, which should keep US interest rates low.

In this environment, we will look for opportunities to add to our duration position while seeking buying opportunities in Asian currencies.

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<sup>1</sup> 24 June 2016, BBC News, United Kingdom Politics

<sup>2</sup> 24 June 2016, Thomson Reuters Datastream, Bloomberg, Local Indices, 0500 US Eastern Time

<sup>3</sup> 27 June 2016, Thomson Reuters Datastream, Bloomberg, Local Indices, 0430 US Eastern Time



## **ASIAN EQUITY TEAM VIEW**

Reviews of our Asian Equity portfolios have confirmed that we have very little direct exposure to the UK. In fact, the current sell-offs have made the investment case for Asian markets even more compelling. Our focus on value investing implies that we invest only in our highest conviction opportunities. The current market volatility throws open opportunities for long term value investors as share prices of many companies appear to have moved significantly away from their intrinsic value.

At the same time, with price to book at 1 standard deviation below historical levels, Asian valuations have never been more attractive since the Asian and Global financial crises. We look for opportunities to add to our holdings in Asian equities.

## **GLOBAL ASSET ALLOCATION TEAM VIEW**

The result is clearly a surprise to markets. The big picture is that both the Sterling and UK equities were only "neutrally" valued leading into the episode. The 10% correction suggests that they are now modestly undervalued. With an over correction, the market might be attractive while the sharp decline in Sterling will likely help both competitiveness and profit translation for the UK companies with international revenues.

For Asia and Emerging markets, the macro implication is the importance of the European region (and the UK) for trade and profits.. However, it is plausible that this episode will lead to further policy easing which might support equities over the coming weeks after the rapid and emotional correction.

Moreover, from a relative stand point, Treasuries and sovereign bonds offer even less compensation for risk. We look for opportunities to add on equities in Asia, EM and Europe at attractive prices.



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