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# Strategy Update: Brexit – Leavers on the line

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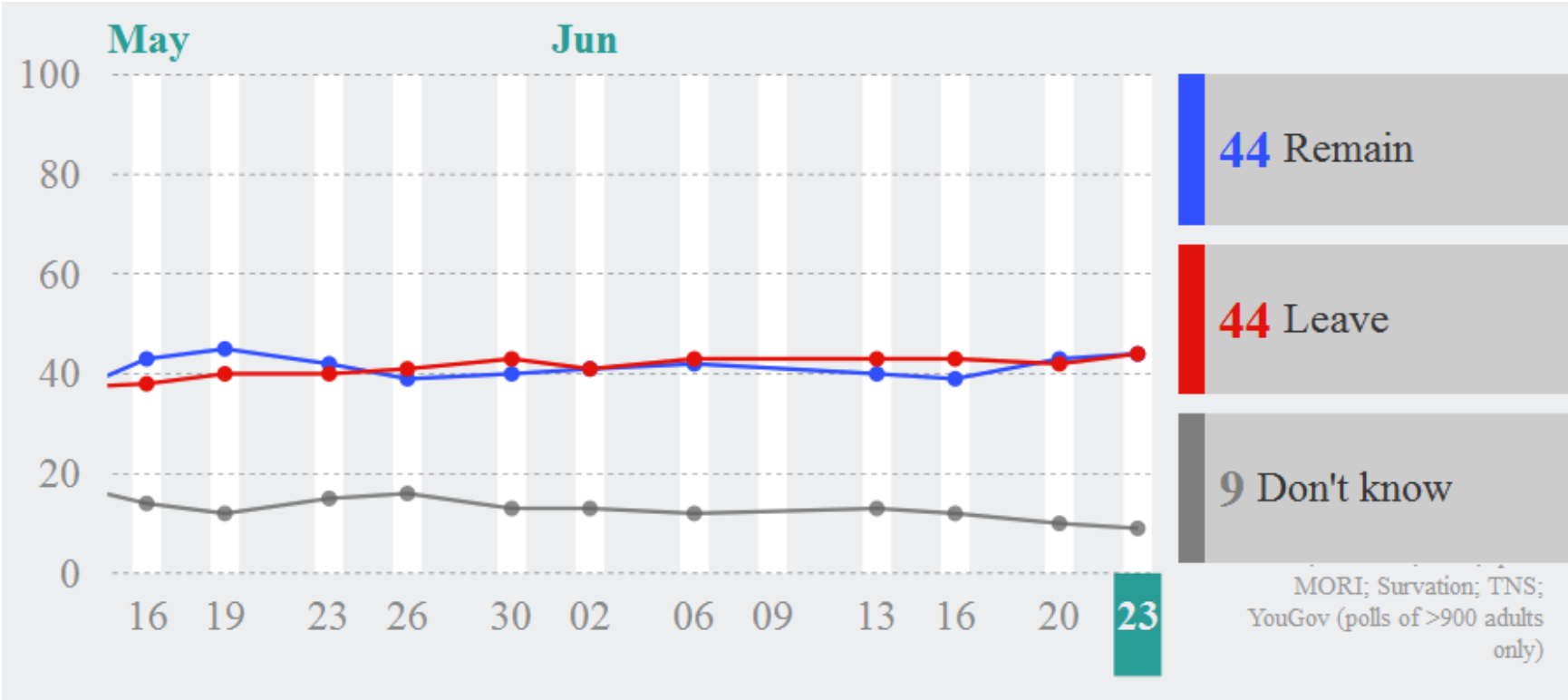
# Brexit – Leavers on the line

## The status quo did not prevail

- ▶ Review of market response to Brexit vote
- ▶ Political and economic implications of Brexit
- ▶ Outlook for global growth & monetary policy
- ▶ Investment strategy implications of Brexit
- ▶ Conclusions

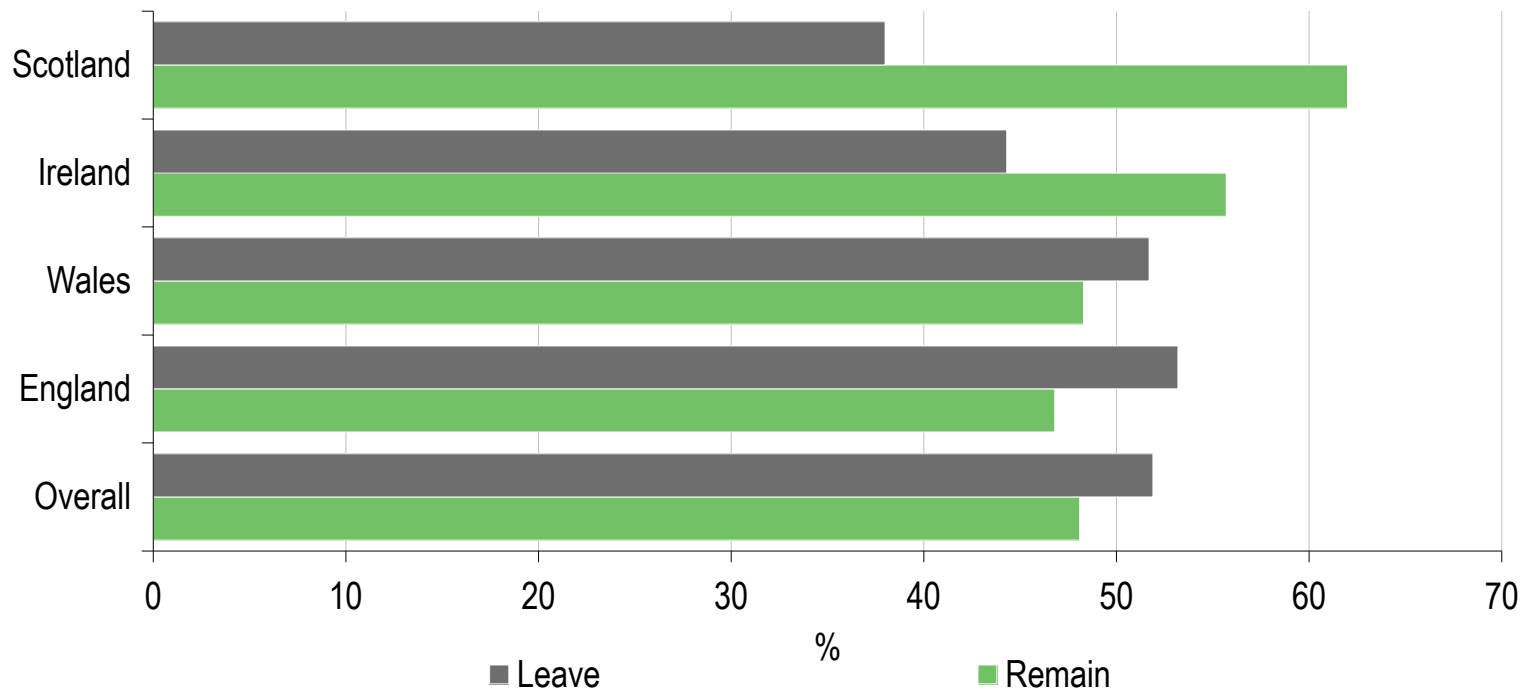
# A surprise result but clearly always a risk

Markets expected a swing to “remain” which was not enough in the end...

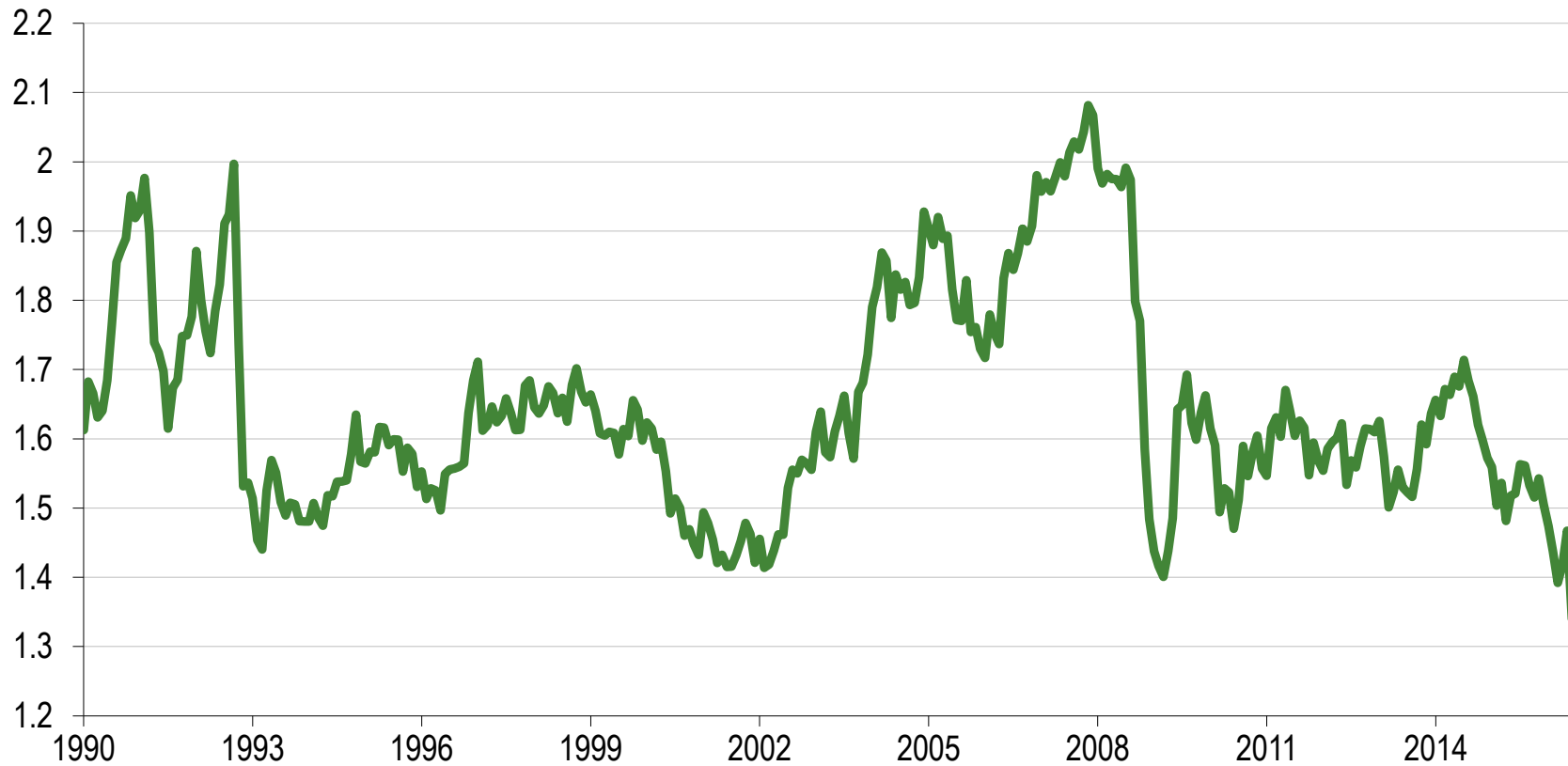


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# Brexit: England and Wales swing vote in favour of Leave



# Lowest value for sterling v dollar in 25 years



# Sterling riding for a fall with Brexit the trigger

Current account deficit and savings rate decline similar to 2008



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# Brexit process - uncertainty in every dimension

## Little clarity who will be PM or leader of the opposition

### ▶ Leadership

- New UK PM will only be known in October
- Labour party in turmoil following vote

### ▶ Process

- Already 2m signatures for a second referendum! Unlikely... But
  - A second referendum on the actual terms of exit cannot be ruled out
  - 2016 Referendum Act does not bind UK to do anything
  - Timing of Article 50 notification entirely in hands of UK
- ▶ A coherent policy & negotiating position for Brexit will need to be developed over summer

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# Brexit negotiation: considerations for each side

## ▶ UK

- Political sovereignty
- Control over borders
- Free trade in (financial) services

## ▶ EU

- Avoidance of destabilising precedents for remainder of EU
- Principle of free trade means free movement of people (Norway model)
- But growth of EU needs growth of UK

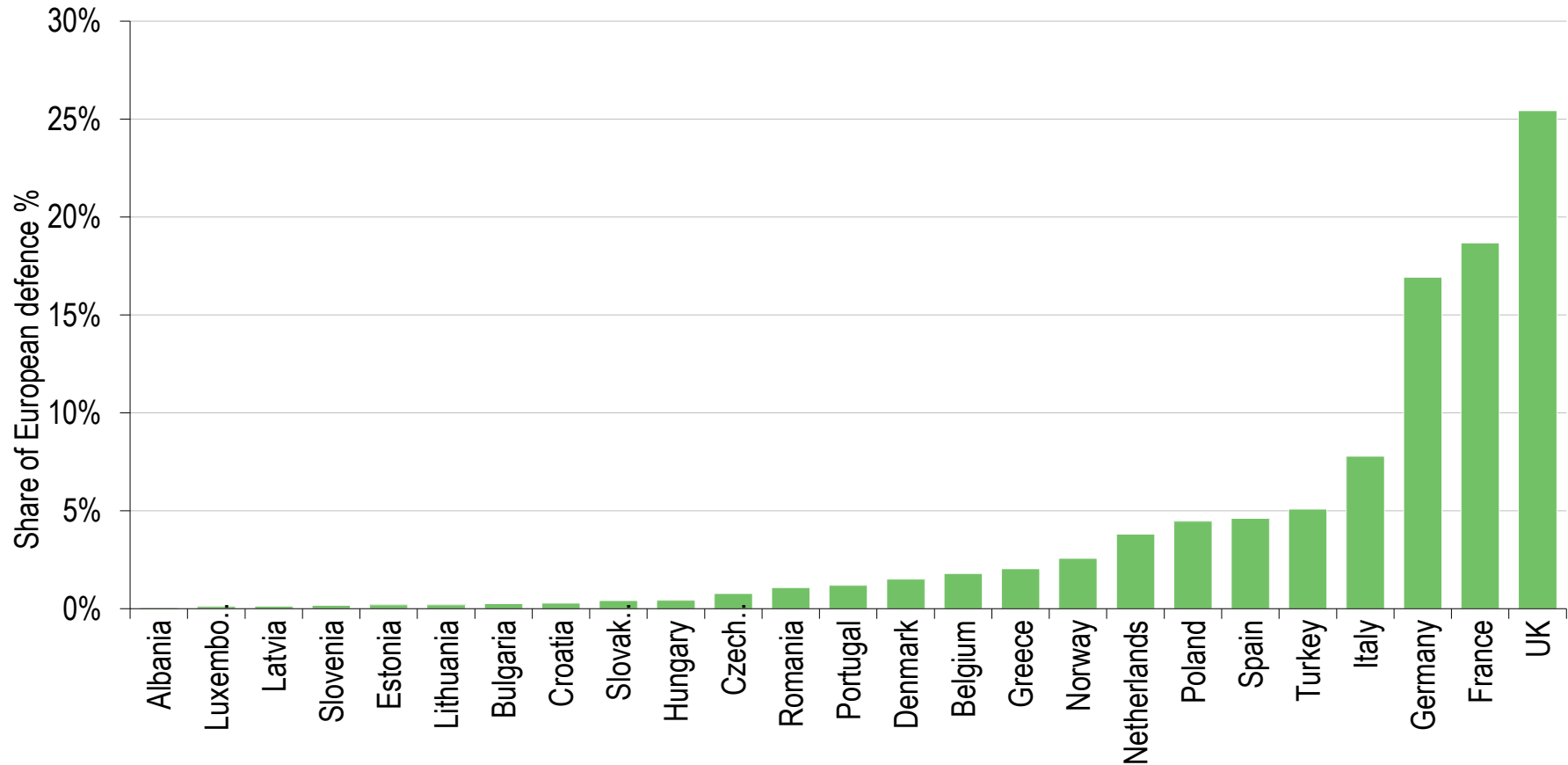
## ▶ Nation states

- Need for continued cooperation on foreign policy and defence
- UK an island of 65m people which is not moving anywhere



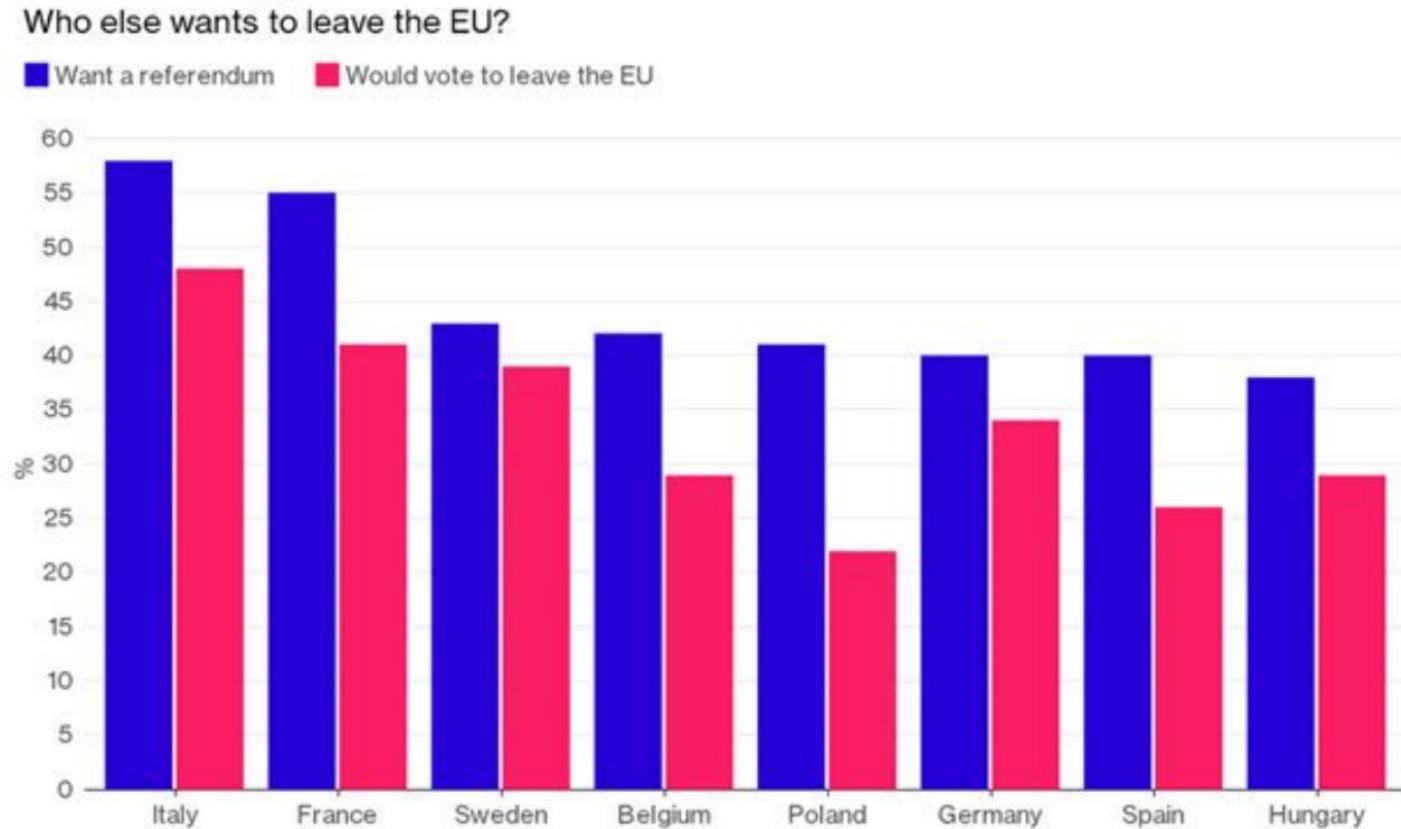
# UK's influence is not just economic

Defence spending largest in EU and 25% of total



# Demand for referenda in other EU nations

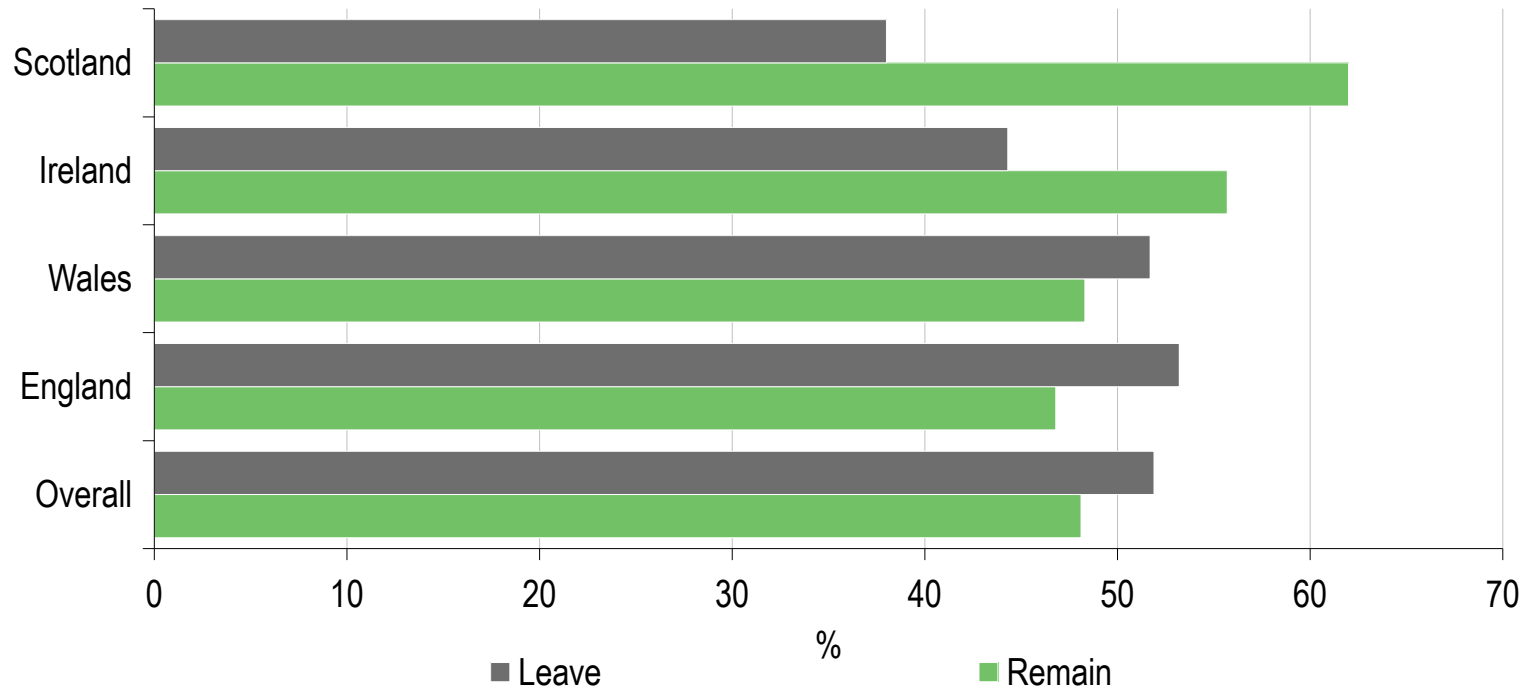
Polls indicate strong support for a vote – although not for an exit, at present



# Brexit: Scottish and Irish question

## More constitutional risk for the UK

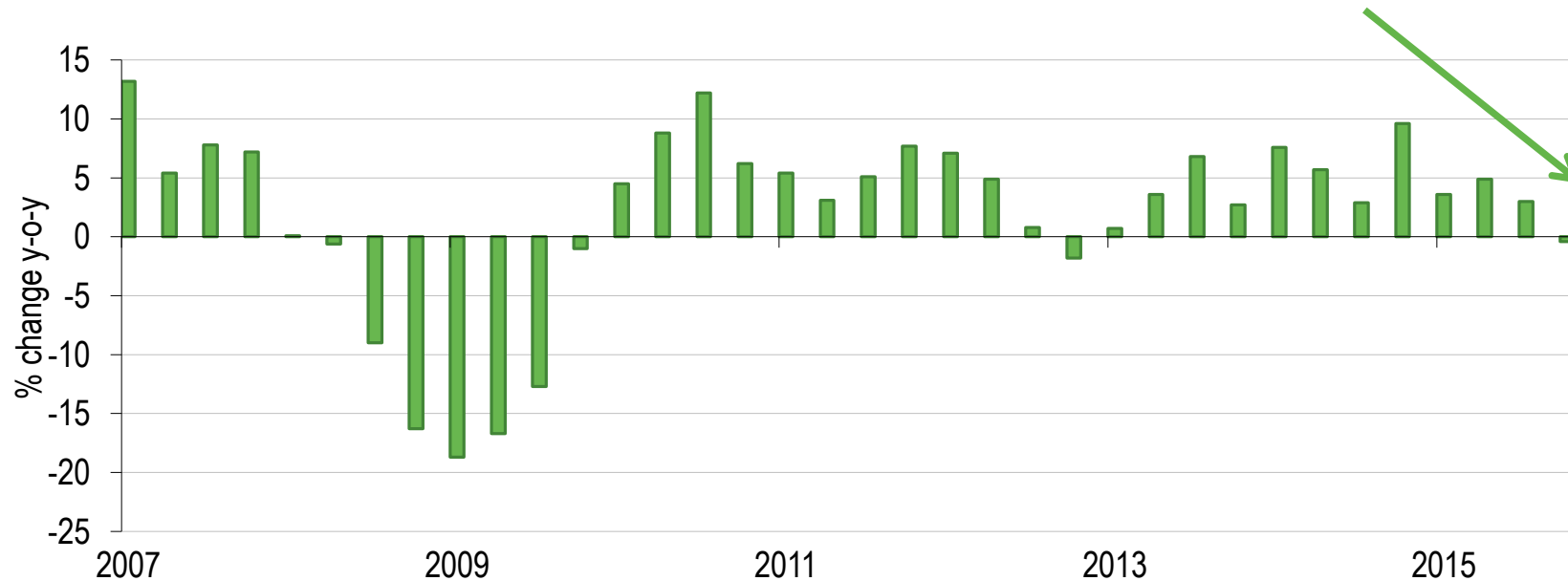
- ▶ Scots likely to wait until the terms of the UK's relationship with the EU have been established (2 years)
- ▶ However the volume is unlikely to be lowered in the meantime
- ▶ 75% of Scotland's EU exports are to the UK



# UK business investment at risk of contracting further

Uncertainty gives business a reason to defer spending

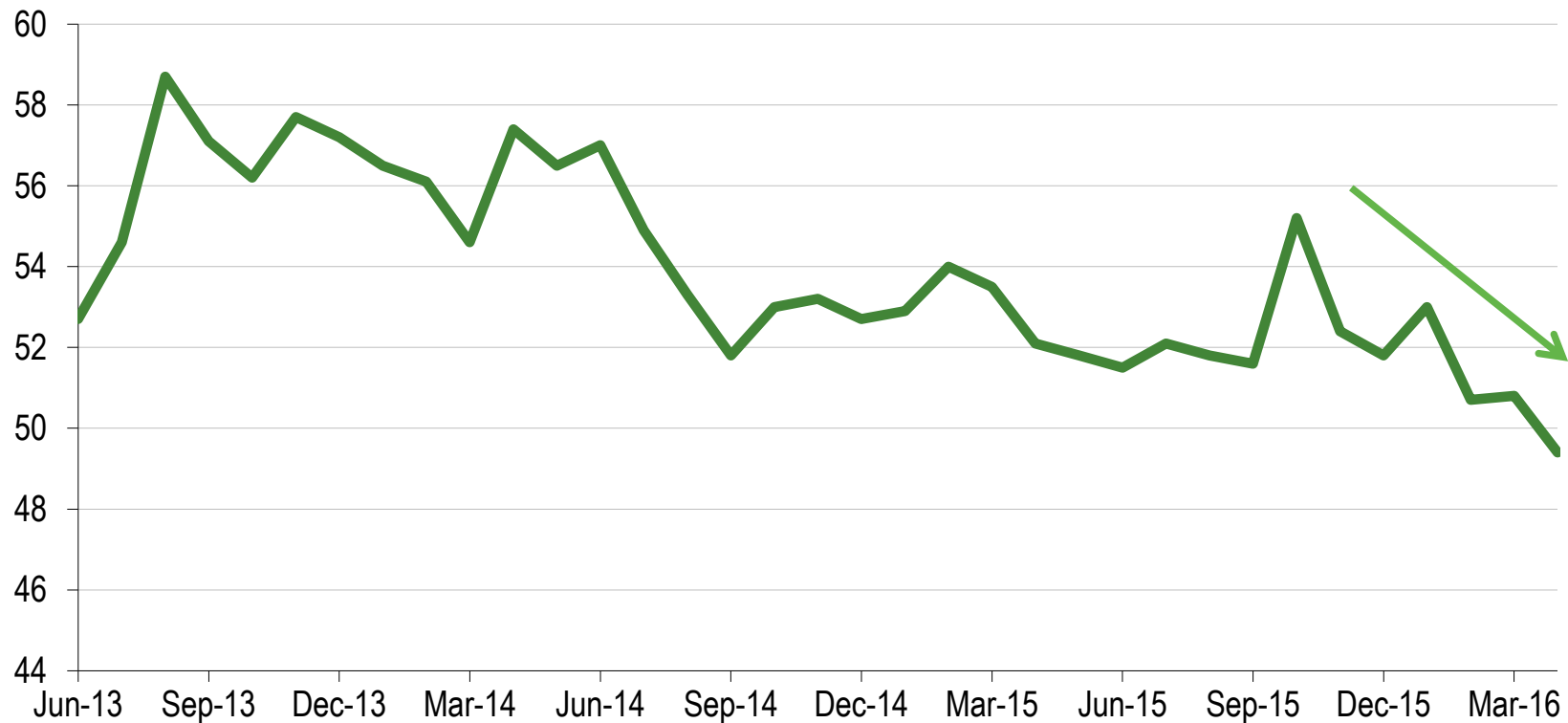
- ▶ UK M&A volumes 75% lower 2016/15



# Brexit gives impetus for a further decline in sentiment

UK manufacturing PMI indicating contraction prior to vote

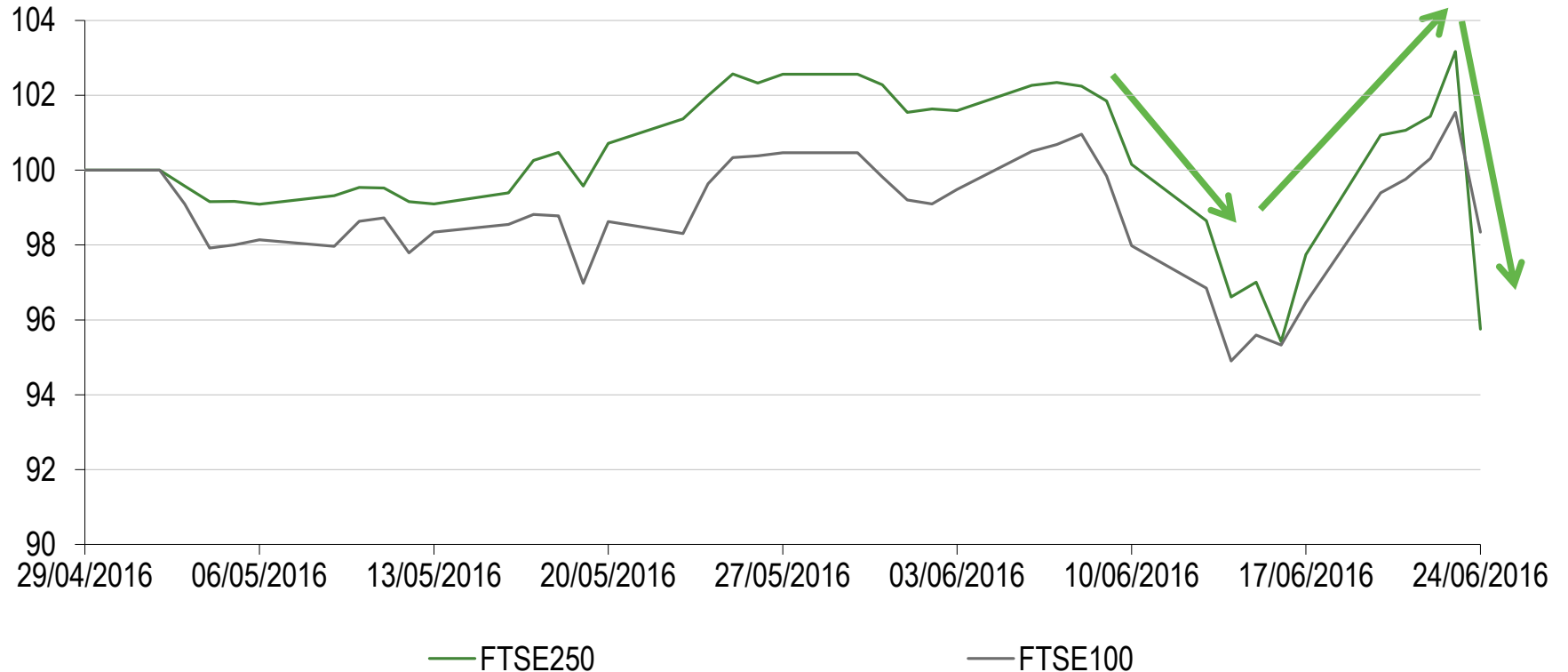
► Sentiment likely to continue to deteriorate in short term



# UK mid-cap index underperforms FTSE 100

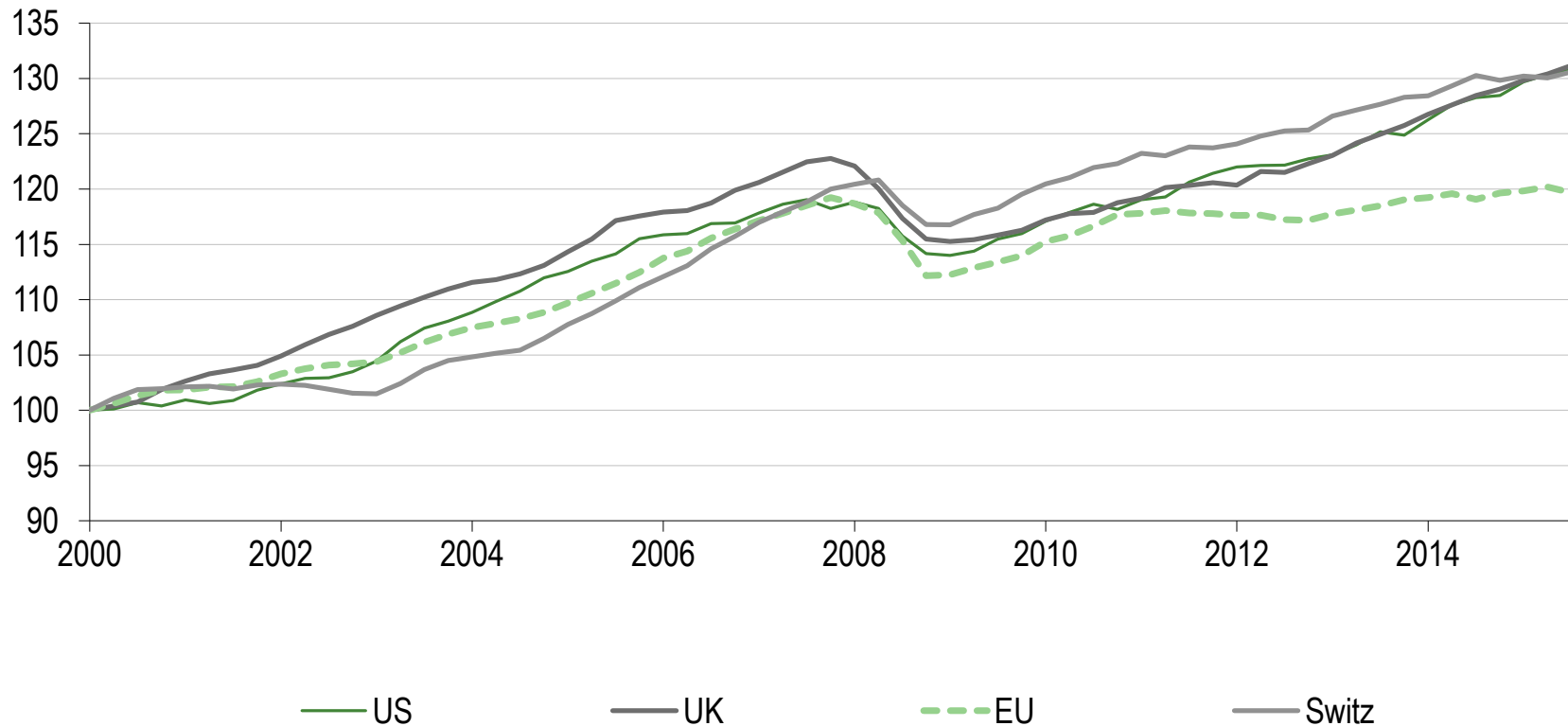
Smaller companies more exposed to the UK

► Relatively less benefit from lower sterling



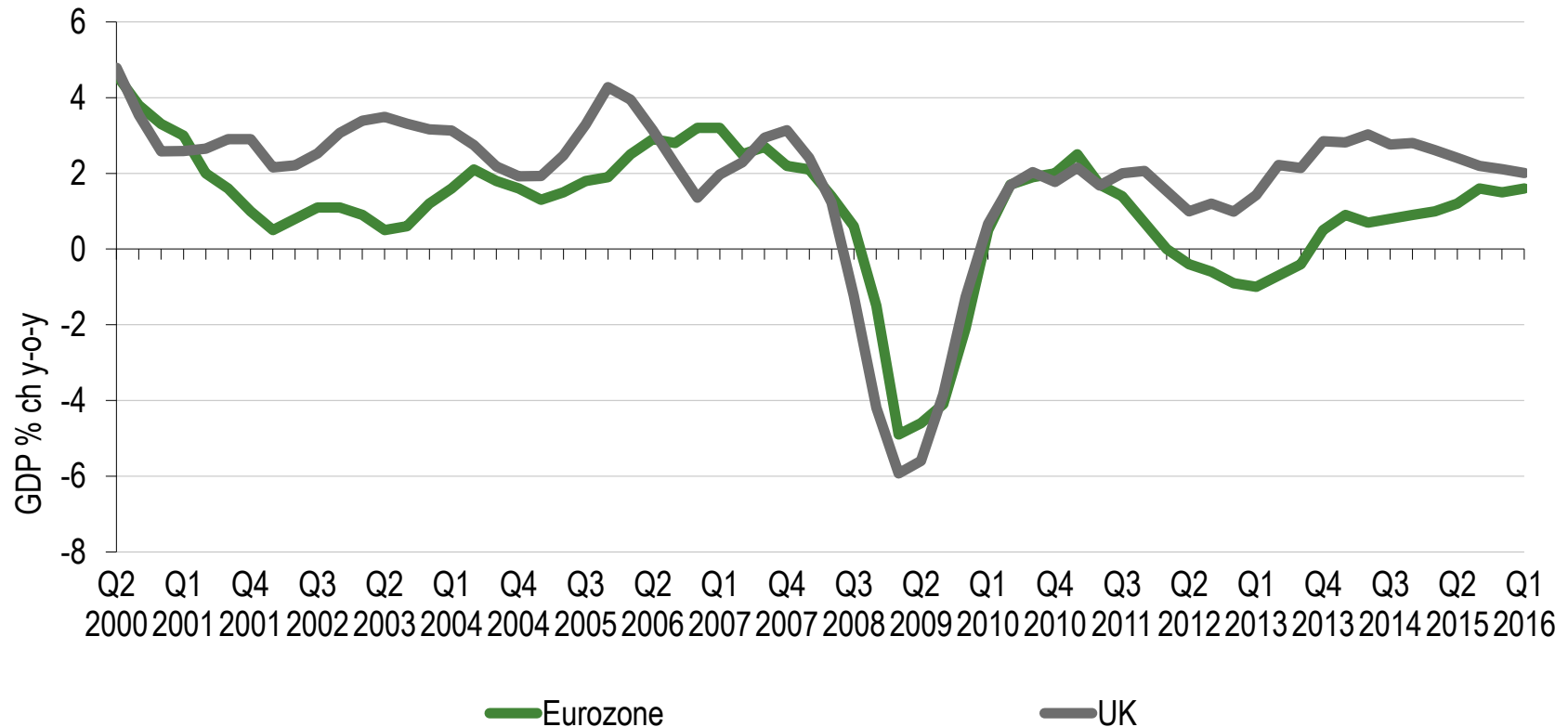
# Slow GDP growth behind disaffection with the EU

EU will need to handle how to deliver growth after losing UK (17% of EU GDP)



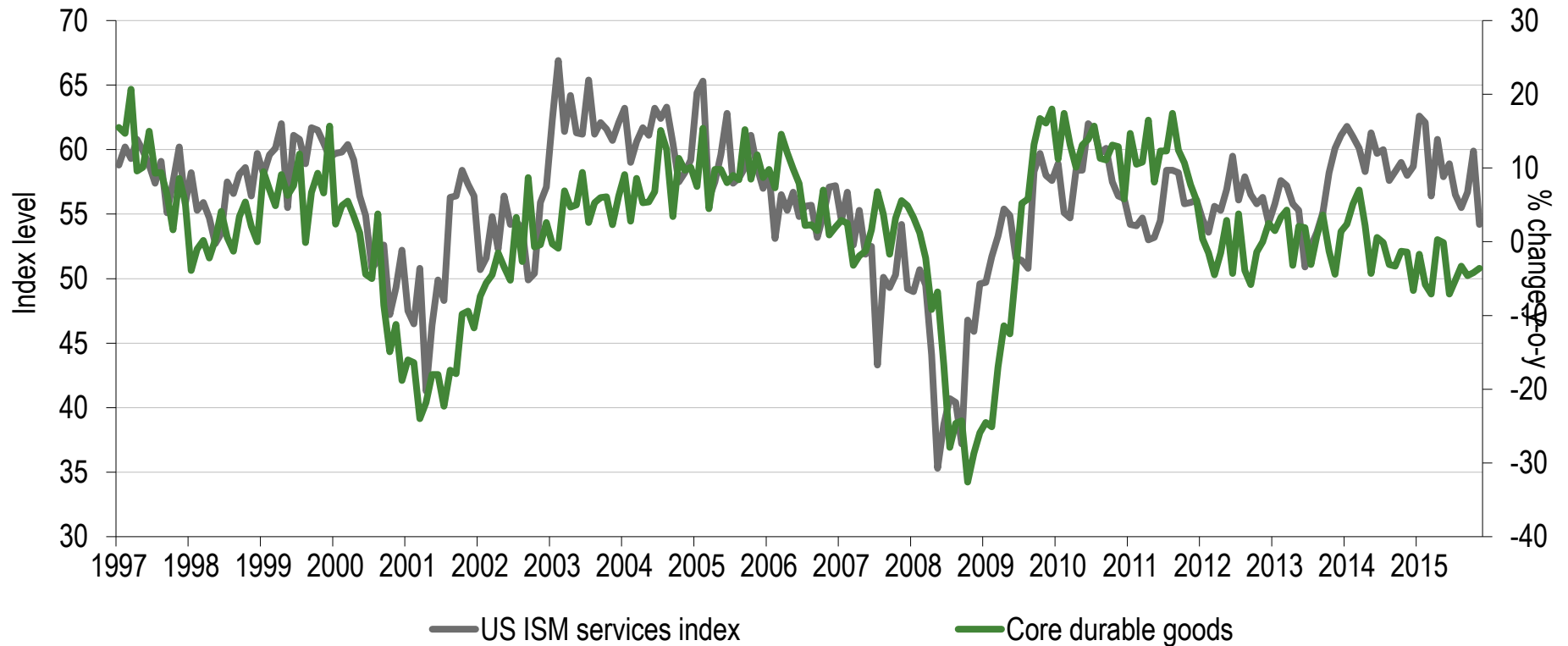
# UK and Eurozone GDP correlation is 80%

A sensible solution needs to be found for both parties

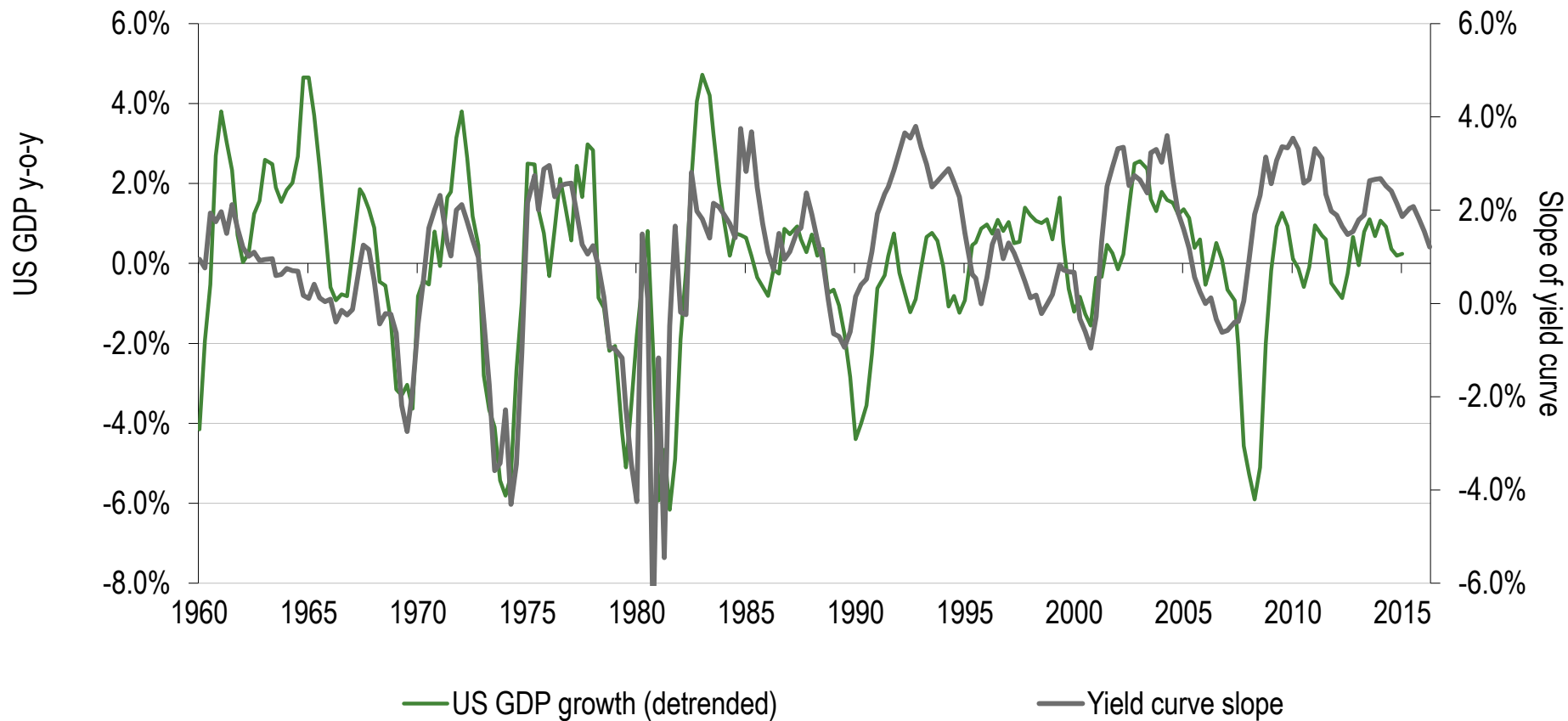




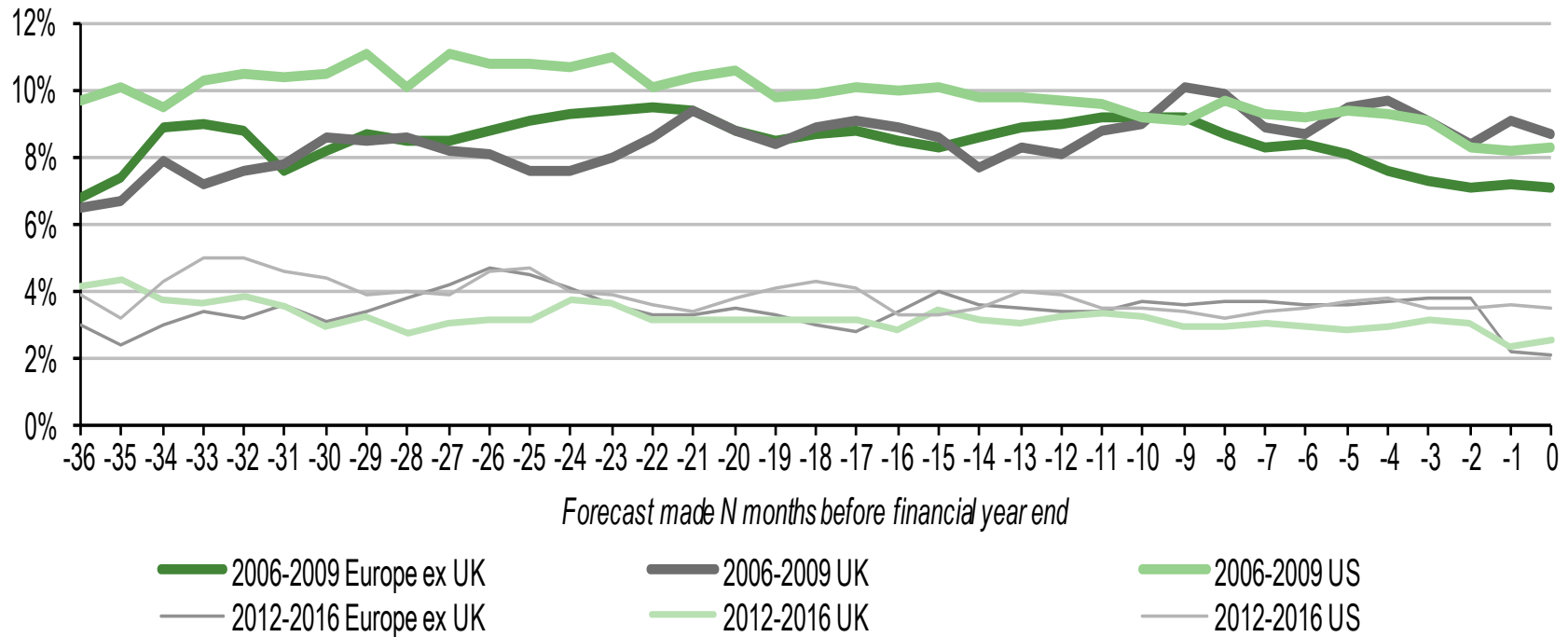
# US economic activity now weakening?



# Flattening US yield curve indicates a slowdown ahead

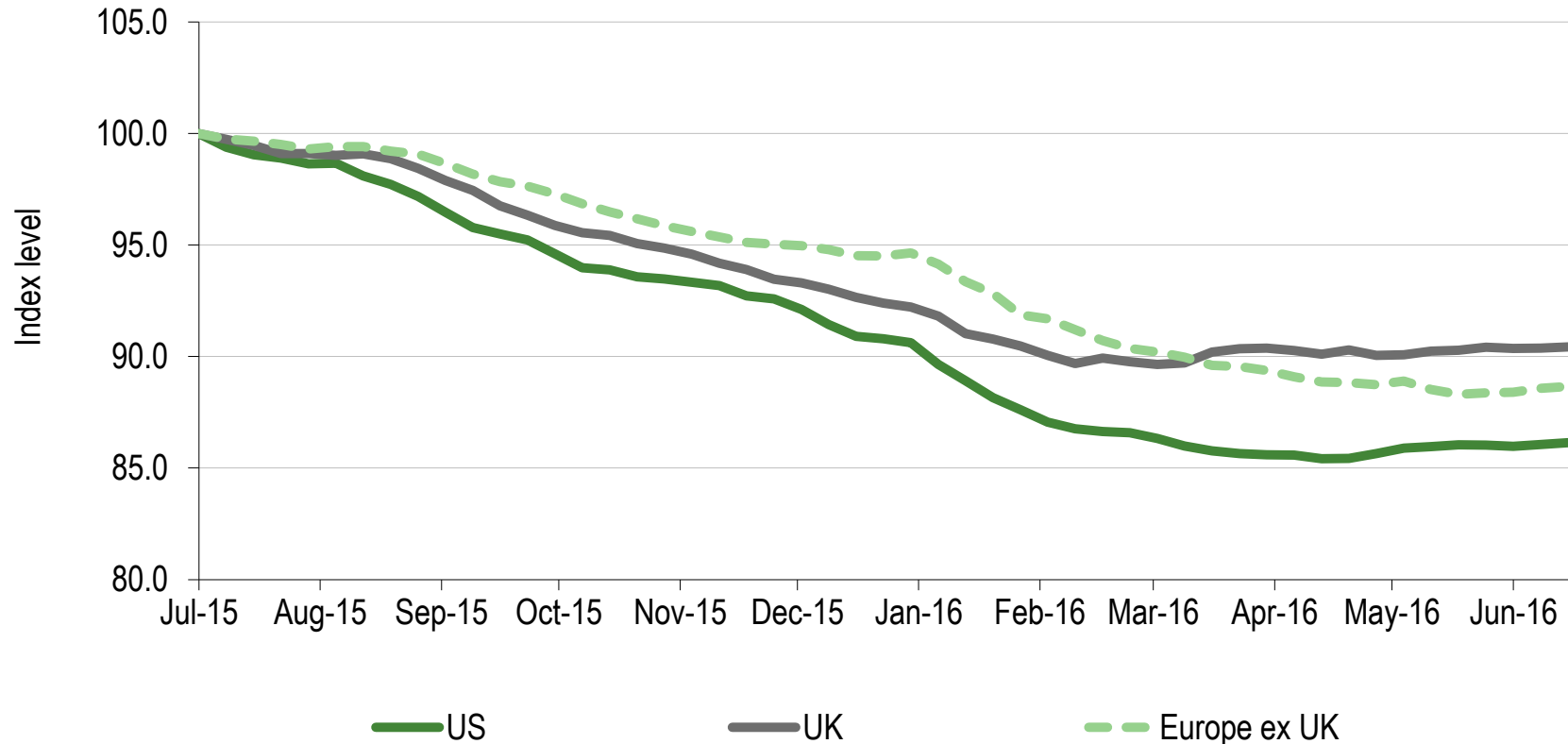


# Sales growth rates have fallen by 50% in this cycle



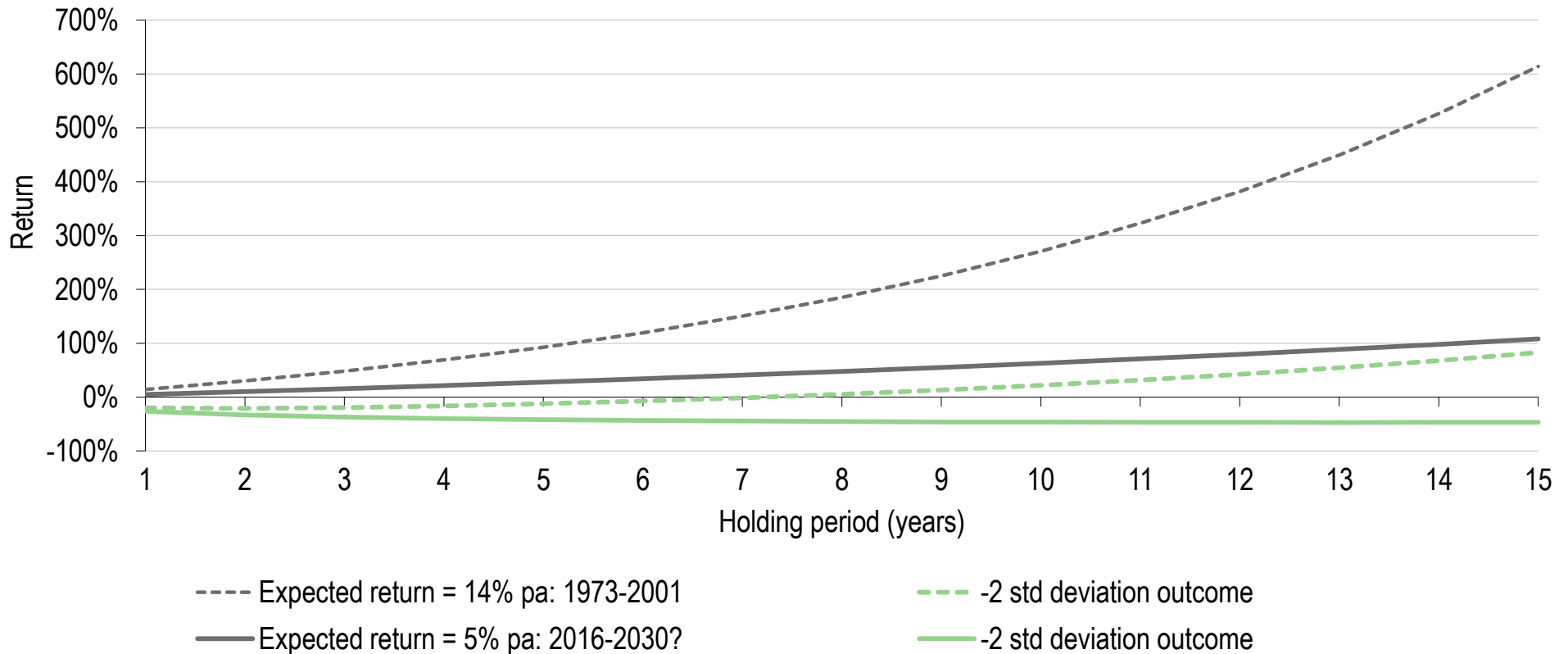
# Earnings momentum: stable for now but downgrades likely

Everyone can blame it on the Brexit...



# Beware of buy and hold

Lowered expected return on equities give no guarantee of outperformance even over 10y holding periods

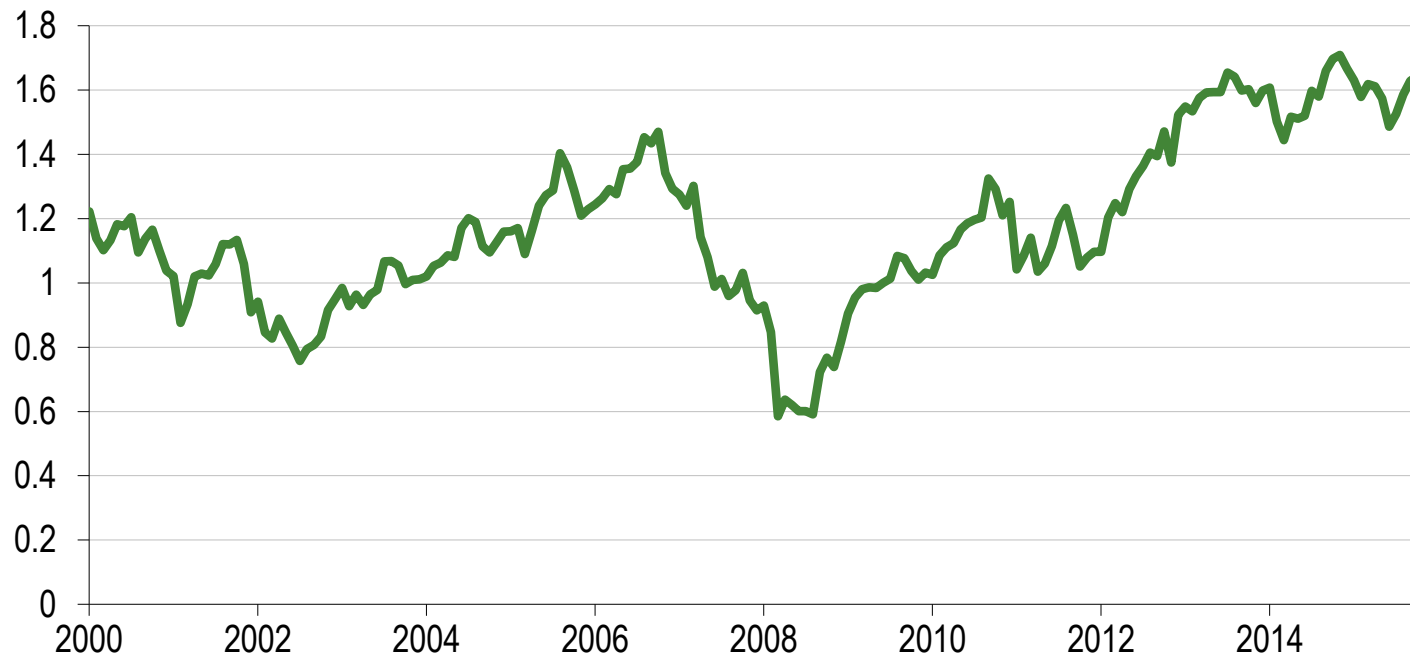


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# UK non-financial price/sales

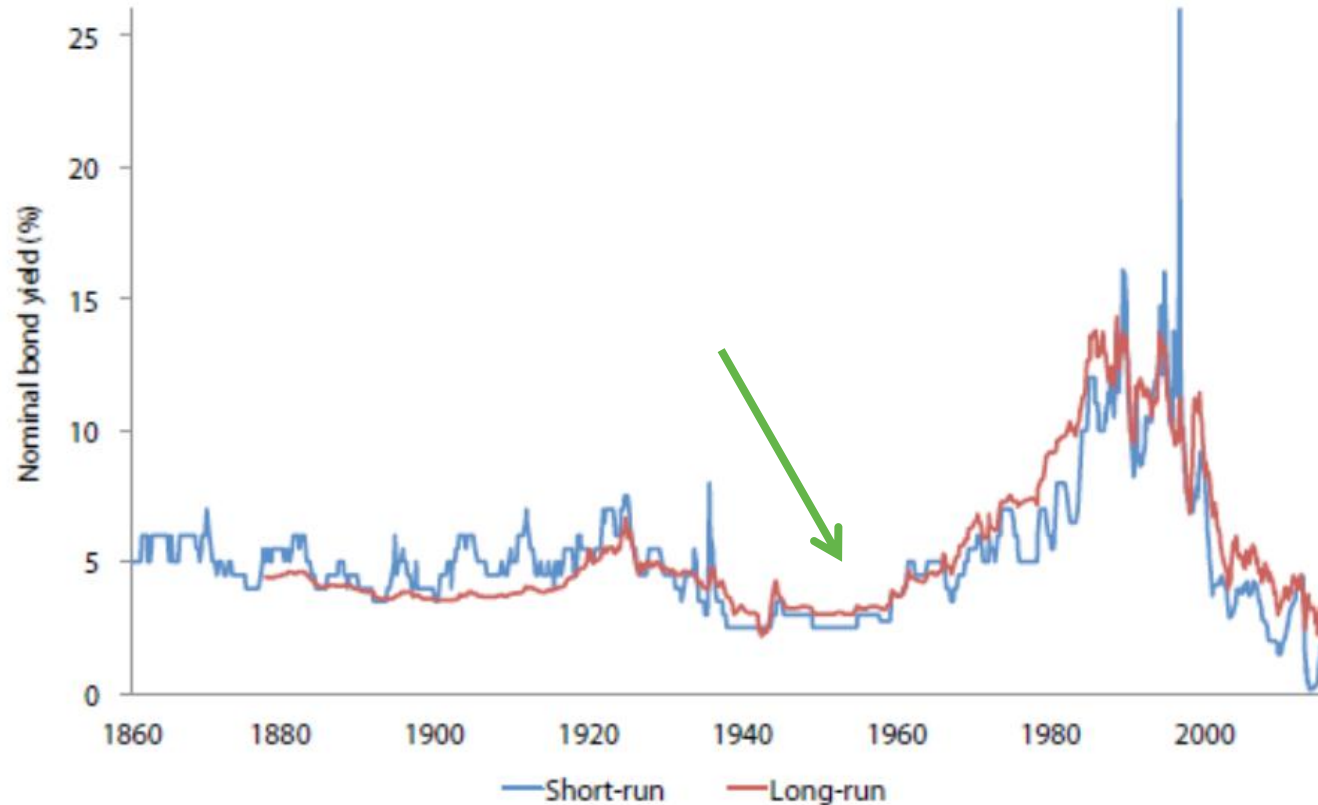
Decline of FTSE 250 names evident in median price/sales...

...but still well above long-run average



# Deflationary forces have upper hand at present but...

The last time policy rates were held down a surge of inflation occurred 20y later



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# Brexit: Leavers on the line

## A period of real uncertainty ahead

- ▶ Expect UK policy to coalesce around new leadership in the summer
- ▶ Mutually assured economic destruction unlikely
- ▶ GDP and earnings forecast now at risk of downgrades
- ▶ Global monetary policy looser but in our view insufficient for a counter-intuitive rise in markets
- ▶ Expected returns too low in equities – keep cautiously positioned
- ▶ Focus on robust rather than optimised portfolios



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