Political Consequences

The longer term political consequences are more worrying. Brexit is a blow to institutions and the so-called political and economic elites. It is a clear sign of a rising populism, nationalism and anti-globalization mood among voters which is not only a UK phenomenon. As we have argued, these feelings are also what has propelled Donald Trump during the Republican primaries and helped Bernie Sanders be such a challenge for Hillary Clinton.

We therefore expect investors to increasingly focus on this theme in coming months with a particular focus on a potential Trump presidency and growing pressures in several other European countries to organize their own LEAVE referendum. Although the UK has often been perceived in other EU countries as a major obstacle for more integration and the anti-EU sentiment is much less pronounced on the continent, this rise in populism and the appeal of regaining one’s full sovereignty will be a constant dark cloud hanging over markets in coming months and years. Our feeling remains that this is not the beginning of the end for the European Union and some of the countries seen as the next shoe to drop (Italeave, Portugo...) are not in a similar position where they could afford to leave (in particular, the fact that they share a single currency will result in much more significant headwinds).

Market Consequences

We have repeatedly argued that markets have entered a much more turbulent risk-on/risk-off phase with limited potential for prices to trend higher amid...
significantly higher volatility. We have reduced the risk in our portfolios earlier this year, being underweight equities, investing in low volatility strategies, focusing on income strategies and extending the duration of our bond holdings. We have also argued that monetary policies will have to stay extremely accommodative for even longer than most investors believe. We now fully expect the Fed to be on hold for the next few months and to see more easing coming from Japan, the ECB and the U.K. In this environment, the path of least resistance is for the dollar to appreciate and for bond yields to remain very low. For equity markets, it means one has to buy on weakness and sell on strength. A bear market will only become a major concern if we get indications that the US and global economies are heading toward a recession. The Brexit vote is unlikely to lead to such an outcome, but it does lead to higher risk premiums and act as headwind for valuations. It might be tempting to walk away from international equities altogether, but we don’t recommend this strategy as this is exactly where valuations are still attractive and we fully expect policy makers to come up with additional measures to support markets and economies (both on the monetary and fiscal fronts).

In summary, the Brexit vote is not the disaster or the Armageddon that some fear it is, but it will lead to ongoing uncertainties in coming months. We recommend investors to avoid panicking when everyone is running for the exit, and become more tactical in how they approach their investments, i.e. selling on strength and buying on weakness. Volatility is definitely here to stay.