



Early Thoughts After the UK Referendum

EDGE is an independent financial firm whose objective advice helps individuals and institutions realize their goals in the areas of investment management and corporate finance. The Edge Research Team's thoughtful and timely reports are based on extensive independent research and analysis of firms, financial developments, and macroeconomic trends.

It is not often that financial markets are so dramatically wrong about a potential outcome. As would be expected in the weeks going into the UK referendum on whether to stay in the European Union, there was volatility across financial markets. Bond yields fell, perceived safe haven currencies strengthened, and equity markets moved lower. As the day of the vote approached, however, markets seemed to gain confidence. On the day of the vote, the British pound rallied. Equity markets too rallied as bond yields fell. It seemed that market consensus was that despite the relative balance in the polls between those who would vote to Remain versus Leave that the large percentage of Undecided would tend towards status quo. As the vote tally came in, that assumption was proven wrong. The preliminary results of the "Brexit" referendum puts a 52% majority in the "Leave" camp.

So now investors and the world are left with more questions. Procedurally, this referendum is a measure of public opinion and not an action in and of itself. It is now left to an act of Parliament to begin the process under Article 50 to enact the secession proceedings. That requires wrangling of the members of Parliament to follow the popular opinion. Prime Minister David Cameron has announced that he will resign from office having supported the Remain camp, clearing the way for fresh leadership and presumably acting on the people's will. Then there is the secession process itself which is structured to take two years though it has never been tested. The European Union, facing other elections in Spain (2016), Germany (2017), and France (2017) where populist and anti-Euro rhetoric has been rising, is likely to make an example of the UK to create disincentives for

EDGE Capital Partners
1380 W. Paces Ferry Road
Suite 1000
Atlanta, GA 30327
404.890.7707

Author
Will Skeeane, CFA

RESEARCH TEAM
Whit Davis
Stephen Halkos
Stuart Huston
Howell Hollis
Harry Jones
Brendan Keelan
Elizabeth Mackie, CPA
Jacobi Padgett, CIMA
Dennis Sabo, CFA
Will Skeeane, CFA

Early Thoughts After the UK Referendum

others taking the cue and unraveling the entire European project. A core principle of the European Union is “no free trade without the free movement of people”. Therefore, it is to be expected that tariffs on exported goods and restriction on the provision of services (most importantly to the UK financial services) will be hotly contested.

The impact will be felt globally. Already, Standard and Poor’s has sent a warning note regarding a likely downgrade from the increasingly rare AAA-rated status, the British Pound (GBP) has fallen in value relative to the US Dollar (USD), and the Euro (EUR) too declined as the fear of “who next” takes hold. Japanese equity markets were down as much as many European markets (almost 8%) in local currency terms as the Japanese yen (JPY) strengthened and further unwound the effects of past central bank stimulus. Oil prices are down over 5%. Gold prices are up almost 5%. At the time of this writing, US equity markets are looking to open down around 3%. You can sense the emotion in the marketplace. The flood of news articles focus primarily on the magnitude of price movements having little else to report. It is human nature to forget that the dramatic moves of the day are mostly unwinding the rise in the market preceding the vote. Looking directly to the UK equity market (FTSE 100), the index is up 1.3% over the trailing one week and almost flat year-to-date in local currency terms as of this writing. Combined with the currency movement, the index is -2.8% and -6.5% in USD terms over the same periods respectively.

Looking forward, there are a couple of key conclusions. This process will play out over a long time and it will be messy. The UK referendum outcome has created more questions than it has answered and volatility will continue, albeit perhaps marginally lower than the emotionally-charged level we see now. Regardless, the risk of underestimating the populist undercurrent through global politics is

Early Thoughts After the UK Referendum

significant. That is important to remember not only looking ahead to European elections which would indicate the future form of the monetary union but also in the US Presidential election approaching. Fundamentally, there is a weakening to the economic outlook for the UK and Europe with knock-on effects to various degrees in the rest of the world. While we have seen many guesses made, the magnitude is unknowable until more details are available. Central banks globally are inclined to extend further support to the best of their ability. Perhaps it is time for the European Central Bank to dust off the Outright Monetary Transactions program which they have yet to use to expand their already sizeable bond purchase program. Even in the United States, the expectations for further Federal Reserve rate hikes have disappeared and the market is now pricing in an almost 15% chance of an interest rate cut by the meeting in November.

In this environment, there will be markets that benefit and those more challenged over the medium term. Where interest rate expectations are falling, all yield-sensitive securities are likely to benefit. Significant changes in the currency value can create benefit for those exporting goods or with revenue exposure to the right regions as well as challenge for those who have a safe haven currency but are trying to create stimulus. Overall, we remain focused on our long-term investment plans and vigilant in analyzing the evolving situation to identify tactical risks and opportunities moving ahead.

This material represents the views of Edge Advisors, LLC. This information is provided to discuss general market activity, industry or sector trends, or other broad-based economic, market or political conditions. This information should not be construed as research or investment advice, and investors are urged to consult with their financial advisors before buying or selling any securities. This information may not be current and Edge Advisors, LLC has no obligation to provide any updates or changes to such information. This material contains forward-looking projections and there is no assurance that these projections will prove correct. Past performance is no guarantee of future results.