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NEWSNOTE

BREXIT ROILS MARKETS, BUT SHOULD NOT DERAIL GLOBAL ECONOMY

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After being a member for 43 years, the United Kingdom (UK) yesterday voted by 51.7% to 48.3% to leave the European Union (EU).

RISK APPETITE DRAINED

Markets were roiled by the outcome. In the days leading up to the referendum, polls swung in favour of the Remain vote and equity markets rallied strongly, as did the pound sterling and emerging market currencies. The big market moves on Friday need to be seen partly as a reversal of the gains seen in the previous few days.

However, the Brexit vote has clearly drained risk appetite from global markets as it introduces a lot of uncertainty. As expected, the pound took the brunt of the pressure, falling to below US$1.35/£, the lowest level against the US dollar in more than 30 years. The safe-haven yen surged to ¥100 per US dollar, while the rand fell from R14.40 to as low as R15.40 against the US dollar. Equity markets in Asia closed sharply lower, while markets elsewhere opened deep in the red.

Brexit is likely to negatively impact the British economy as the way forward is unknown. No country has ever disentangled itself from the EU. Britain will have to do this while negotiating a new trade relationship with the EU. This could take years. In the meantime, businesses might opt to postpone investment decisions until there is more clarity. It is also not clear who would conduct these negotiations, since David Cameron campaigned for the Remain camp and has stepped down as Prime Minister in the wake of the result.

POLITICAL UNCERTAINTY NOW A FEATURE

It also raises the spectre of another Scottish independence referendum, since Scotland (and Northern Ireland) voted strongly in favour of remaining in the EU.

While Britain probably needed the EU more than the other way around, the Brexit vote could provide a further boost to Euro-sceptic parties across the continent. Borrowing costs for southern European economies Italy, Portugal and Spain have risen while the euro slumped against the US dollar. What is clear is that populist politics and political uncertainty, which has long been a staple of the developing world, is now firmly a feature of developed countries.

NOT ANOTHER LEHMAN

Having said all that, Brexit is unlikely to fundamentally change the outlook for the global economy. The UK will not disappear off the face of the earth, but it is an event that matters hugely for the UK. However, it is unlikely to have an economic fall-out in the US or China, the largest economies in the world. The UK economy accounts for around 15% of the EU's economy, but only around 2.3% of the global economy.

This is not a Lehman-like moment since credit markets won't seize up and the Bank of England (and other central banks) are ready to provide liquidity if needed. Importantly, there is no redenomination risk from leaving the EU (unlike the feared exit of Greece from the eurozone a few years ago) since UK debt and assets are still denominated in pounds. The pound is just weaker (which should benefit UK-based exporters and some London-listed multi-nationals).

For South Africa, the impact will largely come through the financial markets channel; if the rand weakens further, it could place upward pressure on interest rates and inflation. Our very important trade relationship with Europe is not in danger, but given that the UK will have to increasingly look outside Europe to do business, our trade relationship with the UK might even improve.

INVESTORS SHOULD FOCUS ON THEIR LONG-TERM PLANS, NOT NEWSPAPER HEADLINES

Market moves of 5% or more are scary but common. On a long-term investment horizon, however, they become small blips that were often good buying opportunities, and bad times to sell out.

Markets typically overreact to such events and are likely to be volatile while the outcome and its implications are digested. Brexit is not an event that requires South Africans to change their financial plans. Financial

NEWSNOTE CONTINUED

plans and investment strategies should be built around life events and life goals, not changes in market volatility. A diversified portfolio remains the best way to manage the inherent uncertainty in investing, instead of a fearful concentrated portfolio of gold or cash.

At Old Mutual Multi-Managers, we follow a longer-term valuation-based investment philosophy. When the market overreacts, it creates opportunities for us to add value through tactical asset allocation. We select managers who share this longer-term valuation focus, and the sell-off similarly provides opportunities for them based on also being valuation-focused.

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