

VIEWPOINT

Newsflash

A new month and the 117th issue of Viewpoint from Imperium Capital.

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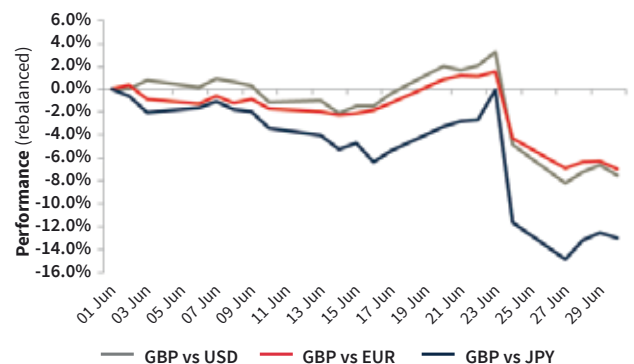
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Market Commentary

Events in June, prior to the UK's EU referendum on the 23rd, became somewhat irrelevant following the shock result. The market reaction was instant and dramatic, with sharp falls in sterling, global stock markets, government bond yields (especially those in the UK) and a flight to safe haven assets such as gold. In the UK, domestically exposed companies such as banks, house builders and retailers have fallen particularly steeply. However, the moves were less violent than predictions prior to the vote and after two days of declines, markets recovered as prospects of global contagion, systemic illiquidity, or funding problems for banks became less tangible. By month-end the UK equity market was higher than its pre-referendum level and up 5.0% in June in sterling terms, while US equities were marginally higher over the month (+0.2%). Emerging markets also had a strong month, up 3.5%, but Europe and Japan suffered significant falls in local currency terms: 4.6% and 9.8% respectively.

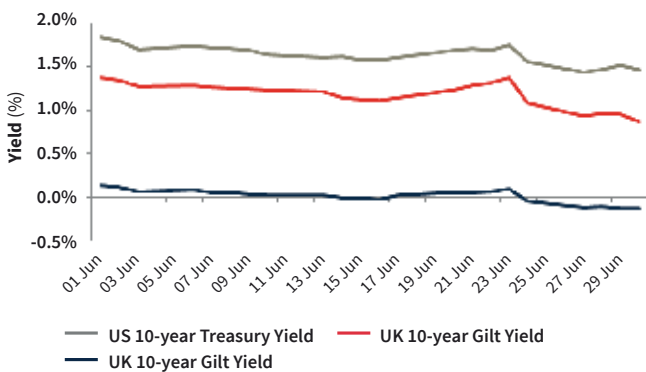
Figure 1. Sterling vs major currencies June 16.



VIEWPOINT

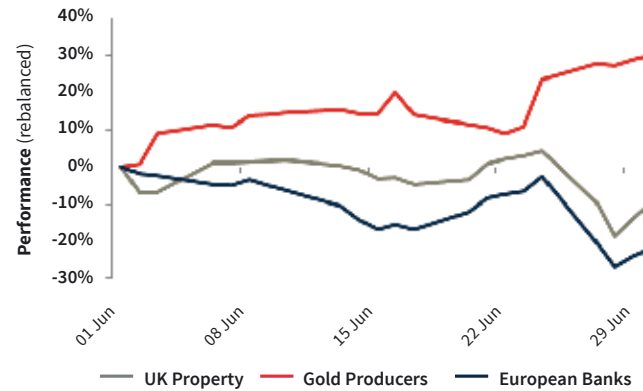
More telling signs of Brexit's economic implications came from bond markets, currencies, domestically focused UK equities, and UK and European financials. UK bond yields fell as the Bank of England signalled its readiness to loosen monetary policy. The Federal Reserve is also expected to delay a rate rise until 2018, and both the European Central Bank (ECB) and Bank of Japan are expected to ease policy further. In the UK, 10-year government bond yields have fallen by 0.60 percentage points to below 1.0%. In the US, falls of 0.40 percentage points have taken the 10-year to a new all-time low of 1.4% (at time of writing, yields have declined further to reach 1.3%). And in Germany and Japan, the 10-year yields on government bonds have now fallen into negative territory. The pound fell by 10.5% versus the greenback from the day of the referendum to month-end, and it has declined by 13% against the Japanese yen over that period.

Figure 2. 10 year government bond yields June 16.



The process of exiting the EU will now introduce significant short-term uncertainty with consequences for investment and consumer confidence; UK growth forecasts have been cut by at least 1% per annum over the next two years. The impact on EU growth is likely to be smaller but still significant, at a time when the union still faces a long period of weak growth post financial crisis. Meanwhile its banking system, notably in Italy, remains substantially undercapitalised. There are also potential existential risks, with anti-EU parties across Europe buoyed by the result in the UK.

Figure 3. Flight to safety.



Even so, Brexit is not a globally systemic event. The UK economy is less than 4% of global GDP such that a fall in UK growth has little material impact on global markets. In the meantime, the Bank of England will support growth: it has already reduced capital requirements for banks, freeing up lending by GBP 150 billion. UK interest rates will likely be reduced and kept close to zero for a prolonged period, too. Implications for the EU are uncertain, but the ECB is seemingly ready to support markets with ample liquidity and maintained accommodative monetary policy. Meanwhile UK equities are underpinned by reasonable valuations, good dividend yields and the fact that in aggregate the largest companies listed in the UK derive over 75% of their sales and profits from outside the UK.

The key question now is what form Brexit will take. It is neither in the interests of the UK nor the EU for Britain to lose access to the single market. The UK's total trade with the EU represents 53% of UK imports and 44% of exports. Exports to the EU are worth 12% of UK GDP. Meanwhile exports from the EU to the UK account for 3% of EU GDP, and the EU runs a substantial GBP 70 billion trade surplus with the UK, which it will be reluctant to lose. Both sides will need to compromise during exit negotiations, and while the UK is unlikely to end up with unfettered access to the single market and full passporting rights into the EU for financial institutions, the outcome is likely to bear resemblance to the current position.

We strongly believe that the UK will thrive and prosper in the long term whether in or out of the EU. In the shorter term, the inevitable rise in uncertainty will push the risk premium on UK and European assets higher, with the latter facing the additional risk of a weak banking system. Financial market volatility will increase until there is some degree of clarity on how Brexit will unfold, but we believe the likely outcome will be broadly market friendly. We are therefore seeking to use periods of weakness to accumulate assets on more attractive longer term valuations;

being patient in this way should help reduce fund drawdowns and ultimately boost returns over time. We note that for overseas investors, UK assets are considerably cheaper today than two weeks ago, following sterling's depreciation, and we expect to see increased foreign investment interest in due course. Furthermore, with global policymakers likely to lean towards more monetary and fiscal accommodation in response to the renewed global growth risks, there should be ongoing support for financial assets going forward.

Market Performance

Asset Class/Region	Index	To 30 June 2016		
		Currency	1 Month	Year to date
Developed markets equities				
United States	S&P 500 NR	USD	0.2%	3.5%
United Kingdom	MSCI UK NR	GBP	5.0%	6.9%
Continental Europe	MSCI Europe ex UK NR	EUR	-4.6%	-8.1%
Japan	Topix TR	JPY	-9.6%	-18.5%*
Asia Pacific (ex Japan)	MSCI AC Asia Pacific ex Japan NR	USD	2.1%	2.4%
Global	MSCI World NR	USD	-1.1%	0.7%
Emerging Market Equities				
Emerging Europe	MSCI EM Europe NR	USD	-0.7%	9.8%
Emerging Asia	MSCI EM Asia NR	USD	2.8%	2.2%
Emerging Latin America	MSCI EM Latin America NR	USD	11.4%	25.5%
BRICs	MSCI BRIC NR	USD	3.8%	4.5%
Global emerging markets	MSCI EM (Emerging Markets) NR	USD	4.0%	6.4%
Bonds				
US Treasuries	JP Morgan United States Government Bond Index TR	USD	2.4%	5.7%
US Treasuries (inflation protected)	Barclays Capital U.S. Government Inflation Linked TR	USD	2.2%	6.6%
US Corporate (investment grade)	Barclays Capital U.S. Corporate Investment Grade TR	USD	2.3%	7.7%
US High Yield	Barclays Capital U.S. High Yield 2% Issuer Cap TR	USD	0.9%	9.1%
UK Gilts	JP Morgan United Kingdom Government Bond Index TR	GBP	6.0%	12.2%
UK Corporate (investment grade)	BofA Merrill Lynch Sterling Non Gilts TR	GBP	2.7%	7.3%
Euro Government Bonds	Citigroup EMU GBI TR	EUR	2.3%	5.7%
Euro Corporate (investment grade)	Barclays Capital Euro Aggregate Corporate TR	EUR	1.0%	4.1%
Euro High Yield	BofA Merrill Lynch Euro High Yield Constrained TR	EUR	-0.6%	3.6%
Japanese Government	JP Morgan Japan Government Bond Index TR	JPY	1.5%	7.7%
Australian Government	JP Morgan Australia GBI TR	AUD	1.9%	6.1%
Global Government Bonds	JP Morgan Global GBI	USD	3.6%	10.6%
Global Bonds	Citigroup World Broad Investment Grade (WBIG) TR	USD	2.6%	8.4%
Global Convertible Bonds	UBS Global Focus Convertible Bond	USD	-0.9%	-0.7%
Emerging Market Bonds	JP Morgan EMBI+ (Hard currency)	USD	4.6%	12.3%

* estimate

Market Performance

Asset Class/Region	Index	To 30 June 2016		
		Currency	1 Month	Year to date
Property				
US Property Securities	MSCI US REIT NR	USD	6.7%	12.8%
Australian Property Securities	S&P/ASX 200 A-REIT Index TR	AUD	2.1%	13.6%
Asia Property Securities	S&P Asia Property 40 Index NR	USD	2.5%	3.1%
Global Property Securities	S&P Global Property USD TR	USD	3.7%	8.9%
Currencies				
Euro		USD	-0.2%	2.3%
UK Pound Sterling		USD	-8.1%	-9.7%
Japanese Yen		USD	7.3%	16.6%
Australian Dollar		USD	3.0%	2.3%
South African Rand		USD	6.7%	5.1%
Commodities & Alternatives				
Commodities	RICI TR	USD	2.3%	10.9%
Agricultural Commodities	RICI Agriculture TR	USD	-0.3%	5.1%
Oil	Brent Crude Oil	USD	0.0%	33.3%
Gold	Gold Spot	USD	8.8%	24.6%
Hedge funds	HFRX Global Hedge Fund	USD	0.0%*	-1.1%*
Interest Rates		Current Rate		
United States			0.50%	
United Kingdom			0.50%	
Eurozone			0.00%	
Japan			-0.10%	
Australia			1.75%	
South Africa			7.00%	

* estimate

Asset Allocation Dashboard

■ Positive
 ■ Neutral
 ■ Negative

Asset class	View
Equities	
Developed equities	●
UK equities (relative to developed)	●
European equities (relative to developed)	●
US equities (relative to developed)	●
Japan equities (relative to developed)	●
Emerging market equities	●
Fixed Income	
Government	●
Index-linked (relative to government)	●
Investment grade (relative to government)	●
High yield	●
Loans	●
Emerging market debt	●
Convertible bonds	●
Alternatives	
Commodities	●
Property (UK)	●
Currencies	
GBP	●
Euro	●
Yen	●

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