# BRITAIN VOTES FOR EXIT. CAMERON FOLLOWS SUIT


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On Friday 24 June Australian time, the UK voted 52% to 48% to leave the European Union (EU) in what turned out to be the biggest snub of mainstream English political power since the peasant revolt of 1381.

This produced a number of market and political results:

- In the immediate aftermath of the vote count, the main UK, German and Japanese stock market indices dropped around 8%. Interestingly, by the end of trade UK shares were down just 3.1% as investors recovered from the surprise result and bought bargain stocks
- The UK Pound fell to a 30-year low against the Greenback (at one point). Even the Zimbabwe Dollar appreciated against the Pound on the day of the vote!
- British PM David Cameron resigned (a new leader will be in place by October) and his Chancellor will probably do the same as he was a leader of the 'Remain' camp. The position of British Labor opposition leader, Jeremy Corbyn, also looks precarious. This means that there are major splits in both major parties so majorities to pass significant reforms will be hard to find. New elections may be needed.
- The Bank of England, European Central Bank, Bank of Japan and US Fed have all indicated they will provide liquidity to support markets but with rates already

low, it's hard to see what central banks can do over the medium-term to improve global growth dynamics.

**Short-term moves**

The reasons markets recorded such a large decline at the end of last week was that they were far too complacent about the Brexit risk - 20/20 hindsight suggests they should have prepared for the worst considering the asymmetric nature of the outcome - "Remain" produces no upside, whereas "Exit" may produce significant dislocation in economic growth as investment and consumption both deteriorate.

**That's one reason many Perpetual funds went into the Friday vote positioned defensively (ie with high cash levels and low exposure to at-risk British/European assets).**

Importantly, a few hours into the US trading session on Friday night, the chaos seemed to have subsided - this is not a GFC-style "Lehman's moment" - the price decline so far has been orderly.

As one of the "Leave" leaders, Boris Johnson, pointed out on the weekend, nothing will change in the UK this morning – all trading arrangements, regulations and contracts remain in place. Indeed some might view the short-term ructions as a buying opportunity – as usual, in these short-term panics, some high-quality assets have got cheaper.

**Longer-term implications**

There are two immediate risks. First, the stability of the UK and European banking sector. However, the G7 central banks have all promised large amounts of liquidity through the use of open market operations and repurchase agreements which will provide banks with all the funds they require, which should prevent any bank runs.

The second issue is the rise of the US dollar and Japanese Yen on safe haven capital flows because if these continue it could reignite the negative spillovers that we saw earlier in 2016 (ie damaging effects on emerging markets).

Over the medium terms the key risk is political contagion.

- The UK will be dealing with a seismic political and economic shift with uncertainty about leadership in both major parties.
- The larger risk for the region is questions about the long-term sustainability of the European Union with numerous parties in other member states demanding their own referendums on EU membership. Popular approval of the way the EU is run is at an all-time low, especially in countries with large fiscal and current account deficits that have had to deal with stringent austerity measures. This has culminated in increased resentment towards Brussels, but also a desire for lower exchange rates - which is not possible in Europe's currency union.

The longer-term question is how much prospective UK, European and global growth will be affected – it is already in a fragile state.

I believe the UK result will weigh on regional and global growth for several years through trade and investment, and while currency movements may absorb some of the trade impact, this only carves up the pie differently rather than growing the overall global economy. This weak growth is the result of too much debt, weak demographics, increased inequality and the disruptive impact of technology.

**What does this mean for investors?**

Australian shares (down 3%) and the dollar were affected by the Brexit fallout but the long-term implications for Australian shares are relatively small. Trade with Asia is much more important for Australian firms.

For long-term investors, these fevered short-term occasions represent a chance to buy good businesses at lower prices. The shares of US banks, Australian retailers and Chinese recruiting websites have fallen even though Brexit has little direct impact on their businesses. If anything, Brexit has reinforced the value of companies that have strong balance sheets, good management and the ability to grow their revenue in tough times.

In the end we can look for some guiding words from a Great Briton - Charles Darwin: 'it is not the strongest that survives, not the most intelligent, but the one that is most adaptable to change.' This applies to regions, markets, companies and investors - those most adaptable will be rewarded.