DNCA INVESTMENTS

Brexit Comment
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# « See EU later at Disunited kingdom »

"See EU later" was the front page headline of the daily newspaper *The Sun* on Friday morning. The British electorate has voted to leave the European Union, wrong-footing the latest investor anticipations. The immediate impact was a simultaneous fall in the pound and the FTSE index. Among European markets, the sell-off initially wiped out the recent rally as risky assets across the board were hit (equities, Southern Europe, banks, etc.). Safe havens (gold and the dollar) on the other hand rallied as risk aversion set in. The very close and indecisive result highlights the paradoxical relationship of Great Britain with the European Union, which navigates between insularity, pragmatism and entryism among the technocratic European institutions. The referendum will have political, economic and financial repercussions. Political fallout will involve a call from the populist parties which will now be dreaming of repeating the same scenario, while other countries included under the Union Jack (Scotland and Northern Ireland) will perhaps wish to join the European Union. It will be impossible to ignore the economic consequences of the ensuing period of deep uncertainty, firstly on the UK economy and then on the rest of Europe, despite the recovery underway in the euro zone. There will also be a financial impact involving tougher financing conditions for the least creditworthy European public and private borrowers. In the US, even the central bank now believes that equity markets are expensive. The next rate hike will signal confirmation of a more positive trend in the US economy. For the time being, the Fed is still hesitating and US companies continue to prioritise share buybacks rather than direct investments. S&P 500 companies bought back 589 billion dollars' worth of their own shares between March 2015 and March 2016, which was more than during 2007. Democratic capitalism and its trade channels (i.e. financial markets) feed off confidence, as the Nobel prize-winner in Economic Sciences Jean Tirole reiterates in his work entitled "Economy for the common good" ("*Economie du Bien Commun*"). Investors are thus willing to risk their wealth, under the belief in a stable environment, in the hope of receiving an acceptable return on capital. However, Europe and the eurozone in particular, have lost much of their political credibility in recent years despite the clear advantages of the common market and the liberalisation of services. The Brexit will simply help extend this generalised mistrust, which could spread to other eurozone countries if European political leaders fail to provide a strong response. Although other electoral deadlines lay ahead (Spanish elections, the Italian referendum, presidential elections in the US and elections in Germany and France), the Brexit is perhaps the most crucial for investors. The risk premium among European markets was already at a relatively high level, which may partially limit a future decline, while current central bank policies should ward off systemic risk. Markets will nonetheless remain volatile and only a healthy reporting season and/or strong concerted action from the central banks and European political institutions may rekindle a bullish trend, or at least stabilise the situation. In the UK on the other hand, a political crisis is already underway. David Cameron has announced his resignation in three months' time. Meanwhile, an economic crisis is not far off, given the intrinsic weaknesses in terms of current account deficits, the property bubble and the over-representation of finance. After a remarkable period of stability ensured by its millennial monarchy, the land of the Anglo Saxons may now become the Disunited Kingdom.

*Text completed on June 24, 2016 by Igor de Maack, spokesperson for DNCA Investments' fund management team.*

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