Market Insights
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Brits Quit European Union

What does Brexit mean for investors and the global economy?
With a final vote of 51.89% to 48.11%, Britain announced its departure of the European Union on June 24. As suspected, global markets reacted in dramatic fashion to the “Leave” vote, despite the fact it may take two years for Britain to actually fully leave the EU.

How long might all of the uncertainty weigh on investors? Insights on short, medium, and long-term impact of the Brexit for markets and the global economy are shared by investment experts from across Natixis Global Asset Management.

David Herro, CFA®
Partner, Chief Investment Officer, International Equities
Harris Associates

There is considerably more short-term uncertainty in the global markets now that Britain has voted to leave the European Union. This usually doesn’t feel good to investors. On the other hand, prices have reacted quite negatively, especially in the financial sector, and many quality stocks are now very attractively priced for long-term investors.

This is not 2008
I think people are comparing this event to what happened in 2008 at the outset of the Global Financial Crisis. I don’t believe this is a correct comparison. There are some positives that need to be considered. For instance, there is a strong global consumer out there. There are high employment rates, low interest rates, low energy costs. So consumers are doing pretty well, and they are not as indebted as they were in 2007 and 2008. We don’t have that debt overhang today.

Overreaction in financials
Looking at their leverage ratios and capital ratios, I believe the banks are better equipped to deal with the uncertainties we are now facing related to the United Kingdom and Europe than they were seven or eight years ago. So as I look at European bank stocks trading down 15% to 20% in the aftermath of the Brexit vote, it seems a bit overdone in some cases. We also have to keep in mind that many of these stocks were at low valuations before the vote occurred. If you look out over the last eight to nine months, in anticipation of the EU referendum vote, valuations were already reflective of something coming.

Time to bargain hunt?
If price separates itself quite aggressively from what we believe is the intrinsic value of a quality business, we usually consider this a buying opportunity. That said, I don’t really think the intrinsic value of a lot of these companies today has fallen by anywhere near what Mr. Market has done to their prices. Therefore, I’m seeing a number of stocks attractively priced for long-term investors. But it’s always important to look for the quality, look for the companies that have good strong financial positions to weather the storm.

What’s next for the UK and Europe?
For today, at least the uncertainty surrounding the EU referendum itself is gone. Now we have to see who is going to assume leadership as David Cameron steps down. More importantly, it will be interesting to see what the European leaders are going to do. For instance, are they going to be reflective and ask: “What caused 52% of the electorate to want to leave the European Union?” “What did we do to cause this?” “Do we need to make Europe a more business-friendly place?” These are the questions that the leaders of Europe should be asking themselves.

Overall, I think whoever is going to be the leader of the UK has to work hard to make the UK an attractive place to stay, work and attract investment. I think that can definitely happen. Maybe I’m overly optimistic, but I think ultimately something good will come from this vote. I think the UK and Europe will reflect and enact changes to make the environment easier and more positive to do business, live and work.

David Lafferty, CFA®
Chief Market Strategist
Natixis Global Asset Management

Last Thursday's historic "Leave" vote in the UK will have both immediate and long-term consequences for the global economy and financial markets. The initial flight-to-quality reaction across asset classes has been exacerbated by the market's misplaced confidence in a "Remain" victory leading up to the vote on June 23. Stock markets around the world rallied in the days leading up to the vote while the British pound strengthened. This action has swiftly reversed with the global equity markets off, bond yields plummeting, and the pound dramatically weaker in the days after the Brits voted to leave the EU. Not surprisingly, gold has rallied. The vote has clearly caught markets on the wrong foot.

This immediate reaction has been swift but is likely to reverberate across time zones in the coming days. Perhaps the three most immediate questions will be: What will a new government in the UK look like? Will the EU offer to renegotiate more favorable membership terms in light of the "Leave" victory? How soon will the UK invoke Article 50 to begin the withdrawal process? These questions will bring a high degree of uncertainty and may continue to pressure asset values globally, but more directly across Europe and the UK.

Brexit: Implications for growth

The longer-term implications of the "Leave" vote are more difficult to handicap. For the immediate future, the UK will continue to exist under EU law throughout the withdrawal process. However, businesses will quickly begin assessing the new landscape of how they will operate outside of EU oversight post-withdrawal. This uncertainty will likely be just another headwind constraining activity across Europe in a period where organic growth has already been difficult to find. The developed economies of the U.S., Japan, and Europe have been unable to come up with a catalyst to shock growth meaningfully higher. The "Leave" vote should make finding this catalyst even more difficult.

Perhaps more damaging will be the longer-term effects on the European Union. Given that euro-skepticism has been on the rise, the precedent set by the Brexit vote may compel other EU members to contemplate withdrawal. Unless EU leaders can better unify their members in both philosophy and policy, the union could face a more existential threat in the years to come. In this regard, the EU is likely to be an onerous counterparty in the UK withdrawal negotiations, if only as a deterrent to other nations. This again will bring more unknowns, more uncertainty, and more volatility across assets.

Reaction vs. overreaction to Brexit vote

In the coming days, investors can expect to be buffeted by conflicting data, new risks, and wild price swings. The macro-economy, already laboring under sub-par growth, may stumble again. But asset price volatility is often an overreaction to the underlying economic fundamentals which evolve more slowly. Activity across the UK and Europe will likely not come to a standstill. Companies should continue to produce and employ – despite the clouded outlook. Central banks will likely supply additional liquidity to act as a firewall against further contagion. And policy makers should quickly seek to address areas of acute vulnerability. The next few days will certainly test investors' tolerance for risk.

It is also a time to review portfolios and reassess the opportunities a Brexit vote may uncover. For starters, extreme price moves bring with them the chance to rebalance and reset portfolio allocations. Stock valuations, which have appeared elevated recently, may look more reasonable to some investors. Plunging bond yields could result in previously unthinkable (and perhaps temporary) gains in fixed-income allocations. While rebalancing can't prevent losses, it may help to mitigate a potentially larger problem – the risk that the portfolio wanders too far from its long-term risk/return objectives.

Brexit: Finding opportunities

The market calamity following Brexit may also provide a good opportunity for investors to assess their true risk tolerance. "Can I live with this level of volatility? Do I have the stomach for this?" This type of real-time financial self-assessment can only be done during periods of actual losses. It cannot be simulated in a lab or gleaned from the textbooks. For investors unfazed by these market gyrations, what ideas have emerged? Which assets now look attractive at a lower price? Which assets have become more overpriced and can be shunned or trimmed? It is almost a cliché to say that "volatility presents opportunity," but market dislocation can bring new ideas into sharper focus.

The long-term political, economic, and financial repercussions of the "Leave" vote are incalculable at this point. But markets adapt. Policymakers adjust. Businesses will change course while they continue to seek profits. Prices will reset. Opportunities will emerge. Market volatility brought on by the UK's historic Brexit vote is no excuse to disengage from portfolio planning. Investors who are willing to look forward, with one eye on the opportunities and one eye on their goals, will be more likely to realize both.

Laura Sarlo, CFA®
Senior Sovereign Analyst
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The UK referendum on European Union membership saw 51.9% of voters favor "Leave," surprising a market that had become confident of a "Remain" outcome over the last few days. Thus far, financial markets have not shown widespread panic, just weakness and increased volatility. We encourage patience as the implications become clear. Below we share our initial thoughts on the economic and financial impact of this historic vote.

A slow upheaval for the United Kingdom

We expect the UK economy to slow toward recession in the second half of this year and fiscal consolidation, about which we have always been skeptical, will likely not occur. Prime Minister Cameron has resigned and is expected to leave office by October. A new government will negotiate the terms of the UK's exit. UK politics may be tumultuous in the next six to eight weeks, and negotiating for Brexit will take at least two years.

The Bank of England (BOE) may cut rates or increase quantitative easing. BOE Governor Carney has already promised £250 billion in liquidity if required. Markets expect a 25 basis point cut from the BOE by February 2017. Standard & Poor's on June 27 downgraded the UK's credit quality from 'AAA' to 'AA'[1], and other rating agencies are likely to follow suit. The pound initially fell sharply Thursday night, and trading has been volatile, packing a year's worth of volatility into recent trading. Currency and market volatility will likely remain elevated.

Concerns for the European periphery

Uncertainty caused by Brexit will hit EU growth. Peripheral economies will remain pressured, and we expect intra-EU government bond spreads to widen. The ECB will seek to protect and defend the financial system and also stands ready to provide additional liquidity if needed.

Brexit could spark political and referendum contagion across the euro zone, which could increase downside risks. For example, Scottish First Minister Sturgeon has announced her intention to propose a new independence referendum. Spanish elections are also Sunday, June 26, and polls indicate a stalemate, which could result in a weak coalition government. Similarly, Italy has a referendum vote in October. We think anti-EU risks are rising in periphery politics.

Ripple effects in global markets

Risk aversion could increase further on the back of Brexit and drive up demand for the U.S. dollar and Treasuries. Central banks, including the Fed, are generally in "wait and see" mode but ready to provide liquidity if needed. Markets have already pushed out additional Fed rate increases to the third quarter of 2018. We don't think the Fed will have to wait that long, though hikes could be off the table for 2016.

While Brexit may make the Fed move more slowly in hiking rates, it could speed up policy action in other countries. For example, if U.S. dollar strength persists, we expect pressure to intensify on the Chinese renminbi. This could trigger a renewed wave of capital outflows and, together with weaker economic data, could spur a policy response. We think a response will involve various liquidity tools as authorities have been reluctant to signal aggressive monetary easing to prevent credit growth acceleration. In Japan, yen strength is a serious concern for the Bank of Japan (BOJ), which may hasten a policy response, but we expect a more measured approach after initial market turmoil subsides.

We have closely monitored Brexit since late 2015 and carefully considered the potential impact of both outcomes. We will remain singularly focused on client portfolios, seeking opportunities amid market volatility.

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[1] Standard & Poors.

Philippe Waechter
Chief Economist
Natixis Global Asset Management

The will of the UK to exit from the European Union will have a strong impact on Brits' lives, but also on the whole of Europe. Nevertheless, in the very short-term, nothing will likely happen on the economic side.

However, expectations could change dramatically and this is what will most likely weigh on financial markets. Central banks may not be neutral and may have to intervene to help avoid a spillover effect from a British shock. Global growth momentum is currently too weak to diffuse such a shock. As we saw during the 2008/2009 crisis, swap agreements between central banks will most likely be reactivated to provide liquidity to the global financial market.

New rules for fifth-largest economy
For the UK economy, the reality is quite simple: Relationships between the UK and the rest of the world will change dramatically. Rules may never be the same for the world's fifth-largest economy. I believe the weight of the UK is by itself a source of concern for the rest of the world. Relationships and rules will have to change in a low-growth environment where central bankers have already adopted very accommodative monetary policies for an extended period of time. Attempting to absorb a negative and persistent shock with little capacity to adjust due to low interest-rate policies is likely to have long-lasting effects on the UK and the world. That's what is worrisome. If we were in a period of strong growth, the impact of such a shock would be limited, but we are not.

Trade may weigh down global economy
The main source of a British shock concern is that the UK will no longer have access to the single European market under the same conditions they have now. A new framework will have to be defined, which will take time and create uncertainty. In the short-term, we don't know what type of conservatory measures will be taken during the trade negotiations. But we can imagine that the British negotiators will want to cut relationships with the EU rapidly, based on the referendum. Britain will also have to negotiate all new trade agreements with the rest of the world, as the existing ones are attached to EU membership. I believe this period of global trade transition will add confusion and weigh on the overall global economic outlook.

Political power struggles continue
In the short run, we may also see perceptions of the UK environment driven by political declarations. Not only will David Cameron be exiting, but it will be nearly impossible to have a majority in Parliament. This impossible majority reflects the fact that the Conservative party is now split between supporters of the two options proposed in the referendum. General elections will be required rapidly in order to define a new and very different political equilibrium.

We will also await the reactions on the future of Europe from the institutions and governments in the rest of the EU. A common dynamic will have to be found to prevent the British referendum from being a catalyst for other votes of this type elsewhere in Europe.

Jens Peers, CFA
Chief Investment Officer, Sustainable Equities
Mirova[2]

The UK has woken up as a divided country. While 52% of the voters prefer to leave the European Union, 48% wanted to stay. At first glance, it looks like some important patterns are visible. London, Scotland and Northern Ireland wanted to stay. Wales and the North of England wanted to leave. Millennials wanted to stay. The older generation wanted to leave.[3]

While this vote does not change the challenges our world is facing in its evolution, it does create a lot of short-term uncertainty. At Mirova, we expect economic growth to be negatively impacted, yields to go lower, central banks to keep rates low for longer and to continue their accommodative policies for the foreseeable future. We also expect equity markets to fall substantially, the British pound and the euro to lose value against the U.S. dollar, the Japanese

[2] Mirova is operated in the U.S. through Natixis Asset Management U.S., LLC
[3] Source: www.ft.com

yen, and the Swiss franc and corporate and periphery bonds to underperform if the market goes into a risk-off mode. Also, within equities, we expect financials and consumer discretionary to underperform and healthcare, energy and consumer staples to outperform.

Political uncertainty may weigh on markets for the next few weeks, not helped by the upcoming U.S. elections and the call from some polity for similar referenda in France and the Netherlands. In this context, we believe it remains important to focus on structural growth trends which we aim to focus on in all of our themes.

The Brexit vote potentially has no impact on climate change, depletion of natural resources and changing demographics for instance. It just adds to the volatility, which may give us an opportunity to add to our highest conviction themes and stocks at lower valuation levels.

IMPORTANT INFORMATION

Brexit refers to Britain voting on a referendum June 23, 2016 to exit the **European Union**, which is a unique economic and political partnership between 28 European countries.

Bond yields are the amount of return an investor will realize on a bond.

Central banks are national banks that provide financial and banking services for a country's government and commercial banking system, as well as implementing the government's monetary policy and issuing currency.

Fed refers to the Federal Reserve System, the central banking system of the United States of America.

Global Financial Crisis of 2007–08 is considered by many economists to have been the worst financial crisis since the Great Depression of the 1930s.

Leverage ratios are financial measurements that look at how much capital comes in the form of debt (loans), or assess the ability of a company to meet financial obligations.

Capital ratios refers to the capital adequacy ratio (CAR), which is a measure of a bank's capital. It is expressed as a percentage of a bank's risk-weighted credit exposures.

Pound sterling (GBP) is the official currency of the United Kingdom. It is commonly known simply as the pound.

Renminbi is the official currency of the People's Republic of China.

United States Treasury securities are government debt instruments issued by the United States Department of the **Treasury** to finance the national debt.

Valuation levels refers to the current price of stocks in the financial markets. Stock valuation is the method of calculating theoretical values of companies and their stocks.

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