Manulife Investments

INVESTMENT NOTE

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After The Vote – What's Ahead?

This Investment Note represents the views of **Philip Petursson** of Manulife Investments

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Against the polls and against the sentiment of the financial markets, Britain voted to leave the European Union last night by a margin of 52%/48%. Immediate market reaction has been negative. Asian markets fell on the vote with Japan's Nikkei Index falling -7.9%, Hong Kong's Hang Seng Index falling -2.9%, and China's Shanghai Composite Index falling -1.3%. Over in Europe the drops have been more severe with many equity indices down more than -10% at time of writing. A risk-off mentality has taken hold amidst the uncertainty of the economic consequences to the vote.

From the Canadian perspective, our country's economic ties to the UK are small. According to Statistics Canada, as a percentage of exports the UK represents 3.1%. The bulk (65%) of those exports fall in the precious metals category (Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metal and articles thereof; imitation jewelry; coin). Any direct impact to the Canadian economy appears limited. Likewise, the economic impact to the United States is similarly limited from a trade perspective. The UK accounts for only 4% of US exports.

The immediate impact is to sentiment rather than economic as this will be a very long and drawn out process. The UK is likely to wait to invoke Article 50 (which initiates the process of leaving the EU) until a new Prime Minister is in place which may not be until the fall. This would also give the UK government time to work out what exactly its goals are before the two year term to negotiate the UK's new trade relationships (dictated by Article 50) begins.

The immediate downside risks aside from the current drop in equity and currency markets include a seizure of the credit markets. In preparation, the Bank of England has signaled it will provide liquidity should the credit markets tighten. This is not about central banks though. It is about political response and it remains to be seen if the politicians in the UK and elsewhere across the European Union can calm the markets. In the aftermath of the vote we are hearing calls from politicians in other countries for similar referendums. More information and analysis of the economic impact will flow out over the weeks, and months to come.

It goes without saying that we are in a period of significant uncertainty. Today, stocks are down and the traditional safe haven trades of the US dollar, US Treasuries and gold are up. However, even now, mere hours following the results and initial market drawdown we are starting to see the fear wane as the downdraft is easing and North American markets are reacting with more resilience. Broader financial contagion appears to be limited.

In the meantime the Brexit result may undermine confidence over the near-term and as such we reiterate our conservative approach to asset allocation. Given the length of the current economic and equity market cycles, higher current equity valuations than in the past 5-years and political uncertainty that may evolve out of Brexit, we expect volatility to remain and returns to be more muted in the year ahead than in the year past. Maintaining a neutral asset allocation may serve investors well over the near-term.

A rise in interest rates typically causes bond prices to fall. The longer the average maturity of the bonds held by a fund, the more sensitive a fund is likely to be to interest-rate changes. The yield earned by a fund will vary with changes in interest rates.

Global events have resulted, and may continue to result, in an unusually high degree of volatility in the financial markets, both domestic and foreign.

Currency risk is the risk that fluctuations in exchange rates may adversely affect the value of a fund's investments.

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